CAROLINE & ASCHABER LLP

CHARTERED PROFESSIONAL ACCOUNTANTS

Tax Tips and Traps Newsletter

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Tax Tidbits

Some quick points to consider…

- The **interest rate** on overdue taxes for the **fourth quarter** of 2022 (October 1 – December 31, 2022) has **increased** by 1% **to 7%**. Make sure to get those payments in to CRA on time!
- **No input tax credit** (ITC) can be claimed if the **vendor** does **not** have a **valid GST/HST** number at the time of the transaction. You can check the validity of an entity's GST/HST business number at CRA's online "GST/HST registry."
- There are approximately **$1.4 billion** in **uncashed cheques** in CRA's bank accounts. Even cheques that are over a decade old can be reissued. Call CRA or visit your CRA "My Account" online to check whether you have an uncashed cheque.

Crowdfunding: Taxable or Not?

A June 2, 2022 **Technical Interpretation** discussed the **taxability of funds** received through **crowdfunding** campaigns. CRA first noted that amounts received through a crowdfunding arrangement could represent **loans**, **capital contributions**, **gifts**, **income** or a **combination** of two or more of these. This means that the funds received could be **taxable** (such as business income) or **not** (such as a windfall, gift or voluntary payment). As the terms and conditions for each campaign vary greatly, the determination of tax status must be conducted on a case-by-case basis.

Where an amount is not a windfall, gift or other voluntary payment, the amount may be taxable if it constitutes **income from a source**. To be a **non-taxable gift** or other voluntary payment, the following conditions must be met:

- there is a **voluntary transfer** of property;
- the donor **freely disposes** of their property to the donee; and
- the **donee confers no right, privilege, material benefit or advantage** on the donor or on a person designated by the donor.

CRA opined that contributions would likely be considered **non-taxable gifts** in the case of a **"Go Fund Me"** campaign created by family members of an **individual with cancer** to **assist** in that individual's **treatment**.

In an August 23, 2019 **Technical Interpretation**, CRA considered whether an **employer's contribution** to their **employee's crowdfunding campaign** to assist with the cost of additional therapies and support for the employee's recently born child would be received in the recipient's capacity as an **employee** (taxable) or **individual** (not taxable).

CRA indicated that, where the person is dealing at **arm's length** with the employer and is **not** a **person of influence** (such as an executive who controls employer decisions), the benefit or amount would generally be received in the person's capacity as an **individual** (non-taxable) where the amount is:

- provided for **humanitarian** or philanthropic reasons;
- provided **voluntarily**;
- **not** based on **employment factors** such as performance, position or years of service; and
- **not** provided in **exchange** for **employment services**.

If considered non-taxable, CRA opined that, as the contribution was not an expense incurred to gain or produce income, it would **not be deductible**.

> **ACTION:** Amounts raised by crowdfunding campaigns may be taxable or non-taxable, depending on the circumstances. Ensure to provide details on these activities so that the amounts are properly reported.

Trusts: New and Expanded Disclosure Requirements

Legislation has been proposed for **trusts** (including estates) with **years ending on December 31, 2022** and onwards that would significantly expand the reporting rules. **More trusts** would be required to **file tax returns**, and **more information** would be required to be **disclosed** in these returns. In addition, **sizable penalties** would be introduced for non-compliance.

More trusts and estates required to file

Under the **existing rules**, **trusts** are exempt from filing a T3 tax return if they have **no taxes payable** and **no dispositions of capital property**. However, under the proposals, **tax returns** will be **required** for all Canadian resident **express trusts** (this generally means trusts created deliberately) that **do not meet** at least **one** of a number of exceptions. Some of the more common exceptions include the following:

- trusts in existence for **less than three months** at the end of the year;
- trusts holding **only assets within a prescribed listing** (including items such as cash and publicly listed shares) with a total fair market value that does **not exceed $50,000** at any time in the year;
- **trusts required by law** or under rules of professional conduct to **hold funds** related to the activity **regulated** thereunder, **excluding** any trust that is maintained as a separate **trust for a particular client** (this would apply to a lawyer's general trust account, but not specific client accounts); and
- registered **charities** and **non-profit clubs**, societies or associations.

