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TAX LETTER

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CONVENTION EXPENSES

When are convention expenses deductible?

If you are self-employed, then you may be able to deduct from business income the expenses of attending up to **two conventions** per year. The rules allowing this deduction are found in subsection 20(10) of the *Income Tax Act*.

Business or professional organization

One of the conditions for the deduction is that the convention be "**held by a business or professional organization"**.

The following additional conditions apply before expenses can be claimed:

- The convention must be held in the same year as you are claiming the deduction.

- The expenses must be *paid* in the year (not simply incurred or payable).

- The convention is held by a business or professional organization "at a location that may reasonably be regarded as **consistent with the territorial scope** of that organization". Thus, for example, a convention of the Winnipeg Widget Manufacturers' Association, held in a resort in Mexico, would not qualify.

However, the Canada-U.S. tax treaty provides that a convention held in the U.S. will qualify if it would otherwise qualify if held in Canada. Thus, a *national* Canadian organization can hold a qualifying convention anywhere in the U.S. This will not necessarily assist a local organization, however.

- You must attend the convention "in connection with" your business or professional practice. However, you do not need to be a member of the organization sponsoring the convention.

Deductibility beyond these restrictions

Subsection 20(10), referred to above, is a *permissive* provision, not a restrictive one. Therefore, if attendance at a convention can be justified as being a current expense **for purposes of gaining or producing income**, and **not on account of capital**, it should be deductible anyway without being subject to the restrictions of only two conventions per year and the other conditions above.

The Courts have sometimes held that convention expenses are "on account of capital", because their benefits are long-term. This was the ruling of the Exchequer Court of Canada in the 1956 *Griffith* case that led to subsection 20(10) being introduced. This was also the ruling of the Federal Court of Appeal in 2004 *Shaver* case. In *Shaver*, the taxpayer was an Amway salesman who attended monthly business seminars. These were held to be "on account of capital" (i.e., not current expenses), and so he was limited to deducting two of these seminars per year.

Still, depending on the taxpayer's business and type of convention, the courts will take a broader view in certain cases. If a taxpayer can show the connection between attending annual conventions and earning current income as a result of the information and contacts obtained at the convention, the expenses will not necessarily be limited to two conventions per year or restricted to the conditions above.

Meals and entertainment

Only 50% of amounts paid for food, beverages or entertainment qualify as a deduction from business income generally. This rule applies to conventions as well. Where the convention fee entitles you to meals and entertainment without specifying a separate price for them, **$50 per day** is deemed to be for the meals and entertainment. Thus, $25 per day of the convention fee becomes non-deductible.

Employees

Since the deduction for conventions is from business income, employees cannot claim a deduction for such expenses.

If an employer requires an employee to attend a convention, reimbursement by the employer of the employee's expenses of attending will generally not be a **taxable benefit** except to the extent there is a personal element to the benefit of attending. Even where there is some personal benefit, it may not be taxable: the Tax Court of Canada held in the 1999 *Romeril* case that there was no taxable benefit because the main purpose of the trip was for business.

If an employee's spouse attends a convention (or travels to it without being registered) and the employer pays, the spouse's attendance is normally considered a taxable benefit to the employee. However, the Canada Revenue Agency considers that there will not be a taxable benefit if the spouse was requested by the employer to go and “the main purpose for going was to assist in attaining the business objectives of the trip”.

More information

The CRA has published an Interpretation Bulletin, IT-131R2, that describes the Agency’s position on convention expenses in more detail. It is available on cra.gc.ca. As noted above, however, the Tax Court may be more flexible than the CRA in some cases.

TAX PREPARERS WILL HAVE TO FILE ELECTRONICALLY

The federal government recently introduced Bill C-38 in the House of Commons, to implement some of the proposals of the March 29, 2012 federal Budget.

Buried in Bill C-38, without any public announcement, is a new rule that will impose a **penalty on a tax preparer who does not file returns electronically**. The rule is still in draft form, but is expected to be passed into law in its current form.

Why file on paper?

“E-Filing” (electronic filing of returns) has been around for years. However, many accountants currently choose to file returns on paper, even though the returns are prepared electronically and include a 2-D bar code that the CRA can scan to pick up the contents of the return.

What do the new rules say?

New subsection 150.1(2.3) of the *Income Tax Act* will require a “tax preparer” to “file any return of income prepared by the tax preparer for consideration by way of electronic filing”, with a few very limited exceptions. Subsection 150.1(2.2) will define a “tax preparer” as a person or partnership who “accepts consideration to prepare more than 10 returns of income of corporations or more than 10 returns of income of individuals”, excluding someone who works as an employee.

New subsection 162(7.3) will subject the **tax preparer** (not the taxpayer) to a **penalty of $25 for each personal return and $100 for each corporate return** that is not filed electronically.

These new rules will take effect January 1, 2013 — in other words, they will apply to 2012 tax returns filed in spring 2013.

