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U.S. and Canadian Personal Returns,
HST, Corporate Returns,
Voluntary Disclosure Program and
CRA Audits and Appeals

BULLETIN

RE: NEW CRA AUTO LOGBOOK RULES

1. INTRODUCTION

In October of 2010, the Minister of National Revenue announced that as of January 1, 2009, self-employed taxpayers and anyone claiming a car expense MUST keep a hand-written automobile logbook prepared by the CRA. This determines the allowable "business proportion" of driving claimable in "Chart A - Motor Vehicle Expenses" in your self-employed T2125 "Statement of Business or Professional Activities" filed in your annual personal T1 tax return. Both the vehicle and home-office expense deductions are based on a "usage test". That is, for vehicles used in business you may deduct only the percentage used for business purposes while for the home-office expense you may deduct only the portion of your home used for business on EITHER a square footage approach or on a room-by-room approach not counting bathrooms - - whichever is more favorable - - of the area of the home which is used exclusively for business. This bulletin will allow agents to claim a high proportion of vehicle expenses such as 90% and higher without the Canada Revenue Agency (CRA) Audit Division being able to reduce the figure on audit. If you provide receipts for all vehicle expenses, the CRA will not be able to reduce your vehicle expense by even one penny.

The CRA requires that you must maintain an auto logbook for one year to get a "base" business percentage and then in subsequent years you need only log any 3 consecutive months and claim the business percentage in that 3-month period. The problem is that a real estate agent would need to put in about 150 to 175 hours or more to log all business and personal car trips for a year using the approved manual logbook provided by the CRA. At 12 trips a day, there would be 4320 entries to complete. The CRA hopes that 99% of agents will abandon the manual logging after a few weeks. The CRA will allow a maximum of only 75% business usage and as low as 50% for those not keeping a logbook. (See reasons below) The solution is to buy and use a GPS-based computerized system which has been approved by the CRA and will reduce the time required to 10 to 15 hours in a year while also tracking business dinners and events and gift purchases.

START LOGGING YOUR DRIVING BY FEBRUARY 1, 2013 OR MARCH 1, 2013 TO GET A 'BASE YEAR' TO JANUARY 31, 2014 OR FEBRUARY 28, 2014 RESPECTIVELY. IF YOU START FEBRUARY 1, 2013, YOU CAN USE THE BEST 3-MONTH PERIOD FROM FEBRUARY THROUGH MAY 2014 - 4 MONTHS - AND MARCH THROUGH MAY IF YOU START MARCH 1, 2013. YOU WILL GET 91%, 92% UP TO THE 95% RANGE AS THESE ARE THE BUSIEST MONTHS IN REAL ESTATE. YOU CAN USE ANY 3-MONTH PERIOD IN THE SECOND YEAR AND THEREAFTER.

2. BACKGROUND

CRA auditors use a punitive approach on self-employed real estate agents and target to disallow 30-40% of all expenses on an audit. They will reduce the business proportion of driving by 20-35% if no auto logbook is provided and you will pay an extra \$2,000 to \$3,000 more in taxes plus interest and the loss of a proportionate amount of HST input-Tax-Credits - - HST spent. Our firm claims 90% business driving for full-time agents and 95% if the agent has gross commissions over \$100,000. Only 1 or 2 of our 700 agents get audited each year as they do not want to deal with our 3 lawyers on staff. The CRA will audit a large proportion of agents who use an accountant for their taxes. Our agents get the 90% to 95% which we claim. With the computerized logbook you will get 90%

plus business usage each year which the CRA will be unable to reduce on audit. Be aggressive in claiming your vehicle deductions and you are 'bullet-proof' on an audit. A computerized system will 'lock in' a percentage of business driving.

It is important to clarify several issues to get 90% to 95% business driving even if you are audited.

1. The CRA is legally wrong in disallowing driving to-and-from the broker's office as personal driving. Real estate agents WERE on employee status until going self-employed in the late 1980s. Section 8 of the Income Tax Act (ITA) governs employee expenses and treats driving to-and-from your employer's place of business as personal in nature. As "independent contractors", agents are now governed by S. 18 (1) of the ITA which allows the deduction of any self-employed expense "incurred for the purpose of earning or producing income". There is no employee relationship but one of an agent licensed under a broker. Once TREB required agents to subscribe for the MLS system and agents set it up at home, their home became their "primary place of business" as set out under S. 18 (12) (a) (i) of the ITA. On a "usage" basis, agents access the MLS system at home, have their computer(s) and office equipment and furniture at home, book appointments there, draft "Agreements of Purchase and Sale" at home, keep their business records at home, book all of their appointments from home, arrange advertising and promotion at home, do their banking at home, etc. Agents are NOT required to meet clients in their home as their home qualifies as their "primary place of business" under the "usage test". Agents benefit in 2 ways. They have an absolute right to claim the home-office expense and business driving commences as soon as they leave their driveway including any trips to and from the broker. This is true even for agents who have segregated space at their brokers so long as they perform most of their tasks as an agent at home as discussed. Our firm has never lost the home-office expense in an audit in the last 25 years.