Reporting will be **required** where a **trust acts as an agent** for its beneficiaries (referred to as **bare trusts** in the government's explanatory notes). No details on the intended breadth of such trusts have been provided by the Department of Finance or CRA to date.

More disclosure of parties to trusts

Where a trust is required to file a tax return, the **identity**, including **residency**, of all of the following people **must** be **disclosed**:

- **trustees**, **beneficiaries** and **settlors**; and
- anyone that has the **ability** (through the terms of the trust or a related agreement) to exert **influence** over trustee decisions regarding the income or capital of the trust.

The requirement to provide information in respect of the beneficiaries would be met if beneficiary information is provided for all whose **identity is known or ascertainable** with **reasonable effort** by the person making the return at the time of filing the return. Where there are beneficiaries whose **identity is not known** or ascertainable with reasonable effort, the person making the return would be required to provide sufficiently **detailed information to determine with certainty** whether any particular person is a beneficiary of the trust. For example, where the beneficiaries are both the current and future grandchildren of the settlor, details in respect of the current children must be provided in addition to details of the trust terms describing the future class of beneficiaries.

The new rules would **not require** the disclosure of information subject to **solicitor-client privilege**.

Substantial penalties

Failure to make the required **filings and disclosures on time** attract penalties of $25 per day, to a maximum of $2,500, as well as further penalties on any unpaid taxes. New **gross negligence** penalties have been proposed, applicable to filings not made on time and inaccurate filings. These penalties are proposed to be the greater of $2,500 and **5% of** the highest total **fair market value** of the **trust's property** at any time in the year. These will apply to **any person or partnership** subject to the new regime, leading to the concern that **multiple persons** could be subject to these substantial penalties **for a single trust.**

ACTION: Make a list of all arrangements that you and your family have that may be considered a trust or bare trust. Review them with a professional to determine whether they would be subject to the rules. Obtain the relevant information that will be required for the filing of the particular trust returns.

Director Liability: Is Asking About Source Deductions Enough?

Directors can be **personally liable** for **payroll source deductions** (CPP, EI and income tax withholdings) and **GST/HST** unless they exercise **due diligence** to prevent the corporation from failing to remit these amounts on a timely basis.

An August 31, 2022 **Tax Court of Canada** case found that the director was **not duly diligent** and therefore was **personally liable** for the corporation's **unremitted payroll deductions**, interest and penalties of $78,121 from January 2011 to April 2012.

The taxpayer argued that he was duly diligent as he **asked** at the **directors' meeting** each **month whether** the **tax remittances** were **up-to-date** and received oral confirmations that they were. The taxpayer stated that he had **"checked the box"** at each directors' meeting. He also argued that his decisions were driven by **materiality**; he focused his efforts on the corporation's overall well-being and safeguarding the millions of dollars of investment, rather than the payroll remittances that he considered **"tiny."**

Taxpayer loses

The Court ruled that the taxpayer was **not duly diligent** in preventing the failure to make adequate payments. It noted that the **taxpayer never contacted CRA** to confirm whether payroll remittances were current, which was particularly **problematic** as he was **unable** to obtain **reliable financial statements** and was **aware** of the **difficult financial situation**. While it was the taxpayer's view that this was **someone else's job**, there was **no evidence** of the **taxpayer** ever **asking anyone** else to follow up with CRA.

ACTION: Prior to accepting any role as a director, ensure to fully understand your responsibilities and potential exposure to personal liability. If currently acting as a director, make sure to be duly diligent in ensuring payroll and GST/HST payments are properly made.

