



CESTNICK

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TAX MATTERS

## Deducting cottage costs may be legitimate, but not always

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Hey, just because a tax deduction sounds crazy doesn't mean that someone hasn't tried to claim it. And some have succeeded. Others – not so much. I've seen people successfully deduct the cost of beer, pet expenses, hair dye, body oil and even breast implants – but they're stories for another day.

Last week, I spoke with a man named Jeremy who owns a cottage and has wanted to deduct as many of the costs of maintaining the place as possible. He's partly succeeding. Let me share his story.

### The Approach

Jeremy is self-employed as a software developer. He spends a lot of time at his cottage between May and October. Since he works from home (and from the cottage in the summer) he has always claimed a deduction for a portion of his home office costs. Fair enough. He's entitled to claim the business portion of his utilities, internet fees, insurance, property taxes, mortgage interest, repairs and maintenance, and certain other costs for his home and cottage.

The business portion of these costs is calculated as the percentage of his home and cottage used for business purposes, based on square feet, and also prorated for the percentage of time each place is used for work.

But there's more here. Jeremy's cottage is on an island, accessible only by boat. So, he's been claiming a portion of his boating costs since he has to take the boat to the mainland to visit clients. He also has, on occasion, invited clients to his cottage and has taken them boating. What does the taxman think about deducting boat costs? The Canada Revenue Agency (CRA) is usually offended.

A technical interpretation (document 2013-0503581E5) issued a few years ago by the CRA dealt with a similar scenario. The CRA said that "if an expense would exist absent any business need, that is a strong indication it is personal in nature." Personal expenses are not deductible against business income. The CRA went on to say: "Generally, expenses incurred to make an individual available to the business, or incurred in travelling from home to the business, are

considered personal expenses.” In Jeremy’s case, the cost of using the boat to get to the mainland for work would be a personal expense in the CRA’s view.

Finally, paragraph 18(1)(l) of our tax law prohibits the deduction of any expenses for a yacht (unless it’s being rented out for income), and a “yacht” has been defined by the courts to include any vessel generally used as a pleasure craft. If Jeremy’s boat is considered a yacht, then its costs would not be deductible.

There’s still more to Jeremy’s story. He’s chosen to rent out his cottage in order to claim a deduction for even more of his costs. Here’s the problem: Jeremy has never shown a profit from renting his cottage. In fact, he’s reported losses from this rental activity for the last three years. His total rents have amounted to \$6,000 over that time, but his deductions have amounted to \$24,000. (Those deductions were primarily for property taxes, mortgage interest and repairs.) And what’s more, he has only rented to friends.

If he continues down this path, he can be sure that the CRA will look to reassess him and deny the losses. And the courts would support this. In 2002, the Supreme Court of Canada rendered decisions in two cases, the “Stewart” and “Walls” decisions, which established that, where an activity has some personal element to it, your losses will only be allowed if there is a sufficient commercial element to the activity, and an expectation of profit.

In Jeremy’s case, his consistent losses call into question whether he really has an expectation of profit, and renting to friends alone creates doubt about this being a commercial activity. Since there’s clearly a personal-use element to his cottage ownership, the taxman would

surely disallow his losses. If there is still any doubt, a court decision from 2011, *Daoust v. The Queen* (2011 DTC 5038), would support CRA’s denial of Jeremy’s losses.

## **The Lessons**

There’s no question that claiming a deduction for part of the costs of maintaining a cottage is possible. The surest way to accomplish this is to work from the cottage some of the time if you’re self-employed. If you’re an employee, your employer will have to require you to work from home more than half the time to claim any costs. As an aside, the rules were more flexible in 2020, 2021 and 2022 during the pandemic when it was possible to claim a flat amount (to a certain maximum) for working from home.

Renting out your cottage can also provide deductions, but make sure your rental activity is truly commercial in nature and that you’re trying to make a profit.

As for deducting the costs of boats and other toys? Don’t count on it unless you’re renting those for income as well.

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