

## **A Tax Loophole Benefits the Other Guy. If it Benefits You, it is “Tax Reform”**

**By**

**Vern Krishna, CM, QC, FRSC, LSM**

As we go into tax filing season, individuals should consider which employment perquisites of office are taxable and which are not. Employees are compensated through salary and perks. Salary is generally fully taxable; perks may be taxable or non-taxable, depending upon statutory exemptions and administrative discretion. Perks can improve one’s standard of living, particularly if they are not taxable. That is why senior executives prefer to cap their salaries and draw benefits through perks of office, particularly if they are non-taxable or taxable at a rate lower than the 54% applicable to salaries above approximately \$220,000.

With few exceptions, employees are taxable not only on their salary and wages, but also on in-kind personal benefits and perks that are directly attributable to their employment. The underlying principle is simple: taxpayers in equal financial circumstances should pay taxes in equivalent amounts. However, applying the principle in practice is complicated and depends upon exemptions and discretionary administrative interpretations.

The Canada Revenue Agency (“CRA”) considers two main questions: what the value of a perk is, and who is the primary beneficiary of the benefit. A perk is an economic advantage or material acquisition measurable in monetary terms that an employee receives from his or her employer in his or her capacity as an employee. Thus, one asks four questions:

- Did the employee receive or enjoy an economic advantage?
- Was the economic advantage measurable in monetary terms?
- Was the economic advantage for the benefit of the employee? And
- Did the employer confer the economic advantage on the employee by virtue of his or her employment relationship with the employee?

The law is clear: If the answer to all these questions is affirmative, the economic advantage or material acquisition, no matter how small, is taxable as employment income unless the perk is specifically exempted by the *Income Tax Act* or through the CRA applying administrative concession.

When filing tax returns, one should be aware that the CRA looks out for certain types of perks, such as, personal use of automobiles, aircraft, vacation properties, condominiums, non-accountable allowances, low interest loans, subsidized tuition, employer paid insurance premiums (unless exempt) and stock options (under continuous review by the Liberal government).

No amount is too small for the CRA to tax. In *Savage*, for example, the Supreme Court taxed a clerk on \$300 that her employer reimbursed for her tuition fees for pursuing a course of studies

directly related to her work. The law does not exempt trifles, because trifles can accumulate into large amounts if multiplied by the number of employees in the country. Administrative discretion, however, turns a blind eye in appropriate circumstances.

It is understandable that employees will attempt to enhance their standard of living by taking their employment income indirectly through perks. Bernard Ebbers of WorldCom, for example, allegedly received \$408 million (U.S.) in loans from his company at 2.3 percent interest rate, which saved him nearly \$28 million each year, compared with the company's corporate interest rate. Even if taxable at 40 percent, the net after-tax benefit was worth nearly \$17 million (U.S.) annually in his pocket. The company rented another of its board members a corporate jet for \$1 a month, nearly \$1 million below its normal annual cost.

However, there is a good deal of administrative discretion in taxation and one agency of government can give a wink and a nod to another depending on the nature of the perk and the status of the recipient. Parliamentary perks, of course, are well known subsidized restaurants, haircuts, gym facilities, and the like are all considered necessary for the administration of onerous legislative duties.

The traditional approach of the tax authorities and the courts has been that reimbursements for personal clothing are taxable benefits unless the employee can use the clothes only for employment purposes without personal use. Hence, employees, such as prison guards, police workers, firefighters, doctors and dentists who use their clothing only for work related purposes are not taxable if they are reimbursed for their special uniforms. This is entirely fair since uniforms are of little use outside the workplace.

Can lawyers and accountants can write-off the cost of their business suits or exclude such benefits if reimbursed by their firms or employers? Reimbursements for business suits and dresses are normally taxable benefits because one can use them for business and personal purposes. Unlike the security guard, a lawyer in his blue pinstripe suit can go to the office, and then go out for a personal evening function in the same outfit. Given the change in clothing fashions towards more casual wear, however, an individual may be able to demonstrate, that the Bay Street blue pinstripe suit, the white shirt, and the necktie are nothing more than uniforms that most professional discard at the earliest opportunity on getting home. If the stereotypical business mufti is no different from a uniform, it is arguable that any reimbursement or expenditure for such expenses is "representational clothing appropriate to local circumstance" and not a taxable benefit.

A tax loophole is something that benefits the other guy. If it benefits you, it is "tax reform".

*Professor Vern Krishna, CM, QC, FRSC, Of Counsel, Tax Chambers LLP, Barristers & Solicitors (Toronto).*

*vern.krishna@taxchambers.ca*

*www.vernkrishna.com*