How will the new rules apply?

We do not yet know how the CRA will interpret these rules.

Will a return still be considered a valid return if it is filed on paper when it is supposed to be filed electronically? (If it is not validly filed, then late-filing penalties and other negative consequences can apply.) One hopes that it will be a valid return, but the CRA is still considering this question.

HST CHANGES COMING: BC OUT, PEI IN, NOVA SCOTIA DOWN

The Harmonized Sales Tax (HST) has been around since 1997, but became much more important in 2010 when Ontario and British Columbia joined the system.

In theory, the HST is just the GST at a higher rate (such as 13% instead of 5%), applying in place of provincial retail sales tax. In practice, it is more complicated, due to various provincial exemptions and special rules.

The HST is in flux, due to a number of recently announced changes. As explained below, many businesses in non-HST provinces have to comply with it.

Here are the current rates and pending changes:

- In British Columbia, the 12% HST applies only through March 2013. As of April 2013, B.C. will revert to the 5% GST plus a 7% provincial retail sales tax. (The province is being forced to do this by a referendum held in summer 2011.)

- In Alberta and the territories (Yukon, Northwest Territories and Nunavut), only the 5% GST applies.

- In Saskatchewan and Manitoba, the 5% GST applies, plus a provincial sales tax.

- In Ontario, New Brunswick and Newfoundland & Labrador, the HST rate is 13%.

- Quebec has the 5% GST plus the 9.975% Quebec Sales Tax (QST). This tax follows most of the GST rules but is *not* harmonized as part of the HST. Starting April 2013, it will be brought more into sync with the GST but will still not be harmonized. (For example, businesses operating only outside Quebec will not need to bill QST to Quebec clients, and will not be able to claim input tax credits for QST charged the way they can for HST.)

- Nova Scotia has a 15% HST, but has announced that that rate will be reduced to 14% at some point in 2014 and to 13% at some point in 2015.

- Prince Edward Island has announced that starting April 2013 it will have a 14% HST (in place of its existing 10.5% provincial retail sales tax plus the 5% GST), although it has not yet reached a deal with the federal government on this.

Businesses throughout Canada must be aware of the HST rates if they have customers in HST provinces. In general, goods shipped to an HST province or services rendered to customers in an HST province must bear HST at that province's rate. However, the "place of supply" rules are complex and there are numerous exceptions and special cases. If you are dealing with customers or events in more than one province, you should seek professional advice to ensure you are complying with the GST/HST rules.

COMPUTER CONSULTANTS

Many individuals in the computer industry work as computer consultants. If you are in this group, are you aware of the various tax issues that affect your work?

Here are some points to keep in mind:

1. If you are an **employee** rather than an independent contractor, you cannot deduct most expenses, and your employer is required to withhold income tax at source, as well as Employment Insurance premiums and Canada Pension Plan (or Quebec Pension Plan) contributions. Similarly, if you have incorporated your business but your relationship with your company's client is really that of employee to employer, you will be considered to carry on a "personal services business" and there will be a very serious tax cost.

If you are working entirely for one company or are under the control of one company, you may well be an employee. The dividing line between employee and self-employed is not always clear. The rest of this article will assume that you are an independent contractor (self-employed), and are not incorporated.

2. If you are an independent contractor carrying on business, the income you earn is **business income**. No income tax will be withheld at source, but you will have to set aside enough money to be able to pay your quarterly instalments (after your first year of carrying on business) as well as your April 30 income tax balance.

3. If you are an independent contractor, you can **deduct the expenses** of earning your self-employment income. This can include office supplies; advertising; liability insurance; capital cost allowance (depreciation) on capital assets such as computer equipment and furniture; travel from your home office to a client site; office telephone and cell phone charges; and, in most cases, a portion of your home expenses (such as mortgage interest or rent, insurance, utilities and maintenance) if you have a home office.

4. If you are an independent contractor, then your income tax filing deadline is June 15 rather than April 30. However, if you owe a balance at year-end, interest (currently at 5% per year compounded daily) accrues after April 30.

5. If you are self-employed as an independent contractor, you are normally not eligible for Employment Insurance (EI) benefits. (However, if you are working through a placement agency, a CRA administrative policy may consider you self-employed for tax purposes but still treated as an employee for EI and CPP deductions.) A new regime introduced recently will allow you to opt into the EI system so as to be eligible for certain benefits such as parental benefits on the birth of a new child. However, once you opt into the system you cannot leave, so you will have to pay EI premiums on your self-employment income forever.

6. Assuming you are self-employed, if your annual revenues exceed $30,000, you must register for **GST/HST** with the CRA and **charge either GST or HST on your services**. See the article above about Harmonized Sales Tax and the rates in different provinces. Whether you charge GST or HST will normally depends on your **client's address** (there are some exceptions, such as where you provide services for a location-specific event, or for court litigation). Thus, for example, if you are billing a Calgary client you must charge 5% GST, while if you are billing a Toronto client you must charge 13% HST.

