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Tax Considerations for Non-Resident Individuals Investing in Canadian Real Estate (Never Rented)

August 25, 2010

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

1) Property Transfer Tax is payable at the time of purchase of real property. This tax is calculated as 1% on the first $200,000 and 2% on the excess over $200,000. Other acquisition costs may include inspection fees, appraisals and legal fees.

2) Municipal property taxes are due annually and a pro-rata portion will be payable based upon the number of days that the property is owned in the year of acquisition. Thereafter, property taxes must be paid each year (e.g. July 1 for Whistler) and arrangements should be made with the municipality to ensure they are paid on a timely bases. 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 property, assuming that the property is classified as residential.

3) Harmonized Sales Tax ("HST ") of 12% will generally be charged on the purchase of a newly built property or on the purchase of a commercial property that had been rented by the previous owner. British Columbia Social Service Tax (commonly called Provincial Sales Tax or "PST") was replaced by HST as of July 1, 2010. This HST will become part of the cost. If your intention is to use the property personally, HST must be paid upon purchase. A purchaser of property used for personal purposes cannot and should not register for HST. HST will not be charged on the purchase of a used residential property (personally used property), which includes most homes, townhouses or condos.

4) The HST will not be applicable to the purchase of used residential homes no matter how it will be used. This is the same rule as the old GST system.

5) 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.

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, HST (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).

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 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.

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, 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 personal use). Complications could also result, for example, from renting a suite in the home.

5) In addition, there will be HST 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 HST, on the rental and on the eventual sale. Please contact us if you feel this may be of relevance to you.

Taxation 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 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% 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 <u>not</u> 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"** (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 Certificate of Compliance, 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 Certificate of Compliance 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 % of the entire purchase price until they receive the Certificate of Compliance. 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 12 to 16 weeks for CRA to process a Certificate of Compliance. The form T2062 may be filed before, and must be filed within 10 days of, closing and 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, he can deduct all related selling expenses such as commissions and legal and accounting fees. In addition, depending on the circumstances, he may be allowed **"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 43%** (for 2010) and if the total tax is less that the withholding tax paid at the time of obtaining the Certificate of Compliance, the non-resident will be entitled to a refund of the difference.

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

Please refer to the attached "Example of Canadian Taxation upon Disposition of Canadian Real Estate by Non-resident Individual".

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 (in English or Japanese), Mike Lam (Cantonese or Mandarin), Bernard Lo (Cantonese).

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Example of Canadian Taxation
upon Disposition of Canadian Real Estate by Non-resident Individual

June 10, 2010

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 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 43% (for 2010).

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".