

The Appropriate Tax Treatment of the Reimbursement of Moving Expenses

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PRÉCIS

Il existe une série de causes, dont la récente décision rendue par la Cour d'appel fédérale dans l'affaire *Hoefele*, dans le cadre desquelles les tribunaux ont traité le remboursement des frais de déménagement d'un employé comme un avantage libre d'impôt. Les auteurs de cet article soutiennent que ces décisions comportent fondamentalement des anomalies. Les frais de déménagement ont toujours été traités par les tribunaux comme des dépenses personnelles non déductibles. Par conséquent, tout paiement ou remboursement à cet égard reçu par un employé devrait être inclus dans son revenu en vertu de l'alinéa 6(1)a). L'employé devrait alors avoir le droit de demander une déduction des frais de déménagement conformément à l'article 62.

La jurisprudence, à partir de l'affaire *Ransom* en 1967, est fondée sur le principe de la valeur en argent établi en 1892 au Royaume-Uni dans le cadre de l'affaire *Tennant v. Smith*. Selon ce principe, une prise en charges par l'employeur, mais qui n'enrichit pas n'est pas un revenu. Ce principe a été éliminé de la loi fiscale canadienne par voie de la formulation claire de l'alinéa 6(1)a), sauf en ce qui a trait au remboursement des frais de déménagement. Dans les affaires récentes *Splane* et *Hoefele*, la Cour d'appel fédérale a élargi l'exception au remboursement de l'augmentation des intérêts hypothécaires attribuable à une majoration du taux d'intérêt ou du montant du capital de l'emprunt hypothécaire. Logiquement, l'exception peut être élargie à toute augmentation du coût de la vie découlant du déménagement. En raison de la perte de recettes entraînée par cet élargissement et de l'iniquité pour les contribuables qui ne reçoivent pas des remboursements libres d'impôt, il est nécessaire d'adopter une législation pour corriger cette situation.

ABSTRACT

There is a line of cases, including the recent decision of the Federal Court of Appeal in the *Hoefele* case, in which the courts have treated an

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employee's moving expenses as a tax-free benefit. The authors of this article argue that these decisions are fundamentally flawed. Moving expenses have been consistently treated by the courts as non-deductible personal expenses. Accordingly, any payment of or reimbursement for such expenses received by an employee should be included in income under paragraph 6(1)(a). The employee should then be entitled to claim a deduction for moving expenses in accordance with section 62.

The case law, commencing with the *Ransom* case in 1967, relies on the money's-worth principle established in the 1892 UK case of *Tennant v. Smith*. According to this principle, what saves the pocket but puts nothing in the pocket is not income. This principle has been eliminated from Canadian tax law by virtue of the clear language of paragraph 6(1)(a) except with respect to the reimbursement of moving expenses. In the recent *Splane* and *Hoefele* cases, the Federal Court of Appeal has extended the exception to the reimbursement of increased mortgage interest attributable to either an increase in the interest rate or the principal amount of the mortgage. Logically, the exception can be extended to all increased costs of living in the new location. The revenue loss from such an extension and the unfairness to taxpayers who do not receive tax-free reimbursements indicate a need for corrective legislation.

Although I have no doubt, as a matter of substance, that the payment received by the appellant should not be included in his income, I have had some difficulty in expressing the reasons why such a result should be obtained.

Mr. Justice Noël in *Ransom v. MNR*¹

Nor is there any reason to disparage or to limit *Ransom*. . . . The *Ransom* case was decided some twenty-eight years ago by a distinguished jurist on the basis of an eminently reasonable principle. . . . It reflects common sense. It is fair. It deserves to survive.

Mr. Justice Linden in *AG of Canada v. Hoefele et al.*;
*Krull v. AG of Canada*²

INTRODUCTION

There has been a spate of cases in the last few years concerning the reimbursement or payment by employers of moving expenses incurred by employees.³ The results in these cases are inconsistent. The analysis of

¹ 67 DTC 5235, at 5243; [1967] CTC 346, at 360 (Ex. Ct.).

² 95 DTC 5602, at 5607 (FCA).

³ The *Hoefele* case, supra footnote 2, dealt with appeals from Tax Court decisions in five cases: *Hoefele v. The Queen*, 94 DTC 1878; [1995] 1 CTC 2177; *Zaugg v. The Queen*, 94 DTC 1882; [1994] 2 CTC 2425; *Mikkelsen v. The Queen*, 95 DTC 118; [1995] 2 CTC 2940; *Krall v. The Queen*, 95 DTC 411; [1995] 1 CTC 2570; and *Krull v. The Queen*, 95 DTC 206; [1995] 2 CTC 2204. Other cases since 1990 include *The Queen v. Blanchard*, 95 (The footnote is continued on the next page.)

the issue by the courts is unsatisfactory and seems unlikely to stem the flow of litigation in this area. In the recent *Phillips*⁴ and *Hoefele* cases, the Federal Court of Appeal missed the opportunity to settle the issue definitively. It should not be necessary for an issue that is so straightforward to be resolved by the Supreme Court of Canada or by corrective legislation, but this possibility is no longer remote.

The issue is simple. If an employee is reimbursed by the employer for various costs incurred in moving from one location to another or if the costs are paid by the employer, is the reimbursement or payment included in income? If the reimbursement or payment is included in income, there is a second, ancillary issue, namely, whether the expenses are deductible in accordance with section 62 of the Income Tax Act.⁵ It is surprising that so simple an issue remains unresolved in the 1990s.

This article discusses the appropriate tax treatment of the reimbursement or payment by an employer of moving expenses incurred by an employee. For convenience, when we refer to the reimbursement of moving expenses, we mean to include both the payment of such expenses by an employer on behalf of an employee and the reimbursement by an employer of such expenses paid by an employee. By “moving expenses,” we mean all the costs associated with moving from one location to another, not just expenses that are deductible under section 62. We use the term “ordinary moving expenses” to describe the costs to which section 62 is limited, namely, the costs of moving the taxpayer, the members of the taxpayer’s family, and their household effects.

As background, the article sets out and discusses the fundamental principles of the statutory scheme for taxing employees under section 5, paragraphs 6(1)(a) and (b), and subsection 6(3). These principles must guide an assessment of the existing case law and the determination of the appropriate tax treatment of the reimbursement of moving expenses. There is a brief discussion of the deductibility of moving expenses both before 1972 and under section 62 since its introduction in 1972.

³ Continued . . .

DTC 5479; [1995] 2 CTC 262 (FCA), rev’g. 92 DTC 6585; [1992] 2 CTC 403 (FCTD); *Krampl v. The Queen*, [1995] 2 CTC 2624 (TCC); *Pezzelato v. The Queen*, [1995] 2 CTC 2890 (TCC); *Oster v. The Queen*, 95 DTC 104; [1995] 1 CTC 2224 (TCC); *The Queen v. Phillips*, 94 DTC 6177; [1994] 1 CTC 383 (FCA), rev’g. 93 DTC 5247; [1993] 2 CTC 27 (FCTD), which had aff’d. 90 DTC 1274; [1990] 1 CTC 2372 (TCC); *AG of Canada v. MacDonald*, 94 DTC 6262; [1994] 2 CTC 48 (FCA); *Vickery v. The Queen*, 93 DTC 993; [1993] 2 CTC 2678 (TCC); *Bolton v. The Queen*, 95 DTC 277; [1993] 2 CTC 3203 (TCC); *The Queen v. Lao*, 93 DTC 5251; [1993] 2 CTC 25 (FCTD); *McLay v. MNR*, 92 DTC 2260; [1992] 2 CTC 2649 (TCC); *Armstrong v. The Queen*, [1992] TCJ no. 683; *Splane v. The Queen*, 90 DTC 6442; [1990] 2 CTC 199 (FCTD), aff’d. 92 DTC 6021; [1992] 2 CTC 224 (FCA); *Black v. MNR*, [1992] TCJ no. 693; *Volpé v. MNR*, 90 DTC 1707; [1990] 2 CTC 2321 (TCC); and *Coté v. MNR*, 91 DTC 261; [1990] 2 CTC 2617 (TCC).

⁴ *Phillips*, supra footnote 3.

⁵ RSC 1985, c. 1 (5th Supp.), as amended (herein referred to as “the Act”). Unless otherwise stated, statutory references in this article are to the Act.

The heart of the article consists of an analysis of the various types of moving expenses and the treatment of these expenses under the case law. These expenses range from ordinary moving expenses to the loss on the sale of an employee's dwelling, to the increased costs of living in the new location (increased costs of housing, entertainment, commuting, etc.). This section of the article focuses primarily on the reimbursement of housing expenses because these expenses have caused the courts enormous difficulty. The reimbursement of employees' expenses other than moving expenses also is examined to demonstrate that the way the courts have dealt with the reimbursement of moving expenses is an aberration. Finally, we have included a brief review of the situation in the United States, because the same problem there was addressed by legislation more than 25 years ago.

Before analyzing the relevant provisions of the Act and the cases, we set out our thesis in some detail. It is important that our subsequent analysis of the Act and the cases be read in the light of this thesis. The later discussion provides an elaboration of the thesis and its application to the reimbursement of various types of moving expenses.

THESIS

In our view, it is indisputable that the basic goal of the statutory scheme for taxing income from employment is to require the inclusion in income of all forms of compensation received by employees. The essential question in any particular case is whether or not the amount received by the employee constitutes compensation or, in statutory terms, a benefit of employment. Thus, for example, the value of fringe benefits, such as board and lodging, must be included in income, but the value of excellent working conditions need not be.

The issue is exactly the same with respect to the reimbursement of expenses incurred by employees. If the reimbursement represents compensation or a benefit of employment, it should be included in income. The reimbursement of personal expenses clearly constitutes compensation and must be included in income.⁶ Only the reimbursement of expenses incurred in the course of employment—expenses that in reality constitute the employer's expenses—should be excluded from income.

The distinction between personal expenses and employment or business expenses is a familiar one with respect to deductions in computing business income. And the issue is essentially the same with respect to the inclusion of reimbursements in income. In our view, if an expense incurred by an employee would not be deductible in computing income, assuming that subsection 8(2) is ignored, any reimbursement received by the employee for the expense should be included in income. This test is a relatively easy one for the courts to apply in most cases. Subsection 8(2)

⁶ Interestingly, section 3(e) of the Income War Tax Act, RSC 1927, c. 97, required the inclusion in income of payments received in respect of "personal and living expenses."

must be ignored because it constitutes an arbitrary statutory constraint on the deductibility of expenses by employees. In the absence of subsection 8(2), the characterization of the expenses as personal or income-earning becomes the crucial issue.⁷ In effect, the deduction of expenses by employees would be governed by the same principles that apply to the deduction of expenses in computing income from a business. For example, if an employee pays a delivery charge out of his or her own funds or pays expenses incurred in travelling in the course of employment and is reimbursed by the employer, the reimbursement should not be included in income. On the assumption that subsection 8(2) did not apply or that the expenses were incurred in the course of carrying on a business, such expenses would clearly be deductible. The rationale for the exclusion from income of the reimbursement of these expenses (often referred to as "out-of-pocket" expenses) is that they are expenses incurred in the course of employment on behalf of the employer; they are not personal expenses; they do not confer any benefit on the employee. In reality, they are expenses that the employer should have paid directly; and if the employer paid them directly, there would be no personal benefit to the employee. They are expenses that would be deductible if they were incurred in the course of carrying on a business.

Returning to the fundamental point that all forms of compensation received by employees should be included in income, it is important to recognize the various methods used by employers to compensate employees. Currently, these methods are not treated similarly for income tax purposes; in our view, they should be. Although we think that the equal treatment of employees in similar economic situations is a fundamental goal of the statutory scheme for the taxation of employment income, apparently the Federal Court of Appeal does not. In the *Hoefele* case, the court seems to suggest that the unequal treatment of employees depending on the form of their compensation is not undesirable:

Notwithstanding that each of these varying methods of reimbursement may have a similar goal in mind, the different forms of transaction may be treated differently, that is, some may be taxed and others may not. This is in no way inequitable. This is not improper circumvention of the tax laws.⁸

This is an incredible statement. We acknowledge that form matters in tax law and that employers and employees should be entitled to plan their affairs in the form that achieves the best tax result. However, in our view, it is usually unfair to treat taxpayers in the same situation differently

⁷ Arguably, a more restrictive approach is appropriate, namely, that any reimbursement received by an employee should be included in income unless the expenses for which the reimbursement is received are deductible under subsection 8(1). This approach would ensure the equal treatment of employees who are reimbursed and those who are not. However, the reason for the restriction on the deduction of employment expenses in subsection 8(2) is, at least in part, to prevent employees from deducting expenses that are unnecessary for earning the income and not required by the employer. This concern is significantly reduced if the employer reimburses the employee for the expenses.

