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When Tax Law Meets Technological Change

RECENT DEVELOPMENTS

MUCH OF CANADA'S TAX LAW and related administrative positions taken by the Canada Revenue Agency (CRA) were formulated in advance of the enormous changes which have taken place in communications technology over the past quarter century. As a result, tax law and policy are sometimes in the position of trying to *catch up* to the impact of technological change, as illustrated by two recent technical interpretations issued by the CRA.

INTERNET COURSES AND THE TUITION TAX CREDIT

There was good news for taxpayers in the form of a change in the CRA's administrative policy on the availability of a federal tuition tax credit for university courses taken over the Internet. Where a post-secondary institution is located in Canada or is located near the Canada-U.S. border and the student commutes from Canada, the only requirement is that the student be *enrolled* in the post-secondary program. However, where the university is located outside Canada, at a distance too great to allow commuting, the Act requires that the student be in *full-time attendance* – enrollment is not sufficient. The CRA has always interpreted *full-time attendance* to mean actual physical presence at the foreign university, but that requirement was recently successfully challenged by taxpayers in the courts.

The two court cases involved students who were enrolled in post-secondary programs at accredited post-secondary institutions (one in England and the other in the U.S.) for which courses were taken over the Internet. Both students claimed the tuition tax credit for tuition paid in respect of their courses and, in both cases, the CRA denied the credit on the basis that the student had not met the requirement of *full-time attendance*, with the Agency taking the position that the attendance requirement imposed by the phrase *full-time attendance* could not be satisfied where courses were being taken over the Internet. Both students disputed the CRA's position and appealed to the Tax Court of Canada. The Court reviewed the statutory language and concluded that full-time attendance at a foreign university could include full-time attendance through the Internet or on-line, as such an approach conformed to both common sense and to the realities of modern technology. The Court noted as well that, if there continued to be doubt on that question, it should be resolved by an amendment to the legislation.

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While a legislative amendment may still be brought forward, taxpayers won't have to wait for such an amendment to begin claiming the tuition tax credit in respect of otherwise qualifying post-secondary courses taken over the Internet. In the recent technical interpretation, the CRA indicated that "in light of recent jurisprudence, we have reconsidered our interpretation of paragraph 118.5(1)(b), such that a student enrolled at a university outside Canada and taking courses over the Internet may be able to claim a tuition tax credit for the related tuition fees, provided that the student is able to demonstrate that their attendance via Internet constituted *full-time attendance* and the other statutory requirements are met.

The CRA's policy change is generally effective only on a *go-forward* basis. In other words, the new position applies only to tuition fees paid for the 2007 and subsequent taxation years. There is, however, a window of opportunity to claim the credit for prior years. Where a taxpayer attempted to claim the credit for prior years, was denied the credit on assessment, and filed a Notice of Objection with respect to that denial (or is still within the time limit for filing of a Notice of Objection), the credit can be allowed on reassessment. In all other

cases, the credit will be made available only for 2007 and following years.

HOME OFFICE EXPENSES

The news for taxpayers, particularly employees, wasn't as good when it comes to claiming home office expenses. In the Fall 2007 issue of the Abacus we discussed the deductibility of home office expenses. To summarize, both employees 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.


The Income Tax Act does not specify what is meant by *meeting clients* and taxpayers have in recent years sought deductions for home office expenses where such meetings took place via electronic means, either telephone or e-mail, rather than in person. In at least one case, *Vanka v. The Queen*, a self-employed physician made himself available by phone to his patients in the evenings,

after regular office hours, and he received an average of seven phone calls each evening. The CRA denied his claim for the deduction of home office expenses, but that assessment was reversed by the Tax Court of Canada. However, it seems that the CRA was not convinced by the Court's reasoning. In a recent technical interpretation request, the Agency was asked for its views on the meaning of *meeting clients* as it related to the deduction of home office expenses by employees. It conceded that while the phrase was not defined in the Act, the dictionary meaning of the words referred to meetings held in person. In its view, the *Vanka* decision involved what it termed *very unique facts and business income*, and that it would continue to impose an *in person* meeting requirement with respect to home office deductions sought by employees under section 8(13) of the Act.

The door may not, however, be entirely closed with respect to *virtual* meetings and the deduction of home office expenses. The CRA did indicate that its position related specifically to section 8 of the Act, which governs home office deductions taken by employees. It's still possible that the Agency will take a more flexible view when it comes to self-employed taxpayers who seek home office deductions in these circumstances.

