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Frequent Flyer Programs

Who Gets The (Taxable) Benefit?



While security issues and the cost of air travel have both taken their toll on business-related travel, such travel is still a fact of life for many business owners and their employees. Where required travel is business-related the cost is, of course, taken care of by the employer; but there is a potential benefit to the employee in the form of the accumulation of frequent flyer points.

Most people are familiar with frequent flyer programs, under which travelers taking flights on a particular airline can accumulate credits, or points, which may then be exchanged for additional air travel or other benefits. In some cases, the points accrue to the employer; who will then use them to "pay" for future business trips. More often, however, the ticket is booked in the name of the employee and any frequent flyer points accumulated are credited to the employee's account with the program.

The Canada Revenue Agency's general position on the tax treatment of frequent flyer points accumulated by an employee in the course of required business travel is that where those points are later used to obtain air travel or other benefits for the employee or his or her family, the employee has received a taxable benefit related to employment. In the Agency's view, that taxable benefit is equal to the fair market value of the air travel or other benefit received.

While the general rule is relatively straightforward in principle, it's much more difficult in application. As is often the case in tax, the devil is in the details. In most cases where an employee has received a taxable benefit related to employment, the employer is required to quantify the amount of that benefit and include it on the employee's T4 slip for the year. When it comes to frequent flyer points, that rule applies where the employer "controls" the employee's use of those points.

However where, as it more frequently the case, the points accrue directly to the employee's account with an airline and the employee determines the use of those points, the employer bears no responsibility for reporting any taxable benefit. Instead, that responsibility shifts to the employee. The CRA expects employees "to determine and include in income the fair market value of any benefits received or enjoyed." How many employees actually conform to that policy (or are even aware of it) is anyone's guess.

Probably because the amounts involved, while potentially significant to the employee, aren't really substantial in the overall scheme of Canada's tax system, there have been relatively few instances in which the Canada Revenue Agency has actually pursued an assessment relating to taxable benefits arising from frequent flyer points as far as litigation.

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FALL 2007

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Federal Budget 2007

Measures Affecting Businesses

Following are measures from the March 2007 Federal Budget that may be of interest to business owners.

LIFETIME CAPITAL GAINS EXEMPTION

The existing limit of \$500,000 on the lifetime capital gains exemption available to qualified small business corporation shares and to farm and fishing property is increased to \$750,000 effective March 19, 2007. Transitional rules will apply to 2007 to ensure the increased limit is only available in respect of net gains arising from dispositions after Budget day.

CAPITAL COST ALLOWANCE RATES INCREASED

The federal government has proposed increases in the capital cost allowance rates applicable to a variety of asset classes. Effective for acquisitions after March 19, 2007, the rate on computer equipment is increased from 45% to 55%, while the rate on buildings used for manufacturing or processing is raised from 4% to 10%.

CHANGES TO INSTALMENT AND FILING RULES

Under current rules, corporations are required to make monthly income tax instalment payments if their tax payable for either the previous or the current year is more than \$1,000. The government proposes to increase that threshold amount from \$1,000 to \$3,000, effective for corporate taxation years that start after 2007.



(FREQUENT FLYER PROGRAMS, CONT'D FROM PAGE 1)

However, where the Courts have had an opportunity to consider the issue, the CRA's position has not received full support. In a Tax Court of Canada case heard several years ago the Court, while agreeing that a taxable benefit had been received by the employee, found that the amount of the benefit, contrary to the CRA's view, was not the normal fare which would be charged for the ticket obtained (i.e. the fair market value of the ticket). As anyone who has ever tried to obtain a flight by redeeming frequent flyer points knows, there are numerous

restrictions attached, including blackout periods and limited seat availability. In the Court's view, such restrictions and limitations reduced the taxable benefit to the value of the most heavily discounted economy class ticket sold for the flight in question.

Where the reward flight in question was in first or business class, things got even more complicated, the Court concluding that "the value of a reward ticket in either business or first class is equal to that proportion of an unrestricted business or first class fare which the price

of the most heavily discounted economy class fare on that flight is of the price of a full fare economy class ticket". Taxpayers faced with quantifying such a benefit could be forgiven for concluding that it's just more trouble than it's worth.

The bottom line in all of this is that where an employee receives a personal benefit (for himself or his family) arising from business related travel, the benefit obtained is taxable, and it's expected that the employee will report that benefit (whether or not it appears on a T4) on his or her income tax return for the year.

Claiming Home Office Expenses

While the majority of Canadian employees still travel to the office at the beginning of each working day, there has been a huge increase over the past decade or so in the number of Canadian who work, on a part-time or a full-time basis, from a home office. Such an arrangement can work to everyone's benefit: the worker is spared the cost and aggravation of the daily commute and, where a significant number of employees work at least part-time from home, the employer's costs of maintaining office space, usually in expensive urban markets, can go down.