Executor: Whether to Accept This Role

Individuals may be asked to take on **various roles** in respect of **loved ones, friends, clients** or others. One role that is particularly riddled with **challenges** is that of an estate executor. While an individual may carry out their duties in an appropriate manner, it is important to **consider** the **risks** of **unhappy beneficiaries** and any **other undesirable outcomes**, including litigation and/or strained relationships.

A March 4, 2022 **Tax Court of Canada** case reviewed whether the taxpayer was **personally liable** for the **estate's tax debts**. On the death of the taxpayer's father in 1994, the taxpayer and his brother became **executors** of the estate. The taxpayer **argued** that he **renounced** his role of **executor** two months after the death of his father and therefore should not be held liable for the estate's tax debts.

The father left most of his estate to the taxpayer's brother, as well as a portion to grandchildren and great-grandchildren. The taxpayer accepted this decision but wanted to ensure that his daughter received her share of the estate. To this effect, in 2010, the taxpayer and his brother took steps to **distribute** a **balance** of $240,000 payable to the taxpayer's daughter, **secured** by a **mortgage** against one of the **estate's properties**. That is, the taxpayer's daughter was essentially provided a $240,000 receivable from the estate. **No clearance certificate** was obtained, and the estate was in **arrears with its taxes**. In 2016, the brother died.

While the taxpayer argued that he renounced his role as executor and provided an alleged handwritten note from 1994 to that effect, the Court did not accept that he **formally renounced** his role. While the Court acknowledged that the **taxpayer** may **not** have **understood everything** about being an **executor** or every aspect of a land transfer, the Court believed he understood that he was **signing** as an **executor**. As he was the executor when the mortgage was secured and did **not** obtain a **clearance certificate**, he was held **personally liable** for the estate's **tax debts**.

The Court further stated that even if it did find that the taxpayer had properly renounced his role, the **taxpayer** acted as a "trustee de son tort" (a person who is not appointed as a trustee but whose course of **conduct suggests** that he be **treated** as one), and for income tax purposes, he would have been considered a "**legal representative**."

ACTION: Acting as an executor comes with significant responsibilities. Failure to properly administer the estate can result in personal liability. If you choose to decline the role, you must do so properly and not act as an executor.

GST/HST Input Tax Credits: Reasonable Expectation of Profit

A July 28, 2022 **Tax Court of Canada** case considered whether **input tax credits** (ITCs) in respect of a farming operation's expenditures were available. The farming activity consisted of **breeding and racing various horses** and involved at least **four full-time employees** at one point. Over a nine-year period (2007-2015), the operations **never experienced positive net earnings** and more than **$4 million in losses** were accumulated. The owner partially financed operations with earnings from his law practice.

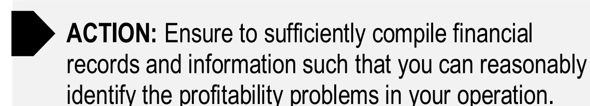
In order for ITCs to be available, supplies must have been made **in the course of a commercial activity**. For a commercial activity to have occurred, there must have been a **reasonable expectation of profit**.

The Court considered the following criteria when determining whether the taxpayer carried on a commercial activity:

- **profit and loss** experience;
- the taxpayer's **training;**
- the taxpayer's **intended course of action**; and
- the **capability** to **show a profit**.

Taxpayer loses

While the Court noted that the taxpayer was clearly **passionate and knowledgeable about horses** and had invested significant funds and time, it was **insufficient** to demonstrate that there was a **reasonable expectation of profit**. Ultimately, the Court found that the taxpayer's **lack of financial organization** (he did not have financial statements) and lack of financial tools left him without the ability to **diagnose the causes of his farm losses**. Without the ability to understand the losses, he did not have the ability to truly stem them, and therefore he did not have a reasonable expectation of profit. The **ITCs were denied**.



ACTION: Ensure to sufficiently compile financial records and information such that you can reasonably identify the profitability problems in your operation.

