Welcome

Welcome to the 2017 edition of KPMG’s Canadian Real Estate Tax Handbook. This book is intended for tax, accounting and finance professionals and others with an interest in the Canadian income tax and GST/HST issues impacting the Canadian real estate industry.

KPMG has prepared this tax handbook in order to provide the Canadian real estate industry participants including private and public owners, operators and developers and other advisors with a useful tax technical guide to help them navigate through some of the tax fundamentals that will assist in creating long term value.

The world is constantly evolving, and in today’s globally integrated economies, governments continue to introduce tax policy changes and tax authorities continue to invest in advanced technologies and resources for enhanced enforcement.

Through KPMG’s assessment of the Canadian Real Estate industry, a number of trends influence today’s tax environment, including:

1. Increasing complexity of relevant laws;
2. Increasing globalization of investment;
3. Increasing sophistication of financial and structural arrangements;
4. Increasing urbanization and intensification;
5. Changing demographics and increasing social media; and,
6. Increasing velocity to take action.

With this pace of change, there are new pressures on tax professionals to continue making informed decisions on the company’s day-to-day operations, managing their tax risks and identifying tax efficient planning opportunities.

We hope that KPMG’s Canadian Real Estate Tax Handbook assists our audience in making more informed decisions on day-to-day operations, and to channel such decisions proactively and positively to create real value for the developers, owners, operators, shareholders, unit holders, investors and lenders who form the real estate industry.

Lorne Shillinger
Partner, National Real Estate Tax Leader
Notice to readers

The information contained in the Canadian Real Estate Handbook (the “Handbook”) is current to October 31, 2016.

All information provided herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavour to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act upon such information without appropriate professional advice after a thorough examination of the particular situation.

The information takes into account the applicable provisions and judicial and administrative interpretations of the relevant taxing statutes, the regulations thereunder and applicable tax treaties. The information also takes into account all specific proposals to amend these legislative authorities or other relevant statutes and tax treaties publicly announced prior to the date of this Handbook, based on the assumption that these amendments will be enacted substantially as proposed. The information does not otherwise take into account or anticipate any changes in law or practice, by way of judicial, governmental or legislative action or interpretation. These legislative authorities are subject to change, retroactively and/or prospectively, and any such changes could have an effect on the validity of the information.

All statutory references herein, unless otherwise noted, are to the Income Tax Act (Canada) (the “Act”). References to the Canada Revenue Agency (“CRA”) herein also include its predecessors (i.e., the Canada Customs and Revenue Agency, Revenue Canada and the Department of National Revenue).
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Common Forms of Real Estate Ownership
Common Forms of Real Estate Ownership

Common forms of real estate ownership include:

- Co-ownerships
- Joint ventures
- Partnerships
- Corporations
- Trusts
- REITs

The particular form of ownership is selected specifically for each property. Particular circumstances and considerations influence the preferred form of ownership. For example:

- The taxable status of the investor may have structural implications and potential limitations on the nature of property held, revenue earned and activity conducted.
- Financing considerations may require a property to be held in a single, sole-purpose entity to ensure the lender’s interest in the property is protected in case of bankruptcy or other similar legal proceedings that may give rise to “super priority” claims.
- If start up losses are anticipated, an entity that can flow through losses for tax purposes (for example, a partnership) may be preferred.
- Where flexibility for independent tax planning is desirable, including separate discretion to claim capital cost allowance (“CCA”), a co-ownership may be preferred.

Joint Ventures

A joint venture is a term used to describe a business undertaking by two or more persons engaged in a single defined project, such as the development of a parcel of real estate.

A joint venture is not defined in the Act or the Excise Tax Act.

The term “joint venture” may be generally used to describe many forms of real estate ownership (i.e., a co-ownership, partnership or corporation). In some cases, it may be used to describe a contractual relationship among the joint venturers and may be similar to, but distinguishable from, a partnership with respect to a particular undertaking.

Co-ownerships

Co-ownerships are commonly used when tax and legal exposures associated with the particular undertaking or business are not expected to be significant. With a co-ownership, the parties each own an undivided interest in the property.

When a party (A) “contributes” a property to a co-ownership, A may have a disposition for tax purposes of an undivided interest in that property to the co-owner. Thus, if A contributes a property with an accrued gain to a co-ownership, A could face a tax liability on creation of a co-ownership.

Where this is the case, the acquiring party (B) (i.e., the other party to the co-ownership) will have an acquisition for tax purposes of an undivided interest in the property contributed by A.

The term “co-ownership” is not defined in the Act. A co-ownership refers to an arrangement under which parties make a joint investment, but each co-owner has a direct ownership interest in that investment. The parties often enter into a co-ownership agreement that sets out their respective rights, obligations, and remedies.
For individual participants, a co-ownership of real estate may be in the form of a “joint tenancy” or a “tenancy in common”.

- A joint tenancy differs from a tenancy in common because each joint tenant has the “right of survivorship” to the other’s share. A right of survivorship means that the surviving individual joint tenant immediately becomes owner of the whole property on the death of the other joint tenant.

- In contrast, on the death of an individual tenant in common, his or her interest will pass according to his or her will.

Tenants in common may have different shares in a particular parcel of real estate. For example, where A and B are tenants in common with respect to Parcel X, A can have a 60% ownership interest in Parcel X while B can have a 40% ownership interest in the same Parcel X.

A co-ownership must be distinguished from a partnership (discussed below).

**Tax Considerations of Co-ownerships**

Income is not computed at the co-ownership level. A co-ownership is not required to file a tax return.

Each co-owner computes its income based on its undivided interest in the underlying assets. In this respect, co-owners will generally share proportionately in the revenues and expenses associated with their undivided interest in the property. Co-owners can optimize their CCA claims in respect of depreciable property (such as buildings) and other discretionary deductions to suit their own tax situation.

A co-ownership does not have its own fiscal period under the Act and is not regarded as a separate person. As such, each co-owner should compute its income from the property earned during its taxation year.

Until 2011, the CRA had administratively allowed a co-ownership to adopt a fiscal period separate from those of its co-owners and to allocate income to the co-owners for that period in a manner similar to a partnership provided that there was a valid business reason that justified a separate fiscal period for the co-ownership. This administrative policy was withdrawn with the introduction of the partnership anti-deferral rules discussed below.¹

¹ See the response to question 40 at the Revenue Canada Round Table at the 1989 Canadian Tax Foundation Annual Conference and CRA, 2002-0146715, “Fiscal year-end joint venture”, dated July 28, 2002.

The tax positions of parties to a co-ownership are independent of each other (i.e., each co-owner can characterize its income differently depending on its own conduct and degree of activity in respect of the jointly owned assets), but the CRA may look for consistent treatment of specific items in similar circumstances.

Income from a co-ownership is not subject to the specified partnership limitations that restrict access to the small business deduction.

A co-ownership is generally preferred when the income from the jointly owned property must be considered property income (as opposed to business income) to one participant such as a tax exempt entity, and may be considered business income to the other participant. However, the proper character of the income to a particular co-owner may depend on the co-owner’s conduct and degree of activity in relation to the property.

Other contractual relationships that create a joint interest in a business activity include participating debt, convertible debt, head leases and ground leases.

**Tax Considerations of a Co-ownership/Unincorporated Joint Venture Fiscal Year-end**

The CRA formerly allowed, on an administrative basis, a joint venture to establish a fiscal period that could differ from the fiscal period of one or more of its participants. In this manner, for tax purposes, financial reporting for the joint venture needed to be prepared only once per year regardless of the fiscal period of its members.

Under the CRA’s former policy, a participant could defer its share of joint venture income if the joint venture established a fiscal period ending after the fiscal period of the participant. The deferral of joint venture income by a participant complied with tax policy because the same opportunity would have been available if the joint venture were structured as a partnership.