As working from a home office has become more common, a certain degree of mythology has also grown up around the tax treatment of expenses related to maintaining a home office. In the most optimistic (and unrealistic) of such scenarios, virtually all household expenses, including the mortgage, are transformed into tax deductions, reducing one's tax liability to miniscule amounts. It goes almost without saying that such is not the case. Deductions are certainly available, but the tax rules governing what's deductible and when are specific and detailed.

It's important, when dealing with the question of the deductibility of home office expenses, to distinguish between deductions claimed by employees and those claimed by the self-employed. As is almost always the case in such matters, the self-employed enjoy a greater degree of latitude in the deductions which may be claimed. That said, both the employed and the self-employed must meet the same basic two-part test in order to be eligible to deduct home office expenses, and that test is as follows:

- the home office must be the place at which the taxpayer principally performs the duties of employment or must be the taxpayer's principal place of business; or
- the home office must be both used exclusively for the purpose of earning income from employment or from the business and must be used on a regular and continuing basis for meeting customers or clients of the employer or the business.

A self-employed taxpayer who meets these criteria is entitled to claim expenses such as property taxes, rent or mortgage interest (but not mortgage principal amounts), insurance, utilities costs etc. However, such expenses are not deductible in their entirety: rather, the taxpayer must apportion the expenses based on the percentage of the total space which is used as a home office. For example, a self-employed taxpayer whose home office takes up 20% of available floor space and who incurs \$1,000 each year in qualifying expenses would be entitled to deduct \$200 (\$1,000 times 20%) in home office expenses for that year.

Employed taxpayers who meet the two-part test set out above must meet a further condition before being eligible to claim home office expenses, as follows:

- the employer must provide the employee with a form T2200, which indicates that the employee is required by his or her contract of employment to provide and pay for the expenses related to the home office;
- the employee must not have been reimbursed by the employer for such expenses; and
- the expenses incurred are incurred solely for the purpose of earning income from an office or employment.

Once the T2200 has been issued, and the other conditions are met, an employee who is a tenant can claim a proportionate part of his or her rent. An employee who owns his or her own home can claim a proportionate percentage of utilities, cleaning costs and minor repairs (but not improvements). An employee is not entitled to claim any portion of property taxes, insurance or mortgage interest paid.

(SEE CLAIMING HOME OFFICE EXPENSES, PAGE 4)

FastFACTS

CRA Announces Interest Rates for 3rd Quarter

Effective from July 1 to September 30, the CRA will charge interest at a rate of 9%, compounded daily, on overdue or insufficient payments of tax. For the same period, the interest rate paid by the Agency on overpayments of tax will be 7%, and the rate used to calculate employee and shareholder taxable benefits on low-interest loans will be 5%.

More information is available at
www.cra-arc.gc.ca/newsroom/releases/2007/june/nr070601-e.html

Canada Revenue Agency Issues Q&A on Proposed Changes to Retirement Savings Plans

The Registered Plans Directorate of the Canada Revenue Agency (CRA) has issued a Q&A dealing with the changes to retirement savings plans which were announced in this year's federal budget.

The document, which deals with issues involving the transition to the new age limit for contributions to and conversions of registered retirement savings plans can be found on the CRA website at www.cra-arc.gc.ca/tax/registered/budget2007-e.html

CRA No Longer Accepting Cash Payments at Counter

The Canada Revenue Agency has announced that, effective as of August 13, 2007, it will no longer be accepting in-person cash payments at its payment counters. Taxpayers can continue to make payments at CRA offices by cheque, money order or debit card, and can continue to make payments in cash without charge at Canadian financial institutions.

The CRA release outlining the change in policy can be found on the Agency's website at www.cra-arc.gc.ca/newsroom/releases/2007/july/nr070706-e.html

(CLAIMING HOME OFFICE EXPENSES, CONT'D FROM PAGE 3)

Slightly more latitude is provided to commission employees who work from home and own their home. Such employees may claim, in addition to the costs outlined above for employees, a portion of property taxes and insurance paid on the home. Mortgage interest and capital cost allowance remain non-deductible.

One of the benefits which is commonly supposed to exist for home office workers is the right to claim depreciation (or capital cost allowance (CCA), in tax parlance) on one's home for tax purposes. For employees, however, such a claim is simply not allowed. And, while the self-employed may be entitled to claim CCA on a home, making such a claim can create short-term benefits with longer term costs. Making a CCA claim on one's home is likely to erode the principal residence exemption from capital gains tax which is claimable when a home is sold, and that exemption is almost always more valuable than any CCA claim which might have been made.

While the deduction of home office expenses isn't the huge tax benefit that popular tax mythology would sometimes suggest it is, it can, assuming that the legal requirements are met and proper records kept, provide some tax relief on expenditures which would likely have to be incurred in any case by the taxpayer.

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