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This publication is a high-level summary of the most recent tax developments applicable to business owners, investors and high net worth individuals. Enjoy!

Tax Tidbits

Some quick points to consider...

- Taxpayers can register for the **CRA's** My Account and get immediate access rather than waiting for a security code by mail.
- A portion of the federal carbon tax will be returned to Canadian-controlled private corporations (CCPCs) with fewer than 500 employees who file their 2023 tax return by July 15, 2024. The automatic rebate, based on the number of employees, will be paid to CCPCs in AB, SK, MB, ON, NB, NS, PEI and NL without needing an application.
- Depositing a cryptocurrency with a trading platform could constitute a disposition resulting in a taxable event.

Capital Gains Inclusion Rate: Proposed Increase

The 2024 Federal Budget proposed to increase the capital gains inclusion rate from 50% to 2/3 of the actual gain, effective for capital gains realized on or after June 25, 2024, for all taxpayers (including corporations and trusts) other than individuals. Individuals would be able to continue to access the 50% rate on the first \$250,000 of capital gains (net of gains offset by capital losses, the lifetime capital gains exemption, and the proposed employee ownership trust exemption and Canadian **entrepreneurs'** incentive) realized annually. An **individual's** capital gains over the annual \$250,000 limit, and all capital gains of corporations and trusts would be included at the 2/3 rate. Full details of the proposal have not yet been released (as of May 13, 2024).

Corporations and trusts with accrued gains may consider accelerating realizing capital gains before June 25, 2024 to access the 50% inclusion rate. The proposals would not impact individuals who do not realize capital gains in excess of \$250,000 annually. However, if an individual is expecting to realize a capital gain greater than \$250,000 in a single year, they may consider realizing the gain (or a portion thereof) before June 25, 2024 or spreading the gain over more than one year.

Before accelerating the realization of any capital gains, consideration should be given to the financial non-tax implications of a sale and the prepayment of tax due to early recognition of the sale.

ACTION: Consideration may be given to accelerating realizing accrued capital gains due to the proposed increase in the inclusion rate.

GST/HST Returns: Mandatory Electronic Filing

For reporting periods that begin in 2024 and onwards, GST/HST registrants (except charities and selected financial institutions) must file all GST/HST returns with CRA electronically. Registrants who file their GST/HST returns on paper are subject to a penalty of \$100 for the first offense and \$250 for each subsequent return not filed electronically. While CRA waived these penalties for monthly and quarterly filers who failed to file returns electronically for periods beginning before March 31, 2024, the relief will end shortly.

ACTION: Ensure that GST/HST returns are properly filed electronically to avoid these penalties.

Short-Term Rentals: Denial of Expenses

In late 2023, the Federal government announced its intention to deny income tax deductions for expenses by non-compliant operators of short-term rental properties (such as Airbnb or VRBO properties rented for periods of less than 90 days). These rules would apply to individuals, corporations and trusts with non-compliant short-term rentals. These rules are proposed to come into effect on January 1, 2024.

A short-term rental would be non-compliant if, at any time, either:

- the province or municipality does not permit the short-term rental operation at the location of the residential property; or
- the short-term rental operation is not compliant with all applicable registration, licensing and permit requirements.

Many municipalities require a business license or permit for short-term rental operations. Where short-term rental activities are carried on without such a permit, the operator would be subject to these proposals and taxable on gross rental revenues with no deductions in 2024 and later years.

Residential property would include a house, apartment, condominium unit, cottage, mobile home, trailer, houseboat and any other property legally permitted to be used for residential purposes.

No expenses incurred with respect to the non-compliant short-term rental would be deductible. For example, consider a short-term rental that incurred \$100,000 in expenses to generate \$20,000 in profit. If non-compliant, all expenses would be denied, resulting in a profit for tax purposes of \$120,000. Assuming the individual owner was in the top tax bracket (53.53% in Ontario), they would pay tax of \$64,236. As the actual profit was only \$20,000, the effective tax rate would be 321% (\$64,236/\$20,000). In absolute dollars, the individual would have to pay \$53,530 in additional taxes due to the denied expenses.

Where the short-term rental was non-compliant for part of the year and compliant for another part of the year, the total expenses incurred for all short-term rental activity would be prorated over the period of that activity to determine the non-deductible portion.

For example, assume that a property was used for long-term rental from January 1 to June 30, then converted to short-term rental on July 1. However, the owner did not obtain a business permit as required until September 1 (62 days non-compliant). Expenses for July 1 to December 31 (the short-term rental period, 184 days) would be 62/184 non-deductible. Expenses related to the long-term rental period would not be part of the calculation of non-deductible expenses.

