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Chartered Accountants  
*Understanding, Advising, Guiding*

**Taxation of Non-Resident Owned Real Estate**  
November 17, 2010

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**Topics**

- Purchase
- Ownership
- Sale

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**NR Purchase of Real Estate**

Financing:

- Canadian banks will typically only finance 35% of the purchase price with no high-ratio options available
- Can financing be obtained abroad?

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**NR Purchase of Real Estate**

Closing costs:

- BC Property Transfer Tax - First Time Home Buyers' Exemption is generally not available...
  - ...unless the purchaser becomes a permanent resident of Canada within 12 months of the purchase (not to be taken lightly)

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**NR Purchase of Real Estate**

Closing costs:

- HST- New Housing Rebates are generally not available...
  - ...unless it is the *current* primary place of residence of the purchaser, or someone related to the purchaser
  - Must consider income tax residence and appropriate ownership

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**NR Purchase of Real Estate**

Closing costs:

- HST- New Residential Rental Property Rebates may be available
  - Ensure non-resident income tax filing requirements for rental income are met
  - Be wary of "changes in use"

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## NR Purchase of Real Estate

### Closing costs:

- HST- What if it's commercial property?
  - A non-resident of Canada can register for GST/HST to claim an input tax credit on the GST/HST paid/self-assessed on the purchase
  - Note that the non-resident owner must charge HST on any future sale (or "change of use") of the property

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## NR Ownership of Real Estate

### Personal use:

- Property tax – Home Owners Grant is not available
  - Must be a Canadian citizen or landed immigrant and ordinarily reside in BC
    - Again, this is not to be taken lightly

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## NR Ownership of Real Estate

### Rental:

- Canada has the ability to tax non-residents on certain types of income and gains earned from sources within Canada
- That includes income and gains from real property located in Canada
- Tax treaties do not provide an exemption from the taxation of real property income and gains, so our domestic law prevails

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## NR Ownership of Real Estate

### Rental:

- Ultimately, the taxation of rental income and gains from real property is not dissimilar from the taxation of such amounts for Canadian residents
- Unfortunately, there is a special filing and withholding tax regime in place designed to protect Canada's ability to collect such taxes from non-residents

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## NR Rental of Real Estate

### Rental income – withholding tax:

- By default, rental income is subject to a 25% withholding tax on the gross amount of the rental income
- This withholding must be remitted to the Canada Revenue Agency ("CRA") by the 15<sup>th</sup> of the month after the rent is paid

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## NR Rental of Real Estate

### Rental income – withholding tax:

- For example:
  - Mr. X receives \$2,000 of rental income in November 2010 as a non-resident of Canada
  - The withholding is \$500, and it must be remitted to the CRA by December 15, 2010

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## NR Rental of Real Estate

Rental income – withholding tax:

- Who is supposed to withhold and remit?
  - The agent/property manager handling the funds (or the tenant, if there is no agent)
- What if they don't withhold and remit?
  - Penalties up to 10% on the failed withholdings (20% if gross negligence)
  - Arrears interest
  - Joint liability for the agent/tenant

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## NR Rental of Real Estate

Rental income – withholding tax:

- Year end reporting – NR4
  - The remitter is also required to file an NR4 to report the gross rental income and related withholdings at the end of the year
  - This is due March 31<sup>st</sup> of the following year (e.g. 2010 NR4's are due March 31, 2011)
  - Penalties (up to \$1,000 for a single NR4) and interest also apply for late filings

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## NR Rental of Real Estate

Rental income – what now?

- Your client has had 25% withheld from gross rental income, and has an NR4 slip to prove it
- Is that the end of it?
- It can be...
  - However, there is an alternative

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## NR Rental of Real Estate

Rental income – S.216 returns

- S.216 is a special part of the Income Tax Act that allows non-residents to file tax returns in Canada to claim expenses against their rental income
  - The net amount is then subject to tax at graduated/bracket rates of tax – rather than a flat 25%
- Most of the time, this is a better option

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## NR Rental of Real Estate

Rental income – S.216 returns

- What can a non-resident deduct as a rental expense?
  - Mortgage interest (*even if the lender is outside of Canada*)
  - Property taxes and insurance
  - Strata, property mgmt, and other fees
  - Repairs and maintenance
  - Depreciation...

