CORPORATE Newsletter

November 2015 Issue 34

Recent CRA Thinking on Topics of Interest

IN THIS ISSUE

The Canada Revenue Agency ("CRA") regularly releases its responses to queries from the general public on various tax matters. These responses give us insight into the CRA's approach to the law, including the actual practices and policies of the government on the issues. Some recent queries and responses of interest to business owners are summarized below.

Payment to Employees for Use of their Cellphones

The CRA was asked to consider the following situation:

- Certain employees must use their own cellphone in the course of their employment since their employer does not provide them with one.
- The employer requires all employees to have a data transfer plan with their cellphone service and provide a copy of their contract.
- The employees must pay and keep a copy of all his or her monthly invoices but do not have to systematically provide them to the employer.
- Every month, they receive a fixed amount from their employer for the business use of the cellphone. The amount paid will depend on the employee's business responsibilities.
- Before making the payment, the employer makes sure that the employee is still employed and still required to use a cellphone to perform his or her duties.

The CRA was asked if the payment by the employer to the employee of the monthly fixed amount constituted an allowance or a reimbursement. The CRA confirmed that, because the employer did not require detailed receipts or invoices from the employees before paying them the fixed amount for the use of their cellphone, the payment was not an expense reimbursement but an allowance to be included in their income. The Federal Court of Appeal concluded in its Verdun decision that reimbursements were payments made by an employer to employees in respect of receipts or vouchers to be presented by them to the employer to be paid. This is clearly not the case in this situation and the amount paid must be treated as an allowance.

Purchase and Renting of Artwork

The CRA was asked if taxpayers buying or renting artwork for the decoration of their offices or common areas of their business place could claim a tax deduction for their expenses. For both purchasing and

renting artwork, the expense must be reasonable to be deductible from the taxpayers' income.

Purchase of Artwork

The CRA confirmed that a tax deduction could be claimed but only if certain specific conditions were met. First, the taxpayers must buy the artwork to earn business or property income to be entitled to claim a tax deduction. Second, they must determine if the expense incurred for the artwork is current or capital in nature. In both case, this is a question of fact and can only be determined after a careful review of the particular circumstances.

If the artwork is a capital expense, it may be claimed as a capital cost allowance if it is not excluded by Regulation 1102(1)(*e*)(i) to (iv) of the Income Tax Regulations (the "Regulations"). However, if this artwork is listed in Regulation 1102(1)(*e*)(i) or (ii) but created by a Canadian, it can be claimed as a capital cost allowance. If the artwork is a current expense, its cost may be deducted from the business or property income in the year of acquisition of the artwork.

Rental of Artwork

The cost of renting artwork is deductible from the taxpayers' income but only if it was incurred for the purpose of earning business or property income, which can only be determined after a careful review of all relevant facts.

Reasonable Motor Vehicle Allowances

Section 6(1)(*b*)(vii.1) of the Income Tax Act (the "Act") provides that an employee is not taxed on the receipt a reasonable allowance for the use of his or her motor vehicle, and s.6(1)(b)(x) of the Act provides that such an allowance is deemed not to be reasonable if it is calculated with respect to anything other than kilometres driven. Regulation 7306 of the Income Tax Regulations (the "Regulations") prescribes maximum per-kilometre allowances that are deductible to the payer where the recipient is not required to take the payment into income.

The CRA was asked whether a per-kilometre motor vehicle allowance exceeding the amounts prescribed under Regulation 7306 could be considered to be reasonable. The CRA was asked further if a per-trip allowance would be considered reasonable.

The CRA noted that it generally considers an allowance to be reasonable if it is not in excess of the prescribed amounts, but that whether a particular per-kilometre amount is reasonable is a question of fact. The question is to be answered by considering the vehicle type, driving conditions, fuel costs in the location of use, etc.

A per-trip allowance, however, cannot be reasonable as it is not calculated solely by reference to the kilometres driven. Where an employee is entitled to the greater of a per-kilometre and a per-trip allowance, but is paid the per-kilometre amount, the fact that the other allowance was potentially available would not render the per-kilometre allowance unreasonable.

Section 249(3)—Fiscal Period Exceeds 365 Days

The CRA was asked to consider a hypothetical situation in which a taxpayer adopted a floating fiscal period. The first began on January 2, 2014, and ended on January 3, 2015; the second began on January 4, 2015, and ended on January 1, 2016. Referring to an earlier interpretation, it was the view of the person posing the question that as the second fiscal period did not exceed 365 days, s. 249(3) of the Act would not apply and the taxpayer would not have a taxation year that ended in 2014.

The CRA noted that the subsection was amended effective for 2012 and subsequent years. Because the first fiscal period exceeds 365 days, s. 249(3)(*a*) of the Act deems the first taxation year to end on December 31, 2014, and the next taxation year to begin on January 1, 2015. Section 249(3)(b) of the Act contains similar rules that apply in fixing the taxpayer's fiscal period.

Given the legislative changes, the CRA's earlier opinion was no longer relevant.

Non-Profit Organization—Lottery Revenue

An incorporated non-profit organization (the "Association") is organized to support the promotion of physical activity as a way of life. Its funding is derived from the sale of lottery products through retail outlets. After deducting related expenses, the Association generates a profit.

Two questions were posed to the CRA: (1) is the net lottery revenue subject to tax in the hands of the Association; and (2) can the Association maintain its tax-exempt status, if none of the profits are retained by the Association?

An internal technical interpretation reviewed the general criteria that the CRA applies in assessing whether an entity is a non-profit organization. The CRA noted that a non-profit organization can earn a profit, particularly through fund-raising, provided the profit-making activity is incidental to its primary purpose.

Here, the CRA concluded that the lottery income could affect the Association's non-profit status as it did not appear to be incidental to or to arise from the Association's objectives. Furthermore, if the lottery income were found to be subject to tax, the fact that none of the profit was retained would not be relevant.

Retention of Books and Records—Regular Corporations, Dissolved Corporations, and Unincorporated Businesses

The CRA was asked to indicate the books and records retention periods for three types of entities:

- regular corporations;
- dissolved corporations; and
- unincorporated businesses (including sole proprietorships).

First, the CRA noted that there were two types of records to consider:

- permanent records (including minutes of directors' and shareholders' meetings, share registers, general ledger, and special contracts or agreements required to understand the entries in the general ledger); and
- non-permanent records (including records and books of account as well as vouchers and accounts required to verify the information in those records and books of account).

Second, the CRA confirmed that the retention periods applicable were the following:

- For regular corporations, permanent records must be kept from the date of incorporation until two years after the corporation's dissolution, and non-permanent records must be kept for up to six years after the end of the last taxation year to which they relate. Note that the retention period for non-permanent records may be extended if an exception is applicable under s. 230(5) to (8) of the Act.
- For dissolved corporations, non-permanent records must be kept for an additional two-year period following their dates of dissolution.
- For unincorporated businesses, permanent records must be kept for six years following the end of the taxation year during which the business ceased its activities, and non-permanent records (including source documents) must be kept for a period of six years following the end of the taxation year to which they relate.