Building a shop: Talk tax before turning a wrench

Tax Talk

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So you want to build a shop. After all, you're handy enough for basic upkeep on your truck. Owning a well equipped garage would mean you're no longer at the mercy of someone else's schedule, skills, and labour rates.

It would also get you out of the elements. Troubleshooting a bad marker lamp or changing an air filter is a lot easier in a dry, insulated, well-lit shop.

Lucky for you, your home is on a property big enough to allow for an extended driveway and a building that could accommodate your truck. So you research the various types of structures available. You talk to contractors about square footage and construction costs. You discuss permits with the building code office. You find a place on the property where the building won't block the view from the kitchen window.

You've made the tough and exciting decisions. But realizing that you're building a business-related structure on personal property, you wisely call your accountant about how this idea of yours would affect your tax obligation.

Here are some topics that you should discuss:

Claiming GST/HST on the cost of the building: Canada Revenue Agency has strict rules about qualifying to claim the GST/HST back from the cost of building the shop. The test is whether the property as a whole is used primarily for business or personal use.

When you're living on a piece of property, it's hard to get over 50% business use on the entire parcel of land. CRA auditors will question whether the garage is used 100% for business (do you park your car or toys in there?). They'll even look at the size of your house relative to the square footage of the shop building.

Buildings are expensive and the amount of GST/HST you incur is worth claiming. You may want to build on a separate lot where it's easier to show that the shop is used for business only.

Expenses to be reclaimed: Once the building is up you can claim all the operating or running costs. Those would typically include interest on loans, insurance, utilities, property taxes, maintenance, minor improvements, or anything else you can justify. Of course, your shop will need tools. These are often considered assets and some can be expensed over two years, some over a longer period.

As silly as it is, buying tools one at a time may get you a more direct write-off than buying a bunch at a time. Talk to your own accountant about your specific situation.

Paying for labour: There's no real advantage to paying yourself for performing labour and expensing it to maintenance or casual labour.

You're creating personal income that will have to be shown on your tax return. However, if you have family members who are capable of working on the truck, you can pay them a reasonable wage or salary, effectively splitting your income and potentially reducing your tax obligation.

Capital cost allowance: The shop is an asset and must be expensed over time on your Capital Cost Allowance schedule, along with your truck and/or trailer. The problem is that CCA rates for buildings are very low. So if you spend $30,000 on the building, your CCA each year may only be $1,500. That saves you maybe $450 in tax.

Great, but think long-term. When you get out of the business, by either retiring or selling the truck, the building will become a personal asset. You must remove that building from your business asset list at fair market value, so how much will it be worth in 10 years? Probably more than its original value, considering the rising value of real estate.

Let's assume the building holds its original value of $30,000. In 10 years, it will have depreciated to $15,000. You exit the trucking business, show that the shop was "sold" for $30,000, and you get a $15,000 recapture lumped into your income. Because tax rates increase the more income we make, adding that $15,000 gain all at once could be very expensive. At the very least you will re-pay all the tax savings of the previous 10 years all at once. Ouch! I'd recommend you don't take the CCA.

Building a shop is a great idea if you can do it. You've spent enough time dropping greasy tools onto a dirty driveway. But the tax implications are serious, and you can't bury your head under the hood and hope they'll solve themselves. Talk to your accountant about how a shop might affect your taxes. And if you have a well-stocked shop and have been depreciating it for years, talk to your accountant again and see what he or she has to say. □

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