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Tax Considerations for Non-Resident Individuals Investing in Canadian Real Estate (NEVER RENTED)

October 10, 2019

Taxation upon acquisition (Property Transfer Tax and GST) and annual property tax

1) Property Transfer Tax is payable at the time of purchase of real property. This tax is calculated on the fair market value of the property at the rate of: 1% on the first $200,000, 2% on the portion of the fair market value greater than $200,000 and up to $2,000,000, 3% on the portion of the fair market value greater than $2,000,000 and up to $3,000,000, and 5% on the portion of the fair market value greater than $3,000,000 if the property is residential. In addition, if the non-resident is a foreign national (not Canadian citizen or permanent resident) and purchases a residential property in the Greater Vancouver Regional District (does not include, for example, Whistler or Squamish), an additional 20% property transfer tax is payable upon purchase. Other acquisition costs may include inspection fees, appraisals and legal fees.

2) Municipal property taxes are due annually. In the year of purchase or sale, a pro-rata portion will be payable based upon the number of days that the property is owned in the year. The lawyer will do the adjustment in the Statement of Adjustments. After the year of purchase, property taxes must be paid each year (e.g. July 2 for Whistler) and arrangements should be made with the municipality to ensure they are paid on a timely basis. The amount is based upon the assessed value and the "mill rate" set by the municipality. As a general "rule of thumb", annual property taxes are approximately 0.5 to 1% of the value of the residential property. There are two main classes for property tax purposes: residential and commercial. These classes are not directly related to the classifications for income tax or GST purposes. Property tax on commercial property is significantly higher than residential. In Whistler, a reduction of property tax is available for the personal use portion of specified commercial properties (known as the STOCAP rules).

3) An Additional School Tax is due annually (effective January 2019). The tax applies to detached homes, stratified condominium or townhouse units, and most vacant land with an assessed value over $3,000,000. Non-stratified rental buildings with four or more housing units and the commercial portion of mixed-used buildings are exempt from the tax. The tax is 0.2% on the residential portion assessed between $3,000,000 and $4,000,000 and 0.4% on the residential portion assessed over $4,000,000.

4) The BC Speculation Tax is also due annually. The tax is 0.5% of the assessed value of property for Canadian citizens and permanent residents of Canada who are not members of a satellite family, and 2% of the assessed value for foreign investors and satellite families. Properties that are used as qualifying long-term rentals are exempt from the tax. Currently this tax does not apply to properties in Whistler and some other areas of BC.

5) The Empty Homes Tax (also known as the Vacancy Tax) applies to properties unoccupied over 180 days only in the City of Vancouver (includes time looking for tenants, empty while listed for sale, unimproved / uninhabitable properties). The tax rate is 1% of the assessed taxable value of the property.

6) Goods and Services Tax ("GST") of 5% will be charged on the purchase of a **newly** built home or on the purchase of a commercial property that had been rented by the previous owner. This GST will become part of the cost. If your intention is to use the property personally, GST must be paid upon purchase. A purchaser of property used for personal purposes cannot and should not register for GST.

7) GST will not be charged on the sale and purchase of a **used** residential property (personally used property), which includes most homes, townhouses or condos.

8) Tax planning issues which should be discussed include ownership structure, capitalization of expenditures to reduce tax or future gains, risks of borrowing outside Canada, and other similar issues.

Please note that the above is just a short summary of the property purchase and annual taxes and since a number of these taxes are new, current advice must be obtained from your realtor, lawyer and accountant.

Adjusted Cost Base

1) For Canadian tax purposes, the tax cost of the property is referred to as the Adjusted Cost Base ("ACB"). The ACB of a property is important when determining the amount of any gain upon the sale of the property. Items which may be added to the ACB include the purchase price, Property Transfer Tax, GST (for new properties), legal fees relating to the purchase, the cost of furniture and fixtures (including taxes) which are sold with the property, and the cost of major improvements or renovations. It is important to keep copies of invoices or receipts for all the above costs as they must be provided to CRA when requesting a Certificate of Compliance (see below). If you wish, we can keep PDF copies of all the above additions to ACB in a special folder on our server, with triple back up. Then all the documents will be readily at hand when the property is sold.