2. Claiming a home-office deduction does not jeopardize the Principal Residence Exemption (PRE) on the sale of your home. So long as the home is used "primarily" - - read 51% of the finished floor-space - - for personal usage, you are fully exempt from taxation on any gain on the sale of your home under the Principal Residence Exemption. Renting out the basement and claiming a home-office expense are treated as "incidental business usage" to the primary purpose of personal usage so long as at least 51% of your home is used for personal usage. You then are fully tax-free on sale and can claim the PRE.

3. You can deduct more than one vehicle if you can justify it on a business basis. If your spouse is on payroll as an executive assistant as required by law, you can claim that spouse's car expenses in your return which can give savings, depending on your tax bracket, of 43.1% or 46.4% versus 20.05% for the spouse. So, you deduct both cars in your return. If you have a luxury car used to get listings and an 'average' car for the majority of your driving, you can deduct the business proportion for each if you can justify the need for 2 cars. If you drive the luxury car only 3,200 kms. in a year but 2880 kms. are for business driving, then you get 90% deductibility - the usage test. Claim 90% to 95% on the less expensive car. We advise high-earning clients in this situation to keep meticulous records on the luxury car. Easy to do since so little driving.

4. The last point is a caution. All audits are referred to as a process of "sufficiency of receipts and vouchers" which means you lose expenses if they are not adequately documented as to the nature of the expense, amount, proof of payment and NAMES for gifts, gift certificates, business dinners and events and dates and addresses for expenses on open houses. You must keep your credit card "chit" as monthly credit card statements alone will NOT be deemed as sufficient to support an expense. As a general rule, the more paper you keep, the better.

The CRA is currently auditing the 2010 and 2009 T1 personal tax returns - - referred to as the "current year and 1-year back". With a 3-year limitation on re-assessing a return from the date of original assessment, they focus on the 2 most recent years to avoid missing the 3-year deadline for issuing a reassessment. Around 2008, the Canada Revenue Agency (CRA) set up Real Estate Audit Teams in all of their Taxation Service Offices to audit real estate sales agents. This was the result of a perception by the CRA that real estate salespersons claiming an unreasonably high proportion of vehicle driving and excessive amounts for business dinners, events and gifts and are notorious for keeping bad records - - otherwise, easy targets.

There used to be a dispute in the case law as to whether taxpayers were required to maintain a car logbook. The Justice of the Federal Tax Court in the case of *Qureshi v. The Minister of National Revenue* said: "Neither was it necessary to keep any kind of mileage log or any records to show how much the appellant's automobiles were used. In fact, this Court would distort the real object of Section 230 of the Income Tax Act by imposing such a burden on the appellant." (Our Emphasis) [NOTE: Section 230 is the record-keeping provision of the Income Tax Act and requires that you keep business records for 6 years.] CRA auditors responded by citing the *Watt* case where the Justice of the FTC said that the taxpayer could have "easily" kept track of his business driving. The new logbook requirement makes recent court decisions irrelevant and CRA auditors will use a punitive approach and adopt a 'cap' of 75% business driving for those without a logbook and allow less for lower earners.

3. CRA AUTOMOBILE LOGBOOK RULES

The CRA has a circular on its website entitled "Motor Vehicle Records" which sets out the new rules and they are, actually, quite simple. The first rules for 12 months of driving is referred to as a "full logbook":

1. Logbooks must be kept for "passenger vehicles" which is defined as a vehicle carrying up to 8 passengers.
2. You must keep a "full logbook" for a period of one year to determine a "base" proportion of business use.
3. Each trip must include a) the date; b) the departure and destination addresses; c) the purpose of the trip; and d) the exact distance driven to the tenth of a kilometer. This requires a date, a street address from which you depart, an arrival address, an entry for the odometer reading at the start and end of a trip, the distance driven PLUS an explanation as to the purpose of the trip. A nightmare.
4. You must do an odometer reading at the beginning and end of each 1-year or 3-month period.
5. Record the dates and odometer readings if you change vehicles.

