

Quarterly Newsletter

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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 **luxury tax** affecting new vehicles and aircraft retailing for more than \$100,000 and new boats over \$250,000 has been rescheduled to commence on **September 1, 2022**.
- The Office of the Auditor General of Canada noted that **\$3.7 billion of overpaid COVID-19 benefits** had been identified.
- The program that has offered **purchase incentives** of up to **\$5,000 for zero-emission vehicles** since 2019 is proposed to be **extended** until **March 2025**, and **eligibility** would be **broadened** to include other vehicle models, including more vans, trucks and SUVs.
- For 2018 and 2019, the **CRA audit hit rate** (percentage of audits resulting in an audit adjustment) was close to **60%**.

Buying and Selling a Home: Budget 2022 Proposals

The 2022 Federal Budget included several **proposals** that would significantly **change the taxation environment** when **buying and selling a home**. Broadly, the government proposed various incentives for first-time buyers and extended family units in addition to bright-line tests/restrictions for those purchasing homes for profit (e.g. home flippers). Taxpayers should consider how the changes will affect their intended purchases and sales. In some cases, it may be beneficial to expedite a purchase or sale, while in others, it may be prudent to delay.

New possibilities and enhanced programs include the following:

- **Home accessibility tax credit** – The annual expense limit would be **doubled to \$20,000** such that the maximum non-refundable tax credit would be \$3,000, proposed to be **effective for 2022** and subsequent taxation years. This credit applies to enduring and integral home renovations in respect of a taxpayer, or a relative who is (or will be) living with the taxpayer, that is either a senior or eligible for the disability tax credit. The renovation must enable the individual to **gain access to the home**, be **more mobile** or **functional** in the home, or **reduce the risk of harm** within, or in gaining access to, the home.

- **Home buyers' tax credit** – The amount would be **doubled** such that eligible first-time home buyers could access **tax relief of \$1,500**, proposed to be **effective** for acquisitions of a qualifying home on or after January 1, 2022.
- **Tax-free first home savings account** – A new **registered account** would allow for **tax-deductible contributions** of up to \$8,000 annually and up to \$40,000 in total; **withdrawals** from the plan (including income earned in the plan) to purchase a first home would **not be taxable**. This initiative is expected to become available in 2023.
- **Multigenerational home renovation tax credit** – A **new tax credit** would provide relief on up to **\$50,000** of eligible **expenses to construct a secondary suite** for a **senior or person with a disability** to live with a relative. This initiative is expected to become available in 2023.

New cautions and restrictions include the following:

- **Residential property flipping rule** – A new rule would be introduced to deem **all gains** arising from the disposition of a **residential property** (including rental property) that was **owned for less than 12 months** to be **business income**, other than any disposition for which an **exception** would apply (such as where a death or addition to the family necessitates a move). Sales on homes owned for 12 months or more would follow the traditional rules. This means that such sales could still be classified as fully taxable business income and not be eligible for the principal residence exemption. This measure would apply to residential properties sold on or after January 1, 2023.
- **Foreign buyer property ban** – **Foreign commercial enterprises and people** who are not Canadian citizens or permanent residents would be **prohibited** from acquiring **non-recreational residential property** in Canada for **two years**. This would not apply to refugees and people authorized to come to Canada while fleeing international crises, certain international students on the path to permanent residency or individuals on work permits residing in Canada.
- **GST/HST on assignment sales by individuals** – All **assignment sales** in respect of newly constructed or substantially renovated residential housing would be **taxable** for **GST/HST** purposes.

In addition to the above tax measures, Budget 2022 proposed to develop and implement a **Home Buyers' Bill of Rights** and national plan to end blind bidding. This Bill of Rights could also include items such as ensuring a legal right to a home inspection and ensuring transparency on the history of sales prices on title searches.

ACTION: Consider the expected timing of implementation for each of these measures and the impacts on purchases or sales.

