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## Crackdown on Unlawful Short-Term Rentals

The federal Government's *Fall Economic Statement*, presented on November 21, 2023, included proposals to address the impact of the booming short-term rental market on the supply of long-term housing in Canada. According to the federal Government,

In Montréal, Toronto, and Vancouver alone, there were an estimated 18,900 homes being used as short-term rental properties in 2020 — a number that has almost surely increased in

recent years. These are not spare bedrooms in someone's home — they are entire houses and apartments that are being used for tourists to rent — in many cases, only for a few days a week.<sup>1</sup>

To mitigate the impact of short-term rentals on the housing supply, the provinces of Québec and British Columbia, and the cities of Toronto, Montréal, and Vancouver, have taken steps to ban or regulate accommodation sharing.

Accommodation sharing entails:

... renting part or all of a property, typically for a short period. It can include your primary or secondary residence. It also includes any rentals facilitated by a third party website or application. Common accommodation sharing platforms include AirBnB, CanadaStays, FlipKey and VRBO.<sup>2</sup>

All income received from an accommodation-sharing arrangement is subject to income tax. This can be in the form of rental income from a property or self-employment business income. Rental income is reported on the operator's income tax and benefit return and on Form T776, *Statement of Real Estate Rentals*. Self-employment business income is also reported on the operator's income tax and benefit return, along with Form T2125, *Statement of Business or Professional Activities*.

In most situations, if the operator rents a space out and provides only basic services, the CRA views this revenue as rental income from property.<sup>3</sup> From rental income, the operator

<sup>1</sup> [www.budget.canada.ca/fes-eea/2023/report-rapport/FES-EEA-2023-en.pdf](http://www.budget.canada.ca/fes-eea/2023/report-rapport/FES-EEA-2023-en.pdf).

<sup>2</sup> [www.canada.ca/en/revenue-agency/programs/about-canada-revenue-agency-cra/compliance/platform-economy/sharing-economy.html](http://www.canada.ca/en/revenue-agency/programs/about-canada-revenue-agency-cra/compliance/platform-economy/sharing-economy.html).

<sup>3</sup> However, the more services provided by the operator (such as meals, security, cleaning), the more likely it is that the CRA will consider the revenue to be self-employment business income. For more information about whether rental income comes from a property or business, see Interpretation Bulletin IT-434, *Rental of Real Property by Individual*, and Interpretation Bulletin IT-434SR, *Rental of Real Property by Individual*.

can deduct any reasonable expenses incurred to earn that income. The following is a list of expenses that may be deductible from rental income:

- Advertising, including advertising in Canadian newspapers and on Canadian television and radio stations, and any amount paid as a finder's fee;
- Insurance;
- Interest and bank charges;
- Office expenses, which includes small items such as pens, stationery, and stamps, but not capital expenditures to acquire capital property, or items like calculators, filing cabinets, chairs, and a desk (these are capital items);
- Professional fees, including legal and accounting fees, but not legal fees to buy the rental property;
- Management and administration fees, including amounts paid or payable to agents for collecting rents or finding new tenants;
- Repairs and maintenance, including the cost of labour and materials for minor repairs or maintenance, but owners cannot deduct the value of their own labour or costs incurred for repairs that are capital in nature;
- Salaries, wages, and benefits, including amounts paid or payable to superintendents, maintenance personnel, and others employed to take care of the rental property (owners cannot deduct the value of their own services);
- Property taxes;
- Travel expenses incurred to collect rents, supervise repairs, and manage the proper-

ties (but not board and lodging, which are personal expenses);

- Utilities, such as gas, oil, electricity, water, and cable;
- Motor vehicle expenses;
- Other rental expenses; and
- Prepaid expenses, which can be legal retainers, advertising costs, and insurance.<sup>4</sup>

If only part of the operator's property is rented, such as a room in a residence, only the expenses that relate to the rented part of the property can be deducted.

In the *Fall Economic Statement*, the Canadian government announced new measures to address the shortage of long-term housing by removing the tax benefits from short-term rental activities in certain situations:

- ... [T]he federal government intends to deny income tax deductions for expenses incurred to earn short-term rental income, including interest expenses, in provinces and municipalities that have prohibited short-term rentals.
- ... [T]he federal government intends to deny income tax deductions when short-term rental operators are not compliant with the applicable provincial or municipal licensing, permitting, or registration requirements.<sup>5</sup>

The *Legislative Proposals Relating to the Income Tax Act* released in December 2023 includes draft amendments to the *Income Tax Act* to implement these measures.<sup>6</sup>

<sup>4</sup> [www.canada.ca/en/revenue-agency/services/tax/businesses/topics/rental-income/completing-form-t776-statement-real-estate-rentals/rental-expenses-you-deduct.html](http://www.canada.ca/en/revenue-agency/services/tax/businesses/topics/rental-income/completing-form-t776-statement-real-estate-rentals/rental-expenses-you-deduct.html)

<sup>5</sup> [www.budget.canada.ca/fes-eea/2023/report-rapport/FES-EEA-2023-en.pdf](http://www.budget.canada.ca/fes-eea/2023/report-rapport/FES-EEA-2023-en.pdf).