⁸ *Supra* footnote 2, at 5606.

because of formal distinctions, and the courts should seek to minimize such unfairness. When the unfairness is mandated by legislative provisions, the courts are obviously constrained. However, the legislative provisions dealing with employee benefits have the clear purpose of treating all employees equally despite the form of the compensation. In this situation, it is perverse for the courts to ignore the clear intent of the statutory words (“benefits of any kind whatever”) and to introduce arbitrary distinctions based on the form of the employee’s compensation. Yet this is precisely what the Exchequer Court did in the *Ransom* case and the Federal Court of Appeal has exacerbated in the recent *Phillips* and *Hoefele* cases. Of course, taxpayers are not to blame for taking advantage of the tax-planning opportunities created by these arbitrary distinctions; the courts are to blame for creating them.

Listed below are the most important methods used by employers to compensate employees for expenses, with a brief discussion of the appropriate tax treatment of each method.

1) *Employer pays expenses on behalf of employee.* In this situation, the tax treatment of the amount to the employee depends on the nature of the expense. If the expense constitutes a personal expense of the employee, the payment should be included in income. For example, if the employer pays the employee’s commuting or rental expenses, there is no doubt that the amounts will be considered fringe benefits under paragraph 6(1)(a). On the other hand, if the expense is incurred in the course of employment, such as rent for office facilities for the employee or business-related travelling expenses, no amount should be included in the employee’s income. Mixed business and personal expenses present the most serious difficulties. For example, if the employer pays the employee’s meal and accommodation expenses while the employee is travelling in the course of employment, there is clearly some element of personal benefit.⁹ The general approach of the Canadian tax system to mixed business and personal expenses is to classify them exclusively as either personal or business/employment-related. Thus, commuting expenses are considered to be entirely personal, and meal expenses incurred while travelling in the course of employment are considered to be exclusively related to employment.¹⁰

The deductibility by the employer of expenses paid on behalf of the employee is not a reliable guide to the treatment of the expenses to the employee. The expenses are deductible by the employer whether they represent personal expenses of the employee or employment expenses. In the former case, the amount is deductible by the employer because it constitutes compensation paid to the employee, just like salary and wages;

⁹ Food and shelter are everyday necessities, which the employee would otherwise pay for out of his or her own funds.

¹⁰ However, under section 67.1, the deduction of meals and entertainment is limited to 50 percent of the amount of the expenses.

in the latter case, the amount is deductible because it represents a general business expense incurred for the purpose of earning income.

2) *Employee incurs expenses and receives reimbursement from employer.* The tax results of this method should be exactly the same as those under the first method. If the employee is reimbursed for a personal expense, the reimbursement should be included in income; if the employee is reimbursed for an expense incurred in the course of employment, no amount should be included in income.

3) *Employee receives an allowance.* Instead of paying expenses directly or reimbursing the employee for expenses incurred, the employer may provide the employee with an allowance. Because paragraph 6(1)(b) generally requires that allowances be included in income (subject to a few listed exceptions), the courts have been required to enunciate the meaning of the term “allowance.”¹¹ In general, an allowance is an arbitrary amount set in advance for which the recipient does not have to account. The essential difference between an allowance and a reimbursement is that a reimbursement is limited to the amount of the actual expenses incurred, whereas an allowance may be more or less than the actual expenses. For this reason, allowances are more problematic for income tax purposes than reimbursements. Allowances may be used as a disguised method of remunerating employees if the expenses actually incurred are less than the amount of the allowance. This is the reason for the requirement in paragraph 6(1)(b) that allowances be included in income, except certain “reasonable” allowances in respect of specific types of expenses. Although the excluded allowances are essentially allowances in respect of expenses (such as travelling expenses) that, if paid directly by the employer or reimbursed to the employee, would not give rise to an income inclusion, allowances in respect of other expenses (for example, moving expenses) are included in income even though, if the employer paid the expenses directly or reimbursed the employee, there would be no income inclusion.

Although the distinction between an allowance and a reimbursement is clear and well established in the case law, the courts have chosen to disregard it in several recent cases, some of which deal with moving expenses.¹² Because reimbursements are often tax-free but allowances are generally taxable, courts have perversely characterized allowances as tax-free reimbursements to the extent of the actual expenses incurred by the employee.

¹¹ See, for example, *Ransom*, supra footnote 1; *The Queen v. Huffman*, 90 DTC 6405; [1990] 2 CTC 132 (FCA); *Gagnon v. The Queen*, 86 DTC 6179; [1986] 1 CTC 410 (SCC); *The Queen v. Pascoe*, 75 DTC 5427; [1975] CTC 656 (FCA); and *AG of Canada v. MacDonald*, supra footnote 3.

¹² See, for example, *Coté*, supra footnote 3; *Huffman*, supra footnote 11; *McLay*, supra footnote 3; and *Lao*, supra footnote 3. Compare *AG of Canada v. MacDonald*, supra footnote 3.

4) *Employee receives a loan from employer and the loan is subsequently forgiven.* Economically, this situation is equivalent to the previous three situations, assuming that the amount of the loan is equal to either the amount of the expenses incurred or the amount of the allowance that would have been given to the employee. However, the tax consequences are quite different. The loan does not result in any immediate income inclusion because the employee has an obligation to repay the amount of the loan. However, the loan may give rise to a benefit from employment to the extent that the rate of interest charged on the loan is less than an arm's-length rate of interest.¹³ If the loan is a home relocation loan, the employee is entitled to a deduction in computing taxable income equal to the amount of the interest on a loan of \$25,000 for a period of five years.¹⁴ If the loan is forgiven, the forgiven amount must be included in computing the employee's income under paragraph 6(1)(a) unless the loan was used for the purpose of incurring expenses in the course of employment.

5) *Employer pays a bonus or increased salary.* The employer could decide to increase the salaries of employees or pay them a one-time bonus rather than introduce sophisticated reimbursement, allowance, or other schemes. There is no question in this case that the amount of the increased salary or bonus would be included in the employee's income. The employee would pay directly for any expenses incurred, and they would be deductible only if they fit within the express provisions of subsection 8(1) or subdivision e. Clearly, personal expenses would not be deductible. Ordinarily, an employer will not require an employee to pay out-of-pocket expenses incurred in the course of employment on behalf of the employer; therefore, the absence of any deduction for such expenses is not a serious problem. In these days of financial restraint, many employers might expect employees to bear all or a portion of mixed personal and employment expenses, such as moving expenses. Therefore, the disparity between employees who are compensated for their expenses and those who are not is likely to be serious.

In our view, it is fundamental that employees should be treated in the same way for income tax purposes irrespective of how the employer decides to structure their compensation. Therefore, an employee who is moved to a new location by his or her employer should be treated in the same way for income tax purposes whether the employer pays the moving expenses, reimburses the employee for the moving expenses, gives the employee an allowance, bonus, or salary increase in respect of the moving expenses, or requires the employee to bear the cost of the moving expenses. The only way to treat all of the employees in these situations in a fair and consistent manner is to require the employee to include in income the amount of any moving expenses paid by the employer on the employee's behalf, or any reimbursement, allowance, bonus, or salary

¹³ Subsections 80.4(1) and 6(9).

¹⁴ Paragraph 110(1)(j) and subsection 248(1), the definition of "home relocation loan."

increase received from the employer, and then to permit the employee to deduct the actual moving expenses incurred in accordance with section 62.

THE STATUTORY SCHEME FOR THE TAXATION OF INCOME FROM EMPLOYMENT

Introduction

The tax treatment of the reimbursement of moving expenses incurred by an employee is part of the statutory scheme for the taxation of employment income. This statutory scheme is straightforward and has been examined in detail elsewhere;¹⁵ consequently, it is described only briefly here.

Under section 5, a taxpayer's income from employment includes salary, wages, and other remuneration, including gratuities. Similar statutory language has been included in the Canadian income tax legislation since it was introduced in 1917. As early as 1927, however, it became necessary to supplement this broad general language with more specific provisions. In 1927, the definition of income was amended to include "personal and living expenses when such form part of the profit, gain or remuneration of the taxpayer."¹⁶ This amendment was probably intended to overcome the money or money's-worth principle in the UK jurisprudence.¹⁷ This principle is discussed below.

In 1948, the provision with respect to personal or living expenses was replaced by the predecessor to paragraphs 6(1)(a) and (b).¹⁸ At the same time, the predecessor to subsection 8(2), which limits deductions in respect of employment income to those specifically authorized, was added to the Act.¹⁹ The final part of the statutory scheme with respect to

¹⁵ See, for example, Brian G. Hansen, "The Taxation of Employees," in Brian G. Hansen, Vern Krishna, and James A. Rendall, eds., *Canadian Taxation* (Don Mills, Ont.: De Boo, 1981), 117-87; Vern Krishna, *The Fundamentals of Canadian Income Tax*, 5th ed. (Scarborough, Ont.: Carswell, 1995), 185-258; Douglas J. Sherbaniuk, *Specific Types of Personal Income*, Studies of the Royal Commission on Taxation no. 16 (Ottawa: Queen's Printer, 1967); Lawrence J. Hayes, "Income Receipts and Deductions in the Computation of Income from Employment, Business and Property," in *Report of Proceedings of the Thirty-First Tax Conference*, 1979 Conference Report (Toronto: Canadian Tax Foundation, 1980), 381-99; Frank D. Jones, "Benefits Under the Income Tax Act" (1968), 6 *Alberta Law Review* 157-74; Kathleen M. O'Neill, "Personal Tax/Employment Income," in *Report of Proceedings of the Forty-Sixth Tax Conference*, 1994 Conference Report (Toronto: Canadian Tax Foundation, 1995), 2:1-20; and W. Gordon Williamson, "Emerging Income Tax Issues: Taxation of Employee Reimbursements and Allowances, and GAAP and Tax," in *Report of Proceedings of the Forty-Fifth Tax Conference*, 1993 Conference Report (Toronto: Canadian Tax Foundation, 1994), 5:1-21.

¹⁶ Section 3(e) of the 1927 Income War Tax Act, *supra* footnote 6.

¹⁷ *Tennant v. Smith*, [1892] AC 150 (HL). See Herbert A.W. Plaxton, *The Law Relating to Income Tax and Excess Profits Tax of the Dominion of Canada*, 2d ed. (Toronto: Carswell, 1947), 63, and Sherbaniuk, *supra* footnote 15, at 40.

¹⁸ Paragraph 5(a) of the 1948 Income Tax Act, 11-12 Geo. VI, c. 52, which replaced section 3(e) of the Income War Tax Act.

¹⁹ 1948 Income Tax Act, section 5.

employment income was enacted in 1949.²⁰ Subsection 6(3) deems certain amounts received by a person before, during, or after employment to be remuneration for services rendered unless it can be established otherwise. The real significance of subsection 6(3), of course, is that it extends the scope of income from employment to amounts received in contemplation of entering into an employment relationship and amounts received on or after the termination of employment. Thus, the basic statutory scheme for employment income has been in place since 1948.

The general purpose of paragraph 6(1)(a), which is discussed in more detail below, is to require the inclusion in income of in-kind benefits associated with employment. The clear underlying policy is that employees should be treated the same whether they receive their compensation in cash or in some combination of cash and in-kind benefits. For the same reason, paragraph 6(1)(b) requires all allowances received by an employee from an employer to be included in income unless the allowance is specifically excluded. Both paragraphs are intended to prevent tax avoidance through the use of disguised remuneration.

