
TaxWatch Canada LLP

Special Tax Research by TaxWatch Canada LLP

PERSONAL VS. BUSINESS EXPENSES

Insight to ensure you are achieving maximum tax savings

Some thoughts regarding the distinction between business and personal expenses:

Section 18(1)(h) of the Income Tax Act disallows deductions for personal or living expenses incurred by the taxpayer other than those incurred away from home in the course of business.

If there is a personal use portion of the business? Is there a reasonable expectation of the activity originally?

Must be able to link the expense to the source of income to be a legitimate deduction.

The Courts, in determining deductibility and their costs, have used different valuation methods for separating personal from business expenses.

- Reasonableness
- Allocation based on time
- ITA (in particular section 67.1)
- Frequency

It is important to be consistent with respect to deducting expenses. Be mindful that expenses must also be reasonable with respect to deductibility.

Must ask yourself "Was the expense incurred for gaining or producing income from a business or property?"

Often times, personal expenses are both personal and business in nature. Would the need exist apart from the business? Some examples of business expenses that include a personal element:

- Auto expenses, Home office expenses, travel, clothing, vacations

The need to document the separation in use for personal and business purposes is crucial in determining deductibility.

It is important from a valuation perspective, as to the PURPOSE of acquiring an asset originally. Allocation methods are different for assets acquired for personal use and are used for business activity, as opposed to an asset acquired for business purposes and used personally. Reference Income Tax Act Section 9(1), 18(1)(a), 18(1)(h), 67, 248(1)

Quotes from tax court judges for perspective (CRA has the upper hand because the burden of proof is on the taxpayer):

As in other areas of law where purpose or intention behind actions is to be ascertained, it must not be supposed that in responding to this question, courts will be guided only by a taxpayer's statements, ex post facto or otherwise, as to the subjective purpose of a particular expenditure. Courts will, instead, look for objective manifestations of purpose, and purpose is ultimately a question of fact to be decided with due regard for all of the circumstances. For these reasons, it is not possible to set forth a fixed list of circumstances which will tend to prove objectively an income gaining or producing purpose.

That there may be appropriate company business expenses that are not acceptable as income tax business expenses, the latter being of a higher standard. What the taxpayer considers a legitimate business expense may not be sufficiently connected to the generation of taxable income to constitute an income tax deduction.

This report is a much-abridged version of a tax research report produced by TaxWatch Canada. We are dedicated to assisting small business, individuals, professionals and corporations maximize their tax savings to make a difference in their lives.

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