Transitional rule

For the 2024 taxation year, if the taxpayer is compliant with all applicable registration, licensing and permit requirements on December 31, 2024, they would be deemed compliant for the entire 2024 year and, as such, would be able to deduct all relevant expenses for 2024.

ACTION: Ensure you comply with all municipal and provincial rules by December 31, 2024, to retain all deductions applicable to your short-term rental for the year.

Short-Term Rentals: Sale of Property – GST/HST Issues

Due to the proposal to deny deducting expenses related to non-compliant short-term rentals, some owners may consider selling their short-term rental property. While it is widely discussed that gains on the sale of a short-term rental property are generally taxable, the GST/HST implications of such a sale may be a surprise.

A March 15, 2024 Tax Court of Canada case considered whether the sale by a corporation of a condominium unit used for short-term rentals attracted GST/HST. The condo was originally acquired in 2008 and used for long-term residential leases. In 2017, the property began to be used solely for short-term rentals (all less than 60 days). The corporation sold the property in 2018 **to an arm's length purchaser**; no GST/HST was charged or remitted on the sale. The taxpayer was registered for GST/HST.

The taxpayer was assessed \$77,079 of GST/HST that was collectable on the property sale as CRA asserted that it was a taxable supply.

Taxpayer loses

For the sale of the condo to not be subject to GST/HST (that is, an exempt supply), the following three conditions must be met:

- the taxpayer was not a builder of the condo;
- the taxpayer did not claim an input tax credit (ITC) with respect to the last acquisition of the condo by them or with respect to an improvement to the condo; and
- the condo was a residential complex.

All parties agreed that the taxpayer was not a builder, and no ITCs were claimed on the condo or its improvements.

As such, the Court examined whether the condo was a residential complex. The Court stated that if all of the following conditions applied, it would not be a residential complex:


- a) the condo was part of a building that was a hotel, a motel, an inn, a boarding house, a lodging house or other similar premises;
- b) the condo was not owned by an individual who used the property primarily as a place of residence for themselves or a related person; and
- c) all or substantially all of the leases, licences or similar arrangements of the condo were provided (or expected to be provided) for continuous periods of use of less than 60 days.

The Court opined that point (a) was met as the furnished condo with utilities included in the short-term rental was akin to these accommodations. In addition, neither the vendor nor purchaser was an individual and therefore point (b) was satisfied.

Regarding point (c), CRA argued that the all or substantially all tests should be determined at the time of the sale rather than over the period of ownership, as argued by the taxpayer. The Court found that, at the time of sale, all or substantially all of the leases were for less than 60 days. The Court further stated that, **even if it were to accept the taxpayer's argument**, the relevant period of ownership would span from the change in use (long-term rental to short-term rental) to the sale. Both would lead to the same result; point (c) being met.

As all three points were satisfied, the condo was not a residential complex, and therefore, the sale attracted GST/HST as it did not constitute an exempt supply.

The Court also opined that the taxpayer acquired the property in 2008 to provide the exempt supply of long-term residential rent and, therefore, did not pay GST/HST on the acquisition of the condo. The Court then found that the taxpayer was deemed to have essentially acquired the condo when they began to use the condo in commercial activities (short-term rentals) in 2017. As the taxpayer did not pay GST/HST on the acquisition in 2008, the taxpayer could not claim any input tax credits on the deemed acquisition in 2017.

 **ACTION:** Before disposing of any property used for short-term rentals, consider whether GST/HST applies to the sale.

Director Liability: De Facto Director

Directors can be personally liable for payroll source deductions (CPP, EI, and income tax withholdings) and GST/HST unless they are duly diligent in preventing the corporation from failing to remit these amounts on a timely basis. Individuals can be personally liable as directors for up to two years after their resignation.

A July 19, 2023 French Court of Quebec case reviewed whether the taxpayer had resigned as a director of a corporation, thereby **protecting the individual from personal liability of the corporation's** failure to remit \$22,418 in QST and \$38,479 of source deductions. The taxpayer argued that she resigned in writing on the day the corporation declared bankruptcy. Revenu Québec (RQ) argued that even if the taxpayer had resigned, she continued acting as a director after the alleged resignation.

Taxpayer loses

The Court found that even after the taxpayer allegedly resigned, she continued to carry on the duties of a director. For example, she signed an income tax return for the corporation, authorized **the corporation's** accountant to discuss matters with RQ, had conversations with RQ regarding collection activities but did not disclose that she was allegedly no longer a director, and sent two \$500 cheques to RQ in an attempt to **settle the corporation's** tax debts.

The Court also reiterated previous jurisprudence that found that a director who has resigned must inform the Minister of their resignation during exchanges of correspondence relating to the **company's tax debt** and those relating to the liability of directors. **While the Court's comment was specific to the Quebec Companies Act**, the Court stated that it did not believe the rules were different for corporations under other provinces or the federal act.

