



CESTNICK

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TAX MATTERS

## Home-based businesses can save you taxes if you do it right

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I love entrepreneurship. There's no end to the types of businesses that can be created. You could, for example, buy some chickens and then rent them out for children's parties or the like (check out [rentthechicken.com](http://rentthechicken.com)). Really. People pay for this stuff.

The advantage of a small business, even part-time, is that you can create extra income and open the door to meaningful tax deductions for things you may be paying for anyway. Part of your home and vehicle costs can provide tax savings, for example.

But a recent court case sheds light on what not to do when making extra money in a home-based or small business. Let me share the story.

### THE STORY

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From 2009 to 2013, a young man in Quebec, whom I will call KB, earned more than \$187,000 by selling electronics (mostly cameras, computers and other electronics) online – primarily

on eBay. KB became a "PowerSeller" on eBay. This is how the taxman first identified him for an audit.

Canada Revenue Agency and Revenu Québec can obtain information from online auction and similar sites to determine who the big sellers are, as I've [previously noted](#). Self-employed folks are often selected randomly for an audit after the taxman considers certain factors, such as the type of business and the type and amount of expenses claimed.

The problem? KB didn't report any of his business activity on his tax returns for 2009 through 2013. Normally, a tax year becomes statute-barred after three years from the date on your notice of assessment, which means that CRA generally can't go back and challenge those tax returns after that time. But where there's been misrepresentation or gross negligence, the taxman can reassess those tax returns no matter how long it's been since a return was filed and initially assessed.

It was Revenu Québec that first reassessed KB. KB didn't challenge the right of the tax department to reassess him despite the three-year statute barred period being over – since clearly, he had misrepresented his income.

The next problem was that KB did no accounting for his business at all. He had no supporting documents for his purchases because he often paid cash when he bought items on Kijiji, Les PAC and other sites to later sell on eBay. The taxman requested KB's bank accounts and PayPal account information to figure out how much income he might have failed to report. As for revenues, the taxman looked for deposits that went into the bank accounts and PayPal account and assumed that the deposits represented sales from his business.

The CRA and Revenu Québec have the right to assess a taxpayer based on reasonable assumptions about a taxpayer's income. The onus is then on the taxpayer to disprove an assessment. In the case *Kay v. Canada* (1994) T.C.J. No. 487, an associate chief justice said: "Failure to comply [with the requirement to provide evidence of income or expenses] will not, of itself, result in the dismissal of an appeal against a reassessment of liability to income tax. But it could interfere with an appellant's ability to discharge the burden of proof on him showing that, on a balance of probability, the reassessment is in error."

In the case of KB, he argued that Revenu Québec neglected to allow a deduction for the cost of goods sold and other operating expenses. In addition, there were certain deposits made into KB's bank account, which he argued were not sales revenues. One deposit was received from his brother as a repayment of a loan made to his brother earlier. KB's brother

had to make an appearance in court to testify to this fact.

The whole case was a mess because KB did not keep any records. In the end, the judge ruled that KB willfully neglected to report his business income and was subject not only to the taxes owing, but penalties for gross negligence.

## THE MORAL

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A home-based business can be a great way to earn extra income and save tax. But let KB's story be a reminder of these things:

- CRA is using sophisticated techniques to identify those who are selling items or services online. So, if you're making money online, make sure you're reporting your income.
- Make sure you keep good records of your income and expenses, otherwise you could find some of your expenses denied. Then you'll have to prove, on a balance of probabilities, that the taxman's assessment is wrong.
- The gross negligence penalties for willfully misrepresenting your income can be significant at the greater of \$100 and 50 per cent of the understated tax and/or the overstated credits related to the false statement or omission, plus interest from the date the taxes should have been paid.

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