



CESTNICK

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TAX MATTERS

## When your side hustle loses money - and the CRA comes knocking

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My friend Jason started a part-time business, buying and selling antique cars on his weekends. He told me, “Tim, the best part about being self-employed is that I like my boss, and I always get the employee of the month award.

“On the downside, office parties can be a little boring; on my birthday I buy a balloon and a piece of cake and sing Happy Birthday to myself.”

Since Jason has self-employment activity to report, his personal tax return is due on June 15. He’s pulling together the information to file his tax return, and he’s concerned because he expects to report a loss for 2025 – just like 2024. The problem? The Canada Revenue Agency has already sent him a letter suggesting that if he’s not carrying on a legitimate business, his losses could be denied. If you’re running a business, full- or part-time, you should understand how the taxman looks at your losses.

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The benefits

First, I congratulated Jason on starting a part-time business from home. He’s opened the door to deducting all types of expenses, including things he’s paying for anyway, such as a portion of his home mortgage interest, property taxes, utilities, insurance, repairs to his home, and vehicle costs including interest on his car loan, capital cost allowance (depreciation on his car), gas, car repairs and insurance.

In addition, he can deduct any reasonable costs incurred for the purpose of earning income from his business. In his case, these expenses have exceeded his income to date – but he’s got an explanation for it. The few cars he’s purchased as inventory have not appreciated in value since buying them, despite some minor restoration he’s completed, because the economy and market have turned sour. He expects this to change, particularly as he invests more to restore the vehicles.

In the meantime, Jason’s losses are saving him taxes because those losses offset other income he’s earning.

The cases

For decades, the CRA used something called the “reasonable expectation of profit” test like a sword. Showing losses for a few years? The taxman could simply declare that you had no real business and then disallow your losses. It was arbitrary, and frankly, it penalized legitimate entrepreneurs during the tough startup years that most businesses go through.

Then came two landmark Supreme Court of Canada decisions – *Stewart v. Canada* (2002 SCC 46) and *Walls v. Canada* (2002 SCC 47) – that changed things. The Supreme Court found that the reasonable expectation of profit test had become a broad-based tool used by the CRA to second-guess commercial decisions made by taxpayers. It concluded that it was not up to the CRA to deny expense deductibility based on the agency’s judgment about whether a business will eventually become profitable.

These court decisions established that if an endeavour is commercial in nature, with no personal element to it, then a “source of income” exists. Where a source of income exists, the CRA must allow reasonable expenses incurred for the purpose of earning that income – even if these expenses create a loss. The CRA cannot disallow losses just because it believes there is no reasonable expectation of profit.

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The caveat

Here’s the catch: Selling antique cars, like my friend Jason does, can blur the line between passion and profession, so Jason may receive extra scrutiny. The CRA will look hard at whether you’re

running a genuine commercial enterprise or simply enjoying a hobby with a thin veneer of business activity on top. If your activity has some personal element to it, the taxman may still allow your deductions, but only if there’s a reasonable expectation of profit.

If you want to protect yourself, your conduct needs to be truly commercial. To demonstrate this, you should show that you operate in a businesslike and profit-oriented manner. The taxman will look for objective evidence such as proper books and records, separate banking, marketing efforts, regular time devoted to the activity, attempts to generate revenue, industry knowledge and steps taken to improve profitability. The more the activity has a personal or recreational element, the more important it is to demonstrate commercial discipline and a genuine pursuit of profit.

In Jason’s case, he should keep a separate bank account, meticulous purchase and sale records, track his mileage, hold on to every restoration invoice and support for advertising costs, and document his auction attendance. He should also build a paper trail that tells the story of a person seriously trying to make money.

I know that Jason also minimizes his personal use of his antique cars. He doesn’t use them for personal enjoyment. Doing so would give the taxman ammunition to argue that the cars are personal-use property, not inventory.

I still think that part-time self-employment is a great tax shelter because of the deductions you can claim. Just be aware of how the taxman views your losses.

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