In 2011, however, new measures were enacted to eliminate the deferral opportunity available to partners where a corporation owns a significant interest in the partnership (these rules are discussed below). Consequently, the CRA withdrew its policy on joint ventures and issued a revised joint venture administrative policy (the “Revised Policy”).² For taxation years ending after March 22, 2011, a participant in a joint venture must include in income for its taxation year its share of the joint venture’s income earned in the participant’s taxation year.³
Partnerships

Partnerships are a common form of carrying on a real estate business because, in addition to the benefit of income or loss flowing through to its partners for income tax purposes, a partnership may permit one or more members of the partnership to contribute property with an accrued gain for tax purposes into an investment vehicle that will accommodate the business transaction without immediate tax consequences.

What is a Partnership?

According to the Supreme Court of Canada (“SCC”) in Backman v R,4 and Spire Freezers Ltd v R,5 the term “partnership” must be given its legal meaning for income tax purposes. The CRA has agreed with this jurisprudence.6

Legal Meaning of “Partnership”

Each of the common law provinces in Canada (i.e., all the provinces except for Quebec) has enacted its own partnership legislation.7 In general, a partnership is a relationship that exists between two or more persons carrying on business in common with a view to profit. Whether a partnership exists is a mixed question of fact and law.

The existence of a co-ownership of property does not, in itself, create a partnership. In Thomas Whealy et al v The Queen,8 a partnership disposed of all its significant assets and was left with only two newly acquired 5% interests in two gas wells with nominal value. The Tax Court of Canada (“TCC”) found that

the partnership did not carry on any business after the disposition, the purported partners did not have a view to profit from their interest in the partnership, and the taxpayers were co-owners of interests in the two gas wells but were not partners of a partnership. In its analysis, the TCC relied on the SCC’s decisions in Backman and Spire Freezers. The Federal Court of Appeal (“FCA”) upheld the TCC decision on appeal.

In contrast to a corporation, a partnership is not a separate legal entity. A general partnership is a partnership consisting of members who are jointly and severally liable for the debts and obligations of the partnership. A partner of a general partnership has unlimited liability in respect of the debts and obligations of the partnership incurred while the person is a partner. A limited partnership consists of limited partners with limited liability and at least one general partner with unlimited liability. A limited partner’s liability for the debts and obligations of the partnership generally is limited to its investment in the partnership. However, to maintain that limited liability, a limited partner’s ability to participate in the management or control of the partnership business is restricted.

Tax Considerations of Partnerships

A partnership is not a taxpayer under the Act, but certain partnerships (i.e., specified investment flow-through (“SIFT”) partnerships) may be liable to pay income tax (discussed below).

A partnership first must compute its income (or loss) for the year as if it were a person resident in Canada and then allocates its income (or loss) for the year to its members.9 With limited exceptions, discretionary tax deductions, such as CCA and tax reserves, are determined at the partnership level.

Unless all partners are principal business corporations, rental property rules, which restrict CCA claims, will apply in computing the partnership’s income (discussed below).10

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3 For the participant’s first taxation year ending after March 22, 2011, the participant was required to include in income each of the following amounts:
   - Its share of joint venture income for the joint venture’s fiscal period that ends within the participant’s taxation year; and
   - Its share of joint venture income for the period commencing in the participant’s taxation year and ending on the participant’s taxation year-end (the “JV Stub Period”).
As a result, a participant whose fiscal period does not coincide with that of a joint venture must include in income for its first taxation year ending after March 22, 2011 its share of joint venture income for a period exceeding 12 months. For a participant in a joint venture who relied on the CRA’s former policy, the CRA offered transitional relief if the participant elected in writing on or before September 22, 2012. Transitional relief was based on the participant’s share of joint venture income for the JV Stub Period Eligible Income. The participant was required to recognize Eligible Income gradually over its five taxation years that follow its first taxation year that ends after March 22, 2011 in a manner similar to, subject to the same conditions as, the reserve for qualifying transitional income (QTI) available to corporate partners of partnerships under section 34.2. In particular, a participant could deduct, as a reserve, the Eligible Income to the extent of 100% for the participant’s taxation year(s) that end in 2011, 85% for year(s) that end in 2012, 65% for year(s) that end in 2013, 45% for year(s) that end in 2014, and 25% for year(s) that end in 2015.

4 2001 SCC 10.
5 2001 SCC 11.
6 CRA Folios, S4-F16-C1, “What is a Partnership?”, dated May 5, 2015.
7 In Quebec, Canada’s only province with a civil law system as opposed to common law system, partnerships are governed by the Civil Code of Quebec, CQLR, c CCO-1991.
8 2004 TCC 377, aff’d 2005 FCA 190.
9 Subsection 96(1).
10 Regulations 1100(11), (12), (13) and (14).
Income (or loss) of a partnership retains its character when allocated to each partner, for example, as business income (business loss), capital gain (capital loss), income from foreign sources, or dividends.

A partnership can have income (or loss) from more than one source, such as business, professional, commission, farming, fishing, rentals and investments. If so, the income (or loss) from each source is calculated separately.

A “Canadian partnership” is defined as a partnership all of the partners of which are Canadian residents. A partnership that does not meet this definition is referred to as a non-Canadian partnership (discussed below).

**Fiscal Period**

Generally, a partnership may select a non-calendar taxation year-end provided that it does not have an individual (including certain trusts) as a member of the partnership. If there is an individual member, the partnership must adopt a December 31 year-end.

In computing its income for the year, a partner must include its share of the income of the partnership for the partnership’s fiscal year coinciding with or ending in the partner’s taxation year. Prior to legislative changes in 2011, this may have allowed a corporate partner to defer recognition of income where the partnership’s fiscal period ended after the corporate partner’s taxation year-end.

However, sections 34.2, 34.3 and 249.1 were introduced in 2011 to limit the deferral opportunity where a corporation owns a significant interest in a partnership.

While a partnership may retain a fiscal period that differs from the fiscal period of its corporate partners, a corporation that owns a significant interest in the partnership must include in income in the year each of the following amounts:

– Its share of the partnership income for the partnership’s fiscal period that ends within the corporation’s taxation year; and

– An accrued amount for the portion of the partnership’s fiscal period, commencing in the corporation’s taxation year and ending on the corporation’s taxation year-end (the “Stub Period”).

**Corporate Partnership Deferral Example—New Rules**

<table>
<thead>
<tr>
<th>Corporate Partner Taxation Year</th>
<th>Stub Period Accrual</th>
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<tbody>
<tr>
<td><strong>Stub Period</strong></td>
<td><strong>$1,100K</strong></td>
</tr>
<tr>
<td>Partnership Fiscal period</td>
<td><strong>$1,200K</strong></td>
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<tr>
<td>(Feb 1 – Jan 31)</td>
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<td></td>
<td>– The corporate partner may no longer defer the stub period income of $1,100K.</td>
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<tr>
<td></td>
<td>– The corporate partner must include 23 months of income ($2,3000K) in taxable income, subject to transitional relief.</td>
</tr>
</tbody>
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A corporation has a “significant interest” in a partnership if the corporation, together with related and affiliated persons or partnerships, is entitled to more than 10% of the income (or loss) of the partnership or the assets (net of liabilities) of the partnership on dissolution.

A partnership’s “Stub Period Accrual” is calculated using a formula and includes the partnership’s income from all sources. Losses of a partnership cannot be accrued for the Stub Period. This approach is called the Formulaic Approach.

Although the Stub Period Accrual may include taxable capital gains, the non-taxable portion of any capital gain giving rise to such taxable capital gains is not included in the computation of a corporate partner’s capital dividend account.

