



## Tax Talk Tribune 2024 – Edition No 2.

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### Tax Tidbits

- 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.

### 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

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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

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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.

## Personal Services Business: CRA Education Initiative

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In general, a personal services business (PSB) exists where the **individual** performing the work would be considered to be an **employee of the payer** if it were **not** for the **existence** of the individual's **corporation**. These workers are often referred to as **incorporated employees**. Where it is determined that the income is earned from a PSB, the **corporate tax rate increases** significantly (potentially as high as 39% over the small business rate, depending on the province). In addition, significantly **fewer expenditures are deductible** against the income.

Since 2022, CRA has been conducting an **educational pilot project** in respect of **PSBs**. They have recently **published findings** from the project and highlighted **future planned phases**.

## Phase I – Identifying companies that hire PSBs

Phase I of the project was conducted from **June to December 2022**. The results were as follows:

- approximately **10%** of participating corporations were **likely** to be **carrying on PSBs**;
- approximately **64%** of **potential PSBs** were incorrectly **claiming the small business deduction** (an average of \$16,711 of additional federal corporate tax would be payable if this were corrected);
- nearly **74%** of **potential PSBs** work in the following **three industries**:
  - **transportation and warehousing** (35%), with 95% of these working in freight trucking;
  - **professional, scientific and technical services** (26%); and
  - **construction** (13%).

## Phase II – Identifying potential PSBs

CRA indicated that Phase II is planned for **October 2023 to June 2024**, and will examine approximately **2,100** randomly selected **corporations** identified as **potential PSBs**. The examination will include a **voluntary interview** and focus on the **2022 tax year**. CRA indicated that they hope to gain **greater insight** into how and why **PSBs operate** the way they do.

## Phase III – Assisted compliance for PSBs

CRA indicated that the **timing** of Phase III has **not yet** been **determined**. They expect to address the **2022 and subsequent tax years** with continued education, **review** of PSBs and **assisted compliance** of **non-compliant** PSBs.

**Action:** Identification of PSBs has become a focal point for CRA. If there is a risk of your corporation carrying on a PSB, inquire as to the corporation's exposure and potential mitigation strategies.

## 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.

## 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.

## 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!

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