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FISCALISTES

RENTAL MANAGEMENT AND TAXES

DEMYSTIFYING WHAT'S DEDUCTIBLE ON YOUR TAX RETURNS

When filing their annual tax returns, many rental property owners wonder what expenses can be deducted against their rental income. Most deductible expenses are of a "current" nature. However, some others, such as tax depreciation on the capital cost of the building, will be of a "capital" nature. This guide is a useful tool for determining which expenses can generally be deducted, and the nature of these expenses.

1. GENERAL CURRENT EXPENSES

- Advertising
- Property insurance
- Mortgage interest
  - The mortgage principal portion is never deductible.
- Office expenses
  - Purchase of leases;
  - Postage;
  - Stationery related to rental properties;
  - Etc.
- Professional fees
  - Accounting fees for rental income statement (also known as the "income statement");
  - Legal fees relating to rent collection;
  - Other fees incurred to earn rental income;
  - **Please note!** Fees paid for refinancing (referral fees, legal fees, survey fees, CMHC guarantee fees, etc.) can be deducted up to a maximum of 20% per year.
- Management fees, administrative costs
  - Fees paid to a property management company, for example;
  - **Please note!** Expenses that you consider to be personal time are not deductible against your rental income.
- MINOR repair and maintenance

- Annual expenses for pest control, housekeeping, etc.
- Expenses for work that does not increase the value of the building (painting, changing locks, etc.), but is necessary to maintain it. See section 3 for other repairs.

- **Salaries**

  - Salaries paid for building maintenance, for example.

- **Property and school taxes**

  - Municipal and school taxes paid for the year;
  - **Please note!** The transfer duties paid in the year of acquisition of the building increase its capital cost, and therefore cannot be deducted as a current expense for the year.

- **Utilities**

  - Electricity;
  - Heating (including propane);
  - Cable TV, if such expense is included in the lease;
  - Any other utilities you pay for according to the lease.

- **Car expenses**

  The rules differ depending on whether you have one or several rental properties.

  - **One building**

    If you own a building, and it is located in the area where you live, you can deduct:

    – Travel expenses (see below how to calculate travel expenses) incurred so that you can carry out some or all of the work yourself. Also note that your vehicle was to be used at the time to transport tools or materials for the repair work.

  - **Two or more buildings**

    Whether or not you own the buildings in the area where you live, you can deduct :

    – Travel expenses (see below for how to calculate travel expenses) for rent collection, rent management or on-site repair/construction supervision.

- **How to calculate your travel expenses**

  Travel expenses **should be prorated based on the number of kilometers driven in the year for business purposes, divided by the total number of kilometers driven in the same year**. Here are some examples of automobile expenses that can be deducted (on a prorated basis):

  - Fuel
  - Car insurance

- Licenses and registrations
- Maintenance
- Etc.
- **Please note!** You must keep a mileage log and retain your invoices to ensure compliance in the event of an audit by the tax authorities.

2. OCCASIONAL CURRENT EXPENSES (EXAMPLES, NON-EXHAUSTIVE LIST)

- **Training costs**
  - Reasonable training costs incurred to perfect your property management skills.
- **Lease cancellation fees**
  - You can deduct the payment made to a tenant for the cancellation of his or her lease on a pro rata basis according to the number of days not elapsed in the year and the number of days not elapsed under the lease.
- **Landscaping**
  - If more than 50% of your building is used for rental purposes.

    For example, if you have a duplex, live in one of the two units, and the divisions are equal, then you don't meet the over 50% test, as you are at 50% personal use.

3. CAPITAL EXPENSES

- **Purchase of assets**
  - Appliances and furniture included in the lease must be depreciated (deducted) according to a predetermined percentage;
  - A computer, for example, must also be depreciated according to a predetermined percentage;
  - Other assets acquired to earn rental income, under certain conditions.

- **Building**

  The capital cost of the building (not the portion that relates to the land) can be depreciated over several years (at a rate of 4%[1] per year)[2]. Please note that the following costs must be added to the cost of the building (on a pro rata basis to the portion attributable to the building):

  - Transfer duties;
  - Notarial fees associated with the initial deed of sale;
  - Certificate of location;
  - Building inspector's fees incurred prior to the purchase of the building;
  - Land survey or appraisal fees when incurred in connection with the purchase or sale (and not for refinancing purposes, for example);
  - Major renovations[3], for example :

    - Replacement of wooden windows with energy-efficient windows: this replacement increases the initial value of the building;
    - Adding a garage;
    - Etc.

Other expenses may be deducted in certain circumstances, subject to certain conditions. It is important to discuss the treatment of these expenses with your tax expert on an annual basis.

[1] There are specific rules that can modify the 4 % rate per year, notably during the building's construction/renovation period, or in the year of acquisition. We have therefore used this rate as a general guideline.

[2] The depreciation claimed over the years will, in most cases, be taxable upon sale of the building as "recaptured depreciation". This occurs when the selling price attributable to the building is greater than the balance to be depreciated.

[3] Substantial renovations are an expense that must be analyzed on a case-by-case basis to determine whether they are deductible in the year, or whether they must be capitalized.