The corporate partner can designate a lesser amount as the Stub Period Accrual by claiming a discretionary deduction. This designation cannot be amended or revoked. This designation is intended to allow a corporate partner to reduce its Stub Period Accrual to reflect its knowledge of the actual partnership income for the Stub Period. This approach is called the Designation Approach.

---

11 Subsection 102(1).
12 Qualification as a “Canadian partnership” is important to achieving certain tax consequences. For example, assets may not be transferred to a non-Canadian partnership on a tax-deferred basis under subsection 97(2) and a non-Canadian partnership may not be dissolved on a tax-deferred basis under subsections 98(3) and 98(5).
13 Subsection 249.1(1).
14 Where a foreign affiliate of a taxpayer is a member of a partnership, these rules do not apply for purposes of computing the foreign accrual property income (FAPi) of the affiliate: see subsection 34.218.
15 This excludes taxable dividends deductible under subsection 112(1) and 113(1).
16 See definition of “significant interest” in subsection 34.2(1).
17 Subsection 34.2(10).
Each year, and separately for each partnership, a corporate partner may adopt either the Formulaic Approach or the Designation Approach. The approach chosen is only binding for the particular taxation year for the particular partnership. Therefore, the corporate partner has discretion to change the accrual approach used in a subsequent year.\(^\text{18}\)

A penalty mechanism deters an excessive discretionary designation for a taxation year (the “Deterrent Penalty”). The Deterrent Penalty requires a corporate partner to include an additional amount in income for the following taxation year, determined by a formula and consisting of two amounts:

- The total of all “income shortfall adjustments” in respect of each qualifying partnership of the corporate partner, which is computed by reference to the prescribed rate of interest; and
- A “penalty” applicable where the income shortfall adjustment exceeds 25% of a “base amount”. The base amount is the lesser of the total of all “income shortfall adjustments” and the total of all amounts each of which is 25% of the amount that would be the income shortfall adjustment in respect of each qualifying partnership if no Stub Period Accrual were included in income for the prior year. The penalty is 50% of the excess.

18 To mitigate the cash tax impact of the initial recognition of accrual income, a corporate partner may have been eligible to claim a transitional reserve on certain “qualifying transitional income” (“QTI”) over a five-year period from 2012 to 2016. QTI includes the total of the corporation’s initial accrual of partnership income for the corporation’s first taxation year ending after March 22, 2011 (i.e., its initial Stub Period Accrual), and partnership income allocated to the corporation under a “single-tier alignment election” or a “multi-tier alignment election” (deemed or actual). QTI is computed as if the partnership deducted the maximum amount of any expense, reserve, allowance or other discretionary amount. The initial calculation of QTI is adjusted upwards or downwards to “true-up” the QTI with the corporate partner’s pro rata share of the actual income of the partnership for the Stub Period. This true-up to the reserve was generally made in the corporation’s second taxation year ending after March 22, 2011 (if there had been no intervening short taxation year of the corporation). Transitional relief was not available or could be lost in certain circumstances.

19 Subsection 249.1(8).

At the same time that measures were introduced in 2011 to limit the deferral opportunity for a corporation that owns a significant interest in a partnership, transitional rules were introduced that allowed the corporate partner to file a one-time election to change the fiscal period of the partnership to align with the taxation year of one or more of the corporate partners, which could have been an off-calendar taxation year (a “single tier alignment election”).\(^\text{19}\) A similar one-time election was available for corporate partners with a significant interest in a tiered partnership structure (a “multi-tier alignment election”). The deadline to file the single tier and multi-tier alignment elections was the earliest filing due date of a corporate partner for its first taxation year ending after March 22, 2011 and was binding on all corporate partners (regardless of whether they held a significant interest in the partnership(s)). The Department of Finance (“Finance”) extended this deadline to January 31, 2012.

---

**Corporate Partnership Deferral Example**

- Designations cannot be amended or revoked
- In the formula, allowable capital losses are streamed against taxable capital gains.

**Income Shortfall Adjustment**

\[- \text{Income shortfall adjustment recognizes the time value of money for the income deferred by reason of the designation}\]
KPMG Observations

A corporate partner with significant interests in multiple partnerships may expect to realize, during the Stub Period, income in one partnership that is offset by losses in another partnership. However, a Stub Period Accrual cannot be negative. Therefore, in such circumstances the Designation Approach may be used to achieve the offset.

The formula for computing the Deterrent Penalty allows a corporate partner to offset an over-reported Stub Period Accrual for one partnership against an under-reported Stub Period Accrual of another partnership. Therefore, a discretionary designation can be made for the profitable partnership equal to the expected loss of the unprofitable partnership.

A deferral opportunity is available for a corporation that conducts condominium development activity in a partnership that adopts a fiscal period that differs from the fiscal period of its corporate partners. As discussed below under “Sale of Condominium Units,” revenue on the sale of a condominium unit is generally recognized on the second closing date, when the condominium is registered and legal title to the property is transferred to the purchaser. This commonly results in the realization of a significant portion of the profit related to that project. Therefore, substantial income may be recognized for tax purposes on this single date. Depending on the timing of the second closing date and the year-ends of the partnership and its corporate partners, a deferral of close to two years may result.

Specified Investment Flow-through (SIFT) Partnerships

Unlike the treatment of other partnerships under the Act, a SIFT partnership is liable for tax at the partnership level.

A SIFT partnership is defined as a partnership that, at any time during the taxation year, and meets the following conditions:

- It is a Canadian resident partnership (e.g., a Canadian partnership and a partnership formed in Canada);
- “Investments” in the partnership are listed or traded on a stock exchange or other public market; and
- The partnership holds one or more “non-portfolio properties” (e.g., (1) shares of a Canadian corporation if the shares have a total fair market value (“FMV”) that is greater than 10% of the equity value of the corporation, (2) Canadian real estate or resource properties if the FMV of all such properties held is greater than 50% of the equity value of the partnership or (3) property that the partnership, or a non-arm’s length person, uses in the course of carrying on a business in Canada.)

Generally, the SIFT rules apply to partnerships whose equity is publicly traded. To determine if a private partnership’s equity is considered “listed or traded on a stock exchange or other public market,” a review of the equity of the partnership and its partners must be made, taking into account the broad definitions of “security” and “investment” in section 122.1 of the Act.

An “investment” in a partnership is defined as a property that is a “security” of a partnership (the “Security Test”); or a right which may reasonably be considered to replicate a return on, or the value of, a security of the partnership (the “Replicate Test”).

“Security” is defined broadly. In the context of a partnership, it includes not only debt and an interest as a member, but also any right conferred by the partnership or an entity affiliated with the partnership to receive, absolutely or contingently, all or part of the capital, revenue or income of the partnership, or any right to acquire any such property.

Thus, if a public corporation (“Pubco”) is affiliated with a partnership (for example, if Pubco is entitled to more than 50% of the income or loss of the partnership or the net assets of the partnership on dissolution), under the Security Test, the partnership would be a SIFT if Pubco’s publicly-listed securities constitute a right to the capital, revenue or income of that partnership. Similarly, under the Replicate Test, a public corporation that owns an interest in a partnership would cause the partnership to be a SIFT if the corporation’s publicly-traded securities constitute a right that replicates a return on, or the value of, a security of the underlying partnership.

The CRA has taken the position that whether the Security Test or Replicate Test is met in a particular case depends on the reasonable expectations of a hypothetical investor.

