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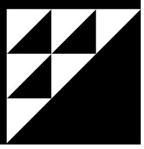

Dear Clients/Friends:
This is a quarterly newsletter which we send to clients, referral sources and friends. The information is meant to be educational and application of the concepts should be on an individual basis.Please do no hesitate to contact us should you require further clarification of any item.

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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…

- The limit on the deduction for **non-taxable allowances** paid by an employer to an employee using a **personal vehicle** for business purposes will increase in 2025 by 2 cents to 72 cents per km for the first 5,000 km driven and to 66 cents for each additional km (higher rates apply in the territories).
- The final phase of enhancement to the **Canada Pension Plan**, which commenced in 2019, **culminates in 2025**. For **employees** earning **$81,200** or more, both employers and employees are each subject to **CPP contributions of $4,430** in **2025**. Self-employed individuals would be liable for both the employee and employer premiums, bringing their required contributions to $8,860.
- **Bare trusts** remain **exempt** from **filing T3 Returns** for 2024, unless CRA specifically requests one.

Tax Proposals: Capital Gains Inclusion Rate

The **capital gains inclusion rate** has been **proposed** to **increase** from 50% **to 2/3**, **effective June 25, 2024**, for corporations and most trusts as well as for the portion of capital gains realized in the year that **exceeds $250,000** for **individuals**, graduated rate estates and qualified disability trusts. While the proposals to increase the **capital gains inclusion rate** are **not yet law**, these were included in a Notice of Ways and Means Motion (NWMM) that was tabled in the House of Commons on September 23, 2024. Consistent with established Parliamentary guidelines, CRA has stated that they will **administer these proposals** based on the NWMM. While CRA can administer the proposals, they do not have the authority to enforce them. Their position has not changed as a result of Parliament being prorogued until March 24, 2025.

What filing options do taxpayers have?

While CRA is administering based on the proposals, the tax system is a **self-assessment system**. As such, taxpayers can **choose** whether to file based on the **proposals** (2/3 inclusion rate) or the **existing enacted legislation** (50% inclusion rate). However, each option comes with risks and considerations.

- **Filing on proposals** (2/3 inclusion rate; in accordance with CRA forms and administrative practice)
    - If the **proposals** are **not ultimately enacted**, taxpayers will likely have to **amend** their **return** at a later date to reflect the 50% inclusion rate. This approach will also generally result in taxpayers making payments that are subsequently refunded, **losing access to that capital** for a period of time.
    - If the **proposals pass**, **no further action** would be required.
- **Filing on existing enacted legislation** (50% inclusion rate; not in accordance with CRA forms and administrative practice)
    - If the **proposals** are **not ultimately enacted**, **no further action** would be required.
    - If the **proposals pass**, taxpayers will likely have to **amend** their **return** at a later date to reflect the 2/3 inclusion rate. This will result in taxpayers being **liable** for the **tax bill**, including being potentially subject to the **non-deductible interest** on the **late tax payment.** For corporations or trusts that are impacted by these changes and have a filing deadline on or before March 3, 2025, CRA indicated that relief from arrears interest and penalties will be provided. The interest relief will expire on March 3rd.

ACTION: If you, a corporation or a trust has realized capital gains since June 25, 2024, consideration should be provided as to your filing position.

GST/HST Tax Holiday: Rebate Applications

For the **December 14, 2024 to February 15, 2025** period, **certain items** normally subject to GST/HST should **not** have **GST/HST applied** at the point of sale. Businesses selling these goods can still claim input tax credits for the GST/HST they paid on inputs acquired to supply the good, as they are zero-rated.

The **types of items** covered by this temporary measure include (but are not limited to):

- **children's clothing**, **footwear**, diapers and car seats;
- **select children's toys**, jigsaw puzzles and video games/devices;
- **printed newspapers and books**;
- **Christmas** and **similar decorative trees**; and
- **various foods and drinks** (including some alcoholic drinks), including but not limited to those provided at establishments like **restaurants**.

If GST/HST is **mistakenly charged** on the purchase of one of these goods, the **purchaser** can request a **refund directly from the supplier**.

If the supplier does **not provide a refund** or is no longer in business, the purchaser can **apply** to CRA for a **GST/HST rebate** (minimum claim is $2) using **Form GST189: Rebate under reason code 1C, "Amounts paid in error."** The application must be filed within **two years** after the date the amount was paid in error. CRA has suggested that a purchaser **consolidate all their claims** (including associated receipts) and submit a single rebate application after the GST/HST break period is over.

ACTION: Ensure to keep receipts for purchases where GST/HST was charged improperly. Multiple claims can be included in a single rebate submission.

My Business Account: No More Paper Mail

In the **Spring** of **2025**, CRA will change the **default method of correspondence** for **most businesses to online only**. This means that most businesses will **receive** their notices of assessment, letters, forms, statements and other documents from CRA **through My Business Account** rather than by traditional mail. **Notifications** that new mail is available online will be sent to the **email address(es) registered** on My Business Account. Business correspondence will be presumed to be received on the date that it is posted in My Business Account.