The Money or Money's-Worth Principle

Under UK case law commencing with *Tennant v. Smith*²¹ in 1892, a benefit in kind constitutes income only if it was readily convertible into cash. Although the rationale for the result in *Tennant v. Smith* is somewhat unclear, some subsequent courts have enunciated the principle that a benefit that cannot be converted into cash, such as rent-free accommodation, does not represent a net addition to the taxpayer's wealth but merely makes it unnecessary for the taxpayer to incur certain expenses.²² As Lord Macnaghten stated in *Tennant v. Smith*:

His income goes further because he is relieved from that expense. But a person is chargeable for income tax . . . not on what saves his pocket, but on what goes into his pocket.²³

It follows from this principle that a reimbursement by an employer of expenses incurred by an employee is not income because it merely saves the employee's pocket. This result was adopted by the House of Lords in the United Kingdom but has subsequently been reversed by statute.²⁴

As will be seen subsequently, virtually all of the cases involving the reimbursement of moving expenses refer to the money's-worth principle to justify the conclusion that the reimbursements do not constitute

²⁰ *Ibid.*, section 24A, added by 13 Geo. VI, c. 25, s. 9.

²¹ *Tennant v. Smith*, supra footnote 17.

²² See *Owen v. Pook*, [1970] AC 244 (HL).

²³ *Tennant v. Smith*, supra footnote 17, at 164.

²⁴ *Owen v. Pook*, supra footnote 22, and see the Income and Corporation Taxes Act 1988 (UK) 1988, c. 1, section 153, requiring all payments of expenses, including reimbursements, to be included in income.

income.²⁵ In none of these cases is there any analysis of the principle. It is simply assumed to be a fundamental principle of income tax law. This is unfortunate because the money's-worth principle has largely been displaced in Canadian tax law as a result of the statutory language of paragraph 6(1)(a) and the definition of "amount" in subsection 248(1). As the Exchequer Court stated over 25 years ago,

the language employed in section 5 [now paragraph 6(1)(a)] to the effect that the "value of board, lodging, and other benefits of any kind whatsoever," is to be included in taxable income, overcomes the principle laid down in *Tennant v. Smith*.²⁶

Consequently, we suggest that the money's-worth principle and its corollary that the reimbursement of an expense is not income have no place in Canadian tax law and, in particular, in the taxation of income from employment.²⁷ This conclusion is corroborated by common sense. An employee who receives a reimbursement of personal expenses derives an economic benefit and is obviously better off than an employee who is not reimbursed.

The Application of Paragraph 6(1)(a)

The application of paragraph 6(1)(a) requires that two conditions be met:

1) The employee must receive a benefit of some kind.

2) The benefit must be received in respect of, in the course of, or by virtue of employment; in other words, there must be some causal connection between the employment and the receipt of the benefit.

If these two conditions are met, the amount or value of the benefit included in income must be determined.²⁸

The term "benefit" is not defined in the Act. Its ordinary meaning includes "advantage, profit, good," or "pecuniary profit."²⁹ Paragraph 6(1)(a) is concerned only with economic benefits, not aesthetic, moral, spiritual, or other types of intangible benefits.

²⁵ See, for example, the *Ransom* and *Hoefele* cases, in which *Tennant v. Smith* is referred to explicitly.

²⁶ *Waffle v. MNR*, 69 DTC 5007, at 5011; [1968] CTC 572, at 578 (Ex. Ct.).

²⁷ Canada, *Report of the Royal Commission on Taxation*, vol. 3 (Ottawa: Queen's Printer, 1966), states at 292: "There is nothing in the Act that would suggest that any distinction is to be made between benefits that come into the pocket and those that save the pocket. Indeed, the use of the words benefits 'enjoyed' as well as those 'received' seems clearly to include benefits that save the pocket." For a detailed discussion of the money or money's-worth principle, see B.J. Arnold, *Timing and Income Taxation: The Principles of Income Measurement for Tax Purposes*, Canadian Tax Paper no. 71 (Toronto: Canadian Tax Foundation, 1983), 99-101. See also Hansen, *supra* footnote 15, at 130, and Sherbaniuk, *supra* footnote 15, at 40.

²⁸ The valuation issues are not dealt with in this article.

²⁹ *The Shorter Oxford English Dictionary*, 3d ed.

In the *Savage* case³⁰ in 1983, the Supreme Court of Canada held that the meaning of the phrase “benefits of any kind whatever” was very broad. It cited with approval the following statement:

I do not believe the language to be restricted to benefits that are related to the office or employment in the sense that they represent a form of remuneration for services rendered. If it is a material acquisition which confers an economic benefit on the taxpayer and does not constitute an exemption, e.g., loan or gift, then it is within the all-embracing definition of s. 3.³¹

The result of the *Savage* case is that paragraph 6(1)(a) is not restricted to benefits that represent compensation for services rendered. Although arguably both section 5 and subsection 6(3) are so limited, the Supreme Court decided clearly that paragraph 6(1)(a) extends to all economic benefits derived by an employee from employment. We are left with the troublesome question of the necessary connection between the benefit and the employment.

Paragraph 6(1)(a) applies only to benefits received or enjoyed by the employee “in respect of, in the course of, or by virtue of an office or employment.” The early jurisprudence interpreted this language to mean benefits received by a person in his or her capacity as an employee as remuneration for services.³² However, as we have noted, in the *Savage* case the Supreme Court of Canada rejected the notion that paragraph 6(1)(a) required that benefits be received in exchange for services performed by the employee. The court held that only benefits received in a person’s capacity as an employee were covered by paragraph 6(1)(a). However, it indicated that the words “in respect of” are words of the “widest possible scope . . . intended to convey some connection between two related subject matters.”³³ In effect, the Supreme Court’s decision in *Savage* creates a presumption that any benefit received by an employee from his or her employer is derived from the employment relationship. This presumption can be rebutted, but only if the employee can establish that the benefit is received in his or her personal capacity (that is, the amount represents a personal gift rather than a benefit from employment).³⁴

In summary, after the *Savage* case, the broad meaning of paragraph 6(1)(a) is well established. All economic benefits derived from employment are included in income unless specifically excepted. It is not necessary for

³⁰ *The Queen v. Savage*, 83 DTC 5409; [1983] CTC 393 (SCC).

³¹ *Ibid.*, at 5414; 399. This statement was adopted from *The Queen v. Poynton*, 72 DTC 6329, at 6335-36; [1972] CTC 411, at 419-20 (Ont. CA).

³² See, for example, *Phaneuf Estate v. The Queen*, 78 DTC 6001; [1978] CTC 21 (FCTD); and *Ransom*, supra footnote 1.

³³ *Savage*, supra footnote 30, at 5414; 399, quoting *Nowegijick v. The Queen et al.*, 83 DTC 5041, at 5045; [1983] CTC 20, at 25 (SCC).

³⁴ See Vern Krishna, “Employee Benefits” (February 1984), 1 *Canadian Current Tax* C7-10. In *Phillips*, supra footnote 3, at 6180; 387-88, although the Federal Court of Appeal did not reject outright the notion that an employee can receive a payment from an employer in his or her personal capacity, it indicated that such situations would be rare.

the benefit to represent compensation for services rendered, to be received from the employer, or to be convertible into cash.

Deductibility of Moving Expenses

Moving expenses incurred by an employee are not deductible in computing income from employment by virtue of subsection 8(2), irrespective of the reasons for or the circumstances of the move. Subsection 8(2) prohibits the deduction of many reasonable expenses that are incurred by employees for the purpose of earning income and that would be deductible in computing business income. However, moving expenses would not be deductible in computing income from employment even in the absence of subsection 8(2). The case law has held consistently that moving expenses are non-deductible personal expenses under paragraph 18(1)(h).³⁵ The rationale for this position was stated by the Tax Appeal Board in 1950 as follows:

There is all the difference in the world between an expenditure incurred in moving from one place to another in order to occupy a position, [or] carry on a business, trade or profession liable to produce income, and an expense made in attending to the duties of the position itself. The first is anterior to the exercise of the trade, business, or profession and is not deductible from income; the second truly contributes to the production of income and therefore is deductible.³⁶

Unfortunately, the case law with respect to moving expenses and other similar expenses such as child care, business meals, and entertainment does not recognize explicitly that these expenses are often incurred for a combination of personal and income-earning purposes.³⁷ Rather, the courts have adopted an all-or-nothing approach in determining the deductibility of these expenses. This approach is understandable because it would be extremely difficult to devise any practical method of apportioning the expenses into their personal and income-earning elements.

Since the cases involving the deductibility of moving expenses are all relatively old, it is possible that a court might be persuaded to re-examine the characterization of moving expenses as non-deductible personal expenses. In the recent *Symes* case³⁸ in the Supreme Court of Canada, Mr.

³⁵ See *Karp v. MNR*, 68 DTC 742; [1968] Tax ABC 1018; *Bishop v. Minister of National Revenue*, 51 DTC 395; (1951), 5 Tax ABC 157; *Hannesson v. Minister of National Revenue*, 50 DTC 170; [1950] Tax ABC 414; and *Tuke v. MNR*, 63 DTC 1311; [1963] CTC 473 (Ex. Ct).

³⁶ *Park v. Minister of National Revenue*, 50 DTC 162, at 168-69; [1950] Tax ABC 391, at 412. This reasoning may support a distinction between the treatment of new and existing employees which has not been picked up in subsequent cases. This point is discussed subsequently.

³⁷ See Neil Brooks, "The Principles Underlying the Deduction of Business Expenses," in Hansen, Krishna, and Rendall, *supra* footnote 15, 189-249, at 201-5; and Claire F.L. Young, "Deductibility of Entertainment and Home Office Expenses: New Restrictions To Deal with Old Problems" (1989), vol. 37, no. 2 *Canadian Tax Journal* 227-66.

³⁸ *Symes v. The Queen et al.*, 94 DTC 6001; [1994] 1 CTC 40 (SCC).

Justice Iacobucci indicated that he was prepared to re-examine the well-established treatment of child-care expenses as personal in the light of changes in social conditions. After an extensive analysis, he concluded that

to the extent that traditional income tax law would classify child care expenses as “personal” simply because such expenses are incurred in order to make the taxpayer “available” to the business . . . it might be correct to assert that the changing composition of the business class and changing social structure demand a reconceptualization.³⁹

However, Mr. Justice Iacobucci did not find it necessary to determine whether such a reconceptualization was required because, in his opinion, the existence of section 63, a specific deduction for child-care expenses, precluded any deduction for these expenses under section 9.

Mr. Justice Iacobucci’s analysis of child-care expenses in *Symes* is equally applicable to moving expenses. Although changing social conditions—the increasing mobility of labour in a global economy and the growing number of employees and independent contractors who work at home—may suggest that moving expenses might be reclassified as business expenses, the existence of section 62, which provides specifically for the deduction of moving expenses, precludes the deduction of such expenses under section 9.

The policy objectives of section 62, which was added to the Act in 1972 as part of tax reform, are “to help remove a deterrent to mobility and to put taxpayers who pay their own moving expenses more nearly on a par with others whose moving expenses are paid by their employers.”⁴⁰ Section 62 authorizes the deduction of certain expenses incurred in the course of moving from one location to another in Canada if the purpose of the move is to commence employment or business activities in the new location and the new residence is at least 40 kilometres closer to the new place of employment or business than the old residence. The moving expenses must be deducted in the year in which the move occurred or in the year immediately following, and the amount deductible in either year may not exceed the taxpayer’s income in that year from employment or from carrying on business at the new location.⁴¹

For purposes of section 62, “moving expenses” are defined to include transporting the taxpayer, the members of the taxpayer’s family, and their belongings to the new residence, meals and lodging near the old or new residence for a period of 15 days, the costs of selling the old residence (including legal fees, commissions paid to real estate agents, and any

³⁹ *Ibid.*, at 6017; 62.

⁴⁰ E.J. Benson, *Summary of 1971 Tax Reform Legislation* (Ottawa: Department of Finance, 1972), 9. These policy concerns are reflected in section 62 in that the deduction is limited to situations in which a taxpayer commences employment or business and the amount of the deduction is limited to income earned from the new employment or business. Deductions are not available to persons who move in an unsuccessful effort to find a new job.