The CRA has stated that the following factors would likely result in the shares of a corporation being regarded as a security of the partnership:

20 Preamble to the definition “income shortfall adjustment” in subsections 34.3(1) and 34.3(3).
21 Subsection 248(1).
22 Subsection 197(1).
23 Subsection 122.1(1).
The terms of the shares provide shareholders with a legal entitlement to, or amounts in respect of, capital, revenue or income from the partnership, or interest payable by the partnership, and can include exchange features;

- The value of, or return on, a class of shares is specifically based on amounts that may reasonably be tracked to revenue, income or capital of the partnership, or to interest payable by the partnership; or

- In the event of a dissolution, or where the partnership returns capital to the corporation for whatever reason, shareholders are entitled to receive from the corporation a return of capital or dividend payment equal to a preset amount or a proportionate amount as determined by an existing formula.25

The CRA also has stated that the following factors would increase the likelihood that the Replicate Test was met:

- The corporation has no other material business undertakings; and

- The corporation has a practice of paying dividends based on its earnings from the partnership (by reason of the share terms or otherwise).26

An exemption from the SIFT rules is available for a partnership that is considered an excluded subsidiary entity.27 To qualify as an excluded subsidiary entity for a taxation year, at all times during that year, the partnership’s equity must not be listed or traded on a stock exchange or other public market and the partnership must be wholly owned by a SIFT, real estate investment trust (“REIT”), taxable Canadian corporation, excluded subsidiary entity, or person or partnership that does not have, in connection with the holding of a security of the entity, property the value of which is determined, all or in part, by reference to a security that is listed or traded on a stock exchange or other public market.

Therefore, where a partnership owns non-portfolio property, and an individual, a tax-exempt entity or a non-resident, holds an interest in the partnership (for example, an exchangeable interest) the value of which is determined by reference to a publicly-traded security, the partnership cannot be an excluded subsidiary entity. Accordingly, such partnership may be a SIFT partnership if the Security Test or the Replicate Test determine that “investments” in the partnership are listed or traded on a stock exchange or other public market.

SIFT tax is computed in respect of the non-portfolio earnings of the SIFT partnership for the year. Non-portfolio earnings are defined to include income from a business carried on by the SIFT partnership in Canada, income from non-portfolio properties of the partnership and net taxable capital gains from the disposition of non-portfolio property.28 Non-portfolio earnings do not include returns of capital, income from businesses carried on outside Canada, and taxable dividends received by the partnership.

The net after-SIFT-tax non-portfolio earnings amount is deemed to be a dividend received by the SIFT partnership from a taxable Canadian corporation,29 and the portion of the deemed dividend allocated to a partner resident in Canada is deemed to be a dividend eligible for a lower rate of tax.30

Transferring Property to a Canadian Partnership

In general, the transfer of property with an accrued gain to a partnership by a taxpayer who, immediately after the transfer, is a member of the partnership gives rise to a disposition and thus a realization of the accrued gain by the taxpayer.31 However, a deferral (or “rollover”) of the entire or part of the gain is available for transfers of certain property to a “Canadian partnership” when the transferor partner and all the other members of the partnership make a joint election.32

Where depreciable property has been transferred to a Canadian partnership on a rollover basis, the capital cost of that property to the partnership is deemed to be the capital cost of the property to the transferor.33 The excess of the capital cost to the transferor over the transferor’s proceeds of disposition will be deemed to be CCA previously deducted by the partnership. As a result, on a subsequent disposition of the property, the partnership will be potentially subject to recaptured CCA up to the transferor’s original capital cost.

If any member of a partnership is a non-resident, the partnership will not be a “Canadian partnership”34 and none of the members will be able to access this rollover provision.

Real Property Inventory Rollover

26 Ibid.
27 For definition of “excluded subsidiary entity”, see subsection 122.1(1).
Real property that is inventory can be transferred to a Canadian partnership on a rollover basis. In contrast, a rollover is not available on the transfer of real property inventory to a corporation.

The CRA has indicated that it may challenge transactions that effectively accomplish a rollover of land inventory to a corporation using intermediate transfers to partnerships. However, in certain circumstances, the courts have determined that the general anti-avoidance rule (“GAAR”) did not apply to such transactions.

In Loyens et al v The Queen, as part of a series of transactions, two brothers (A and B) effectively achieved a rollover of land inventory to Lossco, a corporation with available loss carryovers that was owned by A and B. The rollover was accomplished by using a partnership as an intermediary because the brothers could not have achieved the same result directly. A and B were able to then utilize the losses in Lossco to offset the gain on the sale of the land inventory, which gain was treated as an income (not capital) gain.

The TCC held that GAAR did not apply to these transactions because they did not result in a misuse or abuse of the provisions of the Act as a whole. The TCC found that the purpose of the real property inventory restriction in subsection 85(1) is to prevent the conversion of income into capital gains by a real property trader. The TCC concluded that there was no misuse of these provisions because the transactions did not violate the policy of converting income into capital gains.

Transferring Partnership Property to Members of the Partnership

In general, the transfer of property with an accrued gain by a partnership to a member of the partnership will give rise to a gain realized by the partnership.

In certain circumstances, however, a Canadian partnership that has ceased to exist may defer the realization of the accrued gain when each partner acquires an undivided interest in each partnership property on dissolution of the partnership (subsection 98(3)) or one partner continues the business of the partnership as a sole proprietor (subsection 98(5)).

Subsection 98(3) provides for the pro rata distribution of all of the partnership property and requires that such property must be distributed to persons who were members of the partnership immediately before the partnership ceased to exist, subject to certain additional requirements. Each member of the partnership must jointly elect in prescribed form (Form T2060).

Subsection 98(5) provides that one partner may carry on alone as a sole proprietor, the business of the partnership and requires that any property received by the proprietor continue to be used in the “business” previously carried on by the partnership.

- The CRA has provided a number of helpful comments on the application of subsection 98(5) to a partnership holding real estate rental property:
  - Where the property received is passive rental property, and the recipient continues to use it in the same manner as the partnership, the “business” of the partnership is considered to be carried on for the purposes of subsection 98(5) and the rollover is available. However, this conclusion does not change the nature of the income in the recipient’s hands, which is usually income from property for the purposes of other provisions of the Act.
  - Where a bare trustee or nominee corporation holds legal title to the partnership property, the CRA accepts that the beneficial owner of the property is the owner for tax purposes and a legal conveyance of title may not be necessary.
  - Where the general partner holds legal title to the partnership property, when a partnership ceases, unless a different action is taken, there should be documentation showing that the former general partner is now the bare trustee or nominee of the proprietor (the beneficial owner of the property).

Incorporation of a Partnership

Where a partnership (whether a Canadian partnership or not) that has transferred property to a taxable Canadian corporation on a rollover basis under subsection 85(2) is wound up within 60 days after the transfer; and, immediately before the winding-up of the partnership, the property of the partnership consists solely of money and property received from the corporation as consideration for the transfer (i.e., shares of the corporation), the realization of the accrued gain on the shares of the corporation distributed to the partners may be deferred.
The CRA confirms that a partnership can make a tax-deferred transfer of a partnership business to a corporation under paragraph 85(3)(b), even if the partnership is not able to transfer the legal title to its land within the required 60 days after the partnership transfers the beneficial ownership of the land and other partnership properties to the corporation. The partnership must, however, transfer the legal title to the land to the corporation as soon as is practical.40

**Partnership Not a Separate Entity in Certain Circumstances**

A partnership is treated as a separate person under the Act only for purposes of computing the income or loss of the partnership to be allocated to its members. For purposes of filing elections or paying tax, a partnership is generally viewed as a contractual arrangement among the partners and not as a separate legal entity. Thus the elections and forms made by partnerships must be made by each partner. Typically, under the agreement governing a limited partnership, the general partner is given the right to make and file elections on behalf of each partner.

**Conversion from General Partnership to Limited Partnership or Vice Versa**

The CRA has stated that, generally, the conversion of a general partnership to a limited partnership does not result in the general partners disposing of their partnership interests for limited partnership interests. This view is predicated, however, on there being no significant change in the rights and obligations of the partners other than potential liability.41 This position is also applicable to conversion of a limited partnership interest into a general partnership interest.42 If a limited partner has limited partnership losses available for carryforward at the time the limited partnership interest is converted to a general partnership interest, those losses will not be available in the future.

