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COMMENT

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NON-DEDUCTIBLE FINES AND PENALTIES

Sometimes in life a fine or penalty is incurred; maybe it arises from a minor indiscretion or the late filing of required documents. When this happens in a business context, taxpayers need to determine if such a payment is a tax deductible expense.

The *Income Tax Act* (ITA) contains a specific provision, section 67.6, that prohibits the deduction of fines or penalties imposed under a law of a country, including a political subdivision, state, province or territory. A fine or penalty could be imposed by a person or a public body that has the authority under law to impose the fine or penalty. This could be at a federal, provincial or municipal level or under foreign law.

In addition to the general rule above, there is another provision that denies the deduction, for income tax purposes, of interest, penalties and fines arising under the ITA or interest arising under the Air Travellers Security Charge Act and limited sections of the Excise Act.

The policy reason for disallowing a tax deduction in respect of fines and penalties is that an expense incurred in contravention of a law should not receive subsidization from society in the form of tax relief. Fines and penalties are designed to discourage specific acts or omissions. As such, if a deduction is permitted, it diminishes the disincentive associated with the fine or penalty.

Fines and penalties imposed by law or statute are relatively easy to identify. Examples of public bodies that can impose fines and penalties that would generally be non-deductible include:

- Regulatory authorities – A regulator is established by a government and can develop its own rules and procedures as well as fines and penalties.
- Judicial authorities – A court of law or tribunal can impose a fine or penalty for a breach of public law.
- Professional bodies – Many professional bodies are recognized by statute or other regulatory authority, giving these bodies the authority to levy fines or penalties. Examples of groups that fall within this segment include provincial law societies, colleges of physicians and accounting institutes.

In addition, trade organizations that set standards of performance to which members voluntarily agree to adhere may impose penalties on infractions by their members. Such penalties or fines are not deductible for income tax purposes. A trade association or farmers' association are examples of groups that would typically fall within this segment.

Each province has occupational health and safety legislation. If, for example, a corporation is found to be at fault for failure to meet the provincial legislative standards, any resulting fines and penalties would not be deductible. Similarly, each province has provincial securities legislation. A corporation that incurs monetary sanctions under a provincial securities act cannot deduct the financial penalty for income tax purposes. Parking tickets fall within the scope of this provision, so they are not a deductible expense.

Penalties and damages arising under private contracts are an exception to the general non-deductibility rules. For example, a penalty charged for late performance under a private contract is generally permissible as a deduction. The premise is that such an amount is incurred in the process of earning business income. As well, amounts not characterized or defined as a fine or penalty in the relevant legislation would fall within the exceptions and be deductible.
Consider a corporation that needs to limit its greenhouse gas emissions and purchases carbon offset credits; the purchase of the offset credits is not a fine or penalty and would not be excluded

from deduction pursuant to section 67.6. However, if the company does not implement compliance measures as required by provincial climate legislation, the financial consequences arising from non-compliance could result in non-deductible expenses when the amounts are described as a fine or penalty under the legislation.

By having a rule that clearly prohibits the deductibility of fines and penalties, taxpayers know with certainty that in addition to the expense of the fine or penalty, there is an added cost because of no corresponding income tax relief.

FEES PAID TO A POWER OF ATTORNEY

A power of attorney is a legal document that allows individuals to appoint another person (or more than one person) to act on their behalf, should they become unable to deal with their own financial or medical affairs. The names and requirements for the different types of power of attorneys can vary depending upon an individual's province or territory of residence. The person appointed is referred to as the "attorney" but does not need to be a lawyer.

Depending on the document, the appointed attorney may have the power to take care of the property of the individual and/or make medical decisions on the individual's behalf. Without such delegation, the financial affairs and/or medical decisions can be delayed as family and friends approach the courts for the appropriate authorizations.

When appointed attorneys are entitled to compensation for their work under a power of attorney document, any fees received are taxable and are to be reported as income. The fee received for acting as an attorney could be business income or income from an office. In order to qualify as business income, the individuals would need to demonstrate that they are in the business of providing power of attorney services. Factors to consider would be the number of engagements, the length of the engagements, the amount of time spent on engagements, and the amount of time spent on other activities. When individuals are considered to be in the business of providing power of attorney services, business-related expenses can be deducted from gross revenue. In addition, the individuals would be entitled to report a loss to the extent expenses are greater than revenue; and, such losses would be deductible against other income reported in the year by the individual.

If the power of attorney's compensation is considered to be income from an office, then the ability to deduct expenses is limited to those expenses that an employee could deduct.

Of particular interest is the fact that the person paying the compensation to the individuals in their capacity as an 'attorney' is responsible for reporting the amounts paid (using form T4A or T4) and ensuring the appropriate withholding is made on the payment if the compensation is considered to be income from an office.

MANAGING INHERENT RISK IS A PERSONAL CHOICE

Risk is an inherent part of everyday life. Whether we are crossing a road, driving a car or swimming in a lake, everything we do has some element of risk. Consider the decisions involved in driving a car into a parking lot and picking a parking space. Is it better to drive into a spot and back out later or to back into a spot and then be able to drive out later? The driver could consult books, government literature, driving schools, spouses and friends but would probably end up with no firm consensus. We make these types of decisions daily and typically we do so based on personal risk management.

