

Table of Contents

Chapter 1 The Logic, Policy and Politics of Tax Law	1
I. THE JOY OF LEARNING TAX LAW.....	1
A. Accounting for the Attraction of Tax Law	1
B. Objectives of the Basic Course in Tax Law	5
II. NORMATIVE JUSTIFICATIONS FOR TAX LAWS.....	8
A. Why We Need Tax Laws.....	8
B. The Role of the Tax System in Constituting the Marketplace ...	9
C. The Role of the Tax System in Achieving an Efficient Allocation of Resources.....	10
1. Public goods.....	13
2. Externalities.....	14
3. Asymmetric Information.....	14
4. Cognitive Limitations	15
5. Incomplete Markets.....	15
D. The Role of the Tax System in Achieving a Morally Acceptable Distribution of Income	17
E. The Role of the Tax System in Stabilizing the Economy	20
F. The Role of the Tax System in Increasing the Rate of Economic Growth.....	21
III. TAX TAXONOMY: THE DEFINITION, CLASSIFICATION AND TERMINOLOGY OF TAXES.....	23
A. What is a Tax?.....	23
B. Classification of Taxes.....	26
1. The Tax Base.....	26
2. The Rates of Tax	28
C. Income Tax Terminology.....	30
IV. CRITERIA FOR EVALUATING TECHNICAL TAX MEASURES	34
A. Role of Evaluative Criteria	34
B. Equity.....	36
C. Neutrality.....	40
D. Simplicity	41
V. CRITERIA FOR EVALUATING TAX EXPENDITURES	42
A. Definition of Tax Expenditures	42
B. Evaluating Tax Expenditures	44
VI. METHODOLOGY OF TAX LAW AND POLICY ANALYSIS ...	45
A. Forms of Reasoning About Tax	45
B. Analytical Reasoning.....	47
C. Normative Reasoning.....	48
D. Empirical Reasoning	50
E. Methodological Pluralism	55
VII. ANALYTICAL TOOLS FOR TAX ANALYSIS.....	56
A. Inflation: Nominal Versus Real Values	56
B. Tax Deferral and the Time Value of Money	58

1. Future value	58
2. Present Value.....	59
3. Asset valuation	60
4. Value of Tax Deferral	60
C. Capitalization Effect of Taxes	61
D. The Incentive Effect of Taxes: The Income and Substitution Effects	63
E. Tax Incidence: Who Pays?	64
F. The Deadweight Loss of Taxation.....	67
G. General Theory of the Second Best.....	68
VIII. PRINCIPLES OF STATUTORY INTERPRETATION.....	69
IX. MAKING SENSE OF INCOME TAX LAWS	71
Chapter 2 Source Concept of Income	73
I. LEGISLATIVE AND JUDICIAL DEVELOPMENT OF THE SOURCE CONCEPT OF INCOME.....	73
A. Legislative Framework	73
B. Role of the Courts in Defining Sources of Income.....	74
II. LOSSES	90
A. Current Year Losses.....	90
B. Loss Carryovers.....	92
1. Non-Capital Losses	92
2. Farm Losses and Restricted Farm Losses.....	92
3. Net Capital Losses	93
III. NEXUS BETWEEN A TAXPAYER AND A SOURCE OF INCOME	94
IV. INCOME SPLITTING	100
Chapter 3 Who is Subject to Canadian Income Tax?	107
I. WHAT JURISDICTIONAL BASES ARE AVAILABLE?.....	107
A. General	107
B. Alternative Jurisdictional Bases for Income Taxation	107
1. Citizenship or Nationality.....	107
2. Residence	108
3. Source of Income	108
II. RESIDENTS: WHAT IS RESIDENCE?.....	109
A. Individuals.....	109
1. Case Law Principles	109
2. Deemed Residence (subsections 250(1), (2))	118
3. Part-Time Residence (section 114)	126
4. Ordinarily Resident (subsection 250(3)).....	129
B. Corporations	136
1. General	136
2. Deemed Residence (subsection 250(4))	136
3. Case Law Principles	136
C. Trusts and Estates.....	139