Principal Residence Exemption: CRA Project

In early 2022, **CRA** began to send out **education letters** in respect of individuals claiming the **principal residence exemption (PRE)** in the British Columbia region. Often, regional projects such as this are used as pilots for subsequent national projects. As CRA has indicated that they have a larger overall focus on real estate transactions, similar or extended versions of the project may be coming.

The letters advised that the taxpayer or their representative **review the return** and adjust it if necessary. The letters also stated that an agent would follow up with a **phone call** to answer any questions.

There appears to be **multiple versions of the letters**, with multiple triggers. For example, one version noted that it was sent because the taxpayer **claimed the PRE for two different properties over two years** (2018 and 2019, potentially reviewing whether business income was being generated from flipping activities). Another version was sent because the taxpayer claimed the **PRE** and **also reported a reduction in gross rental revenue** (presumably looking at whether the residence was actually a rental property).

ACTION: If such communications are received, a tax advisor should be promptly advised. Letters that appear strictly educational can turn into costly audits. Inappropriate and untimely responses may lead to adverse assessments in addition to penalty and interest charges.

CERB/CRB: Eligibility Verification

Over the last year, CRA has **increased verification activity** in respect of eligibility for the Canada Emergency Response Benefit (CERB) and the Canada Recovery Benefit (CRB). As a result, a number of disputes have hit the judicial system. One of the focus areas has been the prior earnings test. To be eligible for either **CERB** or **CRB**, an individual must have **earned at least \$5,000 of income** from certain sources (such as employment, self-employment or parental benefits) in **2019** or in the **12-month period** preceding the day on which the application was made (or in **2020** for CRB claims made in 2021).

Acceptable evidence to substantiate a claim can include the following:

- for self-employed individuals or subcontractors, detailed **invoices** for services rendered, which include the **date** of the service, **who the service was for** and the **applicant's or company's name**;

- documentation for **receipt of payment** for the service provided, e.g. statement of account or bill of sale showing payment and the remaining balance owed;
- documentation showing income was earned from **carrying on a “trade or business”** as a sole proprietor, an independent contractor or some form of partnership;
- **contracts**;
- a list of **expenses** to support the net result of earnings;
- proof of **advertising**; and
- any **other documentation** substantiating \$5,000 in self-employment income.

Where an individual is **denied benefits**, they can request a **second-level review** from CRA. If this is still not successful, the taxpayer’s only recourse is to apply to the Federal Court for a **judicial review** of CRA’s decision.

In the cases below, the courts found that CRA’s decision to deny benefits was reasonable. In one case, the court stated that the above list of acceptable proof to substantiate a claim is not an exhaustive list and that CRA may ask for further support. Specifically, the Canada Recovery Benefits Act states that “an applicant must provide the Minister with **any information** that the Minister **may require** in respect of the application.”

Case #1

The taxpayer claimed to have earned **\$5,250** from **tutoring activities in January and February 2020**; however, he ceased operations shortly after due to COVID-19 and applied for **CERB**. No business income was reported in 2019. The taxpayer tried to prove his earnings of **\$5,250** by providing **invoices for tutoring** on which the word “**paid**” was stamped. The CRA agent was **unable to match the names and addresses** on the **invoices** to those on **CRA’s computer systems**. Also, the taxpayer could not support that the amounts were paid; the taxpayer argued that the amounts were **paid in cash** and **never deposited** into his **bank account**. The Court ruled that the taxpayer did **not** provide **sufficient support** to demonstrate that he actually earned the amounts.

Case #2

In a similar case, the taxpayer was **unsuccessful** in supporting her alleged earnings of **\$5,350** in the **twelve-month period prior to application** regarding **home services** (cleaning, food preparation, washing dishes, etc.). The taxpayer did **not** provide **invoices** for the alleged earnings or **bank statements** showing the deposits, both of which the **agent stated** would be needed to verify the prior period income. The Court agreed with CRA that a taxpayer’s **notice of assessment** including the relevant income was **insufficient** to substantiate that the prior period earning requirement had been met.

