A GUIDE FOR ONTARIO RENTAL PROPERTY OWNERS

Repair, or improvement? The CRA draws the line.

The Repair Line

The Rental Renovation Tax Guide

The CRA's actual four-part test, how depreciation works, and the tax bill on sale almost nobody sees coming.

Explained simply — the way I'd tell a friend.

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What's inside this guide

A framework, not a shortcut. Every real number here should be checked with your accountant before you file.

01 Read this first

Spend money on a rental property and the CRA sorts what you spent into one of two buckets: a current expense, deductible against this year's rental income, or a capital expense, which isn't deducted all at once but added to the property's cost and written off gradually over years. Same money spent, same renovation, two completely different tax outcomes depending on which bucket it falls into.

This guide walks through the actual test the CRA uses to sort an expense into one bucket or the other, using CRA's own published framework, then covers what happens to a capital expense afterward: how it gets depreciated, and a specific rule about selling the property later that surprises a lot of landlords who never saw it explained clearly.

> **HOW TO USE THIS GUIDE**
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> Sections 02 through 06 cover how to classify a specific expense. Sections 07 through 09 cover what happens to capital expenses afterward, depreciation and the eventual tax consequence of selling. If you only came for the classification question, sections 02 to 06 are the ones for you.

> **IMPORTANT**
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> I'm a realtor, not an accountant, and this is general education based on CRA's published guidance, not tax advice specific to your situation. Classification depends on the full facts of each case, and the CRA itself says there's no single rule that decides every expense. Confirm your specific renovation with a licensed accountant before you file, every time, not just when you're unsure.

IF YOU REMEMBER NOTHING ELSE

The 3 things that matter most

- Restoring something to what it already was leans current. Making it better, bigger, or different from what it was leans capital. That single distinction drives almost everything else.
- Renovating a property shortly after you buy it, to make a run-down purchase rentable, is usually treated as capital, even for work that would normally look like an ordinary repair.
- Capital expenses reduce your tax bill slowly through depreciation, but claiming that depreciation can create a real tax bill of its own the year you eventually sell. Section 09 explains why.

02 Why the distinction exists

Before the test itself, it helps to see why the CRA cares about this distinction at all, because it explains why the rules are shaped the way they are.

> **IN SIMPLE WORDS**
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> A current expense is treated as the ordinary cost of earning this year's rental income, so it's deducted in full, in the year you paid it. A capital expense creates something that will keep earning you income for years into the future, a new roof doesn't just help this year's tenant, it helps every tenant for the next 20 years, so the tax system spreads the deduction out over that same stretch of time, rather than giving you the whole benefit in year one.

This logic is also why the classification isn't really about how the expense feels to you as the person paying for it. A $30,000 repair and a $30,000 improvement can feel identical writing the cheque. What matters to the CRA is what the money actually bought: restored function, or something genuinely new and better than what existed before.

03 ⇅ The two categories, plainly

- **Current expense.** Repairs and maintenance that keep the property in the condition it was already in, fixing what's broken, replacing a worn part with a similar one, ordinary upkeep. Deducted in full against this year's rental income.
- **Capital expense.** Money that creates, adds, or substantially improves an asset, something that leaves the property better, bigger, or different than it was before. Not deducted immediately, instead added to the property's cost and written off gradually through Capital Cost Allowance, covered starting in section 07.

If your basement is already a finished rental unit and, between tenants, you repair damaged drywall, fix a leaking faucet, and repaint, those are current expenses. If that basement is unfinished and you spend $50,000 adding walls, flooring, electrical, plumbing, and a bathroom to create a rental space that didn't exist before, that's a capital expense, you didn't repair something, you created a new income-producing space.

04 The CRA's actual four-part test

This is the real framework, taken directly from the CRA's own published guidance on current versus capital expenses, not a simplified version of it. The CRA applies these considerations roughly in order, moving to the next only when the previous one doesn't settle the question.

1. Does it maintain, or improve, the property? An expense that simply restores the property to its original condition is usually current. An expense that improves the property beyond its original condition is usually capital. The CRA's own example: repairing wooden steps is current, replacing them with concrete steps is capital, even though both fix the same problem.

2. Is it for part of the property, or a separate asset? Repairing a property by replacing one of its existing parts, like rewiring, which is part of the building, is usually current, as long as it doesn't improve the property beyond its original state. Buying a separate, freestanding asset, like a refrigerator for the unit, is capital, because it's a distinct asset, not a repaired part of the building.

