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# TaxWatch Canada LLP

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## What You Need to Know About Successful Allowable Business Investment Loss (ABIL) Claims

*Find Out if You Qualify for a Refund*



### Includes:

- ✓ Qualifying for an ABIL
- ✓ Eight Common Situations That Can Trigger a Successful ABIL Claim
- ✓ Critical Factors for a Successful Claim

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This document is not meant to be professional advice or specific instructions for tax planning or compliance. Seek professional advice whenever possible, including second opinions.

## INTRODUCTION

If you lost money investing or loaning money to a Small Business Corporation (*including your own business*) you may be able to recover some of that loss as a tax refund.

Canadian tax laws are purposefully designed to reduce the risk of loss of investments or loans to small business corporations. This type of loss is called an Allowable Business Investment Loss (ABIL) which is a special type of capital loss.

It is important to note that ABILs are deductible against all other personal income in certain applicable tax years. Provided Canada Revenue Agency (CRA) has the proper proof and documentation of your loss and proper filing procedures are followed, the actual cash or tax saved could be 15% to 21% of the unrecovered amount invested or loaned depending on your marginal income tax rates. Occasionally, claims have already been made for a portion of losses by others. Corporations cannot deduct ABIL claims for losses regarding loans to other corporations.

### Important Notes:

- A Small Business Corporation = a Canadian Controlled Private Corporation that uses all or substantially all of its assets in operating an active business in Canada. Usually the business has to have been active for a year but alternative compliance procedures may apply.
- Also, it is important to initiate the ABIL claim as soon as possible after the corporation ceases active business operations.

## WHAT IS AN ABIL?

An Allowable Business Investment Loss is a claim (deduction from income) on your tax return that allows an investor or lender in a Canadian Controlled Private Corporation (CCPC) to claim 50% of a "business investment loss". If a CCPC is essentially insolvent, not carrying on business, or is expected to close down, then the taxpayer can be deemed to have suffered a loss, i.e. unrecovered investment or loan if elections are filed.

## HOW DOES AN ABIL WORK?

Half of the actual losses (including certain personal costs forced on shareholders such as paying for GST/HST or payroll deductions and guarantees) are deductible against all other personal income in certain applicable tax years. Although most claims will be in the immediate preceding year or may possibly be established for the current year, many claims can apply up to three years back and forward 10 years. Insufficient documentation, if you do not make an effort to get the money back, loans to a family member's company (you need to prove there was a business purpose in mind), will encourage CRA to deny a claim. In other words, where proper documentation is in place and qualifying factors are met, a successful result is more likely. The final piece is evaluating the best outcome (refund) based on types and levels of income.

### New Development:

If you are not a shareholder and did not charge interest on the loan (not necessarily receive it), it will be difficult to prove that you had intention to earn income from the loan. The loss claim could be denied for this reason. However, if you are a shareholder, loans to the company do not have to bear interest because your expectation of income is from dividends.

## DO YOU QUALIFY FOR AN ABIL?

In order to qualify for an ABIL and a potential tax refund, several factors are involved. Follow the checklist below; ensuring each of the following criteria applies to your situation.

### THE 4 QUALIFIERS

- Your loss was an investment or loan (shares or debt) to a private Canadian Corporation i.e. not listed on any publicly traded market;
- The private Canadian Corporation must be majority owned by Canadian residents;
- The business conducted by the small business corporation must be from a location in Canada **and** must be so called 'active income' (*real estate rentals or portfolio investment firm is not active income*). Holding companies may be eligible in certain circumstances; and
- Unless you are a shareholder in the company that you loaned funds to, interest has to be charged (not necessarily paid) on the loan. Documenting intentions to earn interest income can be discussed. Intention is an important determination of a successful ABIL claim.

### **Important Notes:**

- **All four** qualifiers above must apply in order to claim the ABIL.
- **The funds invested can either be personal or corporate funds.** A reference to 'you' or 'personal' means either you personally or funds of your corporation. Losses within registered funds such as RSP, RRSP, RIFF, LIRA etc. are not eligible.

### **WHAT'S NEXT?**

If your situation meets all four of the previous qualifiers, you are one step closer to a potentially successful ABIL claim. Our experience has shown us that further to meeting the previous criteria, each taxpayer's situation is unique and therefore there could be other factors to determining the success of an ABIL claim. Below is a list of what we have found to be the most common situations for successful ABIL claims. If **any** of the situations below seem even remotely applicable, you may qualify for substantial tax refunds or tax reductions.

### **EIGHT COMMON SITUATIONS FOR SUCCESSFUL ABIL CLAIMS**

- 1. If you bought shares in or loaned money to a CCPC** (Canadian Controlled Private Corporation) and the corporation became insolvent and did not pay you back or you sold the shares for less than you paid for them.
- 2. You invested directly in another person's small business corporation** (either as a shareholder, lender, partner, or joint venture participant) that failed outright or probably cannot repay the investment or loan in full when it becomes due.
- 3. You own or co-own a company (corporation)** that is struggling financially or has become inactive and there is a low probability of ever recovering personal funds of yours or others who have invested or loaned funds to it. Remember that an inactive company can potentially be eligible for a loss claim because it has become insolvent; it is not necessary for it to enter in official bankruptcy or dissolution proceedings.
- 4. You were the victim of a scam or fraudulent business activity** involving either real or phony business activities of a corporation resident in Canada. The business must have been active for one year.

