BUSINESS INCOME VS. CAPITAL GAINS

- The distinction between whether a transaction is on account of business or on account of capital is important because business income gets included in income at 100% whereas capital gains are only included in income at 50%.
- Capital property provides long-term benefits to the company, and the property is used to produce income
  - Think of a tree vs. the fruit
  - The tree helps produce the fruit
  - The tree = capital property (sale of tree – leads to capital gains/losses)
  - The fruit = inventory (sale of fruit – leads to business income)

- Taxpayers would want to report losses as on account of business and gains on account of capital to minimize tax payable

Factors to Determine Business Income vs. Capital Gains

The following factors are used by the CRA and the courts in deciding whether a transaction is business income or capital gain

1. Is the transaction in question **similar** to the taxpayer's normal business?
   - If the transaction is similar to the normal course of business, it may be considered business income

2. How **frequently** does the taxpayer engage in this transaction
   - The higher the frequency of the transaction in question; the more likelihood that CRA will consider it on account of business

3. Is this transaction **an adventure or concern in the nature of trade**
   - Income from an adventure or concern in the nature of trade is treated like business income
   - Adventure in the nature of trade is a something done once in a while and not over a period of years as a business activity
   - The following factors are used to determine if the transaction is an adventure or concern in the nature of trade:

     1) Whether the taxpayer dealt with the property in the **same way as a dealer** ordinarily would deal with it;
        - Dealers generally advertise, do research, and make improvements to their products
        - The following factors give evidence of that you were acting like a dealer:
          - If efforts were made to find a buyer quickly

- If sale took place in a short period of time
- The taxpayer took steps to improve the marketability of the property (i.e. renovate a house before selling)
- If the taxpayer has educational or professional background in the item he is selling
  - A real-estate agent who buys a home under his name and quickly sells it will be treated as business income

2) Whether the **nature and quantity** of the property excludes the possibility that its sale was of a capital nature
   - Nature is such that this property cannot produce income or personal enjoyment and it was only purchased to be sold later

3) Whether the **taxpayer's intention** is consistent with other evidence pointing to a trading motivation
   - Intention is not enough by itself to determine if a taxpayer was involved in an adventure in the nature of trade
   - However, if at least one of the 2 tests above suggests that the taxpayer is involved in an adventure in the nature of trade, and if the **taxpayer's intention** was to sell the property at the first suitable opportunity; the transactions would be on account of business
   - Taxpayer may have **more than one intention** when a property is acquired. If the **primary intention** is said to be the holding of the property as an investment (capital), CRA considers if there was a **secondary intention** to sell the property if the primary intention could not be fulfilled
     i. CRA considers if there is **little likelihood of the property being retained** by the taxpayer because of a lack of financial resources or for some other reason.
     ii. Further, a taxpayer's intentions are not limited to the purposes for acquiring the property but extend to the time at which the disposition was made.

Court Case Example : Frederick Simon Hawa v Her Majesty The Queen, 2006 TCC 612 (TCC)

Case Facts

- Mr. Hawa trades shares and In 2001 he made 151 purchases of stocks in 16 companies through two brokers, mainly TD Waterhouse
- The stock was generally held for short periods of time.
- Mr. Hawa incurred losses on these shares, and wanted to report these losses as business income

Judgement:

- The court ruled that these losses are business losses and not capital losses
    - The judge stated that “here the **volume of trades**, the **rapidity of turnover** and the **appellant's own testimony** that he was buying and selling shares to realize a profit indicate that the concerted activity of the appellant was clearly the carrying on of a business.

Disposing Canadian Securities

- If you dispose of Canadian securities, you may have an income gain or loss. However, in the year you dispose of Canadian securities, you can elect to report your gain or loss as a capital gain or loss.
- If you make this election for a tax year, CRA will consider every Canadian security you owned in that year and later years to be capital properties.
- A trader or dealer in securities or anyone who was a non-resident of Canada when the security was sold cannot make this election.