ACTION: Where eligibility for these supports is at risk, make sure that documentation is retained which demonstrates both the performance of an income-earning activity and also the receipt of funds.

Estimated Sales by CRA: Audit File Selection and Assessment

In an attempt to identify unreported revenue, CRA and Revenu Québec may compare a business’ reported revenue to what would be expected given the business’ level of purchases. The analysis is based on industry-specific profit and revenue ratios.

In a January 31, 2022 French **Court of Quebec** case, Revenu Québec had assessed QST on **additional income** for a pizzeria by applying **industry revenue ratios** to **purchases made by** the restaurant between 2013 and 2017.

The restaurant argued that it **purchased supplies** not only for itself but also as an **agent for other restaurants** so that better deals could be maintained. Further, it argued that it **did not have the capacity** to generate the level of gross revenue that Revenu Québec assessed based on its available resources.

Taxpayer loses

While the taxpayer argued that it did not have sufficient staffing capacity to generate the assessed level of revenues, evidence was presented that indicated that **not all staffing hours were recorded** and reported. Further, one of the parties for whom the taxpayer allegedly purchased supplies **contradicted the taxpayer’s position**. As such, the Court found Revenu Québec’s estimated **assessment of gross revenues correct**.

Another case

In another case, Revenu Québec noted that the sales records for a used car dealership indicated prices as low as \$25. Therefore, the auditors took a **sample of 15 sales** and followed up with **calls to the customers**, finding that several **had paid** prices that were **significantly higher than those reported** on the sales records. The **values** of all vehicles sold were then redetermined primarily by using the values included in a regionally recognized **auto price/valuation publication** (Hebdo Mag guide). The Court upheld Revenu Québec’s assessment.

ACTION: CRA and Revenu Québec often use these and similar techniques to estimate underreported sales. Consider establishing similar tests and metrics to ensure that your revenue is accurately recorded.

Auditing Old Tax Returns: CRA Abilities and Limitations

CRA may reassess the tax returns for CCPCs and individuals within **three years** from the **sending of the notice of assessment**. Returns for which this three year period have expired are commonly referred to as being “statute-barred.” However, CRA may reassess a return beyond this period in certain cases, such as where:

- a **waiver of the normal time limits** has been timely filed, or
- the taxpayer has made a **misrepresentation** attributable to **neglect, carelessness, or willful default** or has committed **fraud** in filing the return or in supplying any relevant information.

Although there are restrictions on when a **(re)assessment** can be made, these **limits do not apply** to the **periods that CRA may audit**. In other words, while a taxpayer may believe that they cannot be assessed for periods beyond three years, CRA still **has the ability to analyze those prior years** and ask for information, as long as it is reasonable. Likewise, although taxpayers are only generally required to retain support for six years after last being applicable, CRA can still **request older documents**. If the older documents are available, they **must be provided**.

In a January 10, 2022 **Federal Court** case, the Court addressed an application for **judicial review** of CRA's decision to expand its **audit** of the taxpayer and his professional corporation to encompass the **2003 to 2018 taxation years**.

The audit, which was initially limited to the 2010 to 2016 tax years, was prompted by **information obtained from Citibank and the Royal Bank of Canada** under an **unnamed persons' requirement** for information on transactions involving the **Cayman National Bank**. The information identified **funds entering Canada**, including **bank drafts to car dealerships** for vehicle purchases. CRA's initial review identified a **Cayman Islands corporation** ("COG") in which the taxpayer and a number of other Canadians, also screened for audit, were involved.

Taxpayer loses

The Court noted the following:

- the taxpayer was **involved** in COG from its **incorporation** in 1996, eventually becoming its **president and sole shareholder**, but had **never declared** any offshore income;
- while it was true that **records** are generally only **required to be retained for six years**, COG's **general ledger** for the 2003 to 2018 tax years was known to be on a **USB key**, so the records were known to exist and were **accessible**;
- the taxpayer's **long association** with COG **justified** CRA's requirement for **accounting information** for that entity; and
- the **documents and other information** sought were **sufficiently detailed** in CRA's correspondence.