**5. You guaranteed a loan to a small business** and were compelled to pay the company creditors personally. It has been settled by case law that it is helpful, but not necessary, to charge a guarantee fee to maintain eligibility for such a loss. *Charles A. Brown v. The Queen, FCTD, No T-2712-91(96 DTC 6091); Byram v. The Queen, 95 DTC 5069* Subsection 39(12) of the Act, deems amounts owing by the corporation to the taxpayer honouring the guarantee to be debt owing to the taxpayer by a small business corporation.

**6. You invested in an investment club** and the club lost investments related to a Canadian Corporation.

**7. Your corporation is in the business of trading in speculative securities in large volumes.** In *Robert G. Crompton and Lenora Crompton v. The Queen, 96 DTC 1703*, it was found that "the fact the gains and losses had been reported on capital account was not sufficient to justify the conclusion that its transactions were on capital account or that there was no active business. E Ltd., was therefore, a small business corporation...and the taxpayer was entitled to the allowable business investment loss".

**8. You were personally assessed by CRA for the company's withholding taxes** (payroll taxes, GST/HST) you paid and your company was unable to pay you back for its tax obligations.

**Note:** You can also be assessed by CRA for unpaid corporate income taxes if you withdrew corporate funds personally (such as loans or dividends) that could have been used to pay the corporate tax debt.

## CRITICAL FACTORS

### ► Is the Loss Acceptable to CRA?

It is the current circumstance of default (the lack of likelihood of recovery) that is a crucial determining factor in whether a loss occurred or not. Convincing CRA that you indeed did not recover the amount you are claiming, is important. Items that will be reviewed by CRA include corporate tax filings, documentation available to prove the original investment, tax treatment of other co-owners or lenders, and so on. This is standard procedure.

### ► The CCPC Must Take the Loss into Income

The claiming of a personal loss related to a corporation usually requires the corporation to take

the loss claim into income. However, there are usually unused losses in the corporation which are applied to this deemed corporate income. TaxWatch reviews the personal loss claim effect on the insolvent corporation's tax position as well.

### ► **Timing is Crucial**

The precise year(s) that the loss is claimed is important. The higher your tax rate the higher your refund will be.

### ► **Fees are Deductible**

Fees paid to a professional firm such as TaxWatch are tax deductible if the service involves tax appeals - which TaxWatch provides.

### ► **The 150% Difference**

Each tax dollar retrieved or saved is the same as having to earn at least 150% of any tax refund produced. For example - to end up with \$100 after tax, you must earn \$150 and then usually pay at least 33% tax. That is why retrieving tax is so worthwhile.

### ► **ABIL Claims Can Fail**

Loss claims submitted to CRA without proper representation fail because of lack of tax law knowledge and insight into the importance of proper procedures and documents required by the CRA.

## **HOW DO I CLAIM AN ABIL?**

If your situation met the four qualifiers and any of the previous situations seem even remotely applicable, you have a good chance at a successful ABIL claim.

You have several choices for filing the claim:

- On your own
- Through your current accountant
- Through TaxWatch Canada's specialized ABIL Tax Refund Service. We are very experienced in this area and our service is quite affordable.

## ABIL TAX REFUND SERVICE

Here is what our turnkey service offers:

- Working with you to get the information and documentation needed.
- Engaging with or communicating with CRA on your behalf starting with the initial loss claim submission and documenting your loss claim for response to CRA inquiries or questionnaires.
- Evaluating the best filing position based on types, levels and timing of income that produces the best outcome (refund) for you.

We believe that valuing professional services based on billable hours expended on a client's file does not provide the best value to clients in these loss claim situations. TaxWatch charges a **flat fee** for its services ranging from preparing the initial loss claim, to the notice of objection if the loss is initially denied. In fact, for these types of services involving CRA, a 'billable hours' process usually becomes too costly in several ways, most notably:

- It reduces the client's control and predictability over professional fees. Unanticipated challenges from any quarter may complicate your file and render your budgeted professional fees meaningless. Sooner or later, the client will face the difficult decision to either continue (and incur even higher fees with no increased certainty of intended outcome) or abandon the work because costs incurred to complete the task may outweigh or reduce the intended benefits.
- It discourages clients (because of the billable hours potential cost) who otherwise want to claim losses because of the costs.
- Clients understand that we have a practice that is motivated based on successful outcomes for clients; the manner in which we believe every business should be conducted.
- We do not enter into engagements that we do not think have potential for succeeding as discussed with our clients.

**GET STARTED NOW**

**Contact us for a free evaluation:**  
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**or**

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