BUCHANAN BARRY LLP
CHARTERED PROFESSIONAL ACCOUNTANTS

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- **UNDERUSED HOUSING TAX — DEADLINE EXTENDED AGAIN**
- **CAPITAL GAINS OR INCOME?**
- **BUYING A TRUCK FOR YOUR BUSINESS NEAR YEAR-END?**
- **GST/HST — RISKS OF DEALING WITH A SHADY SUPPLIER**
- **AROUND THE COURTS**

UNDERUSED HOUSING TAX — DEADLINE EXTENDED AGAIN

We wrote in our April 2023 issue ("*Residential Property Warning — Huge Penalties!!*") about the dangers of the new Underused Housing Tax (UHT). We then wrote in June 2023 about the first filing deadline being extended.

If a home, condo or cottage is owned by a corporation, trust, partnership or non-resident, there may be filing obligations and a $5,000 or $10,000 penalty for not filing a UHT return. These filing obligations and penalties apply even if the home is rented out so that there is no tax to pay.

Legally, the first UHT returns were due April 30, 2023. However, the Canada Revenue Agency announced on March 27 (tinyurl.com/uht-extend) that no penalty or interest would be imposed as long as the first return was filed and any tax was paid by **October 31, 2023**.

Then, on that day — October 31 — the CRA announced a further extension. Owners that must file a return can file until **April 30, 2024** without penalty, provided they pay any UHT owing. See tinyurl.com/extend-uht.

So there is one final extension. If you think you (or a family member or corporation or partnership or trust you are involved with) may have a UHT filing obligation, and haven't yet filed, find out about it now and take action! The penalties for non-compliance are very serious, even if no tax is owing. Ignorance of the law is no excuse and will not protect you from penalties; and the CRA can quite easily find out who owns property from real estate registration records.

Note: This extended date is also likely to be the date for the 2023 UHT return. Therefore, there are two dates which must be considered – December 31, 2022, and December 31, 2023 – in terms of liability/obligation to file in relation to UHT. Also, therefore, if this deadline is missed, there may be double penalties.

For more on the UHT, see the CRA's web page at canada.ca/cra-uht.

CAPITAL GAINS OR INCOME?

Since capital gains are only half taxed, the distinction between *capital gains* and *income* is very important.

Capital property is property on which any gain is taxed as a capital gain. Only half of a capital gain is included in income in your tax return — the "taxable capital gain". Thus, the effect is that capital gains are taxed at half the rate of ordinary income such as interest or employment income.

Not all gains are capital gains. If you are in the business of buying and selling goods — for example, operating a retail store — then obviously your gains from the goods you sell are business profits, which are fully taxable, and not capital gains.

Some types of gains fall close to the line. The *Income Tax Act* defines the term "business" — the income from which is fully taxable — as

including an "adventure in the nature of trade". This phrase has been interpreted in hundreds of reported court cases.

If what you are doing is a "business" or an "adventure in the nature of trade", then your gain will be fully taxable as the sale of inventory. If it is not, then your gain will be only half taxed as a capital gain. On the flip side, *business losses* are fully deductible from income, while *capital losses* are only half-deductible, and normally only against taxable capital gains.

So how do you determine the difference between capital property and inventory?

Basically it comes down to intention. If you buy a property with the intention of selling it, then you are considered to be in business and the gain will be fully taxed as business profit.

Real Estate

The most difficult issues usually arise with respect to real estate. You might build a home to live in (capital), but also with plans to sell it (inventory). Your company might buy land on which to develop a shopping plaza to lease out (capital), or on which to develop a subdivision of new homes that you will sell (inventory).

The Canada Revenue Agency's Interpretation Bulletin IT-218R, "Profit, Capital Gains and Losses from the Sale of Real Estate", provides the Agency's views on whether the purchase and sale of real estate will be treated as leading to business profits or capital gains. Paragraph 3 of the Bulletin sets out twelve factors that the CRA considers relevant:

(a) the taxpayer's intention with respect to the real estate at the time of its purchase;

(b) feasibility of the taxpayer's intention;

(c) geographical location and zoned use of the real estate acquired;

(d) extent to which the intention was carried out by the taxpayer;

(e) evidence that the taxpayer's intention changed after purchase of the real estate;

(f) the nature of the business, profession, calling or trade of the taxpayer and associates;

(g) the extent to which borrowed money was used to finance the real estate acquisition and the terms of the financing, if any, arranged;

(h) the length of time throughout which the real estate was held by the taxpayer;

(i) the existence of persons other than the taxpayer who share interests in the real estate;

(j) the nature of the occupation of the other persons referred to in (i) above as well as their stated intentions and courses of conduct;

(k) factors which motivated the sale of the real estate; and

(l) evidence that the taxpayer and/or associates had dealt extensively in real estate.