3. What's the expense worth relative to the property? Only used if the first two tests don't settle it. A cost that's large relative to the property's value leans capital. But the CRA is explicit that a large bill alone doesn't make something capital, deferred ordinary maintenance, tackled all at once, is still a current expense even if the total is substantial.

4. Is it a repair to used property you just acquired, to make it suitable for use? Covered in full in section 06, because it's the one that most often surprises real estate investors specifically.

> There is no single rule in the Income Tax Act that decides this for every case. The CRA is explicit that classification depends on the specific facts of each expense, viewed from a practical, business perspective.

05 Worked examples

Running a few common scenarios through the four-part test makes the distinction concrete.

- **Repairing a section of damaged wiring with the same type of wiring:** current. It's a part of the building, restored to its prior working condition, not upgraded.
- **Upgrading the panel from 100 amp to 200 amp service:** capital. The property now has meaningfully more electrical capacity than it did before, an improvement beyond the original condition, not a restoration of it.
- **Replacing worn carpet with new carpet of similar quality:** current. Restores the unit to its prior condition.
- **Replacing that same worn carpet with hardwood flooring:** capital. The unit is now better than it was, not just restored.
- **Finishing a previously unfinished basement into a self-contained rental unit:** capital, and not a close call. This creates a new income-producing space that didn't exist before.

> **WHY THIS MATTERS FOR HOW YOU PLAN THE WORK**
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> Because the classification often comes down to like-for-like versus upgraded, the choice you make at the hardware store or with your contractor can change the tax treatment of the exact same repair job. That's not a reason to avoid reasonable upgrades, but it's worth knowing, going in, which side of the line a given choice puts you on, especially on a large project where the difference in immediate deductibility is real money.

06 The used-property trap

This is the fourth test from section 04, and it deserves its own section because it catches real estate investors more than any other part of this framework, precisely because it overrides the logic of the first two tests.

IN SIMPLE WORDS

Normally, restoring something to working condition is a current expense. But if you just bought a run-down property and the repairs are what put it into suitable, rentable condition for the first time under your ownership, the CRA tends to treat those costs as capital, part of what it actually cost you to acquire an income-producing asset, rather than as ordinary repairs to a property you've already been renting out.

This means the same repair, say, replacing damaged flooring, can be classified differently depending on timing. Replace worn flooring in a unit you've rented out for five years, and it's a straightforward current expense. Buy a neglected property, and replace that same flooring as part of getting it ready for its first tenant, and the CRA is far more likely to treat it as part of the acquisition, a capital cost, even though the physical work looks identical.

> If you're buying a fixer-upper specifically to rent out, budget for the likelihood that your initial repair costs will be capital, not immediately deductible, and plan your cash flow accordingly.

07 What happens to a capital expense

A capital expense doesn't vanish from your taxes, it just gets deducted differently, through a mechanism called Capital Cost Allowance, or CCA.

> **IN SIMPLE WORDS**
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> CCA is the CRA's system for deducting the cost of a long-lasting asset gradually, rather than all at once, to reflect the fact that the asset provides benefit over many years. Your rental building itself falls into CCA Class 1, depreciated at 4% per year on a declining balance. Land is never depreciable, only the building, so when you buy a property you have to split the purchase price between land and building, often using the municipal property assessment's ratio as a starting point.

- **Declining balance.** Each year's CCA is 4% of the remaining undepreciated balance, not 4% of the original cost, so the dollar amount shrinks every year rather than staying fixed.
- **Pooled by class.** Multiple assets in the same class are generally tracked together, though rental properties with a capital cost of $50,000 or more acquired after 1971 must be tracked in their own separate class rather than pooled with others.
- **A slow deduction, by design.** On a $400,000 building, year-one CCA (before the half-year rule in section 08) is roughly $16,000, a small fraction of what you spent. The CRA expects buildings to last decades, and the deduction schedule reflects that.

08 The rules that catch people off guard

Two features of CCA surprise a lot of first-time landlords, and both are worth knowing before you file your first return with a rental property on it.

- **The half-year rule.** In the year you acquire an asset, or make a capital addition, you can generally only claim half of the normal CCA rate, not the full amount, regardless of what month during the year the purchase happened.
- **CCA can't create or increase a rental loss.** You can only claim CCA up to the amount that brings your net rental income to zero. If your rental expenses already exceed your rental income before CCA, claiming CCA that year won't help, and won't be allowed.
- **It's optional, every single year.** You're never required to claim the maximum CCA available, or any CCA at all. You can claim less, or skip it entirely in a given year, and the undepreciated balance simply carries forward. This is a genuine planning decision, not an automatic calculation, which is exactly why section 09 matters.