⁴¹ Paragraph 62(1)(f), and *Interpretation Bulletin* IT-178R3, May 28, 1993, paragraph 15.

interest penalty in respect of the discharge of a mortgage), and legal fees and taxes in connection with the purchase of the new residence.⁴² Moving expenses do not include the difference between the cost of the new home and the sale price of the old one, losses on the sale of the old home, or a wide variety of other expenses.⁴³

Section 62 precludes any deduction for moving expenses that are paid by the taxpayer's employer⁴⁴ or for which the taxpayer is reimbursed or receives an allowance unless the reimbursement or allowance is included in the taxpayer's income.⁴⁵ In these situations, the employer and not the employee incurs the moving expenses and the employer is entitled to deduct them as ordinary business expenses. Although these aspects of section 62 prevent an employee from claiming a deduction for moving expenses that are borne by the employer,⁴⁶ they cannot achieve the stated policy goal that employees should be treated equally, irrespective of the manner in which the moving expenses are paid. The lack of equity is attributable to the case law, not to a deficient legislative regime. As the case law stands, an employer can provide tax-free benefits by paying moving expenses on behalf of an employee or reimbursing an employee for moving expenses that would not be deductible under section 62 if incurred by the employee directly. For example, an employer can reimburse an employee for a loss incurred on the sale of the employee's house as a result of a relocation without triggering a taxable benefit. On the other hand, an employee who is not reimbursed for such a loss is not permitted to deduct it under section 62. The unequal treatment of employees in these situations is clearly inappropriate. Later in this article, we will propose a simple legislative remedy that will accomplish the intent of the statute with respect to the treatment of employees' moving expenses.

Summary

It may be useful at this point, before we analyze the specific problem of the reimbursement of moving expenses, to summarize the state of the law

⁴² Subsection 62(3).

⁴³ Such expenses include the cost of installing household items from the old residence; reconnecting costs for household appliances, telephone, and utilities in the new residence; outlays or costs incurred in connection with the acquisition of the new residence; mortgage interest and property taxes for the old residence incurred after the commencement of the new employment; and interest on bridge financing used to acquire a new residence before the sale of the old residence. See *Coté*, supra footnote 3; *Critchley v. MNR*, 83 DTC 278; [1983] CTC 2365 (TRB); *Gold v. The Queen*, 77 DTC 5430; [1977] CTC 616 (FCTD); *O'Gorman v. MNR*, 81 DTC 281; [1981] CTC 2400 (TRB); *Pollard v. MNR*, 88 DTC 1110; [1988] 1 CTC 2138 (TCC); *Rath v. MNR*, 78 DTC 1327; [1978] CTC 2425 (TRB); and *Storrow v. The Queen*, 78 DTC 6551; [1978] CTC 792 (FCTD).

⁴⁴ Paragraph 62(1)(c).

⁴⁵ Paragraph 62(1)(g).

⁴⁶ Paragraph 6(1)(j) is similar in effect. It requires the inclusion in income of any reimbursement or award received by a taxpayer to the extent that it relates to an amount deductible under subsection 8(1).

pertaining to the taxation of employees' fringe benefits and the deductibility of employees' moving expenses.

- Paragraph 6(1)(a) applies to all economic benefits received by an employee in respect of employment; it is not necessary for the benefits to be received in exchange for services rendered.

- The money's-worth principle does not apply to benefits under paragraph 6(1)(a).

- The reimbursement of personal expenses or the payment of personal expenses on behalf of an employee is a benefit under paragraph 6(1)(a).

- The reimbursement of out-of-pocket expenses incurred in the course of employment or the payment of such expenses on behalf of an employee is not a benefit under paragraph 6(1)(a).

- All allowances received by an employee must be included in income under paragraph 6(1)(b) unless specifically excluded, and allowances for moving expenses are not excluded.

- Moving expenses are not deductible under section 9 as ordinary business expenses because they are personal expenses under paragraph 18(1)(h).

- Ordinary moving expenses are deductible, within limits, under section 62.

REIMBURSEMENT OF MOVING EXPENSES

The Ransom Case: Original Sin

How should the reimbursement of moving expenses be treated in the light of the statutory scheme for the taxation of employment income summarized above? As set out in more detail earlier, in our view, since moving expenses are considered to be personal, it follows that any reimbursement of such expenses received by an employee must be included in income as a benefit from employment. On this view, the treatment of the reimbursement of moving expenses is simple. The nature of the expense—ordinary moving expenses, loss on the sale of a house, increased mortgage interest, or increased costs of living—is irrelevant; the form of the compensation—payment of the expenses by the employer, reimbursement of the expenses, allowance, forgiveness of a loan, bonus, or increased salary—is irrelevant. Any type of compensation received by an employee for moving expenses should be included in income, and the employee should be able to deduct the expenses permitted by section 62.

Unfortunately, in the 1967 *Ransom* case, the Exchequer Court disregarded the broad compass and policy of the statutory scheme for the taxation of employee benefits and created an artificial and unrestricted exception for the reimbursement of moving expenses. The only discernible principle underlying the *Ransom* case is that either no reimbursement constitutes income or that no reimbursement for moving expenses constitutes income because it puts nothing in the taxpayer's pocket. Obviously,

either principle goes too far in terms of revenue⁴⁷ and fairness. As subsequent cases illustrate, however, there is no other rational basis for limiting the *Ransom* principle. The conclusion is obvious and inescapable: *Ransom* is wrong.⁴⁸ Until the original sin of *Ransom* is expiated, the law will be plagued by inconsistency and unfairness.

In *Ransom*, the taxpayer, an employee of DuPont Canada, was transferred from Sarnia to Montreal in 1961. He was unable to sell his house in Sarnia until 1963. The cost of the house was approximately \$20,100; it finally sold for \$17,000, which, after legal fees and real estate commission, left the taxpayer with \$16,192. Just before the sale, the house was appraised at a value of \$20,000. In accordance with the company's general policy, Ransom received \$3,617⁴⁹ as reimbursement for his loss. The minister included \$2,809 (\$3,617 less the legal fees and real estate commission) in the taxpayer's income under the predecessor to section 5, paragraph 6(1)(a) or (b), or subsection 6(3).

Mr. Justice Noël recognized the importance of the case as the first Canadian case on the issue. Unfortunately, he was heavily influenced by two UK decisions of the House of Lords that held, on similar facts, that the reimbursements were not taxable because they did not represent compensation for services rendered.⁵⁰ Although the wording of the predecessor to paragraph 6(1)(a) was significantly broader than the UK provision, Mr. Justice Noël adopted the reasoning of the UK cases. In short, the court resolved that the predecessors to section 5 and subsection 6(3) did not apply because they applied only to compensation for services rendered, and the reimbursement for the loss on the sale of the taxpayer's house was not compensation for services rendered. The predecessor to paragraph 6(1)(b) did not apply because the reimbursement of actual expenses incurred was not an allowance. A full-blown analysis of the case is beyond the scope of this article. Because of the importance of the case, however, it is worthwhile and necessary to demonstrate in detail that the Exchequer Court's analysis of the predecessor to paragraph 6(1)(a) is clearly wrong.⁵¹

Reaching the conclusion that the reimbursement was not a taxable benefit was no mean feat, especially in the light of the court's acknowledgment that paragraph 6(1)(a) "uses such embracing words that at first

⁴⁷ Although it is impossible to quantify the amount of tax revenue at stake, it seems clear that, if tax-free cost-of-living adjustments were provided, the revenue loss would be substantial.

⁴⁸ In the quotation at the beginning of this article, Mr. Justice Noël acknowledged that he had difficulty in articulating reasons for the exclusion of the reimbursement from income. The reason for his difficulty is clear: it is impossible to justify the decision rationally.

⁴⁹ It is not clear how this amount was arrived at.

⁵⁰ *Hochstrasser (HM Inspector of Taxes) v. Mayes and Jennings v. Kinder (HM Inspector of Taxes)* were heard together in the House of Lords (1959), 38 TC 673.

⁵¹ See, to the same effect, Hansen, *supra* footnote 15, at 134-35.

glance it appears extremely difficult to see how anything can slip through this wide and closely interlaced legislative net.”⁵² First, Mr. Justice Noël concluded that the reimbursement was not derived from the taxpayer’s employment. According to him, whether a payment arises from an office or employment depends on its “causative relationship” to employment, or the effective cause of the payment. Further, the effective cause of a payment is its legal source, which was the agreement by DuPont to reimburse its employees for certain moving expenses, and not the services rendered by Ransom. Just because Ransom did not provide any specific consideration for the company’s payment did not mean that, by default, the consideration was services rendered by Ransom, because the payment could be motivated by reasons of efficiency or compassion.

This blinkered reasoning is transparently wrong. An employer’s relocation policy is a factor, just like other fringe benefits, that most employees would consider in accepting and retaining employment. On the facts, Ransom had been moved previously by his employer and was well aware of the company’s relocation policy. Employers reimburse employees for moving expenses either because of past services rendered or, more likely, because of the future services to be rendered by the employees. In some cases, the relocation policy is the product of hard bargaining between the employer and the union representing employees. In any event, the Supreme Court’s decision in *Savage* that the words “in respect of” in paragraph 6(1)(a) have the broadest possible meaning and are not restricted to payments for services rendered clearly indicates that *Ransom* is no longer good law on this point.

With respect to the issue of benefit, Mr. Justice Noël’s reasoning is even less convincing. According to him, it could be inferred from the evidence that the reimbursement was intended “not to provide increased remuneration for employees, but as part of a general staff policy to secure a contented staff and ease the minds of employees compelled to move from one city to another as a result of the company’s action.”⁵³ Paying employees more is probably the surest way of securing contented staff, but no one would suggest that their increased pay is not or should not be taxable.

The real reason for the court’s decision that the reimbursement was not a benefit was that the reimbursement simply restored the taxpayer to his economic position before he incurred expenses by reason of his employment. In short, Mr. Justice Noël simply reiterated, without any analysis, the old *Tenant v. Smith* principle:

It appears to me quite clear that reimbursement of an employee by an employer for expenses or losses incurred by reason of the employment (which as stated by Lord Macnaghten in *Tenant v. Smith*, (1892) AC 162, puts nothing in the pocket but merely saves the pocket) is neither remuneration

⁵² *Supra* footnote 1, at 5242; 358.

⁵³ *Ibid.*, at 5242; 359.

as such or [sic] a *benefit* “of any kind whatsoever” so it does not fall within the introductory words of section 5(1) or within paragraph (a).⁵⁴

As explained earlier, the *Tennant v. Smith* principle is incompatible with the wording of paragraph 6(1)(a).

One aspect of the court’s reasoning goes beyond its reliance on *Tennant v. Smith*. Mr. Justice Noël analogized Ransom to an employee who receives reimbursement for travelling expenses incurred by reason of employment:

I can, indeed, see no difference in principle between the case of a salaried employee who is sent away for a few days to work outside and whose expenses are paid whether he remains away for a week, a month or even a year, or [sic] the case of the appellant here who incurred expenses in moving back and forth to wherever he was employed.⁵⁵

It is true that the reimbursement of out-of-pocket expenses incurred by an employee in the course of employment does not represent income. In many of these cases, there is no element of personal benefit to the employee (for example, where an employee pays a delivery charge and is subsequently reimbursed). In the case of travelling expenses, although there may be some element of personal benefit, it has never been considered to be sufficient to cause these expenses to be characterized as personal expenses. Travelling expenses are deductible by both business taxpayers and employees. The reimbursement of moving expenses, and in particular a loss on the sale of a house, is different precisely because moving expenses have always been categorized as non-deductible personal expenses. The court’s failure to recognize this point has resulted in the development of a line of cases with respect to the reimbursement of moving expenses in which some courts have blithely applied the virtually limitless principle underlying *Ransom*,⁵⁶ and other courts have struggled to restrict the principle without rejecting *Ransom* itself. Instead of re-examining the original sin committed in *Ransom*, subsequent courts have accepted and preserved that result without realizing that the *Ransom* principle cannot be limited on any rational basis. We will discuss several of these other cases, and Revenue Canada’s administrative policy, relating to the reimbursement of ordinary moving expenses, a loss on the sale of a house, increased mortgage interest, increased housing costs, and increased costs of living.

