PRENTICE YATES & CLARK
CHARTERED PROFESSIONAL ACCOUNTANTS

Spring 2021

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In This Issue

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the newsletter of Prentice Yates & Clark

Personal tax changes for 2020 related to COVID-19

The past year brought changes and challenges for Canadians. Many suffered job losses due to the pandemic, and they may have received federal government support payments; others found themselves working from home for all or part of the year; others may have changed how they commuted to work so that they could minimize their exposure to the virus. Any of these scenarios has implications for your 2020 personal tax return.

Home office expenses deductions for employees

Before 2020, employees could deduct home office expenses if their home office was the "place where the individual principally performs the duties of employment," which was interpreted to mean more than 50% of the time, or if the space was used exclusively to earn employment income and was "used on a regular and continuous basis" for meeting customers or clients. Their employer would have to complete Form T2200, *Declaration of Conditions of Employment*. This document certifies both of the following:

- the approximate percentage of the employee's duties performed at a home office
- whether they were reimbursed for any home office expenses

The COVID-19 pandemic required many more employees to be working from home on at least a temporary basis. In response, the government introduced several changes for 2020 to simplify the process for claiming home office expenses for both employees and employers.

If you worked from home at least 50% of the time over a period of at least four consecutive weeks in 2020 due to COVID-19, you are now eligible to claim home office expenses for 2020. Previously, the determination of whether the employee worked principally out of the home office was generally

calculated over the full year. This shorter qualifying period will ensure that more employees can claim the deduction.

Two calculation methods available

A temporary flat rate method is available only in 2020 and is calculated at $2 per day worked at home (part-time or full-time), to a maximum of $400 for the year. If you use this simplified method, the employer does not need to certify the conditions of your employment on the T2200 form. This deduction can be claimed for multiple individuals in the same household if the other criteria are met. If you use the simplified method, you cannot claim any other employment expenses such as car expenses.

Alternatively, you can use the detailed method if your employer certifies the conditions of employment using Form T2200 (the original version) or T2200S (a streamlined version for those working at home due to COVID-19). You could then deduct a reasonable portion of eligible expenses that are not reimbursed by your employer. Eligible expenses for all employees include electricity, heat, water, the utilities portion of condominium fees, home internet access fees, maintenance and minor repair costs, and rent paid for the house or apartment where you live. Commissioned employees can also claim home insurance, property taxes and the lease of a cellphone, computer, tablet etc. that could reasonably relate to earning commission income.

To calculate the reasonable portion that you can deduct, you must determine the size of your workspace and divide that by the total square footage of all finished areas in your home. If the workspace has other purposes besides work, you must also prorate the expenses by the number of hours the space was used for business in a week divided by the total number of hours in the week.

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For example, if you work in your 144-square-foot dining room for 50 hours per week, and the total finished space in your home is 1,500 square feet, the employment use percentage would be 144/1500 *x* 50/168 = 2.9%. You can thus deduct 2.9% of the eligible expenses listed above for the period during which you were working from home.

The Canada Revenue Agency (CRA) has created a **calculator** to help employees determine their home office expenses deduction. If you are using the detailed method, the T2200 or T2200S form does not have to be filed with your tax return, but you must keep it for your records.

Other changes for employees

The CRA has also announced additional flexibility in applying rules for determining taxable benefits for employees. An employee will not be considered to have received a taxable benefit if their employer reimburses them for up to $500, supported by receipts, for computer or office equipment to enable the employee to work from home.

The CRA's longstanding position has been that travel from your home to, and parking at, an employer's place of business is normally considered to be a personal expense, and therefore any reimbursement by the employer would be a taxable benefit to you. However, the CRA announced that where an employee incurred commuting expenses over and above their usual commuting costs as a result of the pandemic, they will **not** consider it a taxable benefit if the employer reimburses or makes reasonable allowance for these expenses. This would also apply where an employee is working from home and commuted to their employer's place of business to pick up computer or office equipment.

COVID-19 support payments to individuals

Many of the federal government's support payments for individuals during the COVID-19 must be reported as taxable income on your 2020 personal tax return. These include the:

- Canada Emergency Response Benefit (CERB)
- Canada Emergency Student Benefit
- Canada Recovery Benefit
- Canada Recovery Caregiving Benefit
- Canada Recovery Sickness Benefit

There was some confusion about whether some self-employed individuals actually qualified for the CERB, and especially whether the $5,000 required minimum income in the 12 months before the date of application was based on gross income or net income. Any of the above payments received in 2020 must be included in taxable income in that year. If someone is later found not to be eligible to receive the CERB, they can take a deduction in the year in which they repay the funds.

The federal government announced on February 9, 2021 that self-employed individuals who applied for the CERB and would have qualified based on their gross self-employment income (instead of net self-employment income) in the prior year will not be required to repay the benefit, provided they also met all other eligibility requirements. The CRA and Service Canada will return any amounts to self-employed individuals who may have already voluntarily repaid the CERB to the government.

To see how these changes affect you, it may be useful to meet with your Chartered Professional Accountant (CPA).◆

What Is Blockchain, and Why Do You Need to Know What It Is?