**Issues with Partnerships**

**Presumption of Carrying on Business**

The existence of a partnership may give rise to a presumption that a business is being carried on by the partnership; however, one must consider the activity carried on by the partnership to determine whether the partnership is carrying on a business for tax purposes. This is because the Act distinguishes between income from property and income from a business, on the basis of tests that are not relevant to whether a partnership exists under the relevant commercial law.

Jurisprudence supports the view that each member of a partnership, whether general or limited, is considered for tax purposes to be carrying on any business (or other activity) that is carried on by that partnership.43

However, for certain purposes of the Act, certain limited partners are not considered to carry on the business of the partnership solely because of the acquisition and holding of the partnership interest.44 This provides relief to mutual fund trusts, mutual fund corporations, mortgage investment corporations, investment funds, and certain tax exempt entities, such as certain corporations wholly owned by registered pension plans, that cannot “carry on business”, and thus otherwise would not be able to invest in limited partnerships that carry on a business. Thus, such entities may acquire and hold a limited partnership interest, relying on the protection of section 253.1.

**Income and Loss Allocation**

Where partners have agreed to share income or loss in a particular manner and the principal reason for such allocation may reasonably be considered to be the reduction or postponement of tax, the CRA may determine the partners’ share of income or loss to be the amount that is reasonable having regard to all the circumstances.45

Similarly, where non-arm’s length partners agree to share income or loss in a certain manner and the share is not reasonable in the circumstances having regard to the capital invested or work performed for the partnership, the partners’ share of income or loss is deemed to be the amount that is reasonable in the circumstances.46

With regard to salaries paid by a partnership to its partners, the CRA has expressed the view that, for fiscal periods ended on or after December 31, 2000, salaries paid to partners are not deductible in computing the partnership’s income for tax purposes.47

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40 See subsection 253.1.
41 See subsection 103(1).
42 See subsection 103(1.1).
44 See subsection 253.1.
46 “Revenue Canada Round Table”, 1990 Conference Report, Question 30.
47 1992 Corporate Management Tax Conference, Question 11.
Before the CRA expressed this view, some taxpayers had taken the position that it was possible for a partner to be allocated an amount of income (or loss) greater than the income (or loss) realized by the partnership based on a CRA publication. This circumstance commonly arose when a partner was allocated a larger loss than the loss incurred by a partnership, because the partnership loss was augmented by “salary” paid to a partner. This interpretation is no longer applicable.

Adjusted Cost Base

Generally, a partner’s adjusted cost base ("ACB") of a partnership interest at any time is that partner’s original cost of the partnership interest, plus certain upward adjustments minus certain downward adjustments.

The additions to ACB at a particular time include:

- The partner’s share of income from all fiscal periods ending before that time;
- The partner’s share of any capital dividends and life insurance capital dividends received by the partnership before that time;
- The partner’s additional capital contributed since the partner acquired the partnership interest; and
- Any negative ACB amount since the partner acquired the partnership interest, which was deemed to be a gain from a disposition of the partnership interest before that time under subsection 40(3.1) or paragraph 98(11)(c) or 98.1(11)(c).

The reductions to ACB at a particular time include:

- The partner’s share of losses (other than limited partnership losses), investment tax credits, and resource deductions from all fiscal periods ending before that time;
- The partner’s drawings from the partnership since the partner acquired the partnership interest;
- The partner’s limited partnership loss from all fiscal periods ending before that time; and
- The partner’s share of any capital dividends and life insurance capital dividends.

For certain limited partners or specified members (i.e., non-active members), the amount of any non recourse debt that can reasonably be considered to have been used to acquire the partnership interest unless the partnership interest is a tax shelter investment.

The CRA has expressed the view that a taxpayer’s interest in a limited partnership is considered one capital property, even if such interest is represented by units of multiple classes. Therefore, a partner’s ACB of the partnership interest is the aggregate ACB of all units of the partnership held by the partner. Where there is a partial disposition (for example, the disposition of only one class of units held by the partner), the ACB of the partial interest is computed by determining the portion of the entire ACB that can reasonably be regarded as attributable to the units disposed of.

Negative ACB

A limited partner or specified member (i.e., non-active member) of a partnership is deemed to realize a capital gain if the partner’s ACB of its partnership interest is negative at any time in the year (i.e., where, at any time in the year, the total of the original cost of its partnership interest and the upward adjustments to ACB is less than downward adjustments to ACB). Such capital gain is deemed to be realized by the limited partner or specified member at the end of the relevant fiscal period of the partnership.

However, the interest in a partnership held by a partner active in the business of the partnership (typically a general partner) is not subject to this rule. That is, the ACB of an active partner’s interest in the partnership is allowed to remain negative, although there will be a deemed capital gain equal to the negative ACB when the interest is disposed of (for example, when the partnership has ceased to exist).

Where a partner that is a corporation, individual (other than a trust) or graduated rate estate is deemed to have a negative ACB gain and the partner is a member of the partnership at the end of the partnership’s fiscal period, the partner may elect, in certain circumstances, to treat a positive ACB in the partnership interest at

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49 See paragraph 53(1)(e).
50 See subsection 127(15).
51 See section 66.
52 See paragraph 53(2)(c).
54 Subsection 43(1).
56 See paragraph 40(3.1)(a) and subsection 40(3.11). Certain limited partnership interests in partnerships that actively carried on business on February 22, 1984 (and continue to do so) are excluded from this rule.
57 See subsection 40(3) and paragraphs 53(2)(c), 98(1)(c) and 98.1(11)(c).
the end of the fiscal period as a capital loss from the disposition of its partnership interest at that time. However, the elected loss cannot exceed the amount by which previous negative ACB gains exceed previous amounts elected to be a capital loss by the partner under this provision.58 While there is no prescribed form for this election; a statement that the taxpayer is making the election should be attached to the partner’s tax return for the relevant year.

For dispositions after October 31, 2011, a corporation’s capital dividend account does not include any amount in respect of a deemed gain realized as a consequence of a negative ACB capital gain nor the elected capital loss.

### Limited Partnership Losses

**Partnership losses** available to be claimed by a limited partner are limited to the “at risk amount” of that partner’s interest in the partnership.60 Partnership losses exceeding the limited partner’s at risk amount (“limited partnership losses”) may be carried forward indefinitely and may be deducted against any income to the extent of the partner’s at-risk amount.61

In 2016, in Green v. The Queen,62 the TCC held that a business loss realized in a bottom-tier partnership flows through to limited partners of a top-tier limited partnership notwithstanding that the top-tier partnership has no at-risk amount in respect of the bottom-tier partnership in the year. As a result, business losses of a bottom-tier partnership may be allocated to the ultimate partners, who are subsequently subject to the at-risk rules. This decision is contrary to the CRA’s previously stated position that, where the limited partner is itself a limited partnership, its limited partnership losses are unavailable to members of the top-tier partnership.63 Green is under appeal to the FCA.

Unutilized limited partnership losses cannot be claimed after the limited partnership has been dissolved, as the partner no longer has an at-risk amount in respect of the particular limited partnership.64 Unutilized limited partnership losses are also not available to a general partner who was formerly a limited partner of the particular partnership.65

In simplified terms, a limited partner’s at-risk amount at the end of a fiscal period is the ACB of the limited partner’s interest in the partnership at that time plus:

- Any partnership income allocated to the limited partner for the fiscal period;

minus:

- Any amount that the limited partner owes to the partnership (other than any such amount deducted under subparagraph 53(2)(c)(i.3) in calculating the ACB

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58 Prior to 2018, this rule extended to all testamentary trusts.
59 See subsection 40(3.1).
60 See subsection 96(2.1) to (2.7).
61 See paragraph 111(1)(e).
62 2016 TCC 10.
65 2016 TCC 10.
66 2016 TCC 10.
of the limited partner’s interest in the partnership or under section 143.2 in calculating the cost of that partnership interest); and

- Any amount or benefit the limited partner, or a person not dealing at arm’s length with the limited partner, is entitled to receive in any form or manner, immediately or in the future; and absolutely or contingently, to reduce the impact of any loss to the partner in respect of the partnership interest.66

Note that any partnership loss allocated to the limited partner for the fiscal period does not impact the determination of a limited partner’s at-risk amount at the end of that fiscal period.

