UNDERSTANDING THE TAX IMPLICATIONS OF PROPERTY RENTALS ON AIRBNB AND OTHER ONLINE PLATFORMS

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Many property owners rent out their properties to their tenants through long-term traditional rentals. However, the introduction of online platforms such as AirBnb and VRBO have made it very easy for property owners to rent their properties to guests for short-term stays which can provide significantly more income than traditional long-term rentals or can simply provide supplemental income when their property might otherwise be vacant. Income tax and sales tax implications must be considered before renting properties using these online platforms as there can be significant tax implications in doing so.

Our goal is to provide updates on topical accounting and tax issues. Information contained in this newsletter is not meant to be a comprehensive summary of the issues raised. Rather, we wish to bring what we believe to be important issues to the attention of our valued clients and readers. We would be pleased to discuss any questions that you, the reader, might have in greater detail.

Income Tax

Change in Use of the Property

For income tax purposes, if you change the principal use of the property from personal -use to income-producing, this is considered a “change in use”. This change in use results in a deemed disposition of the property at fair market value on the day the use changes. The deemed disposition requires that you realize and pay tax on any accrued gains up to the date of the deemed disposition. There may be no immediate tax implications if the property has been your principal residence for the whole period of ownership and no other properties were owned during the period of ownership. If you owned more than one personal-use property during the period of ownership of the property that is subject to the deemed disposition, a determination of the optimal principal residence designation should be performed to ensure optimal benefit. There is an election that can be filed with your income tax return in the year in which the change in use occurs which is referred to as a 45(2) election. The purpose of the election is to defer the deemed disposition until you ultimately sell the property. This aligns the potential tax liability with the sale, when cash is actually available to pay the taxes owing. While your election is in effect, you can designate the property as your principal residence for up to four years, even if you do not use your property as your principal residence. If this election is filed, you would not be able to claim capital cost allowance (tax

depreciation) on the property to offset the rental income while it is rented.

Similar rules apply to a "change in use" from income-producing to personal-use. There is also an election to defer the deemed disposition on this change in use, referred to as a 45(3) election.

Sales Tax

Does HST need to be charged on rental fees charged using AirBnb?

In Ontario, long-term residential rentals (rentals of more than one month) are specifically exempt from HST. Landlords of long-term residential rentals do not need to register for HST or collect HST from their tenants. Contrast this with the typical AirBnb rental which is often for a period of less than one month. These types of rentals would not qualify as long-term residential rentals and do not meet the exemption from HST. As a result, when renting properties on a short-term basis, these rentals are subject to HST and landlords must register for and collect HST from their guests.

A "small supplier" is availed of having to collect and remit HST if their gross income does not exceed the small supplier threshold of $30,000. If your gross short-term rental income (and all other income subject to HST) does not exceed $30,000 in the previous four calendar quarters, you are not required to register for HST or collect HST. Once your short-term rental income (and all other income subject to HST) exceeds $30,000 in the previous four calendar quarters, you are required to register for HST and collect HST from your guests. You can register voluntarily before exceeding this threshold, but once you are registered you must collect HST from your guests going forward.

Once you become registered for HST you may be able to recover some of the HST you pay on supplies and operating costs in the form of input tax credits (ITCs). In a mixed-use property, where some of the accommodations are long-term and some are short-term, only ITCs relating to the short-term accommodation can be claimed as ITCs.

Does HST apply the Future Sale of Your Rental Property?

The activity (short-term vs long-term rentals) in which the property has been used determines whether a sale of your rental property would be subject to HST. For the purposes of the application of HST on the sale or deemed sale of a property, a "short-term" rental is considered to be a rental for a period of less than 60 days. Sales of most used residential properties are exempt from HST but using your property for

short-term rentals may impact this exemption.

If the property is used primarily (generally more than 50%) for rentals and all, or substantially all (generally more than 90%), of the rentals are short-term rentals, the eventual sale of the property (or change back to personal-use) could be subject to HST. You can potentially avoid the application of HST if you use the property for personal-use more than 50% of the time or ensure that more than 10% of the bookings/leases are for a period of more than 60 days. This is generally difficult to meet when using online platforms such as AirBnb given that the majority of the rentals are short-term.

HST Specific Change in Use Rules

There are also "change in use" rules to be aware of specifically with respect to HST. When changing the use of a property used for short-term rentals (commercial activity) to a property used for long-term rentals (exempt supply), or vice versa, a change in use could occur for the purposes of HST. As an example, a landlord who has a multi-unit residential building changes the use of the majority of the units from short-term rentals to long-term rentals. This change in use may necessitate a "self-assessment" of HST on the deemed disposition of the property whereby the landlord would be required to pay HST on the fair market value of the property on the date of the change in use. When changing the principal use of a property from long-term rentals to short-term rentals, an ITC may be available on the change in use equal to the "basic tax content" of the property.

Other Taxes

This article only discusses the applicability of the goods and services tax (GST) and harmonized sales tax (HST). Other provincial sales taxes could apply for rentals in those provinces that administer their own sales tax (British Columbia, Saskatchewan, Manitoba and Quebec). Depending on the province and municipality where your property is located, there could also be other local or hospitality taxes that apply to short-term rentals.

Conclusion

The income tax and sales tax implications of property rentals can be quite complex, especially when short-term rentals are involved. The items discussed in this newsletter are common issues that should be considered before beginning the rental of a property. Each taxpayer's situation can be unique, and all the facts should be considered given the many nuances when dealing with income tax and sales tax implications of rentals, particularly short-term rentals facilitated through online platforms such as AirBnB and VRBO. For more information, please feel free to contact our office to speak to one of our tax specialists.

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