TABLE OF CONTENTS

vii

III.	NON-RESIDENTS: CANADIAN-SOURCE INCOME	140
A.	Introduction	140
B.	Non-Residents Employed or Carrying on Business in Canada or Disposing of Taxable Canadian Property.....	140
1.	Employed in Canada	141
2.	Carrying on Business.....	141
3.	Disposition of Taxable Canadian Property.....	156
C.	Non-Resident Withholding Tax.....	157
IV.	TAX TREATIES.....	158
A.	Canadian Tax Treaty Network and the Foreign Tax Credit..	158
1.	Avoiding Double Taxation.....	158
2.	Preventing Tax Avoidance and Evasion	160
3.	Promoting International Trade.....	160
B.	History and Development of Canada's Tax Treaties	161
1.	Withholding Taxes	162
2.	Non-Discrimination.....	163
C.	Implementation of Canada's Tax Treaties	163
D.	Interpretation of Canada's Tax Treaties.....	164
V.	EXEMPTIONS FROM TAX	167
VI.	TAXATION OF INDIGENOUS PEOPLES.....	168
A.	Immunity or Exemption from Tax Liability	171
1.	Immunity or Exemption on the Basis of Aboriginal Right(s).....	171
2.	Exemption by Treaty.....	173
3.	Exemption under the <i>Indian Act</i>	176
4.	Exemption under the <i>Income Tax Act</i>	191
B.	Taxes Imposed by First Nations.....	193
Chapter 4 Income from Employment	197	
I.	WHO IS AN EMPLOYEE?	197
A.	Tax Implications of Distinguishing Between Income from Employment and Income from Business.....	197
B.	Characterizing Working Relationships: Employee or Independent Contractor.....	198
C.	Attempts to Avoid Characterization as an Office or Employment	212
1.	Interposing a Contract for Services.....	212
2.	Interposing a Corporation or Trust	212
3.	Capitalization of the Employment Benefit	213
II.	AMOUNTS INCLUDED IN COMPUTING INCOME FROM AN OFFICE OR EMPLOYMENT	217
A.	Salary, Wages and Other Remuneration.....	217
B.	Benefits	217
1.	Introduction	217
2.	"In Respect of, in the Course of, or by Virtue of an Office or Employment".....	222
3.	"Benefit of Any Kind Whatever"	232

4. Valuation	253
C. Allowances	261
III. DEDUCTIONS IN COMPUTING INCOME FROM OFFICE OR EMPLOYMENT	267
A. General	267
B. Specific Deductions	268
1. Travelling Expenses (paragraphs 8(1)(e), (f), (g), (h), (h.1), (j); subsection 8(4))	268
2. Legal Expenses (paragraph 8(1)(b)).....	274
3. Professional and Union Dues (subparagraphs 8(1)(i)(i), (iv), (v); subsection 8(5))	275
4. Office Expenses and Work Space in Home.....	282
Chapter 5 Income from Business or Property	285
I. THE STATUTORY SETTING	285
II. INCOME FROM A BUSINESS.....	286
A. What Constitutes a “Business”?.....	287
1. Organized Activity	287
2. The Pursuit of Profit	290
3. Adventure or Concern in the Nature of Trade.....	300
B. Income from a Business Distinguished from Other Sources of Income.....	300
1. Income from Office or Employment Compared	301
2. Capital Gains Compared	301
3. Income from Property Compared	301
III. INCOME FROM PROPERTY	303
A. Concept of Property and Liability to Tax	303
B. Income from Property Distinguished from Other Sources of Income.....	305
1. Business Income Compared	305
2. Capital Gains Compared	305
3. Imputed Income Compared	305
C. Interest Income	306
1. Characterization as Interest.....	307
(a) Legal Meaning of Interest.....	307
(b) Discounts	307
(c) Bonuses.....	308
(d) Participating Payments, Income Bonds, and Indexed Amounts.....	309
(e) Late Payment Charges.....	309
(f) Blended Payment or Capitalized Interest	310
2. Timing of Interest Inclusion.....	313
3. Sale of Obligations with Accrued Interest.....	314
D. Rent and Royalties.....	315
1. Meaning of “Rent” or “Royalty”	315
2. Payments Based on Production or Use	315
3. Payments for Computer Software	317