When Bitcoin first came onto the scene in 2008, it came with a new underlying technology called "blockchain." As interest in cryptocurrencies grew, so did special recognition for the technology that made them work. Since then, blockchain has grown to be used in many different industries – making it possibly the next big revolution in the digitization of business.

Blockchain defined

Blockchain represents not just a new technology, but also an important new construct for recording data. And it's gaining momentum as a transparent, immutable and secure method of recording business transactions.

At its rudimentary core, blockchain is the finite organization of digital data into a series of *blocks*. These blocks are then digitally and chronologically connected together into a chain. Each block contains a unique set of data, and is comprised of three components:

- First, it contains specific, and usually transactional, details such as dates, quantities and dollar amounts.
- Second, it contains information, in the form of digital signatures, about who is involved in the transaction.
- Finally, a unique identifier (called a "hash") is assigned to reference the specific block.

These hashes are actually cryptographic codes generated via algorithms. They are dependant on the data in the block and make reference to the block before them. These elements make each hash unique to each block. As data is added or changed, new blocks are added to the chain. It is important to note that the data in a particular block is never changed; erroneous or new data simply adds a new block to the chain. As a result, there is always a complete record of the data, right from its origins.

Blockchain also differs from traditional data recording methods in terms of how the data is stored. The chains are essentially digital ledger systems that are then stored across a wide range of networks (making them often referred to as a "distributed ledger"). Anyone can view the contents of a blockchain and, if they so desire, can have their computer added as a node to the chain. From that point on, their computer will receive a copy of the entire chain every time the blockchain is updated.

This is the main reason why blockchains are considered so secure: In order to modify the data in a particular block, that block would have to be changed on every system where the ledger existed – which creates a significant barrier to malicious intent. Imagine a particular block that is the target of malicious intent. That block would have to be manipulated on literally thousands of nodes (individual computers) for the threat to take affect.

What Is Blockchain, and Why Do You Need to Know What It Is? - continued

Uses of blockchain

Blockchain was initially developed as a ledger system for Bitcoin. To this day, many people still incorrectly refer to blockchain and Bitcoin interchangeably. Given the inherent features of transparency and security, blockchain has easily lent itself to many other uses. It has been employed in healthcare centres for patient medical records; by food manufacturers as a means of keeping lot, batch and ingredient data; and even in the finance industry to track fraud. The list continues to grow.

One of the recent important modifications is how the blockchain is accessed. While one of the defining aspects of the technology is that it is public and fully accessible, more private chains have gained popularity. These new *permissioned* blockchains work just like their predecessors, except that the access to the network where they reside is controlled. Organizations can then grant access only to the individuals or entities they want to include. These forms of blockchain are expected to grow significantly as organizations test this new technology's effectiveness.

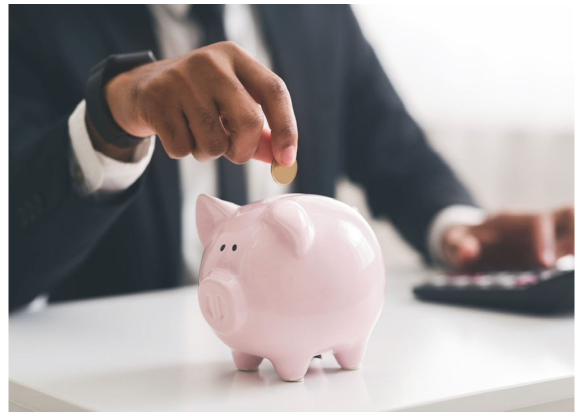
What does this mean to you?

As noted, blockchain represents a new way of recording the interactions (transactions) between individuals and organizations. As this new technology becomes more popular and utilized, questions have emerged as to what the future holds for this new way of transacting.

While the inherent benefits of a system that is transparent, secure and immutable are exciting, conversion to it will still take some time. Unlike many other technological enhancements, blockchain represents not a disruptive technology, but rather a foundational shift. Its advantages will take time to become part of the economic infrastructure. In large part, this evolution will depend on how blockchain is taken up by enterprise.

Key questions for finance and accounting professionals relate to how this technology can withstand audit and assurance challenges. It will be some time before blockchain replaces audited financial statements, but it will increasingly be used to record transactions. As such, it is imperative that these professionals gain an understanding of the system. And while it does record transactions in a new way, auditors will still need to assess whether those transactions were correctly categorized on the financial statements and whether they were authorized, fraudulent, or even illegal.

As technology continues to advance, and business processes continue to be digitized, it is increasingly important to monitor these advances and continually assess their impact on your industry. Blockchain is a key player in this trend that won't be disappearing anytime soon. Whether your business is a technology giant, an accounting firm or a professional organization, it is increasingly important to monitor these advances and continue to assess their impact on your industry.◆



Reverse Saving: Borrowing to Invest in the Stock Market

Legendary investor Benjamin Graham said that the investor's chief problem and even their worst enemy is likely to be themselves. Indeed, borrowing to invest is not for the faint of heart.

Why might you consider borrowing to invest in the stock market?