Canadian Tax Return

1) A non-resident owner of a property, which is not rented, is not required to file an annual income tax return as there is no income to report.

2) The non-resident owner will not be required to file an income tax return until the property is sold. If the property is sold for a gain, the non-resident must file an income tax return to claim a refund of taxes withheld for the purpose of obtaining the Certificate of Compliance (see Taxation on disposition below). If the property is sold for a loss, the non-resident cannot claim the loss as CRA considers this to be a personal expense (i.e. "personal use property").

Change of Use

1) This pamphlet assumes that the property is being used 100% for personal use and is not rented at any time, either for nightly rental or monthly rental.

2) There are special very complex rules for the full or partial change of use of the property.

3) For income tax purposes, there will be a deemed disposition, and re-acquisition, at the fair market value if the property is changed from revenue producing (nightly or monthly rentals) to not producing revenue (e.g. for personal use), or from not producing revenue to revenue producing. This could result in income taxes being payable on any increase in value, even though the property has not been sold. It may be possible to avoid the deemed disposition by doing a special election.

4) There may be additional complications for a change to a mixed-use property (e.g. part-year nightly rental, part-year monthly rental and some personal use). Complications could also result, for example, from renting a suite in the home.

5) In addition, there will be GST complications if the owner commences to rent the property on a nightly basis.

6) If the owner is considering renting the property on either a monthly or a nightly basis, there will be implications for both Canadian income tax and GST, on the rental and on the eventual sale. Please contact us if you feel this may be of relevance to you.

Income Tax on disposition

1) Any gain on the disposition of personal property in Canada will be subject to tax in Canada. This tax is levied in two stages. First, there is a withholding tax at the time of disposition and then a final calculation of tax as reported in the T1 personal income tax return which is due after year end.

2) The withholding tax is paid by filing a form **T2062** and paying a **withholding tax of 25% (on the land portion) and up to 50% (on the building portion) of the interim gain on sale**. The interim gain is calculated as the selling price less the ACB. At this stage, commissions, legal and accounting expenses are not deductible in the calculation of the interim gain. Once this form is accepted by CRA and the tax has been paid, CRA will issue a **"Certificate of Compliance"** ("CC") (see attached "Example of Canadian Taxation upon Disposition of Canadian Real Estate by Non-resident Individual").

   CRA is concerned that the non-resident may sell the property, take the proceeds out of Canada and never pay any tax. It would be very difficult for CRA to collect tax from a non-resident who no longer has any assets in Canada. Therefore, the way that CRA enforces the collection of this tax is to transfer the obligation to pay tax from the non-resident vendor to the purchaser of the property. **Unless the purchaser receives** a signed declaration that the vendor is a resident of Canada or receives the above-mentioned **CC**, **the purchaser will be liable for withholding tax of 25% of the selling price** and the purchaser's lawyer must remit this withholding tax to CRA. Some purchaser's lawyers may demand 50% withholding tax on the entire proceeds. Therefore all knowledgeable purchasers will request a CC when purchasing property from a non-resident. This procedure applies whether the purchaser is a Canadian resident or not.

   In practice, the purchaser's lawyer will generally hold back 25 % (or in some cases, up to 50%) of the entire purchase price until they receive the CC. Technically, this tax must be remitted to CRA by the end of the month following the month of closing. However, this requirement can be waived by obtaining a "Comfort Letter" from CRA. It currently takes about 6 to 8 months for CRA to process a CC. The form T2062 may be filed before, and **must be filed within 10 days of, closing**. We suggest that it be filed as early as possible. Penalties will be assessed if it is filed later than 10 days after closing.

