

Non-Residents Investing in Canadian Real Estate

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Non-Residents Investing in Canadian Real Estate

Potential Structures

Structures commonly used by non-residents to hold properties in Canada include:

- Directly by non-resident individuals.
- Foreign or Canadian trust.
- Foreign or Canadian corporation.
- Partnership or joint venture.
- Combination of the above.

There is no one ideal structure as each has its advantages and disadvantages. The optimal structure will be dependent on the objectives of the investor.

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Factors to consider in determining holding structure:

- Number and value of properties (diversification).
- Holding property for development (business income) or rental (investment income) purposes.
- Long-term vs. short-term investment.
- Potential creditor and estate issues.
- Financing of investments.
- Projected annual income from investment.
- Whether the profit will be reinvested back into Canada.

If improperly structured, the profit from the property may be subject to double taxation.

Consult with a professional familiar with Canadian tax before finalizing the purchase of the property.

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Rental income:

- 25% non-resident withholding tax imposed on **gross** rent.
- Tenant or Canadian agent is required to withhold and remit taxes – due 15th of month following the month rent received.
- If 25% withholding tax is remitted, no other action is required.

Election to file income tax return:

- Owner may elect to file an income tax return and report the net rental income (report gross rent and claim related rental expenses).
- Net rental income subject to normal tax calculations.
- The election must be filed within two years after the fiscal year end.
- Where the taxes payable calculated on the tax return is less than the taxes withheld (i.e. 25% of the gross rent), the difference will be refundable upon filing the return.

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NR 6:

- Withholding 25% of the gross rent and applying for a partial refund in the subsequent year may cause cash-flow issues.
- Canadian agent and the non-resident owner may make a joint election to reduce the withholding taxes to projected net rental income (cash flow available to agent). The 25% withholding tax will be imposed on the net rental income (before claiming CCA).
- If the NR6 form is filed, the tax return must be filed within 6 months after the fiscal year end (i.e. on or before June 30th for individuals)
- If the tax return is not filed by the due date or the taxes are not paid on time, the whole withholding tax (i.e. 25% of the gross rent) must be remitted to the tax authorities.
- Canadian agent is jointly liable for withholding tax (make sure tax return is filed if property sold).

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NR4

- Canadian agent must file a NR4 return to report the gross rent collected by the non-resident person and any taxes withheld and remitted to Canada Revenue Agency.
- The return is due on or before March 31st of the following year.
- Late filing penalty may apply - \$25 per day up to 100 days
- Owner needs the NR4 slip to claim refund, if applicable, of taxes withheld.
- Interest imposed on insufficient withholding and remittance.

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Disposition of Taxable Canadian Property:

Vendor must indicate resident status. If vendor is non-resident, purchaser must withhold and remit taxes to the tax department:

- 25% of the gross selling price
- 50% for depreciable properties

For illustration, assume property is sold for \$1.0 million.

	<u>Land</u>	<u>Building</u>	<u>Combined</u>	<u>Taxes</u>
Proceeds on Disposition	\$750,000	\$250,000	\$1,000,000	
Normal withholding tax	\$187,500	\$125,000	\$312,500	\$312,500

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Clearance certificate (T2062):

Withholding tax may be reduced where a clearance certificate is properly obtained. Withholding tax will be imposed on the calculated “preliminary gain” rather than the gross selling price. The progressive tax rates can be used when calculating the withholding tax on the gain on sale of the building.

	<u>Land</u>	<u>Building</u>	<u>Combined</u>	<u>Taxes</u>
Proceeds on Disposition	\$750,000	\$250,000	\$1,000,000	
Normal withholding tax	\$187,500	\$125,000	\$312,500	\$312,500
Tax cost	-400,000	-200,000	-600,000	
Preliminary Gain	350,000	50,000	400,000	
Reduction in withholding tax				-212,000
W/H tax with clearance certificate	\$87,500	\$13,000 (estimated)	\$100,500	<u>100,500</u>

In calculating the preliminary gain, selling costs will not be deductible. The selling costs may be claimed when the income tax return is filed to report the taxable capital gain realized by the non-resident.

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Tax filing to report gain on disposition:

A non-resident disposing of a taxable Canadian property must file an income tax return to report any capital gain arising from the disposition.

- If the calculated tax liability on the tax return is less than the taxes withheld, the difference will be refundable upon filing the return.
- If the calculated tax liability exceeds the amount withheld (very unlikely), the amount owing must be paid at the time the tax return is filed.
- Recaptured depreciation is reported in a separate income tax return along with net rental income (loss).

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Cash-flow on disposition of Taxable Canadian Property

	Land	Building	Combined	Taxes
Proceeds on Disposition	\$750,000	\$250,000	\$1,000,000	
Normal withholding tax	\$187,500	\$125,000	\$312,500	\$312,500
Tax cost	-400,000	-200,000	-600,000	
Preliminary Gain	350,000	50,000	400,000	
Reduction in withholding tax				-212,000
W/H tax with clearance certificate	\$87,500	\$13,000	\$100,500	100,500
Selling Cost – commission, legal	-24,000	-8,000	-32,000	
Profit on Sale	\$326,000	\$42,000	\$368,000	
Refund upon filing tax returns	\$30,500	\$3,000	\$33,500	-33,500
Taxes payable per tax return	\$57,000 (estimated)	\$10,000 (estimated)	\$67,000	\$67,000

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