The "full logbook" will give a 'base year' percentage. Any subsequent 3-month logging must be within 10 percentage points of the full year 'base' percentage. A "simplified logbook" in any subsequent year requires you to log only for any 3-month period which you choose. Pick the quarter February through April OR March through May as these busy periods will give the highest business proportion. You need not track your driving for the remaining 8 months of the year but can use the **Odotrack** computerized expense feature to record business dinners and events and gifts for that 8-month period. These latter expenses are the most commonly challenged on audit. To get the business proportion as set out in your "Detailed Vehicle Expense Schedule" you need to keep full and adequate receipts and vouchers for vehicle expenses and keep an automobile logbook to preserve a high proportion of business driving.

4. "THE TRAP"

It is clear that the CRA introduced the auto logbook requirement with the expectation that 99% of agents would not spend 200 hours a year making manual notes and the CRA has stated that a maximum of only 75% business driving would be allowed where no logbook is provided. This makes a difference of about \$2,000 a year or more in reassessed taxes with the corresponding HST amount reversed. Forgetting that we

live in a computerized world, what the CRA actually created is a situation where they will not be able to reduce the business proportion of driving at all - - "the trap".

Entrepreneurs in Laval, Quebec created a computerized program which complies with the new CRA rules. This system called the "Odotrack Automatic Mileage Logger" is arguably more reliable and accurate than a manual logbook. The "Odotrack" system uses a GPS unit linked to a main server. You are given a password for your account. Our firm researched products and found Odotrack to be the most reliable and user-friendly. Mount the GPS unit on the dash, enter the make, model and year of your car and the odometer reading and you are set. Having Odotrack is like having an executive assistant in the passenger seat of your car logging all of your driving and expense data.

You hit the button for business or personal driving. If you hit "business" it will treat all trips as business until you hit the "personal" button. The system will automatically enter the specific address of departure and arrival and exact distances driven. It is less subject to abuse than a manual logbook. The "Comment Section" requires entries but it has memory and will automatically enter the business purpose of a recognized address so you would enter for a listing: "Sales Listing - John and Joan Cameron". The comments will take a maximum of 4 to 5 minutes a day, e.g. for the condominium at 50 John Street, you would enter: "Unit 2301 - Agent Open House" - done. At the end of the year, you hit a button and it will give the exact business proportion for the year and print out the 100 pages or more of detailed usage if audited including all details in the "Expense Report" for dinners, events and gifts. You can then pick any 3-month consecutive period in the following years which gives you the highest business proportion. The GPS system is based on addresses. You should log driving and expenses. Enter the names of all restaurants, venues and stores along with the names of guests or recipients in the Comments section.

The advantages for tax preparers and lawyers are many:

- the business proportion of driving will be unchallengeable on audit;
- a lot of previously wasted time arguing for the business proportion of driving is avoided;
- if audited on 2009, 2010 or 2011, you can use current Odotrack data as 'representative' of driving habits and you might lose only 2-3% of your "base" year amount ;
- the most frequently challenged expenses of business dinners/events and gifts are documented;
- with much lower reassessments resulting, the CRA will be less likely to audit real estate agents;
- those with Odotrack could get only a ' cursory' audit with few disallowances;
- the CRA will focus on agents who do not use the Odotrack system;
- the professional fees for an audit and appeal will drop by over a third;
- firms will handle more audits for the more complex and expensive cases of tax evasion; and,
- these more complex cases are very lucrative and end up in Tax Court billed at the highest rate.

Within a few years, the majority of full-time agents SHOULD be using this computerized mileage tracking system as it is recognized as 'user-friendly' and indispensable. The CRA will dramatically reduce auditing agents if there are too few expenses disallowed. The Odotrack system is as important a development as Blackberries and I-Phones and any full-time agent who does not get the system is a fool. They will lose thousands of dollars a year in claiming deductions and if audited.

The Odotrack website is odotrack.ca. Research the system or call them at 1-877-755-3953 or 647-873-1223. Our firm has put a strong endorsement on our website. Your business proportion of driving will be 'bullet-proof' from a CRA attack. The CRA will not be able to knock a penny off your vehicle deduction. A kick in the stomach to the CRA. The cost is only \$34.95 per month, is fully deductible and you will recoup the 13% HST on the cost. If you follow the law as set out in this bulletin you will save several thousands of dollars a year in taxes and get very good results in the event of an audit.

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