⁵⁴ *Ibid.*, at 5244; 361.

⁵⁵ *Ibid.*, at 5244; 362.

⁵⁶ The only principle that supports the result in *Ransom* is that any reimbursement of moving expenses (and possibly any expenses) incurred by an employee does not represent a benefit of employment. If this principle is applied logically by the courts, an employee who is moved to a location where the costs are higher is entitled to tax-free compensation for those higher costs. Such an employee is no better off after the move; the employee has just been restored to the position he or she was in before the move. For obvious reasons, no court has been willing to go this far.

Ordinary Moving Expenses

The reimbursement of ordinary moving expenses incurred by an employee as a result of being moved by his or her employer is not a taxable benefit under paragraph 6(1)(a). This is Revenue Canada's longstanding administrative policy.⁵⁷ Although there is no explicit case law to this effect, the cases and section 62 seem to assume the result. In other words, if, as established by the *Ransom* case, reimbursement for the loss on the sale of a house or for increased mortgage costs is not a taxable benefit, a fortiori reimbursement of ordinary moving expenses is not a taxable benefit. We reiterate that we are using the term "ordinary moving expenses" to mean those costs that are clearly deductible in accordance with section 62.

Under Revenue Canada's administrative policy, the exclusion of reimbursements of ordinary moving expenses applies to

- the relocation of an existing employee,
- a move by a new employee to take up new employment duties, and
- a move out of a remote location on the termination of employment.⁵⁸

It is irrelevant whether the relocation is involuntary from the employee's perspective or whether the reimbursement is made pursuant to an agreement between the employer and the employee that is separate from the employment contract. These two facts were present in the *Ransom* case and have been referred to in many subsequent cases, although never relied on expressly. In the *Phillips* case, the Federal Court of Appeal properly rejected these factors as having any relevance to the exclusion from income of reimbursements.⁵⁹ Both factors are subject to manipulation by taxpayers, and neither of them is relevant to the crucial issue, which must be determined objectively, of whether an employee has received an economic benefit from employment.

The treatment of the reimbursement of moving expenses was improper before 1972 because, as explained earlier, moving expenses were not deductible. Although ordinary moving expenses are arguably more closely connected to employment than the loss on the sale of a house (they are incurred irrespective of an employee's personal choice to live in a house or an apartment), the case law was clear that moving expenses for employees and business taxpayers were non-deductible personal expenses.

⁵⁷ *Interpretation Bulletin* IT-470R, April 8, 1988, and its predecessors going back to 1964. For example, in the *Ransom* case, the taxpayer received reimbursement for his ordinary moving expenses in addition to the reimbursement for the loss on the sale of his house. Revenue Canada did not include the former reimbursement in the taxpayer's income. The Exchequer Court, *supra* footnote 1, at 5244; 361-62, referred to "those other 'removal expenses' (such as the expenses incurred by the employee in moving himself, his family and his household effects) which are considered by the respondent [the minister] as conferring no benefit on the employee and which, as a matter of fact, are not added by the respondent to the appellant's income."

⁵⁸ IT-470R, *supra* footnote 57, at paragraphs 35 and 36.

⁵⁹ *Phillips*, *supra* footnote 3, at 6180; 387 (FCA).

Even after 1972, the exclusion of the reimbursement of moving expenses from income is inappropriate because the types of moving expenses that are deductible under section 62 are much more limited than those that can be reimbursed on a tax-free basis. For example, no taxable benefit is considered to arise if an employer reimburses an employee for

- mortgage interest, property taxes, and maintenance expenses of the employee's old house after the move while reasonable efforts are being made to sell it;
- interest costs of bridge financing;
- the cost of revising a will;
- expenses incurred in house-hunting; and
- expenses of obtaining a new driver's permit and automobile licence.⁶⁰

None of these amounts is deductible under section 62.

It is difficult to understand Revenue Canada's position because the relationship between paragraph 6(1)(a) and section 62 is so clear. An employee should be in the same position for income tax purposes whether or not the moving expenses are reimbursed. If the employee is not reimbursed, the only tax relief for the moving expenses is the deduction under section 62. Moreover, Revenue Canada's position is obviously unfair to employees who incur expenses in moving that are not reimbursed and are not deductible under section 62. Employees who are reimbursed for such expenses have a greater net worth and should be taxable on that amount. If the employee is reimbursed, the reimbursement should be included in income, and the employee should be entitled to claim a deduction only for the moving expenses expressly allowed under section 62.⁶¹

Loss on the Sale of a House

If the exclusion of the reimbursement of ordinary moving expenses from paragraph 6(1)(a) is a summary conviction offence, the Exchequer Court's decision in *Ransom* to exclude the reimbursement for the loss on the sale of a house is an indictable offence. Ordinary moving expenses are mixed employment-personal expenses, whereas the loss on the sale of a house is purely personal.⁶² Ordinary moving expenses are directly caused by the employer's decision to relocate the employee to a new place of employment. In contrast, a loss on the sale of the employee's house is a

⁶⁰ See the paper by Bryan Dath of Revenue Canada delivered to the annual conference of the Tax Executives Institute, Ottawa, May 15, 1991, reproduced in full in Claude Désy, ed., *Access to Canadian Income Tax* (Montreal: DACFO) (looseleaf), 91 TAP 450.

⁶¹ We recognize that, even in this situation, the employee who is reimbursed is better off than the employee who is not reimbursed. However, this result is attributable, not to a lack of neutrality in the tax rules, but to greater compensation provided by the former employee's employer.

⁶² In our view, a lease cancellation payment is similarly personal. However, such a payment is a deductible moving expense under section 62, whereas the loss on the sale of a house is not.

consequence of the employee's decision, for personal reasons, to purchase a house rather than live in rented accommodation. Even if we ignore this fundamental point, a loss on the sale of a house by a relocated employee is not caused by the move. The loss is caused by market forces. The move is the occasion for the recognition of the loss, and even this point assumes that the taxpayer could not retain ownership of the house and rent accommodation at the new location. Perhaps the market might recover if the employee were not required to move and sell the house at the particular time. On the other hand, perhaps the real estate market might deteriorate further. These speculative factors should be irrelevant for the taxation of employees' fringe benefits.

From a tax policy perspective, the exclusion from income of the reimbursement for a loss incurred on the sale of a house constitutes yet another tax subsidy for home ownership. The Income Tax Act subsidizes home ownership in several ways. For example, the imputed income from owner-occupied housing is not taxable; capital gains on the disposition of a principal residence are exempt from tax; the home buyer's plan permits the use of funds in an RRSP to finance the purchase of a home; and interest on the first \$25,000 of a home relocation loan is deductible. It is inappropriate for the courts to extend these subsidies for home ownership by excluding reimbursement for a loss incurred on the sale of a house by a relocated employee. Only Parliament should make this type of decision.

Revenue Canada accepted the result in the *Ransom* case and incorporated that result into its stated administrative policy.⁶³ This action was necessary and appropriate. However, rather than attempting to limit *Ransom* to its facts, Revenue Canada's administrative position extended the holding in *Ransom*. For example, Revenue Canada's policy applies to the reimbursement of a loss on the sale of a house incurred by an employee on the termination of employment in a remote area.⁶⁴ More important, Revenue Canada adopted a policy of permitting an employer to reimburse an employee for the difference between the selling price of the house and its fair market value as determined by an independent appraisal.⁶⁵ The former extension of *Ransom* is perhaps justifiable on grounds of fairness. A terminated employee in a remote area who incurs a loss on the sale of

⁶³ IT-470R, supra footnote 57, at paragraph 37.

⁶⁴ Ibid. The interpretation bulletin does not mention the reimbursement of a loss incurred on the sale of a house by a new employee. However, in *Volpé*, supra footnote 3, it was held that the reimbursement of a new employee for the difference between the selling price and the appraised value was income under subsection 6(3). The Tax Court distinguished the *Ransom* case on the basis that in *Volpé* the reimbursement was part of the employee's contract of employment, whereas in *Ransom* it was part of a separate contract. Further, the court concluded without any reasons that the reimbursement was consideration for accepting the employment. Although, in our view, the result is correct, it is not consistent with the courts' restrictive interpretation of subsection 6(3) with respect to moving expenses. Compare *Lao*, supra footnote 3, discussed in footnote 81, infra.

⁶⁵ Similarly, no taxable benefit arises if the employer purchases the employee's house for its fair market value or cost, whichever is greater.

a house is in the same position as (or perhaps a more deserving position than) an employee who is required to move to a new place of employment. However, the extension of *Ransom* to the reimbursement of an amount up to the fair market value of the house is indefensible. In terms of the reasoning in *Ransom*, an employee who sells a house for less than its fair market value but more than its cost has not incurred any loss; therefore, any reimbursement cannot be said to save the employee's pocket. On the other hand, as we have argued, the *Tennant v. Smith* principle that there is a difference for income tax purposes between saving the pocket and putting something in the pocket is nonsense. Accordingly, in our view, reimbursement of a loss and reimbursement of a reduced gain are the same and should be treated the same for income tax purposes.

The previous point raises the fundamental problem with the *Ransom* case. The rationale for the exclusion of the reimbursement in *Ransom* applies to all reimbursements. There is no principled basis for limiting the *Ransom* decision to the reimbursement of moving expenses and a loss on the sale of a house, or even to relocation costs generally. The Exchequer Court and subsequent courts have failed to address this issue squarely. They have steadfastly refused to examine the correctness of the *Ransom* decision. As discussed subsequently, they have accepted *Ransom* and unwittingly extended it.

In extending the *Ransom* principle, the courts purport to be deciding cases on the basis of precedent and equity. In the courts' view, equity is served by not taxing reimbursements of moving expenses, so that there is "harmony and balance between the employee that is transferred to another city and the employee that is not."⁶⁶ This quote is referred to frequently in the cases. As discussed earlier, this is a mistakenly narrow view of equity that disregards employees who are relocated and not reimbursed for their expenses or are compensated in a different way. As might be expected, the results in the cases are inconsistent and inequitable. In some cases, the courts have gone to great lengths to find for a taxpayer who has incurred expenses as a result of a move. In other equally deserving cases, they have refused to grant any relief. Two Tax Court cases dealing with losses on the sale of a house illustrate the inconsistency in the cases. Both cases were decided by the same judge.

In *Greisinger v. MNR*,⁶⁷ the taxpayer was relocated from Calgary to Edmonton. He received a loan from his employer to assist him in acquiring a new home in Edmonton. The taxpayer could not sell his Calgary home. After a few months, he sold his newly acquired Edmonton home at a substantial loss and moved back to his Calgary home. He continued to work in Edmonton, commuting twice a week at his own expense. His employer forgave \$60,000 of the loan to reimburse him for his loss. The Tax Court held that the forgiveness was not taxable to the extent of about

⁶⁶ *Greisinger v. MNR*, 86 DTC 1802, at 1805; [1986] 2 CTC 2441, at 2444 (TCC).

⁶⁷ *Ibid.*

\$46,000 because that was the amount of the actual loss incurred by the taxpayer on his Edmonton house.

This case is extraordinary. As might be expected, the Tax Court cites the *Ransom* case to justify its decision, but it never mentions the fact that the loss was incurred on the new house and not on the old house. How can the loss on the Edmonton house be considered to have been caused by the move? The taxpayer was not relocated by his employer back to Calgary; that move was purely personal. It is true that the taxpayer was in the difficult position of owning two homes, but this was due, at least in part, to his personal decision to buy a new home in Edmonton rather than rent until he was able to sell his Calgary home.