TABLE OF CONTENTS

ix

E.	Dividends	318
1.	Meaning of “Dividend”.....	318
2.	Special Treatment of Dividends.....	319
IV.	DEDUCTIONS IN RESPECT OF INCOME FROM BUSINESS OR PROPERTY.....	319
A.	Structure of the Act	319
B.	General Approach to Deductions	320
C.	Income-earning Purpose Test	321
D.	Personal or Living Expenses	330
1.	Variability of the Expense.....	331
2.	Child Care Expenses.....	338
3.	Food and Beverages	341
4.	Commuting Expenses	345
5.	Expenses of a Home Workspace.....	353
6.	Entertainment Expenses and Business Meals	354
7.	Education Expenses.....	356
E.	Public Policy Considerations	356
1.	Expenses of Carrying On an Illegal Business	357
2.	Fines and Penalties.....	364
3.	Illegal Payments.....	371
4.	Theft, Burglary or Embezzlement Losses.....	371
5.	Remediation Agreements	372
F.	Interest Expense.....	373
G.	The Requirement of Reasonableness.....	388

Chapter 6 Computation of Profit and Timing Principles for the Recognition of Revenue and Expense 395

I.	SIGNIFICANCE OF TIMING PRINCIPLES	395
II.	RELEVANCE OF FINANCIAL ACCOUNTING PRACTICE...	396
III.	TAX ACCOUNTING.....	404
A.	Differences between Tax Accounting and Financial Accounting.....	404
B.	Tax Accounting Periods.....	405
C.	Tax Accounting Methods.....	406
1.	Cash Method.....	406
2.	Accrual Method.....	406
IV.	TIMING OF THE RECOGNITION OF REVENUE AND EXPENSE.....	407
A.	Timing of the Recognition of Revenue.....	407
1.	Amounts Receivable.....	408
B.	Timing of the Recognition of Expense	418
1.	An outlay or expense incurred.....	419
C.	Modification of General Timing Rules.....	421
1.	Advance Payments or Prepayments	422
2.	Prepaid Expenses	422
3.	Reserves	423
4.	Allowances	426

5.	Inventory.....	426
6.	Modified Accrual for Professionals: Section 34 Election.....	426
V.	TAX TREATMENT OF INVENTORY	430
A.	Definition of “Inventory”	430
B.	Inventory Accounting.....	430
VI.	CAPITAL EXPENDITURE.....	445
A.	Current Versus Capital Expenditure	445
1.	The Basic Test: Enduring Benefit	445
2.	Protection of Intangible Assets.....	457
3.	Repair of Tangible Assets	465
B.	Capital Cost Allowance	474
1.	Fundamentals of the Statutory Regime.....	474
2.	Calculation of Capital Cost Allowance	476
3.	Disposition of Depreciable Assets.....	482
4.	Replacement Property Rules	486
5.	Rental and Leasing Property Restrictions.....	486
6.	The Meaning of “Cost”	487
7.	When is Depreciable Property Acquired?	490
C.	Class 14.1 Expenditures	493
1.	Fundamentals of the Statutory Regime	493
2.	Goodwill	495
Chapter 7 Capital Gains	497	
I.	PREFERENTIAL TAX RATE FOR CAPITAL GAINS	497
II.	DISTINCTION BETWEEN ORDINARY INCOME AND CAPITAL AMOUNTS	500
A.	Significance of the Distinction and its Conceptual Basis	500
B.	Drawing the Distinction: Characterization of a Transaction as an Adventure or Concern in the Nature of Trade	503
III.	THE CAPITAL GAINS FRAMEWORK	523
A.	Adjusted Cost Base	524
1.	Capital Cost and Actual Cost	524
2.	Cost of Property Acquired before 1972	526
3.	Deemed Cost of Property Acquired After 1971.....	526
4.	Adjustments to Cost.....	527
(a)	Additions to Cost.....	527
(b)	Deductions from Cost	528
B.	Disposition and Proceeds of Disposition	528
1.	Statutory Definitions	528
2.	Transactions that are not Dispositions	531
3.	Deemed Dispositions	533
4.	Timing of Dispositions	533
5.	Part Dispositions.....	535
6.	Combined Proceeds for More Than One Property	535
7.	Rollover Treatment on the Reinvestment of Proceeds in a Replacement Property	537