A similar analysis applies to why and how insurance companies add extra ratings. When applicants pursue any dangerous recreational activity, such as sky diving or deep-sea scuba diving, they have chosen to be exposed to a certain level of personal risk. An insurance company can choose to average this risk into their overall pool or may choose to charge an extra amount to better match the risk to the premium charged. The decision to acquire insurance does not eliminate the risk, but rather provides a means of limiting the financial impact of death on the life insured or the life insured's family.

In this example, applicants probably cannot change how the insurance company rates 'dangerous' activities, but they can choose to minimize their personal risk by wearing the appropriate safety equipment, taking training courses or using instructors. The purchase of life insurance does not eliminate the risk of death, as death is inevitable for everyone. It does, however, provide the means to deal with the financial impact in a manner based on one's personal choices.

This same concept could also be applied to retirement planning. The financial risks involved in a long period of retirement include inflation, rates of return, taxation, and life expectancy. While no one can foresee the future nor predict inflation, life expectancy or other inherent risks, planning can help to minimize the financial impact arising from these unpredictable risks. While over-saving could compensate for some of these risks, many individuals begin the savings process late in life and the 'cost' of over-saving might not be worth the impact on current lifestyle choices.

Identifying risk begins with the concept of what can go wrong followed by an assessment of the probability and cost. If the combination of probability and cost exceed an individual's personal-risk tolerance, the first step is to consider alternatives that could reduce the probability and/or cost. This planning process can be applied to many aspects of our personal lives.
Our personal lifestyle choices represent risks that we manage daily. Whether the choice involves diet, smoking, drinking, or exercise, each choice can increase or decrease life expectancy. Understanding oneself and the way in which we each make personal decisions can lower potential risks that we face in nearly every daily activity.

SUMMER ACCIDENTS HIGHLIGHT NEED FOR ESTATE PLANS

Summer is a time when Canadians enjoy a series of long weekends and holiday traditions. Unfortunately, with summer comes an increase in the number of road and water-related accidents.

The rate of motor vehicle accidents increases in the summer months and particularly on weekends. Similarly, the number of summer water-related accidents far exceeds the total number of accidents in the other three seasons combined. A 2016 report published by the Red Cross highlights that an average of 272 Canadians died in the summer months during the period 2011 to 2013, compared with 186 in the combined fall, winter and spring for the same period. Water-related fatalities are a male-dominated risk with males accounting for 82 percent of deaths during the period 1991 to 2013. The Red Cross has identified that persons most at risk are males aged 15 to 34 years old and males over 65.

Aquatics and boating account for the largest proportion of deaths, consistently accounting for more than 60 percent of the summer water-related fatalities when looking at the period 1991 to 2013. The statistics indicate that alcohol was present or suspected in at least 41 percent of deaths for individuals aged 15 and over. For the same period, statistics indicate that lifejackets were worn in only 13 percent of the summer boating accidents resulting in death.

Aquatics includes not only swimming, which accounted for 57 percent of the summer deaths, but also jumping, diving, scuba diving and other water-related recreational activities. About 23 percent of the summer aquatic fatalities occurred on a Saturday, and 43 percent occurred on a weekend.

Road safety is a major theme broadcast by police departments across Canada throughout the summer months. The recent legalization of cannabis has added another drug into the mix when promoting the theme "don't drive high." Yet, a 2017 survey by Health Canada about drug-impaired driving, indicates that 50 percent of cannabis users do not think that cannabis affects their driving much, while 20 percent do not think it has any negative effect on their driving.

The concept of distracted driving has accounted for an increasing share of motor-vehicle accidents. While distracted driving is not limited to mobile devices, a 2017 study by the American Automobile Association found that drivers using mobile devices while driving, either hand-free or hand-held, are up to four times more likely to be involved in a crash.

With many competing activities – timewise and financially - there can be a tendency to put off planning because it is not regarded as urgent. Unfortunately, accidents happen and are unexpected. The results can be devastating both emotionally and financially. While death is not an easy subject, the increased rate of injuries and fatalities in the summer months can turn the spotlight on an individual's plans or lack of plans.

Estate planning addresses some or all of the following questions:

Does the current will reflect the wishes of the testator? Are bequests in place for any promises made to others? Are the bequests funded or will they reduce the residue of the estate? If a specific asset has been bequeathed, is it still there? Are the executors willing to take the role?

Have guardians been named in the will to take care of the children should both parents be involved in an accident? Are the guardians willing to take the role? Will anyone else in the family challenge the named guardian? The individuals acting as guardians will have to be approved by the courts, but the named guardian will give direction to the court as to the wishes of the parents.

Has the surviving family's ongoing financial position been considered? The most important financial consideration for the surviving family will be income. There are only three sources of income: earned income from working, investment income from an investment portfolio and the government. Investment income can be created with the use of life insurance and the quantum is usually more important than the type.

Have the liquidity needs of the estate been considered? Income taxes, last expenses and debts should all be considered. Having the mortgage insured at the bank will eliminate the mortgage upon a premature death, but an insurance policy could give the family the choice of keeping the capital along with the mortgage, depending on the facts at the time of death. Income taxes are not generally due upon a premature death because of the spousal rollover rules; however, an accident could involve both spouses and taxes could mean a significant drain on the estate's liquidity position.

While plans cannot reduce the emotional impact of a sudden loss, estate planning can reduce the financial implications and remove any compound effects of a sudden accident.

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