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## NR Rental of Real Estate

Rental income – S.216 returns

- What's the catch?
  - The S.216 return must be filed within 2 years after the end of the year
  - So for the 2010 calendar year, the S.216 return must be filed no later than December 31, 2012
  - If it's late –you lose the option of filing a S.216 return, and you're stuck with gross withholding at 25%

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## NR Rental of Real Estate

Rental income – S.216 returns

- What are the options if you're behind the eight ball?
  - Voluntary disclosure – if the CRA hasn't already contacted you in any way, shape, or form, you can come forward and they'll (currently) administratively allow you to file S.216 returns to claim expenses against your rental income, even beyond the 2 year deadline

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## NR Rental of Real Estate

Rental income – S.216 returns

- Voluntary disclosure
  - There is a specific process and procedure to follow to ensure you are allowed to file the late S.216 returns without penalties
  - Arrears interest on the failed withholdings will still apply, but this is typically quite manageable
  - This is a one shot deal

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## NR Rental of Real Estate

Rental income – S.216 returns

- If the CRA is the one to make first contact over failed rental withholdings
  - S.216 returns can still be filed for the current and previous two years to claim expenses
  - Older years are too far gone
  - Both penalties and interest will apply

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## NR Rental of Real Estate

Rental income – S.216 returns

- If the CRA is the one to make first contact over failed rental withholdings
  - You're now into fairness applications (to waive interest and penalties) and payment plans (to manage cash flow) – both of which are CRA processes
  - You can file an objection to have the late S.216 returns allowed, but it will be costly with a low chance of success

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## NR Rental of Real Estate

Rental income – S.216 returns

- What are your options if you're ahead of the game?
  - You can work with your property manager or other agent to file an NR6 undertaking

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## NR Rental of Real Estate

Rental income – S.216 returns

- NR6 undertaking
  - This form declares that you are undertaking to file a S.216 return within 6 months after year end (e.g. June 30<sup>th</sup>)
  - This form also allows the property manager/agent to withhold and remit 25% tax on only your net rental income (before depreciation) – so your cash flow is better

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## NR Rental of Real Estate

Rental income – S.216 returns

- NR6 undertaking – what’s the catch?
  - If you don’t file the S.216 return by the June 30<sup>th</sup> deadline, you lose the ability to file a S.216 return at all
  - You revert to being taxed at 25% on your gross rental income
  - Your property manager/agent is jointly liable for this tax
    - Watch the deadlines!

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## NR Rental of Real Estate

Rental income – S.115 “alternative”

- S.115 return – where the income is active business income rather than passive rental income (e.g. hotel v. condo)
  - Regulation 805 waiver of withholding instead of an NR6 undertaking
  - CRA can be sticky about what qualifies as an active business v. a passive rental activity

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## NR Rental of Real Estate

Rental income – S.115 “alternative”

- S.115 returns
  - No “hard” statutory deadline for filing the return to claim expenses, but ordinary deadlines always apply, and the CRA can become impatient and assess the 25% withholding tax anyway (in which case you may have to re-prove that S.115 applies to allow expenses to be claimed)

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## NR Rental of Real Estate

Rental income – S.115 “alternative”

- S.115 returns
  - Expenses paid to other non-residents (such as loan interest) may be subject to withholding
  - Has different GST/HST implications for the income from the property and for the purchase/sale of the property

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## NR Sale of Real Estate

Taxation of gains

- Again, non-residents are taxable on their gains realized on real property located in Canada, just like Canadian residents
- What’s different is the withholding tax and filing regime in place to protect Canada’s ability to collect such taxes

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## NR Sale of Real Estate

Sale of real property – default process

- First, 25% withholding tax applies to the gross sale price of the property
  - The withholding tax must be remitted by the end of the month after the month of the sale
    - E.g. If a \$400,000 sale closes on November 23<sup>rd</sup>, \$100,000 withholding tax must be remitted by December 31<sup>st</sup>