In determining your intention with respect to the property, the Courts have also developed the concept of a *"secondary intention"*. If you have an intention of using the property as capital property, but a secondary intention of selling it if the main intention does not pan out, then the property may be considered to be inventory and the gain fully taxable. The CRA's Interpretation Bulletin IT-459 discusses this issue. Of course, just about everyone will sell their property if the right offer comes along, so the secondary intention has to be something more than just a willingness to sell if the price is right. There is often no clear dividing line, but the Federal Court of Appeal said in the 2008 *Canada Safeway* case that for

there to be a secondary intention, it "must have been an operating motivation in the acquisition of the property".

Principal Residence

The prospect of treating your principal residence (your home) as capital property is always attractive. Even better than the regular "half tax" treatment given to capital gains, the gain on a principal residence is normally completely exempt from tax.

However, if you are in the *construction business*, or if you change homes often, watch out! Many small home builders have tried building a home, moving in, then selling it and moving on to another home, repeating the process a few times. If you do this, the CRA will determine that you do not have an exempt capital gain after all. Instead, you are treating each home as *"inventory"* — even though you lived in it — and you will be fully taxed on the gain as business profit. And if you haven't kept all of your receipts for the costs of construction, you might have a hard time proving that your profit was less than the CRA claims it was!

To make matters worse, if this happens you will also be required to pay GST or HST on the *entire value* of the new home, including the land, as of the date you moved in. As well, unless you have kept receipts showing GST/HST paid on construction costs, your offsetting input tax credits will likely be denied. Quite a number of small home builders have taken such assessments to the Tax Court of Canada and have lost, on both the GST and the principal residence issues.

Note that real estate transfer records are permanent and easily available to CRA auditors once they start looking, and in many cases there will be no statute of limitations — e.g. because your return had a misrepresentation attributable to "carelessness or neglect", or you didn't file a GST return.

The CRA has been known to go after builders even 10, 15 or 20 years after the fact and assess them for tax, GST or HST, penalties and vast amounts of interest that has accrued over the years. If you are in this situation, consider making a Voluntary Disclosure before the CRA comes calling.

Note also that if you sell residential property after owning it for less than 365 days, then under new rules that took effect January 2023, the property is deemed to be inventory and not capital, unless you can show that the sale was due to one of various listed events, such as marriage, divorce, having a baby or being fired from a job. (This rule doesn't change the law very much, as CRA auditors would generally consider such a quick sale to be inventory anyway.)

Shares

When it comes to shares of corporations and other securities, such as bonds and mutual fund units, the CRA generally accepts that most people hold such securities as capital property, even where the shares are junior stocks that are unlikely to pay a dividend any time soon. However, if you trade very actively, buying and selling shares on a regular basis and holding them for only short periods, you might be found to be in business, so that your gains would be fully taxed. (If you have losses, this will be to your advantage.)

You can avoid this situation, with respect to shares in Canadian companies, by filing a "Canadian securities election" (subsection 39(4) of the *Income Tax Act*), on Form T123, with your tax return. Once you make this election, all Canadian securities you hold are deemed to be capital property, **forever**. (In other words, if you have losses from very active trading in a later year, those losses will be capital losses that have limited use, rather than business losses that you can deduct against other income.)

Note that the Canadian securities election does not apply to all Canadian shares. There is an exclusion for "prescribed shares", listed in section 6200 of the *Income Tax Regulations*. These include:

- private corporation shares whose value is primarily attributable to real property or resource property;
- debt to a person or corporation with whom you do not (or did not) deal at arm's length;
- shares or debt acquired from a person with whom you did not deal at arm's length (this would include shares you inherited from a deceased family member);
- exploration and development shares; and
- shares or debt substituted for any of the above.

The election is also not available to a "trader or dealer" in securities.

Lots of rules to be careful about!

BUYING A TRUCK FOR YOUR BUSINESS NEAR YEAR-END?

