TAX FOR THE Owner-Manager

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When Does the Operation of a Rental Property Become a Business?

In *McInnes v. The Queen* (2014 TCC 247, informal procedure), the issue in dispute was whether certain income from a cottage was business income or rental property income, and consequently whether losses incurred from earning such income were subject to the restriction in the Income Tax Regulations that prevents capital cost allowance (CCA) on a rental property from creating or increasing a rental loss.

On May 14, 2004, the appellant purchased a cottage in Quebec that she intended to operate as a tourist accommodation business. Among other things, the appellant registered the property with the local regional tourist association; created a website for the property; and offered a number of services, including cable-connected televisions, DVD and CD players, wi-fi service, long-distance telephone service, heating, electricity, a fully furnished kitchen, laundry facilities, all bedding, and bath amenities. Housekeeping services were made available to customers on request; however, such services usually were not requested. The appellant did not provide any meal preparation services because the property was not a bed and breakfast. The appellant was responsible for property maintenance, including landscaping and snow removal. She employed one person who prepared the cottage for occupancy, welcomed the guests when they arrived, and ensured that the cottage was secure when the guests departed.

The cottage was rented out for short stays, but the main tenant was the Domaine Forget, an international classical music academy. The Domaine had rented the property from mid-June to the end of August for the previous nine years, but it did not use most of the services available from the appellant.

Unfortunately, the appellant never made a profit and ran significant recurrent losses from year to year. When filing her income tax returns, she reported business losses in respect of her 2008 to 2010 taxation years. The minister reassessed those years, disallowing CCA on the basis that there was no net rental income from the property.

Subsection 20(1) of the Act provides a deduction for CCA. However, regulation 1100(11) limits the CCA claim so that a loss cannot be created in respect of the renting of a rental property.

Under regulation 1100(14), "rental property" is defined to mean "a building owned by the taxpayer . . . if, in the [relevant] taxation year . . . , the property was used by the taxpayer . . . for the purpose of gaining or producing gross revenue that is rent." Under regulation 1100(14.1), for the purposes of regulation 1100(14), "gross revenue derived in a taxation year from . . . the right of a person or partnership, other than the owner of a property, to use or occupy the property or a part thereof, and . . . services offered to a person or partnership that are ancillary to the use or occupation by the person or partnership of the property or the part thereof shall be considered to be rent derived in that year from the property."

Regulation 1100(14.2) further provides that regulation 1100(14.1) does not apply in any particular taxation year to "property owned by . . . an individual, where the property is used in a business carried on in the year by the individual in which he is personally active on a continuous basis throughout that portion of the year during which the business is ordinarily carried on."

These definitions interact in a complex way. Simply put, however, the regulations restrict losses derived from a "rental property," which is defined to mean a "property [that] was used principally for the purpose of gaining or producing gross revenue that is rent," and the definition of "rent" is modified so as to not be deemed to include gross revenue from a property owned by a taxpayer "used in a business carried on in the year by the individual in which he is personally active."

In order to determine whether the restriction relating to rental losses was applicable, the TCC had to determine whether the income in question was income from a business. It conducted a detailed review of the relevant case law going back to 1965 and scholarly writings on the topic. The cases included *Wertman v. MNR* (64 DTC 5158 (Ex. Ct.)); *Canadian Marconi v. R* (1986 CanLII 42 (SCC)); *Jong v. The Queen* (1998 CanLII 294 (TCC)); *Orcheson v. The Queen* (2004 TCC 427); and *Venditti v. The Queen* (2008 TCC 553).

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Masse J noted the comment of Margeson J in *Jong*:

> [A] *prima facie* case is made out that the amount received from the property was from rental and not from a business unless the Appellant can show that the range of services provided by the landlord was such that the payment received can be regarded as substantial payment for the services.

Of particular relevance were the cases of *Orcheson* and *Venditti*, which the court considered very similar to the case at bar. *Orcheson* dealt with the rental of three cottages in Ontario. The tenants of the cottages were provided with a small number of amenities (firewood, a boat, a canoe, fresh linen, and certain other amenities) and with certain services, including snow removal, a cleaned yard, and boat launching and docking. *Venditti* dealt with the rental of a Florida condo. The owner provided certain amenities including toiletries, furnishings, linen, and a heated pool. In both *Venditti* and *Orcheson*, the TCC found that the income in question was income in the nature of rent.

In Masse J's view, the question was essentially one of classification. He stated that the "higher the level of services supplied by the taxpayer, the likelier it is that the taxpayer operates a business; the lower the level of services, the likelier it is that the income is from the use of a property." However, he noted that, in general, individuals who own buildings have been found by the courts to be earning income from property. He acknowledged that there is no bright-line test, and he concluded that the question is one of degree. Unless the appellant was able to show that the range of services that she provided was such that the payment she received could be considered to be paid largely in respect of those services, the court would have to conclude that the income in question was income from a property.

The court reviewed the services provided by the appellant and noted that she did not provide personal hygiene products or a restaurant or bar service; that the tenants rarely used the housekeeping services; and that the main tenant, the Domaine, did not want many of the additional services that were offered. On the basis of the foregoing, the court concluded that it had not been established that a substantial part of the rent received by the appellant constituted payment for services rendered by her; consequently, the income in question was income from a property. The court further concluded that the property was used by the appellant for the purpose of gaining or producing gross revenue—that is, rent. The court therefore dismissed the appeal.

McInnes, which was decided under the informal procedure rules and has no precedential value, does not break new ground. Nevertheless, it provides a good review of the law on the issue and serves as a helpful reminder of the factors that influence when income from a rental property ceases to be regarded as rent and is instead viewed as income from services.

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