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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 **pro-rated** 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 themself 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 objectivities**, 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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