If you buy a pick-up truck, van or similar light truck for your business, you do not want it classified as an "automobile" or "passenger vehicle" for income tax purposes. If it is, there are certain tax costs, such as the "standby charge", applying to your personal use of the vehicle, and a cost limit of $36,000 in 2023 (before sales taxes) for purposes of claiming capital cost allowance. (For an electric vehicle, the cost limit this year is $61,000.)

To avoid it being an "automobile", you generally must be able to show that your vehicle meets one of the following conditions:

(i) it is a van, pick-up truck or similar vehicle; *and* it has seating for not more than the driver and two passengers; *and* you used it in the taxation year in which it was acquired or leased "primarily" (more than 50%) for transporting goods or equipment in the course of your business; or

(ii) it is a van, pick-up truck or similar vehicle; *and* you used it in the taxation year in which it was acquired or leased "substantially all" for transporting goods, equipment or passengers in the course of your business (CRA considers that "substantially all" means 90% or more); or

(iii) it is a pick-up truck that you used in the taxation year in which it was acquired or leased "primarily" (more than 50%) for transporting goods or equipment in the course of your business in a remote location that is at least 30 kilometers from the nearest urban area with a population of 40,000 or more.

All of these conditions refer to the extent to which you used the vehicle in the taxation year in which the vehicle is acquired or leased. This creates a trap. Suppose you buy a pick-up truck on December 30, so that you can start claiming capital cost allowance this year. But it's holiday time, and you don't start using the truck until January. The truck will not be able to meet the "use" test, and you will be stuck with the negative effects of having what the Income Tax Act calls an "automobile" — for the entire period that you own the truck.

This is exactly what happened in the case of *Olson v. The Queen*, 2007 TCC 508. The Tax Court of Canada described the result as "harsh" but had no choice in finding against the taxpayer: the "automobile" rules applied to the truck in question.

GST/HST — RISKS OF DEALING WITH A SHADY SUPPLIER

If your business purchases goods or services from other businesses, and you think some of them may not be complying with their tax obligations, there is a serious risk that you need to address. The risk is primarily in the GST/HST area.

This comes up in everything from construction services, agencies that supply temporary personnel, garment work, scrap metal sales, building cleaning services, and many other areas.

Surprisingly, the risk is primarily where the supplier charges you GST/HST. If it does not charge you GST or HST that you should be paying, your risk is far lower, because the worst that can happen is that you have to pay the GST or HST down the road and will normally be able to claim an offsetting input tax credit at that time.

Background

Assuming your business makes "taxable supplies" for GST/HST purposes, you are normally entitled to input tax credits (ITCs) to recover all GST or HST you pay on purchases.

However, as you probably know, these ITCs are available only if the supplier provides you with an invoice or receipt that meets detailed documentation requirements. Those requirements normally include the supplier's name and GST/HST registration number, the price paid, a "description of the supply sufficient to identify it", the amount of GST or HST, the date, the purchaser's name, the terms of payment and certain other details. (See GST/HST Memorandum 8-4.)

These documentation requirements are mandatory; if they are not met, you cannot claim the ITCs to recover the tax you have paid to your supplier.

You can check online that a supplier's GST/HST registration number is valid, using the CRA's "GST/HST Registry". See tinyURL.com/gst-registry.

The problem

The Canada Revenue Agency has been dealing for many years with the problem of companies that bill GST or HST for goods or services, collect the money and then disappear. Quite apart from not paying corporate income tax on their profits, these companies are literally stealing the sales taxes, which they collect on behalf of the government and are supposed to hold in trust for the government.

This problem has also shown up in Quebec, where Revenu Québec (RQ) administers the GST together with the Quebec Sales Tax.

Innocent businesses are denied ITCs

In recent years, the CRA and RQ have aggressively pursued businesses that have dealt with these unscrupulous companies. Not being able to find the thieves, the auditors instead go after the businesses that *purchased* these suppliers' goods and services and have denied the ITCs that those innocent businesses have claimed.

Both the CRA and RQ actually had a lot of success in the Courts when the innocent businesses have appealed.

Despite the fact that a business has no legal obligation to "police" its suppliers to ensure that they remit GST/HST they have collected, the Courts have found ways to make innocent businesses responsible.