The taxpayer in the *Sheldon* case⁶⁸ is, in our view, equally deserving of relief. The taxpayer's employment was terminated in 1985 as a result of the closing of a mine. The taxpayer did not sell his house in the small mining community but received \$63,000 from his employer as compensation for the loss in value of his house as a result of the permanent closing of the mine. The taxpayer argued that the payment was not taxable on the basis of the *Ransom* and *Greisinger* cases. The Tax Court held that the payment constituted income because the taxpayer had not realized the loss. This is nit-picking at its worst. Given the circumstances—a remote mining community and the permanent closing of the mine—it seems clear that the reduction in the value of the taxpayer's house was permanent. The fact that losses are not recognized under the Act until the property is disposed of is irrelevant here; the employee is not attempting to deduct the amount of the loss. The loss or the reduction in the value of the house is simply the measure of the reimbursement agreed on by the employer and the employee. If, under Revenue Canada's administrative policy, an employee can be reimbursed tax-free for the difference between the appraised value of a house and its selling price, it seems very unfair to deny tax relief to Sheldon just because he chose not to sell his house.⁶⁹ Objectively, the loss in the value of his home is unlikely ever to be recovered.

Increased Mortgage Interest

The extension of the *Ransom* case to the reimbursement of higher mortgage interest payments in respect of the employee's new house is a natural one. If a loss on the sale of an employee's house is a legitimate cost of moving, the loss of a favourable mortgage interest rate in respect of the house is not much different. As a result of the move, the employee is required to incur higher interest costs than if he or she had not moved. Moreover, it is not a big step from higher interest costs as a result of an increase in the rate of mortgage interest to higher interest costs as a result of an increase in the principal amount of the mortgage. As a result of the

⁶⁸ *Sheldon v. MNR*, 88 DTC 1392; [1988] 2 CTC 2039 (TCC).

⁶⁹ It would be interesting to know whether the result would have been different if Sheldon had sold his house to his wife to crystallize the loss.

move, the employee is required to take on a larger mortgage in order to acquire a comparable house in the new location.

This line of reasoning has been adopted in several cases and has been accepted recently by the Federal Court of Appeal. The first case involving this issue was *McNeill*,⁷⁰ decided by the Federal Court—Trial Division in 1986. In *McNeill*, the employee, an air traffic controller at Dorval Airport in Montreal, was moved to Ottawa and received an “accommodation differential” and a “social disruption” payment from his employer. The move was motivated by political and air traffic safety considerations because of tension between francophone and other controllers at Dorval. The taxpayer’s home in Montreal cost \$16,500, was appraised at \$28,000, and sold for \$24,000. The principal amount of the mortgage on the house was \$13,000 at an interest rate of 9.25 percent. The taxpayer purchased a house outside Ottawa for \$82,000, with a \$60,000 mortgage with interest at 11.5 percent. He received \$15,571 over five years as compensation for the increased mortgage interest (2.25 percent) on the difference between the selling price of his house in Montreal and the value of a similar house in Ottawa. He also received just over \$2,000 as a social disruption payment.

The Federal Court—Trial Division held that the reimbursement of the increased mortgage cost was not a taxable benefit under paragraph 6(1)(a). According to the court, the payment was not received in respect of the taxpayer’s employment despite the Supreme Court’s decision in *Savage*; it was received “in his capacity as a person.” In effect, the court held that because the move was motivated by political considerations to resolve labour unrest, the payment was a gift to the taxpayer. This argument is obviously flawed. Suffice it to say that one way of avoiding labour unrest is for an employer to pay increased wages, which would clearly be taxable. Although it was unnecessary to do so, the court also went on to find that the reimbursement was not a benefit to the taxpayer on the basis of *Ransom* and *Tennant v. Smith*. In contrast, the social disruption payment was held to be a taxable benefit, but only because the taxpayer did not establish that he had actually incurred any other expenses in connection with the move to Ottawa.

In our view, the result in the *McNeill* case is incorrect. The reasons for judgment are superficial, conclusory, and inadequate to justify such a significant extension of the *Ransom* principle.⁷¹ Revenue Canada did not appeal the decision, perhaps because it was thought that subsequent courts would limit it to its particular facts. However, this was not what happened.⁷²

⁷⁰ *McNeill v. The Queen*, 86 DTC 6477; [1986] 2 CTC 352 (FCTD). *Segall v. The Queen*, 86 DTC 6486; [1986] 2 CTC 364 (FCTD), dealt with similar facts and was heard by the same judge.

⁷¹ For example, the court did not distinguish between the increase in the interest rate and the increase in the principal amount of the mortgage.

⁷² In *Splane*, supra footnote 3 (FCTD), Mr. Justice Cullen expressly rejected the proposition that the *McNeill* case was unique because of the political aspect of the labour dispute.

The leading cases with respect to the reimbursement of increased mortgage costs are *Splane* and *Hoefele*. In *Splane*,⁷³ the taxpayer was moved from Ottawa to Edmonton. He sold his house near Ottawa for \$65,000 and purchased a new house near Edmonton for \$63,000. The interest rate on the taxpayer's new mortgage was 1.75 percent higher, and the taxpayer received amounts over three years to reimburse him for the increased mortgage interest. Although there is no evidence in the case as to the principal amounts of the mortgages, it is evident from the agreed statement of facts in the case and the subsequent *Hoefele* case that the new mortgage was approximately \$2,000 more than the old mortgage, but that the taxpayer was entitled to reimbursement only to the extent of the unexpired principal amount of the mortgage on his old home.

Without any thoughtful analysis or consideration of the implications of its decision, the Federal Court—Trial Division held that the payments were not taxable benefits. In effect, the court parroted the holdings in *Ransom* and *McNeill*:

No economic benefit of any significant value was conferred upon this plaintiff. The plaintiff moved at the request of his employer, incurred certain expenses in the move, and suffered a loss. The reimbursement of these expenses cannot be considered as conferring a benefit within the terms of the Act. The plaintiff was simply restored to the economic situation he was in before he undertook to assist his employer by relocating to the Edmonton office.⁷⁴

The court assumed that an increased mortgage interest rate is the same as a loss incurred on the sale of a house. Moreover, the court did not distinguish between increased mortgage interest as a result of an increase in interest rates and increased mortgage interest as a result of an increase in the principal amount of the mortgage. The court's failure to consider the consequences of its decision is the most serious shortcoming of the case. If the reimbursement of increased mortgage interest is not taxable, the reimbursement of any increased costs of living at the new location should not be taxable.

The Federal Court of Appeal confirmed the Trial Division's decision and simply adopted its reasons.⁷⁵ This did nothing to clarify the law and invited more litigation. In the *Phillips* case, discussed below, the Court of Appeal approved the basic principle of *Splane* that the reimbursement of increased mortgage interest incurred by an employee as a result of a relocation is not a taxable benefit. According to Mr. Justice Robertson, however, the *Splane* principle was limited to reimbursement of the difference between the interest rate on the employee's old mortgage and the rate on the same principal amount in respect of the new mortgage. Mr. Justice Linden refused to limit the application of *Splane* in this way, preferring to wait for a case that raised the issue.

⁷³ *Splane*, supra footnote 3.

⁷⁴ *Ibid.*, at 6445; 203 (FCTD).

⁷⁵ *Ibid.* (FCA).

The Court of Appeal did not have long to wait. In the recent *Hoefe* case,⁷⁶ the court extended *Splane*, in a 2-1 decision, to the reimbursement of interest expense on the difference between the selling price of the old home and the appraised value of a similar home in the new location. The taxpayer was moved by his employer, Petro-Canada, from Calgary to Toronto. The employer paid on the employee's behalf mortgage interest on the difference between the cost of the employee's house in Calgary and the cost of a comparable house in Toronto, which was established to be 1.55 times greater. The interest payments continued for a period of 10 years, declining from 100 percent of the interest in the first year to 50 percent in the 10th year. Petro-Canada advised the employee that the payments were taxable benefits and issued T-4 slips accordingly. However, the payments were designed to be deductible for the employee under paragraph 110(1)(j) as interest in respect of a home relocation loan.

After a superficial consideration of the case law, which concluded with the finding that the *Ransom* and *Savage* cases are entirely consistent, Mr. Justice Linden described the issue as follows:

[T]he question to be decided in each of these instances is whether the taxpayer is restored or enriched. Though any number of terms may be used to express this effect—for example, reimbursement, restitution, indemnification, compensation, make whole, save the pocket—the underlying principle remains the same. If, on the whole of a transaction, an employee's economic position is not improved, that is, if the transaction is a zero-sum situation when viewed in its entirety, a receipt is not a benefit and, therefore, is not taxable under paragraph 6(1)(a). It does not make any difference whether the expense is incurred to cover costs of doing the job, of travel associated with work, or the move to a new work location, as long as the employer is not paying for the ordinary, everyday expenses of the employee.⁷⁷

This statement of the issue, of course, indicates that Mr. Justice Linden has succumbed to the siren song of the money's-worth principle from *Tennant v. Smith*. There is no analysis of the appropriateness or the consequences of using this test for the purposes of paragraph 6(1)(a); it is

⁷⁶ *Supra* footnote 2, disposing of appeals in five cases (see *supra* footnote 3). In four of them, the reimbursement was held not to be income. The government has requested leave to appeal to the Supreme Court. In one case (*Krull*, *supra* footnote 3, at 208; 2209), however, the reimbursement was found to be taxable for the following reason: "The substance of the agreement is that the Appellant received financial assistance for his housing accommodation at the new location, a benefit not provided to his other colleagues or other employees, and one nominally regarded as a personal benefit." In another recent Tax Court case that also will likely be appealed, *Pezzelato*, *supra* footnote 3, the reimbursement of increased mortgage interest caused by higher house prices in the new location was held to be taxable. Judge Bowman made a herculean effort to reconcile *Ransom*, *Splane*, and *Phillips*, but acknowledged failure. He concluded, at 2898, that "while the Federal Court of Appeal went to some lengths to avoid specifically overruling *Ransom* and *Splane*, it is impossible not to conclude that essentially it came so close to doing so that the authority of these cases has been substantially eroded, unless one applies distinctions that are arbitrary or irrelevant."

⁷⁷ *Supra* footnote 2, at 5605.

simply assumed to be correct. Even the exclusion for the payment or reimbursement of “ordinary, everyday expenses” is unsupported by any analysis.

Applying this test to the facts of the case, the Federal Court of Appeal concluded that the payments were not taxable benefits because there was no increase in the taxpayer’s equity in his new house. The court distinguished the *Phillips* case (which involved a lump-sum payment to compensate the employee for higher housing costs at the new location) on the basis that the taxpayer’s net worth in that case was increased. Again, there is no analysis of this assertion. It is true that the Court of Appeal in *Phillips* found that there was an increase in the taxpayer’s net worth, but only because it rejected the objective evidence that the cost of the house in Winnipeg was considerably higher than the cost of a comparable house in Moncton. There is no significant economic or financial difference between the payment of interest on behalf of an employee and the payment of mortgage principal, which results in the employee’s having to pay less interest.⁷⁸ The \$10,000 lump-sum payment in *Phillips* is equivalent to the payment of interest at a certain rate over a certain number of years.

In dissent, Mr. Justice Robertson, who wrote the reasons for judgment in *Phillips*, concluded that the case was similar to *Phillips* in that the taxpayer’s net worth increased in both cases. Although Mr. Justice Robertson still labours under the mistaken belief that the *Ransom* principle is defensible, at least he understands that there is no difference between an employer’s subsidizing an employee’s mortgage interest and a subsidy in respect of mortgage principal:

To suggest that the subsidies go toward only the increased interest component of the mortgage and not the principal, and therefore the payments made by the taxpayer’s employer do not have the effect of increasing the taxpayer’s net worth, is simply to mask the reality of the situation. . . . The reason being, that if you reduce the principal amount of the loan, by means of a lump sum payment, you necessarily reduce the amount of interest that can accrue in the future. In other words, the form in which the payment is made should not detract from the legal reality that the taxpayers have received financial assistance to defray what is, in fact, a personal living expense.⁷⁹

In his dissent, Mr. Justice Robertson tried once again to articulate the distinction he made in the *Phillips* case between payments to compensate for higher housing costs at the new work location, which in his view are taxable benefits, and the reimbursement of actual monetary losses incurred on the sale of an employee’s home, which is tax-free. While the

⁷⁸ There is obviously a difference in the timing of the benefit. A payment of principal results in an immediate increase in a taxpayer’s net worth, whereas the payment of interest on behalf of a taxpayer increases the taxpayer’s net worth only when the payments are made. In most cases, however, this difference is irrelevant because the employee will not sell the house to obtain access to the funds. In some cases, the employer’s housing assistance may be conditional on continued ownership of the house.