   If you and your client are both in Quebec, you normally must charge Quebec Sales Tax (which generally follows the same rules as the GST.)

   The company that is paying you will usually not mind being charged GST, HST or QST, since they will receive an input tax credit (refund) of all the tax that you charge them.

7. If the province you are in has a **retail sales tax** (Saskatchewan, Manitoba, PEI before April 2013 and BC starting April 2013), you may have to charge that tax.

The details vary by province. These taxes are not recoverable by your clients.

8. Once you have been registered for GST/HST for your first year, you are required to pay quarterly **instalments** of GST/HST, unless your total GST/HST for the year or the previous year (prorated to 365 days if it was a short first year) will be less than $3,000.

9. If you have not been charging and collecting all of the sales taxes you should have, you may want to consider making a "voluntary disclosure", to inform the tax authorities and get penalties waived. You may still be able to collect the tax from your clients, even for work done years ago, so that you can remit the tax to the government. The availability and details of voluntary disclosures vary between the federal authority (CRA) and the various provincial authorities that administer provincial sales taxes.

TAX COLLECTION ACROSS INTERNATIONAL BOUNDARIES

Can the Canada Revenue Agency "get you" if you leave Canada owing tax, and don't leave any assets here?

Maybe.

The traditional rule is that "revenue claims" of one government will not be enforced by another jurisdiction, even though most countries have legislation permitting the enforcement of foreign judgments. A "revenue claim" is a tax debt. This court-created rule applies in Canada (1963 Supreme Court of Canada decision in *USA v. Harden*) as well as in most other countries.

However, some of Canada's tax treaties have a section that overrides this traditional rule. It is called "Assistance in Collection", and it appears in Canada's tax treaties with:

- the United States
- Germany
- Norway
- New Zealand — in a new treaty just signed on May 3, 2012, and not yet in force, but which will apply retroactively back for five years once it is ratified by both countries.

In all of these countries, if you leave Canada owing money to the CRA, the CRA can ask that country to collect the Canadian tax using that country's own tax collection system. So if you have assets in those countries, or are earning income there, your assets or earnings may be seized to pay the Canadian debt.

There is one exception, in the Canada-U.S. tax treaty only. It does not allow the IRS to collect Canadian tax from a person who was a U.S. citizen at the time the tax became payable.

The tax collection agreements apply in the other direction as well. If you owe tax to the U.S., German, Norwegian or New Zealand government, the Canada Revenue Agency will be able to use its own collection procedures to seize funds from you and remit them to that government. (However, this will not apply to a U.S. tax debt if you were a Canadian citizen when the tax became payable.)

Finally, there is one more way in which your Canadian tax debt can come back to haunt you. If you leave Canada, but later transfer money or property to relatives or friends in Canada (including by leaving them money or property when you die), they can be assessed under section 160 of the *Income Tax Act*, which catches non-arm's length transfers of property by a "tax debtor". This happened in the 1994 Tax Court case of *Montreuil*. An individual left Canada for the Bahamas with a large tax debt. He died 10 years later, left his money to his children in Canada, and the Canadian government assessed them for his tax debt — including 10 years of interest!

Canada may add the "assistance in collection" provision to more tax treaties in the future. So don't assume that you can escape your tax obligations by leaving Canada.

AROUND THE COURTS

Travel for dental treatment outside Canada was not a valid medical expense

The recent *Tokarski* case highlights an unfortunate restriction in the medical expense credit.

The *Income Tax Act* provides a tax credit for a wide range of medical expenses that exceed a certain threshold. The credit is usually equivalent to a refund of about 22% of the amount paid for the medical expenses, though it varies by province.

One of the allowable expenses is the cost of **travel** to obtain medical care, subject to certain conditions. One of those conditions is that "substantially equivalent medical services are not available" in the locality where the taxpayer lives.

Ms. Tokarski needed major dental work. The cost in Canada would have exceeded $28,000. She could not afford this. However, she could afford to fly to Poland to have the same work done there. She did this. Her total cost including her travel and hotel costs was only $9,000.

Ms. Tokarski claimed the medical expense credit on her tax return, for both the cost of the dental work and the cost of her travel to Poland, including hotel expenses. The CRA allowed the cost of the dental work but not the $2,500 in travel costs. Ms. Tokarski appealed to the Tax Court of Canada.

The Tax Court judge, with some regret, dismissed the appeal, ruling that the expenses were non-deductible. While Ms. Tokarski's actions were entirely reasonable, the requirement in the Act was that equivalent services not be "available" in British Columbia where she lived. In the judge's view, this was simply not the case. The fact that the dental services were priced too high for Ms. Tokarski to afford did not mean they were not "available".

This decision has not been appealed to the Federal Court of Appeal, so it currently stands as the Tax Court's view of the law.

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