This change will **apply to all** of the following:

- **existing businesses** registered for **My Business Account**;
- **businesses who have a representative** that access taxpayer information through Represent a Client; and
- all entities that register for a **new business number** or program account.

CRA recommended taxpayers sign in to My Business Account to **ensure the email address** on file **is current**. There can be up to three email addresses for each program account.

Owners of new businesses should ensure to register for My Business Account and provide a valid email address to ensure that they do not miss notifications or correspondence from CRA.

Impacted businesses can continue to **receive paper mail** by **opting out** of the online default by taking one of the following two actions starting in **May 2025**:

- selecting paper mail as the delivery option in My Business Account; or
- filling out and mailing Form RC681 – Request to Activate Paper Mail for Business to CRA.

No information was provided on the required lead time to avoid the transition and continue to receive traditional mail.

This change will **not apply** to the following who will continue to receive traditional mail:

- existing businesses not registered for My Business Account through the business owner or an authorized representative (via Represent a Client);
- charities, unless they sign up to receive online mail; and
- non-resident businesses that do not have access to My Business Account through their representative or an owner who is a Canadian resident.

ACTION: Ensure that your email address listed in My Business Account is up to date. Consider opting out of electronic only communications in May 2025, if that is your preference.

Insurable Employment: Related Individual

A September 6, 2024 **Tax Court of Canada** case reviewed whether a **taxpayer's employment** by a corporation **owned by her brother** was **insurable**. The taxpayer performed various office duties for the corporation.

As the taxpayer was **related to the corporation**, she was **non-arm's length** to the employer. A non-arm's length employee is engaged in **insurable employment if** it is reasonable to conclude that they would have entered into a **substantially similar employment contract** with an **arm's length person**. Some aspects commonly relevant to such determinations are remuneration paid, duration of work performed, nature and importance of work and terms and conditions of employment.

Earnings not insurable

The Court stated that the taxpayer's **evidence was not credible** and concluded that her **employment was discretionary** (that is not substantially similar to a contract with an arm's length person) and **not insurable**, supported by the following facts:

- at various times, the taxpayer indicated that she was **paid** based on **salary**, **hourly** wages or **both** at the same time;
- the taxpayer was **unable to explain** how the insurable earnings reported on her **Records of Employment** were computed, and they were **not consistent** with her testimony on how her compensation was determined;
- the evidence provided indicated that her **employment was sporadic**, with layoffs at various times of the year (in a period of just over five years, the taxpayer was laid off at least once during each calendar month); and
- the taxpayer's **vacation** in each year **varied** from 2 to 33 weeks.

The Court concluded that **similar terms** would **not** have been **available to an arm's length employee**, so the employment was **not insurable**.

As the earnings were **not insurable**, the employee and employer would **not** be responsible for **EI premiums**; however, the employee would **not** be **eligible** to **receive EI benefits** (such as sickness benefits, caregiving benefits, maternity or parental benefits or regular benefits).

ACTION: If an employee is a relative of the business owner, confirm whether their income is insurable or not, as this affects EI premiums and benefit eligibility.

Secondary Suites: Various Tax Implications

There are several reasons an individual might **convert** part of their **home** into a **rental property**. However, this action can have **significant income tax implications**, including **potentially limiting access** to the **principal residence exemption**, which can be easily **overlooked**.

Two June 27, 2024 **Technical Interpretations** analyzed the tax **implications of creating secondary suites**. The suites reviewed in one interpretation were eligible for provincial program that provided forgivable loans, while the suite in the other interpretation qualified for the **multigenerational home renovation tax credit**.

Provincial program – forgivable loan

The program (BC Secondary suite incentive program) offers a forgivable loan to homeowners who **create a new secondary suite** or accessory dwelling unit on the property of their **principal residence**. For this particular program, the loan would be forgivable if the suite is rented at below-market rates for at least five years. The secondary suite must be a newly constructed legal self-contained unit and could include secondary suites attached to the primary residence (e.g. basement suites) or detached secondary suites (e.g. laneway homes and garden suites). Participants must enter into a rental agreement with a tenant who is not an immediate family member. Similar programs may be offered in other provinces and jurisdictions.

Source of income

CRA opined that the **rent received** would **likely** be a source of **property income**. The actual rent would be reported and not adjusted to fair market value. CRA noted that it was possible, depending on all facts and circumstances, that the activity would not be a source of income, in which case any losses would not be deductible.

Treatment of forgivable loan

The **forgivable loan** would generally be government assistance and result in a **reduction of the cost** of the secondary suite.

Change of use

CRA noted that a taxpayer who has **partially converted** their principal residence to an income-producing use would be **deemed to dispose** of (and reacquire) that part of the property for proceeds equal to its proportionate share of the property's fair market value. Any resulting capital gain may be eliminated or reduced by the principal residence exemption.

CRA referred to their policy not to apply the deemed disposition provision in certain cases where a principal residence is also used to generate income but opined that the creation of a second housing unit as required for the provincial program would be a structural change, and therefore the deemed disposition provision would apply.