For purposes of the at-risk amount calculation, if the limited partner acquires the limited partnership interest from an existing partner, the ACB of that partnership interest is computed as if the cost to the limited partner of the interest is the lesser of:

- The cost otherwise determined; and
- The ACB (not less than nil) of the selling limited partner.67

**Elimination of Section 88 Bump on Certain Partnership Interests**

Section 88 generally permits a taxable Canadian corporation (the “parent”) that has acquired control of another taxable Canadian corporation (the “target”) to increase the tax cost of certain non-depreciable capital assets acquired by the parent on a winding-up of the target.68 A similar rule applies to a corporation formed by a vertical amalgamation of the parent and the target. The parent is permitted to apply the bump to the tax cost of shares of the target corporation to tax exempt persons or flow-through entities following an amalgamation or winding-up, within certain limits.

The bump applies to non-depreciable capital assets, such as land, shares of a corporation or an interest in a partnership, but does not apply to income-producing assets such as eligible capital property, depreciable property, inventory and resource property (i.e., assets that, if sold, might produce income).

A common way to accommodate the transfer of non-qualifying assets held by a target corporation to tax exempt persons or flow-through entities following an acquisition of control was to have the target corporation transfer the assets to a partnership on a rollover basis prior to the acquisition of the target corporation. Since the partnership interest held by the target corporation would generally constitute non-depreciable capital property, the acquirer could bump the tax cost of the partnership interest acquired on the wind-up or amalgamation of the target corporation. The partnership interest could then be sold by the acquirer without any capital gain being realized and, if the purchaser were a tax exempt person or flow-through entity, it could generally continue to operate or wind up the partnership without being subject to any Canadian tax. Any income realized by the partnership in respect of the income assets generally would not be subject to Canadian tax in the hands of its partners due to their tax exempt or flow-through status. The CRA has challenged some of these transactions on the basis of the GAAR in subsection 245(2). However, in Oxford Properties Group Inc. v The Queen,69 the TCC found that the GAAR did not apply.

Following the 2012 Federal Budget, the Act was amended to prevent these transactions. As a result, a bump to the tax cost of a partnership interest is limited to the accrued gain in respect of the partnership interest that is reasonably attributable to the amount by which the fair market value of the partnership’s non-depreciable capital property exceeds their cost amount.70 Moreover, property may not be transferred to a Canadian partnership on a rollover basis under subsection 97(2) where the transfer is part of a series of transactions that includes an acquisition of control and winding-up or amalgamation where a designation is made to bump a partnership interest and the property transferred to the partnership would not itself be eligible for a bump.71

These rules apply to income assets that are held directly by the partnership or indirectly through another partnership. However, assets directly owned by a taxable Canadian corporation, the shares of which are owned by the partnership, will not be considered to be indirectly held by the partnership.

This measure applies to amalgamations that occur and wind-ups that begin on or after March 29, 2012. However, the new measure will not apply where a taxable Canadian corporation amalgamated with its subsidiary before 2013, or began to wind up its subsidiary before 2012, provided that before March 29, 2012 the corporation had acquired control or was obligated, as evidenced in writing, to have the target corporation transfer the assets to a

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66 Subsection 96(2.2).
67 Subsection 96(2.3).
68 Subsection 87(11).
69 2016 TCC 204.
70 See subparagraph 88(1)(d)(ii.1).
71 See subsection 97(3).
to acquire control of the subsidiary and the corporation had the intention, as
evidenced in writing, to amalgamate with or wind up the subsidiary.

Subsection 15(2) and Partnerships

Subsection 15(2) includes in a shareholder’s income amounts received from a
corporation as a loan or other indebtedness with specific exceptions provided in
the legislation.

Subsection 15(2) reads as follows:

Where a person (other than a corporation resident in Canada) or a partnership
(whether a general partnership or limited partnership) has in a taxation year received a loan from or
became indebted to (other than by way of a pertinent loan or indebtedness) the particular
person or partnership is connected with a shareholder of a particular corporation; or

and the person or partnership does not deal at arm’s length with, or is affiliated with, the
the person or partnership does not deal at arm’s length with, or is affiliated with, the
shareholder, unless, in the case of a person, that person is:

(a) A shareholder of a particular corporation;

(b) Connected with a shareholder of a particular corporation; or

(c) A member of a partnership, or a beneficiary of a trust, that is a shareholder of
a particular corporation;

and the person or partnership has in a taxation year received a loan from or
became indebted to (other than by way of a pertinent loan or indebtedness) any other corporation related to the particular
corporation or a partnership of which the particular corporation or a corporation
related to the particular corporation is a member, the amount of the loan or
indebtedness is included in computing the income for the year of the person
or partnership.

Effective for loans made or indebtedness arising after October 31, 2011, a
partnership may be connected with a shareholder of a corporation and may be
subject to the benefit provisions of subsection 15(2). The relevant definition is
found in subsection 15(2.1) and reads as follows:

Meaning of connected—For the purposes of subsection (2), a person or
partnership is connected with a shareholder of a particular corporation if that
person or partnership does not deal at arm’s length with, or is affiliated with, the
shareholder, unless, in the case of a person, that person is:

(a) a foreign affiliate of the particular corporation; or

(b) foreign affiliate of a person resident in Canada with which the particular
corporation does not deal at arm’s length.

Therefore, this shareholder debt provision must be considered when a corporation
provides debt financing or working capital funding to a partnership (other than a
partnership each member of which is a corporation resident in Canada) with which
it is connected. It is applicable whether the partnership is a general partnership or
limited partnership.

Subsection 15(2) technically applies to the entire amount of a corporate loan to
a partnership notwithstanding that a person other than a corporation resident in
Canada (i.e., an individual or trust) has a minority interest in the partnership. As
an example:

- In this example, although the “benefit” of 90% of the loan from a Canadian
corporation (“Canco”) is derived by another Canadian corporation (the 90%
partner in the limited partnership), the partnership is technically deemed to
receive a benefit under subsection 15(2) equal to the entire amount of the
Canco loan as the members of CanLP include a person other than a corporation resident in Canada (Trust);

- CanLP is connected with a shareholder (Parent) of a particular corporation
(Canco) as CanLP and Parent are affiliated (Parent is the majority interest partner
of CanLP); and,

- CanLP has received a loan from the particular corporation (Canco).
Consider also the following example where subsection 15(2) technically applies to a partnership notwithstanding that a loan is not made by a corporation:

In this example, although the loan is derived entirely from non-corporate funds, CanLP2 may technically be subject to the rules in subsection 15(2) as:

- The members of CanLP2 include a person other than a corporation resident in Canada (Trust);
- CanLP2 is connected with a shareholder (Trust) of a particular corporation (GPCo2) as CanLP2 and the Trust are affiliated (Trust is the majority interest partner of CanLP2); and,
- CanLP2 has received a loan from a partnership (CanLP1) of which a corporation related to the particular corporation (GPCo1) is a member (GPCo1 and GPCo2 are related as they are controlled by the same person (Trust)).

**Non-resident Partner**

A non-resident member of a partnership that carries on business in Canada is liable for Canadian income tax, subject to a relevant tax treaty providing relief to the non-resident.  