Traditionally, discussions with your financial professional related to borrowing and investing occur at the same time. This typically happens when the two following market conditions are present:

- Borrowing rates are low.
- Stocks are cheap after a dramatic decline in stock prices.

For instance, there was nowhere to hide in the first quarter of 2020: With the novel coronavirus spreading rapidly around the world, economies were closed for business as stay-at-home orders were issued in Canada and abroad. Stock markets and interest rates both fell dramatically, offering investors these traditional incentives to pursue a leveraged investment strategy.

Are you fit to borrow to invest?

These two key factors should dictate whether borrowing to invest is right for you:

- your ability to take risk
- your willingness to take risk

To assess your *ability* to take risk, you would look to the factual details laid out in your financial strategy or retirement plan. If your retirement plan cannot sustain higher expected risk (in other words, your cash flow is tight), then this investment strategy is not something you should consider.

Inside PYC

We would like to welcome **Leon Li** as a new member of our professional staff.

Reverse Saving: Borrowing to Invest in the Stock Market - continued

Borrowing to invest is a better strategy for investors who have excess cash flow and need help building long-term equity outside their principal residence and/or business. Those who typically might benefit from this strategy are professionals with their own practices, such as partners at law, accounting firms, doctors or dentists.

Next, consider your *willingness* to take risk. If you can't sleep at night because your portfolio of investments using your own money has declined in value – never mind other people's money that you are considering borrowing from the bank – then this strategy is not right for you. However, if you are among the investors who have survived previous "bear markets" (i.e., stocks declining 20% or more) and have not panicked, then this strategy is one for you to consider.

Another situation that favours this investment strategy is that Canadians are traditionally very good at paying down debt, but they may struggle with building equity through savings outside their registered RRSP and TFSA accounts. So, this leveraged strategy of borrowing to invest could make sense – it forces the investor to save while they focus on paying down debt, which they have historical experience doing aggressively.

Your leveraged investment plan: A double-edged sword

Whether you acquire real estate with a mortgage or a stock portfolio using borrowed funds, the returns on those investments are magnified by the use of leverage and the cost of borrowing. As a result, you will see an enhanced and asymmetric impact on returns – the returns swing up and down.

In plain language, this means that if your portfolio (half borrowed and half not borrowed money or "equity") earned or lost 10% in a given year, the impact on the equity within your portfolio will move up and down by 17% and 23% (this is a highly simplistic example that assumes a 3% per annum cost to borrow). You can see that although the portfolio returns were symmetric – both up and down 10% – the equity return is asymmetric: it is higher and lower than the portfolio return, and it increases and declines by unequal amounts.

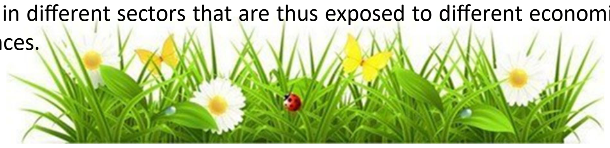
The enhanced equity returns up and down are caused by the use of leverage, while the asymmetry in returns is caused by the cost of borrowing. This asymmetry in returns creates the added need to get the timing right on your leveraged investment strategy. If you implement the leveraged investment strategy and your portfolio declines in value, stress and emotion can kick in and derail even the most seasoned investor's plan, resulting in a bad outcome overall.

Keep your leveraged investment plan clean and tax deductible

Borrowing to invest is tax-deductible in Canada when money is invested in a non-registered account. To keep your cost of investing clear for the Canada Revenue Agency (CRA), set up a line of credit dedicated only to your leveraged investment strategy. That way, it will be crystal clear how much it cost you to invest.

Success is based on diversification

Although we like to believe we can predict the future, we must accept that uncertainty is a part of the investing process, so with this realization you should spread out your investment risk to accommodate various scenarios. One way to achieve this is by owning stocks in different sectors that are thus exposed to different economic influences.



A common idea behind this leveraged strategy is to cover your cost of borrowing by purchasing dividend-paying stocks. You can find dividend-paying securities in almost all sectors of the economy, not just in the long-established Canadian banking sector.

Another way to diversify is to look at your portfolio in a North American context, and not just focus on Canadian stocks. Although you can realize tax advantages to owning Canadian dividend stocks through the dividend tax credit, tax considerations should be secondary in your mind to enhanced diversification.

Canadians who invest a portion of their leveraged strategy in the United States are likely to find many more stocks in a wider range of sectors of the economy (technology, health care, consumer discretionary, etc.), which can enhance your portfolio's diversification and outcomes. In addition, exposure to the U.S. greenback has historically provided Canadian investors with an enhanced source of diversification against market uncertainty.

The golden rule

Ignoring all the factors already discussed, the golden rule for anyone contemplating borrowing to invest is to look at the worst-case scenario.

Consider what would happen if your leveraged investment strategy went to zero and you still owed the bank the loan and interest. If this scenario would impair your family's current and expected lifestyle, then you should reconsider this strategy. Because, in essence, this strategy should be viewed as being more aspirational: We are trying to achieve the lifestyle we want in future, but not by losing the foundation (our needs) we have at present.◆

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