3) **After** the end of the taxation year in which the property is sold, the non-resident may file a T1 personal tax return to report the disposition of the property and calculate the actual gain and the final tax. In this calculation of the actual gain, the non-resident can deduct all related selling expenses such as commissions, legal and accounting fees. In addition, depending on the circumstances, the non-resident can normally claim **"capital gains treatment"** which means that **only 1/2 of the gain will be taxable**. The taxable income will be subject to progressive rates from **22% to 49%** (for 2019) Since the total actual tax will be less than the withholding tax paid at the time of obtaining the CC, the non-resident will be entitled to a refund of the difference. Please refer to the attached "Example of Canadian Taxation upon Disposition of Canadian Real Estate by Non-resident Individual".

4) Complications which may arise in the application for CC may include: significant renovations, significant renovations without receipts, joint title, title different from beneficial ownership, insufficient funds to pay out a mortgage, previous deemed disposition upon change of use, principal residence before change of use, previous inheritance of property, joint owners each with different residence status, transfer upon divorce, vendor emigrating from Canada and other issues. We can help with these situations.

5) GST should not be charged on the sale of a **used** residential property which was used for personal purposes only.

This memo is of a general nature only and professional advice should be sought before completing any transaction.

We can help you

We can assist a non-resident as noted in our pamphlet entitled "Services for Non-resident Individuals Investing in Canadian Real Estate".

In particular, we can assist a non-resident with the following:

- Keeping track and calculating the ACB during the period of ownership,
- Advising on the tax implications of a change in use,
- Applying for a Certificate of Compliance upon sale, and
- Preparing and filing the T1 personal tax return to report the gain on sale, and apply for a refund.

In order to provide you with the services noted above, we ask that you complete our Questionnaire.

Please contact us if you would like either of the above. Please note that we also have additional pamphlets regarding nightly rental producing rental income, nightly rental producing business income and monthly rental.

Contact

For further details or questions, please contact Don Nishio.
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Example of Canadian Taxation
upon Disposition of Canadian Real Estate by Non-resident Individual

October 10, 2019

Assumptions:

Purchase (Note 1)		
Purchase price	$	393,000
Property transfer tax		6,000
Legal fees on purchase		1,000
Tax Cost ("Adjusted cost base" - "ACB")		400,000
Sale (Note 1)		
Selling price		600,000
Commission for selling		22,000
Legal and accounting fees for selling		4,000
Mortgage loan balance at time of sale		200,000

Withholding tax at time of disposition to obtain Certificate of Compliance ("CC")

Selling price	$	600,000	
less: ACB		(400,000)	
Interim capital gain		200,000	
Withholding tax rate			25%
Withholding tax payable (Note 2)			50,000

Cash flow on sale

Selling price		600,000	
less: Commission	22,000		
Legal and accounting fee	4,000		
Mortgage payout	200,000		
Holdback by lawyer at 25% on 600,000	150,000		
		(376,000)	
Net payment to non-resident ("NR") owner on closing			224,000
Holdback by lawyer		150,000	
less: Withholding tax paid for CC (see above)		(50,000)	
Net payment to NR owner upon receipt of CC			100,000

Final tax upon filing T1 personal tax return

Selling price			600,000	
less:	ACB	400,000		
	Commission	22,000		
	Legal and accounting fee	4,000		
			(426,000)	
Capital gain			174,000	
Taxable Capital gain - 50% of capital gain			87,000	
Final income tax (estimated at approximately 32%) (Notes 3 & 4)				28,000
Less: Withholding tax paid for CC (see above)				(50,000)
	Tax refund to NR owner - summer of the following year		**$**	22,000

Notes:

1 Assume that all furniture and fixtures are included in the purchase and selling prices.
2 The lawyer will generally hold back $150,000 (25% of $600,000) until the CC is received, but could be more than 25% under some circumstances.
3 The final income tax will be calculated at progressive rates from 22 to 49% (for 2019).
4 The calculation of the final income tax assumes that there is no recapture of CCA.
5 Please refer to our pamphlet "Tax Consideration for Non-Resident Individuals Investing in Canadian Rental Real Estate".