⁷⁹ *Supra* footnote 2, at 5611-12.

attempt to limit the *Ransom* principle is laudable, this distinction is not tenable. The only viable alternatives are to reject the *Ransom* principle entirely and require all reimbursements of moving expenses to be included in income, or to accept the *Ransom* principle with the recognition that it encompasses all reimbursements of increased costs of living at the new location.

Although the *Hoefe* case deals with increased mortgage interest costs, and in that regard it can be seen as simply an application of the *Splane* case, in fact, it goes much farther than either *Splane* or *Phillips*. As Mr. Justice Robertson recognized, the majority's decision is based on the assumption that a relocated employee is entitled to the same standard of living in the new location as he or she enjoyed before the move. Consequently, the *Hoefe* case, in his view, "paves the way for other tax-free benefits intended to redress variations in the cost of living from one region of Canada to another."⁸⁰

Increased Housing Costs

The leading case with respect to housing costs is the 1994 Federal Court of Appeal decision in *Phillips*.⁸¹ The taxpayer was moved by his employer from Moncton, New Brunswick to Winnipeg, Manitoba. The taxpayer sold his house in Moncton and purchased a replacement house in Winnipeg. Pursuant to a relocation agreement between the employer and the union, the taxpayer received a \$10,000 payment to compensate him, as an eligible employee, for increased housing costs in Winnipeg, although no restrictions were placed on the use of the \$10,000 payment.

The Federal Court of Appeal quickly disposed of the taxpayer's argument that the \$10,000 relocation payment was a non-taxable gift. Sensibly, the court applied the broad approach of the *Savage* case and concluded that the payment was received by the taxpayer in his capacity as an employee. In this respect, both the employer's motivation for the payment—to protect its economic position by resolving a labour dispute—and the condition of the employee's continuing employment indicated that the reasons for the payment were firmly grounded in the employment relationship.

⁸⁰ *Ibid.*, at 5613.

⁸¹ *Phillips*, supra footnote 3. See also *Lao*, supra footnote 3, and *Krampl*, supra footnote 3. In *Lao*, the taxpayer accepted new employment in Toronto and received a payment of \$22,500 to compensate him for the increased cost of housing in Toronto. The Tax Court held that the amount was a reimbursement and excluded from paragraph 6(1)(a). The Federal Court—Trial Division heard the appeal at the same time as the *Phillips* case and affirmed the Tax Court's decision. The result is questionable because *Phillips* was reversed by the Federal Court of Appeal. In *Krampl*, the taxpayer was moved by his employer from Vancouver to Penticton in 1986 and back to Vancouver in 1989. The employer loaned him \$50,000 in 1989 to assist him in purchasing a home in Vancouver because housing costs there had increased substantially since 1986. In 1991, the taxpayer's employment terminated, and he negotiated a severance package that included the forgiveness of \$25,000 of the housing loan. The Tax Court found that the forgiveness of the loan was a taxable benefit within the meaning of paragraph 6(1)(a).

The court also refused to give any weight to the fact that the payment was made pursuant to a collateral contract.

In dealing with the benefit issue, the Federal Court of Appeal distinguished two types of housing costs incurred by relocated employees: losses incurred on the sale of a house and expenses incurred in acquiring a new house. The first type of cost includes a capital loss on the sale of a house and a loss incurred as a result of the discharge of a mortgage at an interest rate lower than the prevailing market rate. The second type of cost includes costs attributable to higher housing prices in the new location, including increased mortgage interest. The court concluded, on the basis of the *Ransom* and *Splane* cases, that relocation payments that reimburse an employee for losses incurred on the sale of a house are tax-free. In contrast, payments that reimburse an employee for expenses incurred in acquiring a replacement house are taxable benefits. Unfortunately, the court never explains why these costs should be treated differently. It seems apparent that the court finally realized that the wholesale acceptance of the *Ransom* principle meant that the reimbursement of any increased costs of living at the new location would be tax-free. Consequently, the Federal Court of Appeal was faced with the unattractive dilemma of overruling *Ransom* or drawing an arbitrary line in the sand to restrict its application. It chose the latter alternative.

The Court of Appeal re-examined the *Ransom* case and at least acknowledged the argument that a loss on the sale of a house, even on a forced relocation, is a personal expense. However, the court concluded incorrectly that *Ransom* was consistent with the purpose of paragraph 6(1)(a) to treat employees equally irrespective of the form of their compensation. According to the court, “the true rationale underlying *Ransom*” is (as stated in the *Greisinger* case)⁸² “harmony and balance between the employee that is transferred to another city and the employee that is not.”⁸³ As we explained earlier, this application of the principle of horizontal equity is too narrow. It does not consider relocated employees who receive no compensation for their costs or who receive compensation in a different form, such as increased salary or a relocation allowance. In the end, the Court of Appeal concluded that “*Ransom* has become so enmeshed in our conception of taxable benefits that it is, in my view, for the Supreme Court or Parliament to set aside its logic.”⁸⁴ The court’s reluctance to overrule *Ransom* is perhaps understandable given that it is so widely accepted by employers, employees, Revenue Canada, and the courts. Apart from a statutory amendment, however, overruling *Ransom* is the only way to put the tax treatment of the reimbursement of moving expenses on a sound and consistent basis. The *Ransom* case is the source of the problem.

⁸² *Greisinger*, supra footnote 66, at 1805; 2444.

⁸³ *Phillips*, supra footnote 3, at 6183; 391 (FCA).

⁸⁴ *Ibid.*

Although the Federal Court of Appeal confirmed its acceptance of *Ransom*, it refused to extend the *Ransom* principle to the reimbursement of increased housing costs. The court gave three reasons for its decision. First, payments in respect of increased housing costs add to a relocated employee's personal wealth. According to the court, the payment to the taxpayer "did more than save his pocket—it put money into it,"⁸⁵ despite the evidence that a comparable house in Winnipeg cost \$23,000 more than the taxpayer's house in Moncton. This reasoning is hardly convincing. It continues to rely on the inappropriate money's-worth principle of *Tennant v. Smith*. Moreover, the court's rejection of the evidence of different house prices in different locations on the basis that house selection is subjective is facile. Employers do not compensate employees on the basis of their personal tastes, but on the basis of objective evidence of differential house prices.

Second, the court argued that if payments in respect of increased housing costs were tax-free, the relocated employee would gain an undue advantage over other employees in the same area who must acquire housing with after-tax dollars. Here the court switches its test case for horizontal equity from a comparison of the taxpayer with employees in Moncton who were not moved to a comparison of the taxpayer with employees in Winnipeg who were not moved. If the same test had been applied in the *Ransom* case, the reimbursement of the loss on the sale of the house would have been taxable because Ransom received a payment from his employer that other employees resident in Montreal did not receive. In the *Ransom* case, the comparison was made between employees who were relocated from Sarnia to Montreal and as a result incurred costs and employees who were not relocated and did not incur the same costs.

Third, the court was concerned that, if the *Ransom* principle extended to payments for increased housing costs, it would apply to many other reimbursement payments: "Perhaps the most persuasive rationale for limiting the application of *Ransom* lies in the myriad expenses which its extension could exempt from taxation."⁸⁶ The court was concerned that allowing these expenses to be reimbursed on a tax-free basis would create an unacceptable "window of opportunity for those intent on structuring tax-free compensation packages for employees required to relocate to urban centres where costs of living are appreciably higher."⁸⁷ However, the source of the problem is not unacceptable tax planning for employee relocations; it is the state of the case law, which makes such tax planning possible and necessary.

Although the decision of the court was unanimous, in a brief concurring judgment Mr. Justice Linden castigated Parliament for causing the inconsistencies in the case law: "The reason for these inconsistencies is

⁸⁵ *Ibid.*, at 6185; 393.

⁸⁶ *Ibid.*, at 6184; 392.

⁸⁷ *Ibid.*

not judicial frailty; rather, it is Parliament's failure to resolve consistently these intricate, subtle and complex issues of benefits and allowances."⁸⁸ Consequently, he suggested that the courts should decide only the specific issues that come before them and leave it to Parliament to clarify the state of the law on the basis of tax policy considerations. With respect, the courts should not be able to shirk their responsibility, or avoid accountability, so easily. The state of the law is confused and inconsistent only because the courts have made it so. The second-highest court in the land decided *Ransom*; no one else is responsible. And despite the temporary retreat suggested by *Phillips*, the courts have extended *Ransom* inexorably. In recent years, Revenue Canada has resisted this extension vigorously. The Department of Finance has not proposed legislation to correct the sorry state of the law, perhaps because it is waiting to see the outcome of the cases.

Increased Costs of Living

We have argued throughout this article that the principle of the *Ransom* case extends to the reimbursement of any increased costs of living at the new location. In a 1979 case, the Tax Review Board held precisely that:

[I]f in *Ransom* the reimbursement of moving expenses was not regarded by the learned Noël J as being a benefit, . . . it is very difficult to conclude in the present appeal that the payments to counteract the cost of living in a foreign country are part of the remuneration from an employment for the services rendered by the appellant.⁸⁹

Further, in a recent Federal Court of Appeal decision, Mr. Justice Linden, who also wrote the majority judgment in *Hoefele*, suggested that on the basis of the *Ransom* case, all reimbursements received by an employee are excluded from the application of paragraph 6(1)(a):

Paragraph 6(1)(a) leaves little room for exceptions, but a few have surfaced in the jurisprudence. First, reimbursements paid by an employer to an employee for expenses incurred by that employee are not taxable. They are not benefits. They do not put anything in the taxpayer's pocket, but merely save the pocket of the taxpayer. . . . Reimbursements for costs actually incurred are, therefore, not caught by paragraph 6(1)(a).⁹⁰

Although this statement was obiter, it does indicate clearly that at least some members of the Federal Court of Appeal view the *Ransom* principle as virtually unlimited. It also suggests that the court's attempt in the *Phillips* case to limit *Ransom* to the reimbursement of a loss on the sale

⁸⁸ *Ibid.*, at 6185; 394.

⁸⁹ *Demers v. MNR*, 79 DTC 918, at 920; [1979] CTC 3132, at 3135 (TRB). The taxpayer received just over \$4,000 to compensate him for the higher costs of living in Haiti, where he was employed by the Organization of American States. The decision was reversed on appeal (*The Queen v. Demers*, 81 DTC 5256; [1981] CTC 282 (FCTD)) on the formalistic ground that the payment was a cost-of-living adjustment to the taxpayer's salary rather than a reimbursement for the increased costs of living in Haiti.

⁹⁰ *Blanchard*, *supra* footnote 3, at 5480-81; 264-65 (FCA).

of a house and the loss of a favourable interest rate was unsuccessful. The clear implication for tax planning is to ensure that employees are compensated for moving expenses, including increased costs of living at the new location, and other expenses by way of reimbursements rather than in some other form such as an allowance.

In our view, payments of and reimbursements for increased costs of living are taxable benefits. Mr. Justice Linden's statement that all reimbursements of costs actually incurred are tax-free may be the logical extension of *Ransom*, but it makes a mockery of his earlier acknowledgment that the wording of paragraph 6(1)(a) "is plain and unambiguous; all types of benefits imaginable are to be included." If an employer reimburses an employee for clearly personal expenses, such as food, clothing, commuting expenses, entertainment, etc., such reimbursements must be included in income in order to maintain the integrity of the statutory scheme for the taxation of employment income.