CRA's **requests** were held to be **reasonable**, so the application for judicial review was dismissed.

ACTION: Review document retention and destruction policies to ensure that they align with CRA guidance and the applicable law. CRA may review filings for years even though they appear to be statute-barred.

Money Received from Abroad: CRA Reviews

As of 2015, financial institutions must **report electronic fund transfers (EFT) into Canada of \$10,000 or more** not only to FINTRAC but also to **CRA**. Where two or more EFTs of less than \$10,000 each are made within 24 consecutive hours by or on behalf of the same individual or entity, and the total is \$10,000 or more, they are considered to be a single transaction and must be reported. CRA may use this data to **identify and audit taxpayers**, with the goal of **reassessing the receipts as taxable business income**.

In a December 14, 2021 French **Court of Quebec** case, a married couple had received **funds from China** totalling just over \$600,000 from 2009 to 2011. The taxpayers owned a small restaurant in Montreal. Revenu Québec took the position that, since they could **not verify where the funds came from** and why, the funds were **undeclared income**. The taxpayers argued that they were **gifts and loans** from family members in China.

Taxpayers win

Although the taxpayers were **not able to obtain banking records** from China supporting their argument, they were able to have the **parties in China corroborate** their representations via video conference. The Court determined that this was sufficient to transfer the burden of proof to Revenu Québec, who was not able to demonstrate that the funds were undeclared income. Therefore, the funds received were **determined to be non-taxable**.

ACTION: Often, support beyond the taxpayer testimony is required to demonstrate that funds received from offshore accounts are not taxable. Recipients of such funds should obtain and retain support demonstrating what the funds were for and who they were from.

Digital Adoption Program: Grants, Loans and Professional Assistance

On March 3, 2022, the Canada Digital Adoption Program (CDAP) was **launched and opened for application**. This **\$4 billion program** provides funding through two initiatives.

Grow Your Business Online Initiative

This initiative provides **\$2,400 micro-grants** and access to **e-commerce advisors** to help applicants **adopt digital technology**. Grants can cover costs such as **website development, search engine optimization, subscription fees for e-commerce platforms and social media advertising**. To be eligible, businesses must be **for-profit** (including for-profit social enterprises and co-operatives), be registered or incorporated, have **at least one employee**, commit to **maintaining a digital adoption strategy for six months** after participation and partake in post-program surveys, share information with the government

(e.g. Statistics Canada) and allow the **business' name** to be **published** as a recipient of funding. Corporate chains, franchises or registered charities, representatives of multi-level marketing companies and real estate brokerages are ineligible.

Boost Your Business Technology Initiative

This initiative provides Canadian-owned small and medium-sized enterprises grants to **develop a digital plan** and leverage funded work placements to help applicants with their digital transformation. The grant can cover **up to 90%** (to a maximum of \$15,000) of the cost of **developing a digital adoption plan**. Businesses can also apply for an **interest-free loan of up to \$100,000** from the Business Development Bank of Canada. Eligible businesses must be a Canadian **sole proprietor** or **corporation**, be a **for-profit** privately owned business, have between 1 and 499 full-time **employees** and have had an **annual revenue of at least \$500,000** in one of the three previous tax years.

Applicants will also need to complete a **digital needs assessment** that will generate a report outlining the applicant's **digital maturity** and **compare** it to an **industry-specific benchmark**. Once the assessment is completed, applicants can **select a digital advisor** from those registered with CDAP and determine the specific terms of work and cost for the **digital application plan**. Once the advisor has completed the digital application plan, it can be submitted for grant payment. **Organizations** that meet specific criteria to **deliver digital advisory services** can **register with CDAP** to provide these services to eligible applicants.

ACTION: Review eligibility for these supports to help with digital commerce and apply as soon as possible.