09 Recapture: the tax bill on sale

This is the part of CCA that most catches landlords off guard, because it only shows up years later, on a completely different tax return than the one where the deductions were claimed.

IN SIMPLE WORDS

Every dollar of CCA you claim reduces the property's undepreciated capital cost (UCC). When you eventually sell, if the sale proceeds allocated to the building exceed the remaining UCC, the difference, up to the total CCA you originally claimed, is "recaptured" and added back to your income in the year of sale. Unlike a capital gain, which is only 50% taxable, recaptured CCA is 100% taxable as ordinary income.

In plain terms: the deductions you claimed over the years weren't free, they were a timing benefit. If the property holds or gains value, as GTA real estate generally has, you're likely to pay most or all of that benefit back in the year you sell, and at your full marginal tax rate that year, not at the lower capital gains rate that applies to the property's actual appreciation.

WHY THIS IS A REAL PLANNING QUESTION, NOT A REASON TO PANIC

This isn't a reason to avoid claiming CCA, it's a reason to claim it deliberately. Some landlords choose to claim less than the maximum, or skip it in high-income years and resume it later, specifically to manage the size of the eventual recapture, or to time it against a lower-income year. Whether that's the right call depends on your income trajectory, how long you plan to hold the property, and your overall tax picture, which is exactly the kind of question worth bringing to your accountant before you file your first year of CCA, not after several years of claims are already on record.

10 Documenting your renovation

Whichever bucket an expense lands in, the classification is only as strong as the paperwork behind it, and one document matters more than the rest.

- **The permit,** where one applies, is stronger evidence of what was actually done than an invoice alone. It also happens to matter for insurance and resale, covered in a companion guide, The House File.
- **Itemized invoices,** that separate materials and labour by task, rather than one lump sum, make it far easier for your accountant to classify a mixed project where some parts are current and others are capital.
- **Before and after photos,** help demonstrate whether work restored the property or improved it beyond its original condition, directly relevant to the first test in section 04.

INSIDER TIP

On a project that mixes both categories, a kitchen refresh that includes both a like-for-like faucet repair and a genuine upgrade, ask your contractor to itemize the invoice by task rather than providing one combined total. It makes correct classification, and your accountant's job, meaningfully easier.

11 Questions to ask your accountant

Copy these into an email before tax season, or before you start a major renovation project.

- Based on what I actually did, does this renovation look like a current expense, a capital expense, or a mix of both?
- I bought this property recently and did repairs shortly after, does the used-property rule in section 06 apply here?
- How should I split my purchase price between land and building for CCA purposes?
- How much CCA should I actually claim this year, the maximum, less, or none, given my income this year?
- What would my estimated recapture be if I sold this property in the next few years?
- What documentation do you need from me to support this classification if it's ever reviewed?

12 Glossary

Every term in this guide that can sound intimidating, in everyday language.

Current expense
A cost that maintains or restores a property, deductible in full against rental income in the year it's paid.

Capital expense
A cost that creates, adds to, or improves a property beyond its original condition, added to the property's cost and deducted gradually over time.

Capital Cost Allowance (CCA)
The CRA's system for deducting the cost of a capital asset gradually, reflecting the benefit it provides over many years.

Undepreciated capital cost (UCC)
The remaining balance of an asset's cost that hasn't yet been deducted through CCA.

Declining balance method
A depreciation method where each year's deduction is a percentage of the remaining balance, not the original cost, so the dollar amount shrinks over time.

CCA Class 1
The CRA classification for most rental buildings acquired after 1987, depreciated at 4% per year.

Half-year rule
A rule limiting the CCA claim to half the normal rate in the year an asset is acquired or added to.

Recapture
Previously claimed CCA that gets added back to income, fully taxable, in the year a property sells for more than its remaining UCC.

Terminal loss
The opposite of recapture, a deduction available when the last asset in a CCA class is disposed of for less than its remaining UCC.

Betterment
CRA's term for an improvement that makes a property better than its original condition, a hallmark of a capital expense.

The same dollar spent, sorted correctly,
is worth planning around, not guessing at.

Buying a rental property, or planning a renovation?

Send me your questions, happy to point you in the right direction. Reach out on Instagram **@jayp.realestate**.

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