Tax and Real Estate

Prepared for: Legal Education Society of Alberta

49th Annual Refresher: Real Estate

Presented by:

Ebony Verbonac CPA, CA

KPMG

Lethbridge, Alberta

For presentation in:

Lake Louise, Alberta – April 24 - 26, 2016

TAX AND REAL ESTATE

INTRODUCTION

This paper primarily focuses on two separate and distinct discussions as it relates to managing real-estate transactions in Canada. The first part focuses entirely on the concept of non-resident vendors and the reporting requirements. The sale of Canadian Real Property by a non-resident creates a potential tax obligation to Canada, and therefore requires purchasers to ensure these tax amounts are paid prior to releasing funds to the vendor.

The second portion will be focused on GST and real-estate transactions. It will overview some of the basic understandings many of us have established, and look at some of the intricacies associated with different types of properties.

In addition to the two main topics above, discussion is also included as it relates to special tax deferral opportunities on the disposition of real-estate.

Though each topic is distinct from the other, having a general understanding of all will allow for better issue identification and mitigating potential tax liability from missed reporting.

NON-RESIDENT VENDOR – GENERAL PRINCIPLES

When Taxable Canadian Property ("TCP") is acquired from a non-resident, specific payments of withholding tax may be required to be remitted to the CRA in order to meet the Canadian tax requirement by the vendor.

Essentially, a purchaser of TCP is required to withhold 25% of the gross proceeds and remit to the CRA on behalf of a non-resident vendor. This requirement can be reduced or waived completely if the purchaser has taken the appropriate steps to establish the vendor has paid the tax or posted security for any potential tax obligation.

In order for the purchaser to provide evidence, the vendor will have to apply to the CRA for a Section 116 Certificate of Compliance. This is done by completing the necessary prescribed forms provided by the CRA[1]. The information included in the request includes; personal information of the vendor, a description of the property sold, verification of the proceeds of disposition and verification of the adjusted cost base of the property.

[1] Forms T2062 "Request by a Non-resident of Canada for a Certificate of Compliance Related to the Disposition of Taxable Canadian Property" or Form T2062A "Request by a Non-Resident of Canada for a Certificate of Compliance Related to the Disposition of Canadian Resource or Timber Resource Property, Canadian Real Property (Other than Capital Property), or Depreciable Taxable Canadian Property".

Requests can be made in advance of the transaction or no later than ten days after the transaction. Before the CRA will issue the certificate of compliance, the non-resident vendor will be required to make payment or post security as it relates to the transaction. The amount to be paid for capital gains is equal to 25% of the capital gain (essentially 25% of the difference between the adjusted cost base and the proceeds of disposition). Failure to comply with the requirements may result in a penalty and applicable interest.

The theory seems simple enough, however, complications can arise. Such issues can come into play when defining whether your property is considered TCP. Also, what if the property in question is owned by a corporation, partnership or trust? Defining whether you have a non-resident vendor in these situations can be problematic. Another consideration is what if the property is not being sold, but instead being moved as part of a reorganization or estate planning. Do you still have a tax burden even though no cash proceeds are to be received?

DEFINING TAXABLE CANADIAN PROPERTY – REAL ESTATE

Subsequent to the 2010 federal budget, the definition of TCP was revised. The following is not a complete excerpt of the definition of TCP but highlights the parameters that would come into play as it relates to real estate transactions[2];

(a) Real or immovable property situated in Canada;

(b) Property used or held in, or eligible capital property in respect of, a business carried on in Canada;

(c) Designated insurance property of an insurer;

(d) A share of the capital stock of a corporation (other than a mutual fund corporation) that is not listed on a designated stock exchange, if, at any time in the last 60 months more than 50% of the fair market value of the share was derived directly or indirectly from one or any combination of;

  (i) Real or immovable property situated in Canada;

  (ii) Canadian resource properties;

  (iii) Timber resource properties, and;

  (iv) Options in respect of, or interest in, or for civil law, rights in a property described in i), ii) or iii) above, whether or not the property exists.

[2] For complete definition, see Canadian Income Tax Act – Section 248 definition of "taxable Canadian property"

(e) An interest in a partnership if, at any time in the last 60 months, more than 50% of the fair market value of the interest, was derived directly or indirectly form on or any combination of the properties listed in (d)(i) to (d)(iv) above;

(f) An interest in a trust (other than a unit of a mutual fund trust or an income interest in a trust resident in Canada) if, at any time in the last 60 months, more than 50% of the fair market value of the interest was derived directly or indirectly from one or any combination of the properties listed in (d)(i) to (d)(iv) above.

When considering whether a transaction involves TCP, the question first becomes, is the non-resident vendor disposing of an interest in real or immovable property in Canada. Real property is not defined in the Income Tax Act ("ITA"). Ultimately, it takes on the meaning from the relevant provincial law. The CRA has stated that it is generally understood that real property is to include land. Identify these types of transactions is generally strong, in that identifying when a non-resident is directly selling an interest in land in Canada, the requirement to file under Section 116 is obvious.

However, consider the following situation, individual A is considering purchasing farmland located in Central Alberta. The land is not owned by an individual, but is instead owned by a company ("LandCo"). The shareholders of the company would prefer to sell their shares in LandCo as opposed to the company selling the interest in the land. This is a common transaction, and often LandCo's are being sold for the purposes of utilizing special tax exemptions that are available to farmers on shares in farm companies.

For the example, let's say LandCo is owned by two individuals, brother and sister. Brother is a resident in Canada, and the controlling shareholder. Sister has moved south, and now resides in Arizona. LandCo was incorporated in the province of Alberta. The question becomes, is there a section 116 requirement on the purchase of the shares from Brother and Sister?

As can be seen in the definition of TCP from above; paragraph (d) identifies when shares of Private Corporation are being sold. It notes that if at any time over the last 60 months more than 50% of the fair market value of the shares was derived from real or immovable property in Canada, we have TCP. In this situation, as often seen with similar LandCo's, the only assets owned in the company is farmland. The CRA interprets value as gross asset value ignoring liabilities.[3] With the increasing value of land, it becomes apparent that it is not difficult to have 50% of the fair market value of the shares be attributable to real or immovable property. Therefore, in our example, the shares

[3] CRA Views docs 2011-0425901C6