Medical Travel Insurance AND THE Medical Expense Tax Credit

READING THE FINE PRINT



As summer comes to an end and the cold weather looms, many Canadians will begin thinking of a vacation in the sun sometime during the winter or even, in the case of *snowbirds*, spending the entire winter in a warmer, sunnier place.

Whether a planned vacation is short or long, most Canadians who are leaving the country purchase medical travel insurance to ensure coverage of unexpected medical expenses while down south. In many cases, the cost of that insurance will constitute a qualifying medical expense eligible for a tax credit on the taxpayer's Canadian return for the year. However, a recent technical interpretation issued by the Canada Revenue Agency (CRA) indicates that, when it comes to the medical expense tax credit, not all medical travel insurance is created equal.

The general rule is that the cost of medical travel insurance will qualify as a medical expense if the cost is a premium, contribution or other consideration paid for coverage under a private health services plan. Such coverage must be in respect of hospital care or expense or medical care or expense which normally would otherwise have qualified as a medical expense under the provisions of the Income Tax Act. Where, however, a medical travel insurance policy, in addition to providing medical expenses coverage, provides coverage for additional benefits that would not qualify as medical expenses, such as a providing for a death benefit, the CRA takes the position that the entire amount of premiums

paid to acquire the policy would not qualify as a medical expense. It would seem, therefore, that even if the premiums payable in respect of the non-qualifying benefit could be segregated out or were paid separately, the existence of the non-medical benefit would *taint* the entire policy such that even the otherwise qualifying premiums would be disallowed as an eligible medical expense.

It goes without saying that it's important, when obtaining insurance coverage of any kind, to read the *fine print* so as to be aware of the various inclusions, exclusions and limitations which may apply. Given the CRA's administrative policy with respect to limitations on the availability of the medical expense credit, taxpayers would also be well advised to review any prospective policy from the point of view of the tax treatment of premiums paid. Where the availability of a medical expense tax credit for premiums paid is important, and benefits beyond strictly medical expense coverage are desired, it would seem prudent to arrange for such additional benefits under a separate policy. That way, the often substantial premiums which may be levied for coverage for medical costs can remain eligible for the medical expense tax credit on that year's return.

FastFACTS

CANADA'S LABOUR FORCE TO SHRINK AS BABY BOOMERS RETIRE

Statistics Canada's analysis of 2006 census figures has confirmed the popular perception that Canada is likely to face a labour shortage over the next quarter century. The impending retirement of the baby boomers, combined with a lower birth rate in the post-baby boom generation will mean that, within the next decade, the number of persons leaving the workforce may exceed the number entering it for the first time. Stats Can's summary of the labour force implications of the census figures, together with a link to a more detailed analysis, can be found on the Agency's website at:

<http://www.statcan.ca/Daily/English/070717/d070717a.htm>

\$13.8 BILLION FEDERAL SURPLUS RECORDED FOR FISCAL 2006-07

The Department of Finance has released the Annual Financial Report for the 2006-07 fiscal year ended March 31, 2007, and that report indicates that a budgetary surplus of \$13.8 billion was recorded in 2006-07. Federal debt stood at \$467.3 billion at the end of the year, down \$95.6 billion from its peak of \$562.9 billion in 1996-97. The government has indicated that the interest savings resulting from the reduction in the federal debt will be used to reduce personal income taxes. The full Report can be found on the Department of Finance website at:

http://www.fin.gc.ca/toce/2007/afr2007_e.html

UNEMPLOYMENT RATE DROPS TO 33-YEAR LOW IN SEPTEMBER

The Canadian unemployment rate dropped below 6% in September for the first time since November 1974. The actual unemployment rate for the month stood at 5.9%. Details of the employment picture by province, economic sector and worker age are provided in the Labour Force Survey issued by Statistics Canada, and available on the StatsCan website at:

<http://www.statcan.ca/Daily/English/071005/d071005a.htm>

PENSION INCOME INCOME-SPLITTING LEGISLATION

The new pension income-splitting legislation that was announced last year by the federal government applies to 2007. For information on the new rules see Canada Revenue Agency's website at:

www.cra-arc.gc.ca/agency/budget/2007/pension-e.html

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