22 Subsection 2(3).
Corporations

The Act defines a “corporation” as an incorporated entity. A corporation may be incorporated in Canada under a provincial, territorial, or federal statute.

A corporation is a legal person separate and apart from its shareholders.

Shareholders of a corporation have limited liability.

Unlimited Liability Corporations

An unlimited liability corporation ("ULC") is also a separate legal person from its shareholders, but shareholders do not enjoy unlimited liability.

Only three jurisdictions in Canada permit the formation of a ULC (Alberta, British Columbia, and Nova Scotia). Shareholders of a ULC have, either on winding up or more generally, liability for all the obligations of the ULC, subject to certain exceptions.

A ULC may be eligible to be treated as a “disregarded entity” or a “partnership” for certain US income tax purposes.

ULCs are routinely used by US investors to hold investments in Canada, although care must be taken because the Canada-US Income Tax Convention has special rules that may apply to payments made by a ULC to non-residents.

Tax Considerations of Corporations

Since a corporation (including a ULC) is considered to be a legal person, it is a taxpayer under the Act. Thus, it pays tax on its taxable income for the year. A corporation paying dividends (other than patronage dividends) to its shareholders is subject to tax on its taxable income for the year. A corporation that is a CCPC is a private Canadian corporation that is not controlled, directly or indirectly, in any manner whatever, by certain persons (e.g., non-resident persons, certain public corporations, or any combination thereof). For this purpose, control is also to be determined on the basis that all shares owned by non-residents and public corporations are owned by a single person. Active business income of a CCPC may be eligible for a lower tax rate on the first $500,000 of taxable income for federal income tax purposes.

Passive income may be taxed differently depending on the corporation’s status.

Active Versus Investment Business

Active business income does not include income from a “specified investment business,” which is generally a business the principal purpose of which is to derive income from property. A “specified investment business” does not include a business that has more than five full-time employees, with the result that income earned from such a business is eligible for the small business deduction even though its principal purpose is to derive income from property.

The number of employees of a business carried on by a CCPC is not relevant to the CCPC’s eligibility for the small business deduction, unless the principal purpose

78 See definition in subsection 248(1).
79 As defined in section 135.
80 For a taxation year ending after December 31, 2006. Non-capital losses prior to 2006 may be carried forward either 7 or 10 years, depending on the year in which the loss was incurred.
81 See subsection 111(1)(a). A short taxation year counts as one year for these purposes.
82 See subsection 85(1).
83 See subsection 85(1.2).
84 Subsection 125(1).
of that business is to earn income from property. Where a business has the principal purpose of earning income from property, the CCPC may still be eligible for the small business deduction if the business has more than five full-time employees.

Whether the principal purpose of a business is to earn income from property is a question of fact. The CRA has published guidance and a significant body of case law has developed relating to the factors that are relevant in making this determination.

For example, in 0742443 B.C. Ltd. vs. The Queen the FCA upheld the TCC decision that a mini-storage business was a specified investment business because its principal purpose was to derive income from property, notwithstanding that ancillary services were provided by the taxpayer. The taxpayer did not employ more than five full-time employees.

Although a public consultation process was undertaken after the 2015 Federal Budget, Finance announced in the 2016 Federal Budget that it completed its review and does not propose any modifications to the active versus investment business rules in the Act regarding the small business deduction.

**KPMG Observations**

**Planning Idea—Converting Active Income Into Passive Income**

This idea may be beneficial if a corporation’s rental income is “active business income”; but the corporation is not entitled to the small business deduction and bonuses are not feasible. The refundable taxes paid on passive income can also facilitate estate planning.

**Approach**

Consider transferring employees to an unassociated entity (corporation, partnership or trust) which will thereafter provide the property management services. The property owning corporation must retain no more than five full-time employees.

**Result**

The property-owning corporation’s rental business will then be a “specified investment business” and 30.67% of its federal income tax will be added to its “refundable dividend tax on hand” balance. Refundable taxes can then be recovered on the payment of dividends to the shareholder(s). The effective tax rates on passive income earned by a CCPC and distributed to a Canadian resident shareholder are substantially the same as if such income was earned personally by the shareholder.

Falling federal and provincial corporate tax rates influence this planning idea.

If the shareholder does not personally require the income, active business income earned by—and taxed in—a corporation may yield cash tax savings that can be reinvested by the corporation until ultimately paid to the shareholder as a dividend. Further with enhanced gross-up and dividend tax credit for eligible dividends after 2005, the ultimate tax cost of using a corporation to earn active business income (subject to high general tax rates) is substantially mitigated. Tax results will differ from province to province due to different provincial corporate and personal tax rates.

**Note:** This or any other planning idea should only be acted on with appropriate professional advice after a thorough examination of the particular situation.

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**Trusts**

A trust is “the right, enforceable solely in equity, to the beneficial enjoyment of property to which another person holds the legal title; a property interest held by one person (the trustee) at the request of another (the settlor) for the benefit of a third party (the beneficiary).”

A trust is defined in the Act as including an “inter-vivos trust” and a “testamentary trust.”

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85 2015 FCA 231.
86 See definition in subsection 125(7).
87 Blacks Law Dictionary, 10th ed., sub verbo “trust.”
88 See subsection 108(1).
A testamentary trust is a trust that arose on and as a consequence of the death of the individual who created the trust. An inter-vivos trust is a trust other than a testamentary trust.

In 2016, the Act was amended to introduce the concept of a “graduated rate estate” (“GRE”) and a “qualified disability trust” (“QDT”). A GRE is the estate that arose on and as a consequence of an individual’s death provided that certain requirements are met.

**Tax Considerations of a Trust**

A trust is deemed to be an individual in respect of the trust property for purposes of the Act. As such, a trust is treated as a separate taxpayer and is generally taxed as an individual, other than as discussed below.

The residence of a trust is a question of fact. In Garron Family Trust (Trustee of) v R, the SCC held that, as with corporations, residence of a trust should be determined by the principle that a trust resides for the purposes of the Act where “its real business is carried on”, which is where the central management and control of the trust actually takes place. The question is who exercises the central management and control of the trust (trustees or beneficiaries) and where do such tasks take place. The CRA has accepted the application of the central management and control test in establishing the residence of a trust.

Prior to 2016, all trusts, except for testamentary trusts and SIFT trusts (in respect of distributed non-portfolio earnings), paid tax at the highest marginal rate applicable to individuals. Effective for 2016 and subsequent taxation years, all trusts, with the exception of GREs and QDTs, are subject to the highest marginal rate applicable to individuals.

A GRE of an individual at any time is an estate that arose on and as a consequence of the individual’s death if:

- That time is no more than 36 months after the death;
- The estate is at that time a testamentary trust;
- The deceased’s SIN is provided in the estate’s tax return for the year and all prior years;
- The estate designates itself as the GRE of the individual in its tax return for its first taxation year after 2015; and
- No other estate is designated as the individual’s GRE.

A trust is generally allowed a deduction in computing its income for the year to the extent that any part of the income is paid or becomes payable to beneficiaries in the year. To the extent income is paid or becomes payable (e.g., the beneficiary is entitled in the year to enforce payment of the amount) in the year, the trust acts as a conduit and the beneficiaries pay tax directly on the income of the trust for the year although, with limited exceptions, the source of the income is not flowed-through to the beneficiary.

To prevent trusts from holding property indefinitely without recognizing accrued gains, trusts are generally deemed to dispose of all of their properties at their FMV every 21 years. Certain trusts (including mutual fund trusts and trusts the interests in which have vested indefeasibly) are not subject to this 21 year deemed disposition rule.

In general, if a taxpayer transfers property to a trust, the taxpayer will be considered to have disposed of the property at its FMV.