TABLE OF CONTENTS

xi

8. Other Rollover or Non-Recognition Transactions.....	538
9. Reserve for Future Proceeds	538
C. Expenses of Disposition.....	540
D. Capital Losses.....	540
1. Netting and Carryover of Allowable Capital Losses.....	540
2. Non-Recognition of Capital Losses	541
(a) Depreciable Property.....	541
(b) Personal-Use Property and Listed Personal Property	541
(c) Superficial Loss.....	543
E. Capital Gains Deduction	544
F. International Aspects.....	545
1. Non-Residents and Capital Gains.....	545
2. Deemed Disposition or Acquisition on Change of Residence	546
IV. INTRA-FAMILY TRANSFERS.....	547
A. Realization Versus Rollover Treatment	547
B. Gifts and Non-Arm's Length Transactions.....	548
C. Spousal Transfers.....	550
D. Transfer of Farm or Fishing Property.....	551
V. THE PRINCIPAL RESIDENCE.....	551
A. The Elements of the Principal Residence Exemption	552
B. Deemed Disposition on Change in Use	556
VI. TAX ON INCOME-SPLITTING (TOSI)	558

Chapter 8 Refining What is Taxed — In Search of an Ideal

Income Tax System	561
--------------------------------	------------

I. INTRODUCTION	561
II. SUBDIVISION E DEDUCTIONS.....	577
A. Moving Expenses	577
B. Child Care Expenses.....	586
C. What Expenses Qualify?	598
D. Alimony and Maintenance Payments	610
E. Retirement Savings: Tax-Assisted Private Pension Plans.....	613
III. TAX CREDITS.....	617
A. Personal Credits for Individuals and Dependents.....	618
B. Charitable Donations	623
C. Medical Expense Tax Credit (METC).....	636
D. Disability Tax Credit.....	645
E. Tuition Credits	653
F. Other Credits	656
IV. ALTERNATIVE MINIMUM TAX.....	658

Chapter 9 Taxation of Intermediaries and the Relevance of Income Tax

to Other Areas of Law.....	661
-----------------------------------	------------

I. TAXATION OF INTERMEDIARIES.....	661
A. Taxation of Trusts and Beneficiaries.....	661

1.	Definitions.....	661
2.	Overview of the Taxation of Trusts and Beneficiaries....	662
3.	Transfers of Property to a Trust.....	663
4.	Transfers of Beneficial Interests and Distributions of Trust Property	665
B.	Taxation of Partnerships and Partners	666
1.	Definitions.....	666
2.	Overview of the Taxation of Partnerships and Partners.....	667
3.	The Partnership Interest	669
4.	Transfers of Property to a Partnership.....	670
5.	Transfers of Partnership Interests or Partnership Property	671
C.	Taxation of Corporations	673
1.	Definitions.....	673
2.	Overview of the Taxation of Corporations — Rules Applicable to all Corporations	674
(a)	Computation of Income and Taxable Income.....	674
(b)	Tax Rates.....	674
(c)	Income Tax Credits.....	674
3.	Special Rules for Private Corporations and CCPCs	675
(a)	General Concepts.....	675
(b)	Investment Income Other than Inter-Corporate Dividends Earned by a CCPC.....	675
(c)	Inter-Corporate Dividends — Part IV Tax	676
(d)	Small Business Deduction	677
(i)	Active Business Income	677
(ii)	Associated Corporations.....	677
(iii)	Corporate Partnerships.....	677
(iv)	The \$500,000 Business Limit	677
D.	Corporate Distributions.....	678
1.	Ordinary Taxable Dividends	678
2.	Dividends in Kind and Stock Dividends	679
3.	Capital Dividends	680
4.	Deemed Dividends	681
(a)	Paid-Up Capital.....	681
(b)	Capitalization of Surplus	681
(c)	Distributions on Winding-Up, Discontinuance or Reorganization	682
(d)	Redemption, Acquisition or Cancellation of Shares	683
(e)	Reduction of Capital	683
5.	Stripping Transactions.....	684
(a)	Dividend Stripping.....	684
(b)	Capital Gains Stripping	684
6.	Shareholder Benefits and Loans	685
(a)	Shareholder Benefits.....	685