REIMBURSEMENT OF OTHER PERSONAL EXPENSES

Revenue Canada and the courts have not generally applied the money's-worth principle of *Tennant v. Smith* in applying paragraph 6(1)(a) to the reimbursement or payment of personal expenses other than moving expenses. In these cases, payments have been held to be taxable benefits within the meaning of paragraph 6(1)(a). For example, in *Cutmore*,⁹¹ the employer paid for its senior executives and their spouses to have their income tax returns prepared by tax professionals in order to protect the employer's reputation for integrity. The Tax Court held that the payment was a benefit under paragraph 6(1)(a). The court rejected the taxpayer's argument that having his tax return prepared professionally was a requirement of his employment and conferred no economic benefit on him. In two cases in which a director and officer of a company was indemnified by the company for legal expenses incurred in successfully defending himself against criminal charges associated with the business activities of the company, the taxpayer was considered to have received a taxable benefit.⁹² Similarly, the payment of a lawyer's professional dues and liability insurance by his employer was held to be a taxable benefit.⁹³ Along the same lines, reimbursement of the cost of financial counselling or tools for employees is considered by Revenue Canada to be a taxable benefit.⁹⁴ Under the *Ransom* principle, the taxpayer should win in all

⁹¹ *Cutmore et al. v. MNR*, 86 DTC 1146; [1986] 1 CTC 2230 (TCC).

⁹² *Clemis v. The Queen*, 92 DTC 6509; [1992] 2 CTC 232 (FCTD); and *Pellizzari v. MNR*, 87 DTC 56; [1987] 1 CTC 2106 (TCC).

⁹³ *J.S. Deitch v. MNR*, [1989] 1 CTC 2350 (TCC). See R.B. Thomas, "Some Benefit!" Current Cases feature (1988), vol. 36, no. 2 *Canadian Tax Journal* 398-401, for a comment on the case. Section 8 was subsequently amended to allow employees to deduct annual professional dues, including payments for professional or malpractice liability insurance: subparagraph 8(1)(i)(i) and paragraph 8(5)(b).

⁹⁴ IT-470R, supra footnote 57, paragraphs 26 and 23, respectively (as amended by Special Release dated December 11, 1989).

these cases because the payment by the employer put nothing in the taxpayer's pocket but simply saved the taxpayer from having to incur an expense as a result of his employment.

The ostensible distinction between these cases and those dealing with the reimbursement of moving expenses is that the latter involve employment rather than personal expenses. In one case, the Tax Court put the issue as follows:

While the actions which give rise to the criminal charges took place in the context of the plaintiff's employment with the company and his membership on the Board of Directors I could not find that there is the close nexus between their outlay and the plaintiff's position as an employee and director of the corporation, in order to conclude that they were incurred *by reason* of that employment or directorship.⁹⁵

In our view, the connection between the expenses and the employment in these cases is arguably as close as in the moving expense cases. As explained earlier, the case law is clear that moving expenses are non-deductible personal expenses. The same test should be applied to the determination of whether the reimbursement or payment of an expense is a taxable benefit under paragraph 6(1)(a). In other words, would the particular expense be deductible on the assumption that subsection 8(2) is ignored? On the basis of this test, at least the reimbursement of the cost of tools and the lawyer's dues and liability insurance should not be included in income because they are deductible costs of earning income and not personal expenses.⁹⁶

In the *Huffman* case,⁹⁷ a plainclothes police officer received an allowance of \$500 to defray the additional expense involved in purchasing oversized clothing needed to accommodate his police equipment. The Tax Court held that the allowance was a reimbursement because the taxpayer spent at least \$500 on the clothing and, further, that no benefit was conferred on the taxpayer under paragraph 6(1)(a) because "[t]he taxpayer was simply being restored to the economic situation he was in before his employer ordered him to incur the expenses."⁹⁸ The Tax Court erred, in our view, in treating the allowance as a reimbursement. If, however, this aspect of the case is ignored, the result is correct, not because of the money's-worth principle, but only if the special clothing would be a deductible business expense rather than a personal expense for a business taxpayer.

Unfortunately, the courts have not articulated a clear distinction between the reimbursement of personal and employment expenses. Usually, the courts have focused on whether the expense was incurred *by reason of* employment rather than, as we have suggested, on the well-established

⁹⁵ *Clemis*, supra footnote 92, at 6518; 245.

⁹⁶ The fact that the tools represent capital expenditures is a potential problem.

⁹⁷ *Huffman*, supra footnote 11.

⁹⁸ *Ibid.*, at 6407; 135. A similar decision was reached in *McLay*, supra footnote 3, and *Shoveller v. MNR*, 84 DTC 1195; [1984] CTC 2207 (TCC).

case law dealing with the distinction between business and personal expenses under paragraph 18(1)(h). Employees receiving a reimbursement of moving expenses are treated more favourably than employees receiving a reimbursement of other personal expenses. It is unclear why the courts are more generous with respect to relocation expenses. We suspect that the general sentiment in favour of home ownership and promotion of labour mobility are important considerations.⁹⁹ In our view, however, the promotion of labour mobility and home ownership through the Income Tax Act is the responsibility of Parliament, not the courts. Indeed, although Parliament has provided a statutory deduction for moving expenses to encourage labour mobility, the courts have extended that tax subsidy significantly by allowing the tax-free reimbursement of many types of moving expenses that are not deductible.

TAX TREATMENT OF MOVING EXPENSES IN THE UNITED STATES: A POSSIBLE MODEL FOR CANADA

Until 1970, the reimbursement of moving expenses incurred by employees generated the same problems in the United States that currently exist in Canada. Any reimbursement of moving expenses was generally a tax-free benefit, even though employees who incurred unreimbursed moving expenses were entitled to deduct only limited types of expenses.¹⁰⁰ This fundamental unfairness in the treatment of employees who were reimbursed for moving expenses and employees who were not was corrected by statutory amendments in 1969.¹⁰¹

Under the express provisions of the Internal Revenue Code, any reimbursement or payment of moving expenses, other than ordinary moving expenses, received by an employee directly or indirectly, must be included in income.¹⁰² However, the reimbursement or payment of ordinary moving expenses (expenses of moving the employee, the employee's family, and their household goods and personal effects from the former residence to the new residence) is not required to be included in income.¹⁰³

⁹⁹ See Robertson J (dissenting) in *Hoefele*, supra footnote 2, at 5611.

¹⁰⁰ Although section 61 of the Internal Revenue Code of 1954, as amended, contained a provision similar to paragraph 6(1)(a) of the Act, the courts interpreted that provision narrowly and held that the reimbursement of moving expenses was not income to the employee: see *England v. United States*, 345 F.2d 414 (7th Cir. 1965), cert. denied, 382 US 986 (1966); and *United States v. Woodall*, 255 F.2d 370 (10th Cir. 1958), cert. denied, 358 US 824 (1958). The Internal Revenue Service accepted the courts' interpretation with respect to existing employees but resisted the extension of the interpretation to new and terminated employees.

¹⁰¹ The relevant sections are sections 82, 132, and 217 of the Internal Revenue Code of 1986, as amended (herein referred to as "the Code").

¹⁰² Code section 82 provides, "Except as provided in section 132(a)(6), there shall be included in gross income (as compensation for services) any amount received or accrued, directly or indirectly, by an individual as a payment for or reimbursement of expenses of moving from one residence to another residence which is attributable to employment or self-employment."

¹⁰³ Code section 132(a)(6).

These ordinary moving expenses are deductible under the Code if they are incurred by the employee.¹⁰⁴ Because the definition of ordinary moving expenses is the same for both purposes, it makes no difference whether the reimbursement is excluded from income, in which case no deduction can be claimed, or the reimbursement is included in income and the expenses are deducted.¹⁰⁵

CONCLUSION

The thesis of this article is that any reimbursement of personal expenses received by an employee or the payment of personal expenses by an employer on behalf of an employee must be included in income as a taxable benefit of employment. The test of whether an amount is a personal expense or an employment expense should be the same test that is applied under paragraph 18(1)(h) with respect to the computation of income from a business.

In general, the courts follow this approach in applying paragraph 6(1)(a) to the reimbursement of employees' expenses or the payment of employees' expenses by an employer. However, the treatment of moving expenses represents a serious aberration from this approach. The courts have created an important exception to paragraph 6(1)(a) with respect to the reimbursement of moving expenses and the payment of moving expenses by an employer on behalf of an employee. This exception started with the *Ransom* case in 1967 and has been steadily expanded by the courts to cover increased mortgage interest costs, increased housing costs, and other costs of relocation that are not deductible under section 62. This steady extension of the *Ransom* case seemed to end with the Federal Court of Appeal's decision in the *Phillips* case in 1994. Although the court confirmed the application of *Ransom* to ordinary moving expenses, losses on the sale of a house, and increased mortgage interest costs, it refused to extend the principle to increased housing costs at the new location. However, that court's subsequent decision in *Hoefele* throws doubt on the *Phillips* case and indicates that the scope of the *Ransom* case is still uncertain.

¹⁰⁴ Code section 217, which is similar to section 62 of the Act.

¹⁰⁵ However, gross income is used for certain non-tax purposes, such as social security and unemployment insurance payments, and, when the reimbursement is excluded, an employee's "gross income" is unaffected. (See *Tax Reform Act of 1984: Supplemental Report of the Committee on Ways and Means U.S. House of Representatives on H.R. 4170*, HR Rep. no. 432, part 2, 98th Cong., 2d sess. 1590-1608 (1984).) Therefore, in the case of ordinary moving expenses, if the employee is reimbursed, the reimbursement is excluded from income; if the employee is not reimbursed, the employee can deduct the expenses. If, however, an employee is reimbursed for other moving expenses, such as a loss on the sale of a house and higher mortgage interest in respect of a new house, the reimbursement must be included in income. No deduction is permitted in respect of these other moving expenses. The scope of deductible moving expenses under Code section 217 is narrower than that under section 62 of the Act. Deductible moving expenses do not include the cost of house-hunting trips, temporary living expenses at the new location, or the expenses of selling the old residence or cancelling a lease in respect of the old residence.

We have argued that the *Ransom* case is wrong. The courts have accepted without any analysis the naive rule in *Tennant v. Smith* that an amount that saves the taxpayer's pocket, but does not put anything into the pocket, is not income. As we have shown in this article, the *Tennant v. Smith* rule not only defies common sense; it has been ousted from the income tax law of Canada and is not generally followed by the courts with respect to the reimbursement of expenses other than moving expenses. All moving expenses, including the loss on the sale of a house, are personal expenses, and their reimbursement or payment by an employer should represent a taxable benefit to the employee. Only in this way will all employees be entitled to the same deductions for moving expenses under section 62, whether or not the employer provides compensation for those expenses and irrespective of the form in which such compensation is provided. Unfortunately, the Federal Court of Appeal has created an artificial and arbitrary distinction between taxable and non-taxable benefits with respect to the reimbursement of moving expenses. The court has not been successful in stemming the flood of moving expense cases; nor has it been successful in eliminating the inconsistencies in the decisions and the resulting unfairness for taxpayers. As Mr. Justice Robertson said in dissent in the *Hoefele* case:

What is required is a fundamental re-examination of the jurisprudence surrounding paragraph 6(1)(a) of the Act. It is no longer sensible to search for rational ways of distinguishing cases when, in fact, there is no underlying doctrinal thread that ties them together.¹⁰⁶

Although we agree with this statement and we share the sense of frustration reflected in it, we doubt that the courts have the ability to rectify the situation in a timely and efficient manner. Only by overriding the deeply entrenched *Ransom* principle can the law be rationalized. However, the courts have shown a stubborn reluctance even to question the principle, let alone reject it.

In our opinion, the only practical solution to the confused and unfair state of the law and the potential revenue leakage is a legislative amendment.¹⁰⁷ Fortunately, the required amendment is quite simple. Any reimbursement of moving expenses incurred by an employee and any payment of moving expenses on behalf of an employee should be included in the employee's income under paragraph 6(1)(a).¹⁰⁸ The employee should then be entitled to deduct the moving expenses in accordance with section 62. In conjunction with this amendment, it might also be appropriate for Parliament to consider expanding the types of moving expenses that are deductible under section 62.

¹⁰⁶ *Supra* footnote 2, at 5613.

¹⁰⁷ Compare Allan R. Lanthier, "Comments," in Williamson, *supra* footnote 15, at 5:7, in which the author states that corrective legislation would be inappropriate.

¹⁰⁸ It might be necessary for this purpose (but not for purposes of section 62) to define moving expenses to include, for example, the loss on the sale of a house, increased interest costs, and increased housing and other costs.