The Court also stated that just because a corporation is bankrupt, the director does not lose their status as a director.

The Court ruled that the taxpayer did not resign as a director and was personally liable for the corporation's unremitted QST and source deductions withheld.

ACTION: If resigning as a director, ensure that you properly resign and cease acting as a director to limit personal liability.

Motor Vehicle Allowances: Carpooling

Reasonable motor vehicle allowances received by employees in the course of employment duties are non-taxable. An allowance is not reasonable (and therefore taxable) if any of the following are met:

- the allowance is not based solely on the number of kilometres driven for employment purposes;
- the employee is reimbursed in whole or part for expenses in respect of that use; or
- the per-km amount is not reasonable.

A November 23, 2023 French Technical Interpretation considered the tax implications of an employer increasing the motor vehicle allowance paid to its employees by an additional per kilometre amount for each person accompanying the driver. CRA opined that the two parts of the allowance (base and additional amount per passenger) constituted a single allowance since both were intended for the same use of the vehicle. They then opined that as the allowance provided was not solely based on the number of kilometres travelled to perform the duties of employment, the entire allowance was taxable.

ACTION: Ensure that allowances paid to employees meet the strict conditions for being tax-free to avoid a surprise tax bill for the recipient.

Unnamed Persons Requirement: Another CRA Compliance Tool

In 2023, CRA issued Shopify an unnamed persons requirement (UPR) that required Shopify to provide information on more than 121,000 Canadian vendors for the past six years. CRA uses this information to verify whether the unnamed persons for whom it received information have fulfilled their income tax and GST/HST obligations.

CRA has recently been using UPRs to detect non-compliance in several other industries, such as construction, crypto-assets and real estate. They can request various types of information in a UPR, including client information (e.g. names, addresses, phone numbers, date of birth) and books and records (e.g. sales and purchase records and legal and public records). CRA reiterated that a UPR differs from an audit as information requested from a business in an audit generally only pertains to the specific entity. However, for a UPR, the requested information typically pertains to an identified group of the business' clients.

Taxpayers who have not complied with their tax obligations may qualify for penalty relief through the voluntary disclosure program. However, the program does not apply if CRA has commenced an enforcement action, such as a UPR, or received information about potential tax non-compliance.

ACTION: Ensure you properly report all of your income. Once CRA commences an enforcement action, including receiving information about non-compliance, the voluntary disclosure program is no longer an option.

Online Reviews: Employees Must Disclose their Connection to the Business

Under the Competition Act, employees posting reviews online about their employer or the competition must disclose their connection to the business, even if the individual provides their honest opinion. This requirement applies to all types of reviews, including testimonials. A January 18, 2024, Competition Bureau Canada News Release (Online reviews posted by employees: businesses could be liable) recommended that businesses establish policies and provide employee training to reduce the risk of liability. The release also recommended that if an employee cannot make the connection clearly visible in a review, they should avoid posting it. This may occur when an employee intends to provide a star rating for a product or service but cannot disclose their connection with the provider.

ACTION: Ensure employees are aware of this requirement under the Competition Act and properly disclose relevant connections when posting online reviews.

Non-Profit Organization: Maintaining its Status

An August 30, 2023 Technical Interpretation discussed whether an entity could maintain its status as a non-taxable non-profit organization when investing in a subsidiary. NPOs need to maintain their status, as NPOs are exempt from tax on their income.

CRA stated that to maintain NPO status, the organization must be operated exclusively for purposes other than to earn profit. While an organization can have many purposes, none of them can be to earn a profit.

Incorporating and holding shares of a taxable subsidiary will not in and of itself cause the organization to lose its status. Earning incidental profit from activities directly connected to the non-profit objectives does not constitute a profit purpose. However, where the profit is not incidental or does not arise from non-profit objectives, the entity will be considered to have a profit purpose even if the income is used to further the non-profit activities. This could be the case where long-term investments in shares of a corporation are held as the purpose would be to derive income from property.

CRA noted that, in general, an **organization's** investment in a taxable corporation will indicate a profit purpose where the following conditions are met:

- the taxable **corporation's** activities are not connected to the **organization's objectives**;
- the organization does not have control of the corporation;
- the organization holds fixed-value preferred shares of the corporation; or
- other shareholders have invested in the corporation to earn a profit.

ACTION: If involved in an NPO, ensure that the **organization's assets and activities do not taint their NPO status.**

The preceding information is for educational purposes only. As it is impossible to include all situations, circumstances and exceptions in a newsletter such as this, a further review should be done by a qualified professional.

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If you have any questions, give us a call!