IMA CANADA - COUNCIL

October 31st, 2006

Canada Revenue Agency
Technical Interpretation Department
305 Boul, Rene-Levesque W.
Montreal, (Quebec) H2Z 1A6

Object: TAXABLE BENEFITS–6(1)(a)Income Tax Act TWO NON-CASH AWARDS PER YEAR POLICY
Our reference: 18110/mem/2006/Interpretation letter awards-CRA

Dear Sir,

Following a conversation we had with your department on October 2, 2006, we would like to obtain a written confirmation from Canada Revenue Agency (hereinafter: "CRA") to the questions below.

Please note that the present letter and the written confirmation from CRA must remain **private** and **confidential** and **should not become public knowledge**. In the eventuality that these documents **could not be kept private** and **confidential**, please **advise us as soon as possible** and **ignore the present request**.

I. TAX ASPECTS OVERVIEW

a) INCOME TAX ACT

In accordance with paragraph 6(1)(a) of the Income Tax Act (hereinafter: "ITA"), the value of benefits of any kind whatever received or enjoyed by a taxpayer in a year in respect of, in the course of, or by virtue of an office or employment shall be included in the income of the taxpayer.

b) **TECHNICAL NEWS NO.22 DATE JANUARY 11, 2002**

CRA explains its new position in this document, as follows:

Response 4: (Third paragraph)"Employer will be able to give employees two non-cash awards per year, on a tax free basis, in recognition of special achievements such as reaching a set number of years of service, meeting or exceeding safety standards, or reaching similar milestones where the total cost of the rewards to the employer is less than $500 per year. The employer will be able to deduct the cost of the gifts and awards.

This new position was developed after extensive consultations, reflects current business practices and is in keeping with other reasonable positions that we have set out in our Interpretation Bulletin IT-470 Employees' Fringe Benefits. It makes it easier for employers to administer because it removes the burden of determining the fair market value of small gifts and awards – something that is very subjective when the gift or award has a company logo."

Response 6: "If the cost exceeds the $500 threshold, then the full fair market value of the gifts or awards will be included in the employee's employment income."

c) **INTERPRETATION BULLETIN IT-470R Employees' Fringe Benefits**

This bulletin indicates in the second paragraph of section 9:

"If an item is personalized with a corporate logo engraved with the employee's name or a message, the fair market value of the item may be negatively affected. In such cases, the amount to be included in the employee's income may be reduced by a reasonable amount, having regard to all the circumstances."

II. ASSUMPTIONS

The following hypothetic situation is divided into two sections:

a) DETERMINATION OF TAXABLE BENEFITS

An employer gives an award to an employee, which is a pen. The cost to the employer is $600.00 (including sales taxes).

The fair market value of such an item determined by a competent person is $400.00 (including taxes). This fair market evaluation reflects the fact that such an award is engraved with the name of the employee and a corporate logo of the employer.

b) VARIOUS SERVICES RENDERED BY THE SUPPLIER

The supplier of the awards to the employer renders the following services to the employer:

- Creation and production of brochures;
- The services of professionals who created the program;
- Tracking and evaluating results for the program;
- Managing the database of the employees and ongoing administration of the program for the employer;
- Creating and managing websites strictly designed for the employer;
- Selling and wrapping the award selected by the employee, after applying appropriate logos and engraving names.

The first five elements indicated above form part of an administrative process. The last one represents the selling of an award, which includes the profit element of the vendor.

We assume that the supplier acting reasonable breaks down the charge to the employer between the following two elements in his monthly invoice:

- Cost of administration of the program for the employer;
- Charge for the award selected which includes an appropriate profit margin in such circumstances.

III. <u>TAX ISSUES</u>

a) DETERMINATION OF TAXABLE BENEFITS

What is the amount of taxable benefit that should be included in the employee taxable income, would it be:

- $400.00 representing the full market value of the item? Or
- $0 because the value is below the threshold of $500.00?

b) VARIOUS SERVICES RENDERED BY THE SUPPLIER

Would CRA recognize that the cost of the award for the employer corresponds to the amount specified on the invoice, which is strictly related to the charge made for the reward and excluding the cost of administration of the program?

IV. OUR INTERPRETATION

a) DETERMINATION OF TAXABLE BENEFITS

Our understanding of the CRA position is that an award is not considered as a taxable benefit for an employee **when the total cost of such an award for the employer is less than $500.00 and the number of awards received by such an employee is not more than 2 per year.**

If the cost of the award for the employer exceeds the amount of $500.00 the fair market value needs to be established in order to determine the amount to be included in the employee's income.

Such fair market value may be lower than the cost to the employer because the award is engraved with the name of the employee and a corporate logo of the employer. The fair market value amount determined must then be included in the taxable income of the employee regardless whether the fair market value amount exceeds $500.00 or not.

In the situation mentioned above, the cost of the pen for the employer is $600.00. As a result, we are of the view that the amount of the fair market value determined by competent evaluators would be required to be included into the employee's income. In our particular case mentioned above this amount would be $400.00.

b) VARIOUS SERVICES RENDERED BY THE SUPPLIER

We are of the view that the administration of the program by the supplier is an independent service rendered to the employer that is not related to the cost of a particular award item distributed to an employee.

Consequently, the charge for the reward indicated separately on the invoice (and independently from the other services rendered by the supplier) issued by the supplier to the employer would constitute the cost of the award to the employer for purposes of establishing the taxable benefit in accordance with section 6910(a) of the ITA.

The cost of such an award could then be used in the application of CRA position regarding whether or not the policy related to two non-taxable awards with a cost lesser of $5000.00 per year applies.

V. COMFORT LETTER

We would like to have CRA opinion regarding the tax issues described in section III above and whether or not our interpretation indicated in section IV above is correct.