One way that the government and the Courts have nailed the innocent businesses is by ruling that the invoice was not from the "real" supplier. Even though the invoice was from a numbered company that was properly GST-registered

(and you checked the online GST/HST Registry), and otherwise met the documentation requirements, the Courts have ruled in some of these cases that the supplier named on the invoice was not the "real" supplier, and thus the documentation requirements were not met.

How can a business protect itself from this risk?

It is of course preferable to deal only with reputable and established suppliers, so this problem will not come up. However, you might not know whether or not a particular supplier is going to disappear without complying with its tax obligations, and for practical reasons you may not always be able to choose your suppliers.

One way to address this problem is to take steps to document that the business named on the invoice you pay is the same legal entity that you are dealing with and is properly registered with the CRA (or RQ) for GST/HST (and, in Quebec, for QST).

(1) To check that a supplier is GST/HST-registered: For any new supplier, go to tinyurl.com/gst-registry, before you pay them any GST/HST, and enter their name and the GST/HST registration number they give you. The online registry will tell you if the person is indeed registered under that name as of the current date. (You have to get the full name exactly right as it is registered, so you may need to check with the supplier as to precisely how its name is recorded on the CRA's database.)

(2) For identity:

- If the invoice is in a personal name, get a copy of the person's driver's license or other government-issued photo ID, and check that it's the same name as the GST/HST registration on the registry you checked in (1) above, and that it's the name that appears on the invoice you are paying.

- If it's a company name, especially if it's a numbered company, the only way you can ensure that the entity identified on the invoice is the one you're actually contracting with is to ask the supplier for documentation that shows who the directors of the company are (this information is also available online from the provincial government); and check the identity of the person you're dealing with as being a director of the company, by getting a copy of their driver's license or other photo ID. Ideally, you also want a contract or bill of sale showing that you're contracting with the company because a director is signing on its behalf. This will provide a paper trail that shows you really are contracting with this particular company, and even if they disappear without remitting the HST, the CRA or RQ wouldn't be able to say this person wasn't the real supplier but was using a false invoice name provided by the real supplier.

Of course, every business will have to determine whether it's worth going through these procedures, or whether the risk of suppliers being tax-thieves is low enough that these steps are not worth the cost and effort. But for those seriously at risk of being reassessed to have substantial ITCs denied, these steps can prove to be a lifesaver.

AROUND THE COURTS

Do you realize what giving CRA your email address means?

Many taxpayers do not realize what happens if they give CRA their email address.

If you include your email address on your tax return, or provide it to CRA when you are online, then you are telling CRA that they can send you notices by uploading them to your online CRA account and sending you an email to tell you that there is a message waiting for you.

These rules are now built into the Income Tax Act (subsection 244(14.1)). As long as you have authorized the CRA to provide notices electronically, the CRA can do so, and you are considered to have received the notice even if you never went online to read it, and even if you never saw the email telling you that there was a notice waiting for you. What some taxpayers don't realize is that providing CRA with your email address constitutes "authorizing" the CRA to give you notices this way, because there will be text on the screen, or on the form, that says this.

The recent case of *DiPierdomenico v. The King*, 2023 TCC 146, is a good example of what can happen. Mr. DiPierdomenico, who was a Canada Post mail carrier, enrolled in the CRA's "My Account" system as many taxpayers do, and in the process he authorized electronic communications to him — likely without realizing what this meant.

The CRA sent Mr. DiPierdomenico Notices of Assessment for his 2015 and 2016 tax years in December 2020 and January 2021. They did this by uploading the Notices to his My Account, and then sending him email to tell him that he should check his My Account. He apparently did not receive the email messages, and never checked his My Account. In time, the 90-day period for filing a Notice of Objection expired; and then the one-year possible extension period for an extension of time also expired. By the time Mr. DiPierdomenico applied to the Tax Court for relief, it was too late.

The Tax Court ruled that Mr. DiPierdomenico could not appeal his assessments, because he had not filed a Notice of Objection in time. The fact he had not actually received the Notices of Assessment did not matter.

So be warned: if the CRA has your email address, check your My Account monthly. And if you have a business account, such as for GST/HST or for a corporation you own, check your My Business Account monthly. Make sure you have a reminder system in place for these, so you don't forget. Otherwise, even if the CRA makes a mistake and assesses you an amount that shouldn't have been assessed, you will lose all your rights of appeal.

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