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3 tax changes in the fiscal update you may have missed

Jamie Golombek: Changes may affect you if you own real estate or have a privately owned business

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The federal government announced that starting Jan. 1, 2024, it will deny income tax deductions for expenses incurred to earn short-term rental income. PHOTO BY PETER J. THOMPSON/FINANCIAL POST

This week's fall economic statement had very little in the way of tax measures, but there were a few items that may affect you if you own real estate or are considering the succession of your privately owned business.

Short-term rentals

In an attempt to curb investment in certain residential real estate properties, which some say has led to an increase in the cost of housing in some markets, the federal government announced that starting Jan. 1, 2024, it will deny income tax deductions for expenses incurred to earn short-term rental income, including mortgage interest expenses. This new rule will only apply, however, in provinces and municipalities that have prohibited short-term rentals.

The government also announced it will deny income tax deductions when short-term rental operators are non-compliant with the applicable provincial or municipal licensing, permitting or registration requirements when it comes to their rental properties.

The government's thinking is that real estate owners will be encouraged to return those properties to the long-term housing market if they are denied the ability to deduct short-term rental expenses.

It cites an example of a Quebec investor, whom we'll call Jacinthe, who owns three condo units in downtown Montreal, but does not live in any of them. Instead, she rents them out year-round on a digital short-term rental platform such as Airbnb or Vrbo. The condos are in an area of the city that only permits the occasional short-term rental of a primary residence, but she still lists the condos as short-term rentals.

Jacinthe charges an average rent of $250 per night and makes a total of about $120,000 per year from renting the three condos to tourists on vacation in Montreal. Her annual expenses, including mortgage interest, cable and internet, property insurance, condo fees, property taxes and capital cost allowance (tax depreciation), total about $120,000, which means that she currently doesn't pay any tax on her short-term rental income. She also hopes to benefit from an increase in value of the three properties over time.

Starting in 2024, Jacinthe will no longer be allowed to deduct the $120,000 of expenses because her condos are not properly registered or licensed by either the city of Montreal or the Quebec government.

As a result, if Jacinthe was already in the top federal tax bracket of 33 per cent, she would have to pay an additional $40,000 in federal tax per year, which the government hopes "could be a strong incentive to stop using these properties as short-term rentals and return them to the long-term housing market."

Underused housing tax (UHT)

The government in 2021 announced a national, annual one per cent tax on the value of Canadian residential real estate owned by non-residents and considered to be vacant or "underused," effective Jan. 1, 2022. This tax is called the underused housing tax (UHT).

Under the rules, each individual who, as of Dec. 31 of a calendar year, is an "owner" of a residential property in Canada, other than an "excluded owner," is required to file a UHT return for the calendar year for the property. If an owner of a residential property is a corporation,

partnership or trust, the owner must file an annual UHT return for the property even if no tax is owing due to the fact that the corporation, trust or partnership is substantially or entirely Canadian-owned.

This was seen as a major hassle by property owners who were required to file essentially "NIL" returns simply by virtue of the ownership of property in a Canadian private company via a partnership, or in a trust. This was a time-consuming and costly endeavour, and viewed as a waste of time since the property was effectively 100 per cent Canadian-owned, so the UHT simply should not apply.

In this week's economic statement, the government announced it was dropping this tedious filing requirement for most Canadian corporations, partnerships and trusts, making them excluded owners for UHT purposes.

The first deadline for filing the inaugural UHT returns (for the 2022 calendar year) was supposed to be April 30, 2023, but in late March 2023, after much lobbying by real estate owners (along with their accountants and lawyers), the Canada Revenue Agency announced it would waive penalties and interest provided the 2022 UHT returns were filed by Oct. 31, 2023, effectively extending the deadline by six months.

At the final hour on Oct. 31, the CRA further announced this transitional filing relief would be extended by another six months, giving owners until April 30, 2024, to file their 2022 UHT returns. This week's fiscal update confirmed that UHT returns for 2023 will also need to be filed by this April 30, 2024, deadline to avoid penalties and interest.

The government also announced it is lowering the penalties for not filing the UHT return by the deadline. Under the current rules, the minimum penalty for an individual who fails to file a UHT return on time is $5,000 per failure. The government proposed to reduce this minimum penalty to $1,000 for individuals.

Employee ownership trusts

An employee ownership trust (EOT) is a form of employee ownership where a trust holds shares of a corporation for the benefit of the corporation's employees. EOTs can be used to facilitate the purchase of a business by its employees, without requiring them to directly pay to acquire shares. For business owners, an EOT provides an additional option for succession planning. The United States and United Kingdom each have measures supporting employee ownership arrangements.

The 2023 federal budget announced amendments to the Income Tax Act to permit EOTs in Canada starting next year. To make EOTs more attractive, this week's economic statement proposed to exempt the first $10 million in capital gains realized on the sale of a business to an EOT, subject to certain conditions. This incentive would be in effect for the 2024, 2025 and 2026 tax years.