TAX ADVISOR

Keeping it in the Family

If you're an advisor hiring a spouse, employ lessons learned from these two cases

COURT REPORT

JAMIE GOLOMBEK

Welcome to Court Report, a space devoted to exploring recent tax cases of interest to financial advisors and their clients. In this inaugural column, we'll take a closer look at a tax case released near the end of 2004 that deals with a common income-splitting technique utilized by advisors: hiring your spouse.

If you are an advisor who is considered self-employed, you should have no trouble hiring your spouse or partner to help you with your practice, and gain tax advantages, as long as he or she actually performs the work and is paid a "reasonable" salary for the work being done (I'll talk more about what "reasonable" means a bit later).

ADVISORS WHO ARE EMPLOYEES

It is more complicated for an advisor who is considered to be an employee to hire a spouse or another family member to assist in his or her practice. An October 2004 Tax Court of Canada decision, *Schnurr v. The Queen*, 2004 TCC 684, dealt with whether the investment advisor could deduct a salary paid to his wife.

In the years in question, Grant Schnurr was a successful investment advisor with a major brokerage firm. Mr. Schnurr hired his wife as his assistant and paid her a fair salary, making sure to make the appropriate payroll deductions. Mrs. Schnurr's role was to perform various secretarial duties with respect to Mr. Schnurr's clients' records, as well as to coordinate the annual Christmas card mailing and purchase gifts for clients. She also engaged in various business development activities in the community that helped attract new clients.

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The judge did not question the validity of Mrs. Schnurr's employment by her husband. He found that her salary was reasonable in relation to the services that she performed, noting that "the amount paid to Mrs. Schnurr in the overall context of the high income and substantial business generated by Mr. Schnurr is, in fact, rather modest."

REQUIREMENT TO HIRE AN ASSISTANT

The main issue in the case was the Income Tax Act's rules governing the deductibility of salaries paid to an assistant by an employee. In the terms of the legislation, to be able to deduct the cost of an assistant's salary, an employee must be "required" by the contract of his or her employment to pay for an assistant.

While the Canada Revenue Agency's administrative position is that the term "required" necessitates that there be an "express requirement within the terms of a written contract of employment," the CRA acknowledges that such a requirement can still exist if the employee can establish that it was "tacitly understood" by both parties (the employee and the employer) that the payment must be made and was necessary, under the circumstances, to fulfill the duties of the job.

The CRA argued that the employment letter between the brokerage firm and Mr. Schnurr was silent about the hiring of an assistant and, therefore, it was not "required." The judge disagreed, and found Mrs. Schnurr's salary to be fully tax-deductible, concluding that it was "implicit in the relationship with [his employer]…that if Mr. Schnurr is to generate the sort of business … that [his employer] expected him to, he is required to hire someone to perform the type of services that his wife performed. Such a provision need not be explicitly set out in the agreement between the employer and the employee."

COMPLETION OF FORM T2200

While this decision may certainly sound like good news for advisors who are deemed employees, there is still one major stumbling block. In order to be able to claim a salary paid to an assistant, you must complete CRA Form T2200, "Declaration of Conditions of Employment." You fill in the first part of the form and your employer fills in the second part. Specifically, in question 9(b) of the form, your

employer is required to respond to the following: "Did you require this employee under a contract of employment to … pay for a substitute or assistant?"

If your employer refuses to complete the form, you will not be successful in claiming a salary paid to an assistant. The judge explained the purpose of the form in his decision as follows: "The filing of Form T2200 serves a dual function: it is a statutory condition precedent to the claiming of an employment expense deduction under … [the Act] … and it provides evidence of the terms of employment. I doubt that the form is conclusive or determinative if the evidence showed it to be wrong but it is at least prima facie evidence."

SALARY MUST BE "REASONABLE"

Finally, ensure that the salary paid to your spouse is "reasonable" and reflective of the work being performed. In other words, what would you pay an arm's-length person for the amount of work you are hiring your spouse or partner to do?

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Another recent case decided in September of 2004, *Hampson v. The Queen*, 2004 TCC 623, involved a self-employed psychologist earning just over $60,000, who attempted to deduct $16,000 in salary paid to his wife to assist him in his work.

In court, Mr. Hampson produced a list of tasks that made up the work for which he paid his wife. The list consisted of such things as receiving and responding to phone calls and e-mails, scheduling appointments, paying bills and keeping receipts current. The CRA maintained that these types of activities really amount to "little or nothing more than any stay-at-home spouse would do without compensation … [and that $16,000 was] an unreasonable amount to pay for those services." The judge agreed and disallowed the expense.

While hiring a spouse can still be an effective income-splitting method, given these two cases you may wish to ensure that your employer is onside and that the amount you pay is, indeed, reasonable. AER

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Creditor Proof?

BY CHARLEY TSAI

Recent court decisions may alter the status of non-insurance RRSP accounts when it comes to creditor protection. For now, however, whether your clients' RRSPs are protected by creditors depends on where they reside and whether they are alive or not.

