Alberta Flood Relief Payments: Income for Tax Purposes?

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Matter considered:
Tax treatment of $1 billion of Alberta government flood relief payments

The June flooding of Calgary and other parts of southern Alberta has been described as “one of the largest natural disasters to ever hit the province”. Thousands of Albertans have been displaced from over 10,000 homes, some of which are damaged beyond repair. Personal losses from the floods are beyond calculation, and total financial losses to personal property and businesses are as yet untallied. The Alberta government has pledged $1 billion in immediate financial assistance, but it is unclear how those funds will be allocated.

It is also unclear how various types of flood relief assistance might be treated for tax purposes. In the aftermath of the flood, the tax consequences of flood relief payments will not be at the forefront of recipients’ minds. Whether flood relief payments made by the Alberta government are taxable in the hands of flood victims will depend on the wording used to explain the purpose of such payments, and, for business compensation, whether the province has created a legal obligation to compensate for business losses.

On June 27th, the provincial government began providing those impacted by the floods with pre-loaded debit cards in the amount of $1,250 for each adult and $500 per dependent child. The cards are available to individuals who were issued evacuation orders and who self-declare an inability to return home for at least seven days. There are no restrictions on how the payments may be used. According to the Government of Alberta they are intended “to be used responsibly to support Albertans with expenses related to being evacuated” including for “immediate housing needs and day-to-day purchases”.

What would be the tax consequences if these payments were treated as ordinary income, taxable in the hands of recipients? The top combined federal and provincial personal income tax rate is 39%. If the Government of Alberta’s flood assistance payments were included as ordinary income for tax purposes, individuals’ tax liability would be as much as $488 on payments for adults, and $195 for each payment in respect of a dependent child, where a taxpayer receives income subject to the top marginal rate.

Fortunately for Albertans receiving these payments, the Income Tax Rulings Directorate of the Canada Revenue Agency (“CRA”) has clarified its position that “disaster assistance payments made by a government, municipality or public authority to individuals in respect of an individual’s personal losses or expenses, as opposed to business expenses, would not be included in the recipient’s income for income tax purposes” (see here). The reason for the exclusion,
according to the Rulings Directorate, is that the payments are intended to compensate for expenses that are personal in nature, as opposed to losses incurred by a business.

(It should be noted that rulings issued by the Rulings Directorate are not binding law. It is possible for the CRA to take an assessing position at variance with a prior CRA ruling, although generally the CRA considers itself bound by these rulings).

The CRA’s use of the term “personal” expenses, while correct in the technical tax context, might be misleading to a person unfamiliar with tax law. Tax professionals often use the term “personal” to describe receipts or expenses that fall outside the source concept of income, which is the basis for defining income for tax purposes in Canada. (The Supreme Court of Canada found in Schwartz v Canada, [1996] 1 SCR 254 that paragraph 3(a) of the Income Tax Act, RSC 1985, c 1 (5th Supp), contemplates sources of income not mentioned in that Act; however, fortuitous, non-recurring receipts are often, though not always, held not to be income from a source). Thus, when the CRA states that flood relief assistance is not taxable because it is in respect of “personal expenses,” the CRA means that the relief amounts do not relate to a source of income that the Income Tax Act would bring into the calculation of income for tax purposes. Flood relief assistance would be taxable if it were received in connection with a source of income for tax purposes, such as business, property or employment. This could be the case even if the compensation was earmarked for expenses that would be considered personal in common parlance. (For example, if an employer provided employees with flood relief assistance to cover their personal expenses, but the amount was paid to employees in their capacity as employees, the assistance amount would be taxable – see The Queen v Savage, [1983] 2 SCR 428. The CRA has released an interpretation on when employer-provided flood relief may be non-taxable because it was received by an employee in his or her individual capacity).

As was suggested above, business is a source of income for tax purposes (see in particular sections 3 and 9 of the Income Tax Act). Thus, if the government set up a compensation program for lost business income, that compensation could be brought into income for tax purposes. As the case discussed immediately below demonstrates, the amount would be taxable if the government created a legal right for taxpayers to receive the compensation. The tax treatment of the compensation amount would be the same as if it had been received directly as income earned by the business.

The taxability of flood compensation paid to a business was considered by what was then the Exchequer Court of Canada in a case called Federal Farms Limited v Minister of National Revenue (Ex Ct, 1959), 59 DTC 1050. The Minister of National Revenue had reassessed the taxpayer to include additional income of $40,144, characterizing it as business income even though it was a voluntary payment funded by private donations to a flood relief fund. The Minister considered the payment to be compensation for the taxpayer’s crops, which had been destroyed in the Holland Marsh flood of 1954. Had the flood not destroyed the crops, they would have been sold for proceeds that would have been taxable as business income. Therefore, the Minister argued, the compensation for lost crops should be taxed in the same manner as income from the business source which the compensation was intended to replace. The Minister would have prevailed, had the proceeds been from an insurance contract, and had they been paid pursuant to a legal obligation. Since the payments were voluntary, the taxpayer prevailed and the compensation was held not to be taxable.
What would constitute a legal obligation sufficient to tax government compensation to businesses for flood losses? Would such compensation be voluntary in the absence of legislation defining the rights of flood victims? The Alberta legislature is currently adjourned for the summer, so emergency legislation cannot be enacted. Would it be sufficient to create a legal obligation if the Alberta government set up an informal compensation program, as it has done with the pre-loaded debit cards?

There is precedent for the federal government to resolve the taxing questions that arise from disaster relief payments. A little-known paragraph of the *Income Tax Act*, paragraph 81(1)(f), exempts from income:

a pension payment, a grant or an allowance in respect of death or injury sustained in the explosion at Halifax in 1917 and received from the Halifax Relief Commission the incorporation of which was confirmed by *An Act respecting the Halifax Relief Commission*, chapter 24 of the Statutes of Canada, 1918, or received pursuant to the *Halifax Relief Commission Pension Continuation Act*, chapter 88 of the Statutes of Canada, 1974-75-76.

As was done for some relief payments arising from the Halifax Explosion of 1917, it would be possible for the federal government to simply announce that targeted legislation will exempt from taxation government compensation to victims of the 2013 flooding of southern Alberta. It is common for draft tax legislation to be drafted after its announcement, and made retroactive to the date of announcement. A federal legislative amendment would also exempt flood relief payments for Alberta income tax purposes, since all provinces except Quebec calculate provincial tax owing using taxable income as determined by the federal *Income Tax Act*.

Arguably, government flood compensation that substitutes for business income, employment income, or that represents a capital gain on the deemed disposition of destroyed property, is properly within Canada’s technical tax base. Specific exemptions of otherwise taxable income could be classified as government expenditures, to the extent that uncollected tax represents financial relief to flood victims. Alternatively, the legislation could clarify that such compensation amounts are in the nature of non-taxable gifts or windfall payments, since the Alberta government is not under a legal obligation to compensate flood victims. It is doing so on a voluntary basis, and there is a compelling argument to be made that government assistance ought not to be included in flood victims’ income for tax purposes.

In the wake of such horrific losses, both personal and financial, taxes on government compensation will be the last thing on most Albertans’ minds. A number of types of flood relief payments, both private and public, may be subject to tax. It is possible that neither donors nor recipients will be taking tax consequences into account. Since taxable income is determined by the federal *Income Tax Act*, the federal government has the responsibility to clarify what types of payments will be excluded from income for tax purposes. The CRA can issue non-binding rulings and technical interpretations on the matter, but only the Department of Finance can announce a legislative solution.

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