CRA confirmed that an election to avoid the deemed disposition could be filed. In this case, the deemed disposition would be avoided; however, CCA could not be claimed against the rental income.

Multigenerational home renovation tax credit (MHRTC)

The MHRTC provides tax credits for homeowners who **renovate their homes** to create a **secondary unit** for a **qualifying individual** (a senior or an adult eligible for the disability tax credit). The secondary unit must be self-contained with a private entrance, kitchen, bathroom and sleeping area and must meet local standards to qualify as a secondary unit.

Change of use

Whether a **deemed disposition** occurs upon partial change in use is a **question of fact**. Since the MHRTC does not require the secondary unit to generate rental income, and the unit would be **used by a family member**, there **may not** have been a **change in use** to gaining or producing income (from personal use). As such, the partial change in use rules may not apply.

Principal residence exemption (PRE) for secondary suites

Both interpretations discussed **how secondary suites affect the PRE**. If two units are each **self-contained**, each with its own entrance, kitchen and bathroom and can be ordinarily inhabited separate from each other (that is, without access to the other unit), CRA's view is that they will **generally** be considered **separate housing units** for the PRE. Where it can be demonstrated that the two units are **sufficiently integrated** (both structurally and in their usage) and are being used for the exclusive use and enjoyment of the taxpayer and their family (that is, the two units are integrated to function as one single-family residence), it is **possible** that they would be a **single housing unit**.

In discussing the **provincial program**, CRA noted that the **secondary suite** would be a **separate housing unit** for PRE purposes. Even if it is part of the same structure or lot as the main home, **only one unit** could be **designated** as the **principal residence** each year. Since the suite must be rented to a **non-family** member to qualify for the program, it would **not typically** be **inhabited by the homeowner**, so it would likely not qualify for the PRE. However, the main residence could still qualify if it meets the usual requirements.

In the context of the **MHRTC**, CRA indicated that a taxpayer who constructs a secondary unit that is a self-contained housing unit eligible for the MHRTC would **generally** be considered to have **two separate housing units**. However, where the **second unit** is used for **personal purposes** and the taxpayer can demonstrate that the **two units are being used together** and functioning as a **single unit**, it may be possible to treat the property as a single unit **eligible for the PRE**. The determination of whether there are two self-contained housing units would be fact-dependent, as discussed above. Key factors would include the extent of the integration between the units and whether they share legal titles, mailing addresses, entrance doors and utility accounts.

ACTION: Adding a secondary unit to a home may trigger a taxable disposition or limit the principal residence exemption. Assess tax implications before starting renovations.

Sale of Real Estate: Income or Capital Gain?

A July 19, 2024 **Court of Quebec** case considered whether the **sale of a house** in 2016 was on account of **capital or income**. The taxpayer had purchased the property during a temporary marital separation but later reconciled and sold the property within six months at a profit.

The property was sold before the federal property flipping rules took effect on January 1, 2023. Under the property flipping rules, sales within a year of acquisition are treated on account of income, unless an exception applies. Sales over a year or where an exception applies, may be on account of capital or income based on the factors discussed below.

Taxpayer loses

The Court provided multiple reasons for concluding that the taxpayer's **primary intent** in selling the property was to **make a profit**, thereby classifying the gain as **fully taxable income**.

First, the Court emphasized that the property was purchased significantly **below the municipal assessment** from an estate, without legal warranty, and was **promptly renovated and resold** within six months at a substantial profit. This quick turnover, coupled with extensive renovations, indicated a real estate flip rather than a long-term personal residence. Moreover, the property was **insured as vacant**, and the taxpayer **never changed her address** to reflect her asserted intention to move into the property.

Second, the **financial arrangements** and the **listing description** (at acquisition) suggested a **profit-oriented motive**. The taxpayer took out a mortgage without any penalties for early repayment, which **facilitated a short-term sale**. The property listing itself described the house as a **good opportunity for a "flip,"** signaling an expectation of resale for profit. These factors contradicted her assertion that she purchased the property primarily as a residence.

Third, the Court considered the **broader pattern** of the **taxpayer's behaviour**. It noted two **subsequent real estate transactions** in 2018 and 2019 where the taxpayer engaged in **similar transactions** (purchases, renovation and quick resales for significant profits). None of these properties were used as her residence. The frequency and similarity of these transactions demonstrated a pattern of business activity.

Additionally, the Court noted that the taxpayer's claim of marital difficulties influencing her decision to buy the property was contradicted by her husband's actions. Shortly after the couple supposedly reconciled and sold the property, her husband purchased another property under similar conditions, casting further doubt on the couple's stated reasons for these transactions.

Overall, the Court found these combined factors – purchase conditions, financial strategy, renovation and resale practices and a pattern of similar transactions – indicative of a **clear intent to profit**, thus justifying the **classification of business income**.

ACTION: Disposing of real estate may be fully taxable as income or partially taxable as a capital gain. If it is a capital gain, the principal residence exemption may be available. Consider what evidence you have, or could obtain, to support your filing position.