<sup>6</sup> [fin.canada.ca/drleg-apl/2023/ita-lir-1223-l-eng.pdf](http://fin.canada.ca/drleg-apl/2023/ita-lir-1223-l-eng.pdf).

According to the *Explanatory Notes to Legislative Proposals Relating to the Income Tax Act* released in January, the new rules operate as follows:

In calculating the income of a taxpayer from a business or property, the *Income Tax Act* generally permits the deduction of reasonable expenses incurred in the ordinary course of earning that income. New subsection 67.7(2) prohibits the deduction of any amount for an outlay or expense in respect of a short-term rental to the extent that it is a “non-compliant amount”.<sup>7</sup>

A “non-compliant amount” is determined by multiplying the total outlays and expenses incurred related to a residential property’s use as a short-term rental in the taxation year by this fraction:

$$\frac{\text{Number of days in the taxation year the property is a non-compliant short-term rental}}{\text{Number of days in the taxation year the property is a short-term rental}}$$

A residential property is “... all or any part of a house, apartment, condominium unit, cottage, mobile home, trailer, houseboat or other property, the use of which is permitted for residential purposes under the applicable laws of the province or municipality in which the residential property is located.”<sup>8</sup> A short-term rental is defined as a residential property offered for rent for a period of less than 90 consecutive days.

These rules — which took effect January 1, 2024 — eliminate the option to deduct expenses from short-term rental income in jurisdictions where the practice is carried out unlawfully.

The Government hopes this will incentivize operators to return their properties to the long-term housing market. The *Fall Economic Statement* also pledged \$50 million over three years, starting in 2024–2025, to support the municipal enforcement of restrictions on short-term rentals.

The *Fall Economic Statement* provided the following example of the proposed tax measures’ effects on an operator:

An investor who is resident in Quebec owns three condos in downtown Montréal, but does not live in these condos; instead they rent them out, year-round, on a digital short-term rental platform. They know their condos are located in an area of Montréal that only permits the occasional short-term rental of a primary residence, but still decide to go ahead with listing the condos as short-term rentals. They charge about \$250 per night and make about \$120,000 per year in income from renting the three condos to tourists.

The investor’s expenses on the condos—mortgage interest, cable and internet bills, property insurance, condo fees, property taxes, and capital cost allowance—are about \$120,000, which means they don’t pay any tax on the \$120,000 in short-term rental income coming in. And they expect the value of the condos will grow significantly over time. Meanwhile, three families in Montréal are prevented from renting these condos.

As a result of a crackdown on short-term rentals announced in the 2023 Fall Economic Statement, the investor would no longer

<sup>7</sup> [fin.canada.ca/drleg-apl/2023/ita-lir-1223-n-eng.html#a31](https://fin.canada.ca/drleg-apl/2023/ita-lir-1223-n-eng.html#a31).

<sup>8</sup> [fin.canada.ca/drleg-apl/2023/ita-lir-1223-n-eng.html#a31](https://fin.canada.ca/drleg-apl/2023/ita-lir-1223-n-eng.html#a31).

be permitted to deduct the \$120,000 of expenses because they are not properly registered or licensed by the Ville de Montréal or the Government of Quebec. Moving forward, they would have to pay tax on the \$120,000 in short-term rental revenue, which would cost about \$33,100 in additional federal tax per year. The increase in tax payable would provide a strong incentive to stop using these properties as short-term rentals and return them to the long-term housing market.

There is some transitional relief for taxpayers — temporary “deemed compliance”. A short-term rental is deemed not to be a non-compliant rental for the 2024 taxation year if the rental complies with all short-term rental registration, licensing, or permit requirements on December 31, 2024.

The Explanatory Notes include two examples of the deemed compliance rule:

This rule would apply where, for example, an individual operates a short-term rental

throughout 2024 in a jurisdiction that requires registration. The individual only obtains the proper registration in December 2024. This rule would deem the short-term rental not to be a non-compliant short-term rental throughout 2024 since the proper registration was in place on December 31, 2024. Accordingly, subsection [67.7](2) would not apply to deny any expenses in 2024 in respect of the short-term rental.

As another example, assume a corporation has a June 30th year-end. The corporation obtains the proper registration as of October 1, 2024 (and the registration remains in place as of December 31, 2024). The short-term rental would be deemed not to be a non-compliant short-term rental throughout the corporation’s taxation year ending on June 30th, 2024. However, it would still be a non-compliant short-term rental for the portion of the corporation’s 2025 taxation year prior to it obtaining the proper registration (i.e., from July to September 2024).