Tips Collected Electronically: Withholding Requirements

Where **tips** are **"paid"** by an **employer**, they are **pensionable** and **insurable**. In such cases, the employer must also **withhold income tax** and **report** the amounts on the employee's **T4**.

CRA's current administrative policy is that if the **tip** is **controlled by** the **employer** (controlled tips) **and** then **transferred to** the **employee**, it is considered to be **paid by the employer**. In contrast, **direct tips** are considered to have been **paid** directly **by** the **customer** to the employee. Therefore, the tips are **neither insurable nor pensionable**, **income tax deductions** are **not** required to be **withheld** and amounts are not required to be reported on the T4.

Controlled tips are generally those where the **employer** has **influence** over the **collection** or **distribution formula**. CRA has provided several examples of controlled tips, including the following:

- the employer adds a **mandatory service charge** to a customer's bill to cover tips;
- **tips** are allocated to employees using a tip-sharing **formula determined** by the **employer**; and
- **cash tips** are deposited into the employer's bank account and become, or are even **commingled** with, the **property** of the **employer**, and then are **paid out to the employees**.

Direct tips are paid directly to the employee by the customer, where the **employer** has **no control** over the **tip amount** or **its distribution**. CRA has also provided several examples of direct tips, including the following:

- a customer leaves **money on the table** at the end of the meal and the server keeps the **whole amount**;
- the **employees** and not the employer **decide how** the **tips** are pooled or **shared** among employees;
- a customer includes an amount for a **tip** when paying the bill by **credit or debit card,** and the **employer returns** the **tip** amount in **cash** to the employee at the **end of the shift**. In exceptional situations, the cash tips could be paid out the day after, for example, if there was not enough available cash on hand; and
- the restaurant owner informs the server that if a customer pays by **credit or debit card** and includes a voluntary tip, the restaurant will **return the full tip** amount to the server in cash at the **end of each shift**.

An August 31, 2022 **Federal Court of Appeal** case reviewed whether the **electronic tips** left by restaurant **customers** (e.g. paid by credit or debit cards) that were **distributed by** the **restaurant** to the **servers** were considered "paid" and therefore **pensionable and insurable**. Only a **portion** of the **electronic tip** was **distributed to the servers**, based upon the particular tipping arrangement at the restaurant (some funds were retained for items such as credit card fees and tip-outs to the kitchen staff). Amounts were **transferred** to the servers the **day after the particular shift** was worked. The Tax Court of Canada (TCC) previously held that the amounts transferred to servers were paid by the employer, and therefore, pensionable and insurable.

Taxpayer loses

The FCA found that the TCC did not err in its finding. In particular, the TCC noted that the electronic tips had **not previously** been in the **server's possession**. Instead, the customers had provided the **electronic tips** to the **employer** as part of a single transaction to settle the dining bill. The TCC followed a 1986 **Supreme Court of Canada** case that found that the word **paid** could be **interpreted broadly** to mean the **mere distribution of an amount by the employer** to the employee.

The **FCA** also stated that **factors** such as the following are **not determinative** and might be of little to no relevance when determining whether an amount is **paid by an employer**:

- when the amount is paid;
- **whether** the server is **paid all or some** of their own tips or pooled tips;
- whether the **employer keeps a portion** of the tips; and
- whether the tips are **distributed under a collective agreement**, a written contract, an **oral agreement** or otherwise.

The case did **not deal with** any **cash tips** the servers may have received or **tip-outs** received by kitchen staff, on-site management or support staff. Likewise, the FCA was not concerned with the **total electronic tips** left for the servers, but only the net amount paid out the next day.

ACTION: Restaurant operators should be vigilant for developments on this issue and be prepared to adjust tipping policies, and/or reporting and withholding policies if necessary.

It remains to be seen whether CRA's administrative policy will be changed to reflect the courts' rulings. As of October 10, 2022, the CRA website did not have information showing an integration of the courts' rulings into their administrative policy.

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For any questions… give us a call at +1 705 444 9987