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

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

- 1) Property Transfer Tax is payable at the time of purchase. This tax is calculated at 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 payable annually and you will be required to pay that portion of the annual amount based upon the number of days you own the property in the year of acquisition. Thereafter, you must pay on an annual basis. The amount is based upon the assessed value and the “mill rate” set by the municipality however, as a general “rule of thumb”, annual property taxes are very approximately 0.5 to 1% of the value of the property, assuming that the property is classified as residential.
- 3) Goods and Services Tax (“GST”) of 5% will generally be charged on the purchase of a newly built property. This GST will become part of the cost. No GST will be charged on the sale of a used residential property, which includes most homes, townhouses or condos. The purchaser should not register for GST.
- 4) Tax planning issues which should be discussed include ownership structure, capitalization of expenditures to reduce tax or future gains, foreign exchange 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 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 (including GST and PST) of furniture and fixtures 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 Clearance Certificate (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 Clearance Certificate (see below). If the property is sold for a loss, there may be a benefit to filing the return to record the capital loss which can be carried forward to future years.

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 rules for the full or partial change of use of the property. For example, regarding a change from residential to rental (either nightly or monthly), there will be a deemed disposition and re-acquisition at the fair market value at the time of the change. This could result in income taxes being payable on any increase in value, even though the property has not been sold.
- 3) There may be additional complications for a change to a mixed-use property (e.g. part-year nightly rental or part-year monthly rental). Complications could also result, for example, from renting a suite in the home.
- 4) In addition, there will be GST complications if the property is rented on a nightly basis.
- 5) 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.

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, commission expenses, 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 **“Clearance Certificate”** (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 Clearance Certificate, 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 demand a Clearance Certificate 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 he receives the Clearance Certificate. 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 8 to 10 weeks for CRA to process a Clearance Certificate. 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 will usually 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 **24% to 43%** (for 2006) and if the total tax is less than the withholding tax paid at the time of obtaining the Clearance Certificate, the non-resident will be entitled to a refund of the difference.
- 4) GST 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 of, and calculating, the ACB during the period of ownership,
- Advising regarding the tax implications of a change in use,
- Applying for a Clearance Certificate, and
- Preparing and filing the T1 personal tax return to apply for a refund.

In order to provide the services noted on the above pamphlet, we would request that you complete our Questionnaire.

Please contact us if you would like either of the above.

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**

Jan. 24, 2008

Assumptions:

Purchase (Note 1)		
Purchase price	\$	400,000
Property transfer tax		6,000
Legal fees on purchase		1,000
Tax Cost ("Adjusted cost base" - "ACB")		407,000
Sale (Note 1)		
Selling price		607,000
Commission for selling		22,000
Legal and accounting fees for selling		2,000

Withholding tax at time of disposition to obtain Clearance Certificate

Selling price	\$	607,000
less:ACB		(407,000)
Interim capital gain		200,000
Withholding tax at 25%		25%
Withholding tax payable (Note 2)		50,000

Final tax upon filing T1 personal tax return

Selling price	607,000
less:ACB	407,000
Commission	22,000
Legal and accounting fee	2,000
	(431,000)
Capital gain	176,000
Taxable Capital gain = 50% of capital gain	88,000
Final income tax (estimated at approximately 31%) (Note 3)	28,000
Less: Withholding tax paid for Clearance Certificate	(50,000)
Refund	\$ 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 \$151,750 (25% of \$607,000) until the Certificate is received.
- 3 The final income tax will be calculated at progressive rates from 24 to 43% (for 2008).