TABLE OF CONTENTS

xiii

	(b) Shareholder Loans	685
E.	Corporate Reorganizations	686
	1. Section 85 - Transfers of Property to a Corporation	686
	2. Section 85.1: Share-for-Share Exchanges	689
	3. Section 51: Conversion Rights.....	690
	4. Section 86: Capital Reorganizations.....	690
	5. Section 87: Amalgamations.....	691
	6. Section 88: Winding-Up.....	693
II.	RELEVANCE OF INCOME TAX TO OTHER AREAS OF LAW	695
A.	Corporate and Commercial Law	695
	1. Choosing A Business Format	695
	2. Corporate Finance	697
	(a) Debt Financing.....	697
	(b) Equity Financing	698
	(c) Hybrid Financing.....	698
	(d) Financing Owner-Managed Businesses	699
	3. Corporate Distributions and Reorganizations.....	699
	4. Petroleum and Natural Gas	699
	(a) Intangible Expenditures	699
	(b) Flow-Through Shares	700
	(c) Successor Rules.....	700
	(d) Disposition of Resource Properties	701
	5. Commercial Real Estate	701
	(a) Characterization of Gains and Losses	701
	(b) Reallocation of Proceeds.....	701
	(c) Inventory Valuation	702
	(d) Limitations on Deductions.....	702
	(e) Separate Depreciable Property Classes for Rental Properties	703
	(f) Tenant Inducement Payments	703
	(g) Replacement Property	703
	(h) Non-Residents	704
	(i) Farm and Fishing Property.....	705
	(j) Life Estates.....	705
B.	Taxation on Death.....	705
	1. Income	706
	2. Property	707
	(a) Capital Property	707
	(b) Property Transferred to, or in Trust for, a Spouse or Common-Law Partner.....	708
	(i) To a Spouse or Common-Law Partner.....	708
	(ii) Tainted Conjugal Trusts	709
	(c) Other Property.....	709
	3. Deductions, Credits and Exemptions	710
	(a) Deductions	710
	(i) Reserves	710

	(ii) Capital Loss Utilization.....	711
(b)	Computation of Tax.....	711
	(i) Charitable Donations	711
	(ii) Medical Expenses.....	712
4.	Other Separate Returns	713
C.	Family Law	713
1.	Support Payments	714
2.	Division of Matrimonial Property	717
	(a) The Principal Residence Exemption.....	717
	(b) RRSPs	717
	(c) Pensions	718
	(d) The Canada Pension Plan (“CPP”)).....	718
3.	Conjugal Rollovers.....	718
4.	Income Attribution	719
5.	Legal Fees	719
6.	Domestic Contracts.....	719
D.	Civil Litigation	720
1.	Damages, Interest and Other Payments.....	720
	(a) Damage Awards	720
	(b) Interest.....	721
	(c) Legal Fees	721
2.	Employment Litigation	722
	(a) Retiring Allowances	722
	(b) Non-Taxable Amounts	722
3.	Personal Injury Awards	723
	(a) Pecuniary Loss.....	723
	(b) Non-Pecuniary Loss and Non-Compensatory Damages	724
	(c) Structured Settlements	724
E.	Criminal Law	725
1.	Taxation of Illegal Income.....	725
2.	Net Worth Assessments	725
3.	Garnishment.....	726
4.	Defence of Charges under the Act	726
5.	Legal Fees	726
F.	Aboriginal Law.....	727
G.	Environmental Law.....	727
1.	Accelerated CCA Claims for Environmentally Friendly Assets (Paragraph 20(1)(a)).....	727
2.	Canadian Renewable and Conservation Expenses (Sections 66 and 66.1 and Regulation 1219)	727
3.	Contributions to or Acquisition of a Qualifying Environmental Trust (Paragraphs 20(1)(ss) and (tt)).....	728
4.	Gifts of Ecologically Sensitive Land (Paragraphs 38(a.2) and 110.1(1)(d) and Section 118.1).....	728

Chapter 10 Dispute Resolution, Statutory Interpretation and Tax Avoidance	729
I. DISPUTE RESOLUTION	730
A. Returns and Assessment	730
B. Refunds, Interest and Penalties	732
C. Waiver of Interest and Penalties	733
D. Voluntary Disclosure Program (VDP).....	733
E. Objections and Appeals	734
F. Settlements	736
II. INTERPRETATION OF TAX STATUTES.....	737
A. Strict Interpretation.....	737
B. The Modern Approach.....	739
C. Other Legislation Affecting the Interpretation of Tax Statutes	745
D. The “Hansard Rule”	751
III. TAX EVASION VERSUS TAX AVOIDANCE.....	752
A. Tax Evasion	752
B. Tax Avoidance.....	757
<i>Table of Statutory References</i>	797
<i>Table of Cases</i>	815
<i>Index</i>	837