



CESTNICK

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TAX MATTERS

# Save taxes this year by making a claim for money you've lost in a business

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I'm not sure what it is about my social circle, but some of my friends and family have weird ways of making a living. I once mentioned my nephew, who was hired by a research company as an armpit sniffer to test deodorants. Really. It's a thing.

Then, there's my friend, Rolando, who started a business two years ago offering professional line-standing services. You could hire him to hold your spot in a line. He has waited in lines for Black Friday shopping events, for concert tickets, and has held spots in line at government offices. His slogan was "Skip the line, not the show."

Rolando invested \$100,000 in his business two years ago. But alas, he's now closing up shop because the business is not working financially. He asked me whether he can deduct the \$100,000 he's lost. In his case, the answer is yes. What about you? Have you invested in a business venture that failed? Maybe your 2024 tax return is the key to getting some cash back. Let me explain.

## The losses

In Rolando's case, he had loaned \$100,000 to a corporation that he had set up. He properly documented the loan, and the amount is now uncollectible. His company has ceased operations and is insolvent.

The good news? If you lend the money to, or invest in the shares of, a small business corporation, you might be entitled to claim a "business investment loss." This is better than a typical capital loss, which must be applied to offset capital gains – but not other types of income. With a business investment loss, one half of that loss – called an Allowable Business Investment Loss (ABIL) – can be applied against any type of income.

An ABIL can be applied to offset income in the year you report the loss and can then be carried back up to three years, or forward 10 years. After 10 years, the ABIL turns into a regular capital loss.

## The criteria

To qualify for an ABIL, you must have invested in capital property that is either shares in, or a loan to, a small business

corporation (SBC). An SBC is a Canadian-controlled private corporation in which all, or substantially all, of the assets are used in an active business carried on primarily in Canada. If you made a loan to someone personally, and not through a corporation, you won't be allowed an ABIL (you might have a capital loss in this case if you had charged interest on the loan).

In the case of an ABIL, it's not a mandatory requirement that the loan be interest-bearing. Rolando didn't charge interest on the loan to his company, but he's still able to claim an ABIL. If he had invested the \$100,000 in shares of his company rather than a loan, he'd still be entitled to claim an ABIL.

In order to claim an ABIL, you have to dispose of the shares or debt to an arm's-length party. Now, that will be tough. After all, who's going to buy your worthless shares or debt? Not to worry. If you're not able to dispose of these, you can still make an election under subsection 50(1) of our tax law, which will treat your shares or debt as though you've disposed of them.

In the case of shares you own, the company will have to be insolvent or bankrupt to allow for an ABIL. When it comes to debt owed to you, it's required that the loan be a bad debt; that it's uncollectible, and that the loan was initially made with the expectation of earning income from the business. The Canada Revenue Agency's view – based on the case *Byram v. R* (99 DTC 5117) – is that a loan can be made at no interest and still be connected with an expectation of earning future income – perhaps dividends – from the company borrowing the money. This was Rolando's situation.

## **The expectations**

If you plan to claim an ABIL, be aware that the taxman will audit the claim. No need to panic over this, but you'll want to make sure you have all your documentation in order. In a recent court decision from December, 171517 Canada Inc. v. QRA (2024 QCCQ 7580) – a Quebec case – the taxpayer failed to prove the existence of legitimate loans, which caused the taxpayer's ABIL to be denied – among other reasons for the judgment.

A loan should be accompanied by a promissory note or loan agreement. Shares should be supported by share certificates properly issued and kept in the minute books of the corporation; evidence of insolvency or bankruptcy (financial statements of the corporation are a place to start) will have to be provided to the taxman. And documentation related to a disposition, or a subsection 50(1) election will be necessary.

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