TAX ADVISOR

Hiring Your Kids

The CRA frowns on child-labour tax deductions

COURT REPORT

BY JAMIE GOLOMBEK

Last month, we discussed a case where an employee hired his wife and successfully wrote off the cost of hiring her as a tax-deductible amount. This month, let's focus on a similar recent tax case, decided just last month, involving a self-employed commissioned insurance salesperson who hired her kids (*Bradley v The Queen*, TCC 2006 500).

In 2001, Nancy Bradley employed her daughter Rachel, who was 8, and her son Mathew, who was 12, and deducted $2,000 "allegedly paid" to her daughter and $5,000 "allegedly paid" to her son as salary expense in computing her income from the sale of insurance. She did the same for 2002.

The Canada Revenue Agency challenged the salaries paid to the children, claiming they "were not based on the duties they performed or the hours they worked" nor were they "reasonable in the circumstances." The CRA also questioned whether the amounts were, in fact, ever truly paid to the children.

Bradley and her son testified the salaries were deposited either into bank accounts or mutual fund "in-trust" accounts.

The judge maintained that since only Bradley could release the funds from the "in-trust" accounts to her children, she effectively was in sole legal control of the monies. And since the salaries never left Ms. Bradley's control, "the alleged payments were never made to the children."

Bradley, on the other hand, testified that both her and Mathew would regularly discuss and agree on what amounts were to be withdrawn from the accounts and how the funds were to be spent. For example, some of the money was withdrawn to buy an ATV for Mathew, while other monies were used to buy him a vehicle when he turned 16. The remaining funds were partly to be used to fund his future post-secondary education. Unfortunately for Bradley, the judge concluded that since the funds could not freely be withdrawn by the children, the amounts were not tax-deductible.

This case is just the latest among dozens of cases wherein parents attempt to hire their children and deduct salaries paid to them for work performed. Perhaps one of the most egregious examples where amounts were found not to be "reasonable" and therefore not deductible was the 2001 decision in the case of *White v The Queen* (2001 DTC 3722) in which Robin White and his wife operated an Amway business in 1995 and 1996.

During those years, White paid his sons, ages 7 and 9, a total of $4,600 and $4,800 for 1995 and 1996 respectively. No time records of the hours worked by his children were maintained, and the cheques issued to his children were not cashed, but rather were kept by the children. If the children wanted to buy something, they would present the cheque to a parent to endorse, as long as the purchase was acceptable to the parent.

The Canada Revenue Agency challenged the amounts paid to the White's sons on the basis that they were "not reasonable in the circumstances."

White objected, arguing that he hired his sons as "subcontractors" and that their duties included answering the phone when he couldn't, taking and relaying business messages, assisting with the pick-up, transportation and delivery of business materials along with "cleaning" of the business portion of the family home and assisting with the "child care of children of clients and business associates when the clients and business associates were in the (White's) home for business purposes."

Perhaps not surprisingly, the judge concluded that the payment for services performed by the children was not tax-deductible, adding that such payment was "motivated in part by the perceived tax advantage" to White. The judge also concluded that the amounts paid were perhaps more akin to "children's personal allowances rather than fees for services rendered."

The lesson from both these cases should be obvious: When deciding to hire the kids, adopt a "reasonable" approach and you may have more success than these two taxpayers did. AER

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