Generally, a creditor can seize a debtor's assets unless they are declared exempt in that province or territory. But to date, only Saskatchewan and Prince Edward Island have enacted laws to exempt non-insurance RRSPs and RRIFs from creditors while the annuitant is alive.

The rules change slightly in the case of a deceased RRSP annuitant. British Columbia and PEI, for example, have legislation that exempts RRSPs from forming part of the estate. PEI's legislation goes further, specifically excluding RRSPs from being subject to claims by creditors of the deceased annuitant.

It is possible that the courts in other provinces may take guidance from the Ontario decision.

Alberta, which currently has no legislation protecting clients' non-insurance RRSPs from creditors, has insurance legislation protecting insurance RRSPs from creditors. Almost, if not all, provinces have insurance legislation protecting insurance RRSPs from creditors.

Two recent court decisions may affect the creditor-proofing status of RRSPs in the future. First, in May, the Supreme Court of Canada in *Bank of Nova Scotia v. Thibault* ruled that creditors in Quebec can seize a debtor's RRSP because the terms of the RRSP failed to meet the conditions necessary under Quebec legislation to exempt these assets from creditors.

Then in June, Ontario's top court in *Amherst Crane Rentals Limited v. Arlene Clare Perring* upheld a lower court decision exempting a deceased annuitant's RRSP from being seized by his creditors even though there is no legislation in Ontario that specifically protects RRSPs from creditors.

Until the *Amherst Crane* case, the prevailing view from courts was that RRSPs can be seized by creditors of a deceased annuitant even if the RRSP had named beneficiaries.

The impact of this decision may extend to clients living in other provinces as well. All common-law provinces and territories have beneficiary designation legislation that is quite similar, and it is possible that the courts in other provinces may take guidance from the Ontario decision. AER

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PROVINCIAL CREDITOR PROTECTION FOR RRSPS

	During annuitant's lifetime	Subsequent to annuitant's death
British Columbia	Court decisions have confirmed RRSPs are not protected from creditors while the annuitant is alive.	Provincial legislation excludes RRSPs from forming part of the deceased's estate. As a result, it is likely RRSPs will be exempt from creditors of the deceased annuitant.
Alberta	Creditors' ability to seize RRSP assets has been confirmed by the courts in Alberta.	There appears to be no reported court decision on this issue. However, an Alberta court has ruled an RRSP formed part of a deceased's estate for purposes of a dependant relief claim.
Saskatchewan	The Registered Plan (Retirement Income) Exemption Act of Saskatchewan specifically exempts RRSPs from any enforcement process except for support payments.	The above legislation does not appear to protect RRSPs of a deceased annuitant from his or her creditors. However, a court ruling in Saskatchewan has disallowed creditors from seizing the RRSP assets of a deceased annuitant.
Manitoba	Court decisions have confirmed RRSPs are not protected from creditors while the annuitant is alive.	The province's highest court refused to protect assets held in an RRSP from a deceased's creditors back in 1997. The same court was reluctant to follow its own ruling in a subsequent decision involving the same issue, but did not expressly overrule it.
Ontario	A number of Ontario court cases have held that RRSPs are not protected from creditors during the annuitant's lifetime.	The *Amherst Crane* case reversed several lower court decisions that had held that RRSPs were available to creditors of deceased annuitants. As a result of *Amherst Crane*, RRSPs are now creditor-proof on the death of the annuitant so long as the annuitant's estate is not the designated beneficiary of the RRSP.
Quebec	Although Quebec law exempts fixed-term annuities purchased from trust companies from seizure on the same terms and conditions as annuities obtained from insurers, the Supreme Court of Canada decision in *Thibault* will make it very difficult for most RRSPs to qualify. In essence, the Supreme Court said an annuity will not exist if the annuitant is allowed to retain control of the annuity capital. Since the terms of most RRSPs allow the annuitant to decide how the assets in a plan are invested, and to make unrestricted withdrawals from the plan, it is likely that most RRSPs will not generally qualify as annuities and, therefore, are not protected from creditors.	Based on *Thibault* and other prior decisions in the province, it is likely that most RRSPs will not be protected from creditors following the death of the annuitant.
New Brunswick	Case law in this province has confirmed that RRSPs can be seized by creditors.	New Brunswick does not appear to have any reported court decisions on this issue. It is therefore unclear whether creditors can seize RRSPs of deceased annuitants.
Prince Edward Island	PEI legislation exempts an annuitant's RRSP from creditors, provided a spouse, child, grandchild or parent is the named beneficiary of the RRSP.	PEI legislation also exempts RRSPs from creditors of a deceased annuitant.
Nova Scotia, Newfoundland, Northwest Territories, Yukon	There are no reported cases on this issue in these provinces and territories. However given these provinces and territories do not have laws excluding RRSPs from seizure, it is quite likely creditors will be able to seize these assets.	There are also no reported cases on this issue in these provinces and territories. It is uncertain how the courts in these provinces and territories will deal with this issue.