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## NR Sale of Real Estate

Sale of real property – default process

- Second, the sale of the property must be reported on a special Form T2062
  - The form reports certain details of the property sale (vendor, purchaser, address, sale price, cost base, etc.)
  - The form and supporting documents must be filed within 10 calendar days after the sale, or a penalty of \$25/day up to \$2,500 applies

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## NR Sale of Real Estate

Sale of real property – default process

- Third, the CRA issues a “clearance certificate” which confirms receipt of the gross withholding tax for both the vendor and purchaser

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## NR Sale of Real Estate

Sale of real property – default process

- Fourth, after the end of the year, the non-resident vendor files a Canadian tax return to claim the cost base of the property and selling costs against the gain
  - The net gain is then subject to graduated tax rates (rather than a flat 25%)
  - Any excess amounts withheld are refunded

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## NR Sale of Real Estate

Sale of real property – default process



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## NR Sale of Real Estate

Sale of real property – proactive process

- First, file the T2062 before closing
  - Doing so requests that the withholding be reduced from 25% of the gross sale proceeds, to:  
 $25\% \times (\text{Proceeds} - \text{Cost Base})$
  - Note that selling costs cannot be factored in at this stage

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## NR Sale of Real Estate

Sale of real property – proactive process

- Second, the CRA reviews the T2062 and:
  - Approves the amounts; and
  - Issues a notice confirming the reduced amount of withholding taxes to be remitted
- The CRA review process can take 12 to 16 weeks, and may require further submissions of information (desk audit)

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### NR Sale of Real Estate

Sale of real property – proactive process

- Third, on the closing date, 25% is still withheld from the sale price
  - However, instead of being remitted in full, it is retained (typically by the vendor's lawyer) in a trust account
  - What the lawyer does remit to the CRA is the reduced amount of withholding confirmed in the CRA notice

### NR Sale of Real Estate

Sale of real property – proactive process

- Fourth, the CRA accepts the remittance, and issues a Clearance Certificate
  - This usually takes a few days
  - Upon receipt of the Clearance Certificate, the lawyer may then remit the remainder of the 25% withheld from the sale price to the vendor

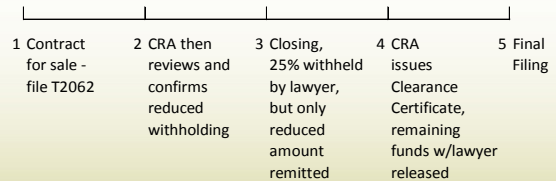
### NR Sale of Real Estate

Sale of real property – proactive process

- Fifth, after the end of the year, the non-resident vendor files a Canadian tax return to claim selling and other costs not previously permitted
  - The net gain is subject to graduated tax rates (rather than a flat 25%)
  - Any excess amounts withheld are refunded

### NR Sale of Real Estate

Sale of real property – proactive process



### NR Sale of Real Estate

- Other details to note
  - If the property is a rental property or business premises, 50% withholding tax technically applies to the building portion of the sale price
  - If the property is a development or "flip" property, 50% withholding tax technically applies to the entire sale price
  - In these cases, a separate Form T2062A must be filed

### NR Sale of Real Estate

- Other Tips and Traps
  - Corporations can have non-calendar year ends – so their filing deadlines may be different

## NR Sale of Real Estate

- Other Tips and Traps
  - Watch out for changes of use
    - Rental to personal use, and vice versa
    - Short term rental (<1 month at a time) to long term (>1 month at a time), and vice versa
    - Can result in *deemed* dispositions and re-acquisitions at fair market value, triggering HST and capital gains taxes

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## NR Sale of Real Estate

- Other Tips and Traps
  - Non-residents can potentially have access to the principal residence exemption too
    - When they are former residents of Canada...
    - Or even when they are not...

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## NR Sale of Real Estate

- Other Tips and Traps
  - Consider leveraging to minimize Canadian income taxes on passive rental properties (particularly where the borrowing is outside of Canada)

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## NR Sale of Real Estate

- Where you can help
  - Purchase
    - How should the purchase be structured given the expected use?
  - Ownership
    - Know a good property manager?
    - Market evaluations for changes of use
  - Sale
    - Being proactive with the process

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