Trusts can only distribute income, not losses, to their beneficiaries. Therefore, the taxable income of the trust should be monitored so that losses are not “stuck” in the trust. Non-capital losses of trusts incurred after 2005 can be carried back 3 years and carried forward 20 years, subject to the restrictions in the Act.

Distributions of capital from a trust to a corporate beneficiary would not form part of the corporation’s capital dividend account and therefore, to the extent that the capital distribution represents previously taxed and undistributed earnings of the trust, tax inefficiencies may arise due to the lack of integration.

Trusts are used to own real estate because they provide the flow through of income, allowing the beneficiaries to manage their own tax positions, while providing income...
splitting and certain income characterization opportunities. Trusts are always subject to the rental property CCA restrictions. Operations carried on through a trust should be structured to ensure adequate liability protection is in place.

**Alternative Minimum Tax**

Trusts are generally subject to Alternative Minimum Tax ("AMT"), which is a federal and provincial tax applicable to individuals (including trusts other than mutual fund trusts) that arises when the ordinary income tax liability is less than a minimum amount of tax that would be payable based on income computed on an adjusted basis. In the context of a typical real estate investment, AMT may arise when a trust deducts interest and certain tax preference items to shelter rental income, or utilizes non-capital loss carryforwards that arose from such deductions.

Prior to amendments to the Act in 2013, AMT could arise where a trust was a member of a limited partnership, which allocated losses to the trust, regardless of the nature of the activity of the limited partnership. For the 2012 and following taxation years, this rule has been narrowed so it only applies where the partnership is or is required to be registered as a tax shelter. For the 2006-2011 taxation years, an individual could elect to have the narrower rule apply if an election was filed with the Minister by March 11, 2014.99

AMT is intended to operate as a prepayment of tax; any AMT paid in a year can be applied to reduce the taxpayer’s ordinary income tax liability in any of the next seven taxation years, to the extent that such liability exceeds the minimum amount. Depending on the lifespan of the real estate project, AMT may not be fully recovered. For example, AMT can easily arise when a trust incurs losses due to deductions for interest and other soft costs before the property is fully leased and then applies those losses against net rental income or taxable capital gains in a subsequent year. If a taxable capital gain arises on the disposition of the property and the trust has no further activity or income tax liability, the AMT may not be recovered.

Part XII.2 Tax

It is typically not advantageous for non-residents to invest in Canadian real estate through a Canadian trust where the trust is earning “designated income” and designates that income as payable to the non-resident beneficiaries.

The designated income of the trust is generally its income from carrying on a business in Canada and its income from real property in Canada, including taxable capital gains from dispositions of Canadian real property.

Part XII.2 imposes a tax at a rate of 40%100 on designated income of a Canadian-resident trust that is payable by the trust to a non-resident beneficiary. Part XII.2 tax does not apply to a GRE (and, before 2016, did not apply to any testamentary trust).

Part XII.2 tax is deductible in computing income under Part I.

**KPMG Observations**

In addition to the tax payable under Part XII.2, withholding tax is imposed at the domestic rate of 25% on amounts distributed to a non-resident beneficiary of the trust. Thus, the rate is effectively increased to 55% to the extent that the trust makes its designated income payable in the year to its non-resident beneficiary, or to 49% where the withholding tax rate is reduced by a treaty to 15%.

This effective rate approximates the rate of federal tax that would apply if a top rate non-resident individual (including a non-resident trust) earned the income directly.

**SIFT Trusts**

A SIFT trust is liable to tax under the Act in respect of its non-portfolio earnings. A SIFT trust is defined as a trust (other than an excluded subsidiary entity or a real estate investment trust) that at any time during the taxation year is resident in Canada; investments101 in which are listed or traded on a stock exchange or other public market; and that holds one or more non-portfolio properties.102 Consistent

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99 In a comfort letter dated January 6, 2016, Finance states that it will recommend extending the AMT rules to allow individuals (including trusts) to claim certain partnership losses incurred in their 2003–2011 taxation years. Based on the wording in this comfort letter, to claim the losses for these years, eligible individuals were required to file an election on or before March 11, 2014. The previous amendments, which were part of a legislative amendment in Bill C-4 that received Royal Assent on December 12, 2013, applied to losses incurred in the 2006–2011 taxation years if a timely election was filed.

100 The 40% rate of Part XII.2 tax applies to 2016 and subsequent years (before which the rate of Part XII.2 tax was 36%). This amendment was consequential on the increase in the top personal tax rate under Part I of the Act from 29% to 33%.

101 Subsection 122.1 defines “investment” as a property that is a security of the trust, or a right which may reasonably be considered to replicate the return on or the value of such security. The definition of “investment” excludes an “unaffiliated publicly-traded liability” of the trust and “regulated innovative capital.” Security is similarly very broadly defined and includes both debt and equity of the trust.

102 See section 122 and subsections 122.1(1) and 248(1) for various definitions.
with commentary for a SIFT partnership, if a private trust is "affiliated" with a publicly-traded enterprise, one must review the broad definitions contained in the Act and CRA guidance on the meanings of "security" and "investment" to determine whether the private trust is a SIFT trust.

Non-portoflio earnings of a SIFT trust for the year are not deductible by the trust even if the trust distributes such amounts to beneficiaries (the "non-deductible amount").

Amounts payable by a SIFT trust to its beneficiaries are first payable out of income other than non-portoflio earnings.

Rather, the non-deductible amount is deemed to be taxable dividends paid by a taxable Canadian corporation to the unitholders of the trust, allocated per beneficiary. In addition, these dividends deemed received by unitholders resident in Canada qualify as "eligible dividends" (i.e., the unitholders are entitled to the enhanced dividend gross-up and the enhanced federal and provincial dividend tax credits for eligible dividends).

The SIFT tax is computed on the non-portoflio earnings of the SIFT trust for the taxation year.

Bare Trust

It is common to use a "bare trust" to hold legal title to real estate. Generally, in a bare trust, the trustee is the registered owner of the property without any duty to perform except to convey the property to the beneficiary, or as the beneficiary directs, on demand. The Act states that, except for limited purposes, a trust is deemed not to include an arrangement under which the trustee can reasonably be considered to act as agent for all the beneficiaries under the trust with respect to all dealings with all of the trust's property.

A bare trust may include a fiduciary, including an agent that holds legal title to property for the principal. For real estate, the bare trustee is typically a corporation formed solely for that purpose.

For income tax purposes, a bare trust is typically ignored and the property of the trust, including any profit or loss realized on the property, is considered that of the beneficiary. In addition, any transfer of legal title to the property from the bare trust to the beneficiary does not result in a disposition of the beneficial interest in the property for income tax purposes. The CRA stated this position at the 2006 STEP Conference.

Real Estate Investment Trusts

A REIT is generally structured to flow through income to unitholders without entity-level income or capital taxes.

Before the enactment of the SIFT rules in 2007, the Act did not contain a definition of a REIT.

A REIT is not subject to the SIFT tax.

A REIT is established as an inter-vivos trust that is a "unit trust" and a mutual fund trust. All of the prescribed conditions must be met at all times for the trust to qualify.

Unit Trust Requirements

The unit trust requirements are found in subsection 108(2). To qualify as unit trust, the trust must be an inter-vivos trust, the interest of each beneficiary of which is described by reference to units of the trust.

Unit trusts may be either "open-end" or "closed-end".

- Paragraph 108(2)(a) sets out the requirements of an open-end unit trust with redeemable interests:
  - 95% or more of the FMV of all units of the trust must have a right of redemption by the holder.
  - The right of redemption is typically structured as a "soft" in specie redemption right that balances the requirement for a redemption feature and terms that limit the cash portion of such redemption payment (recognizing that real estate is an illiquid investment).
  - The CRA has ruled that bona fide redemption mechanics may be partly effected through the distribution of notes, as long as such property would be

References:

103 Often if the “majority-interest beneficiary” of the trust is a publicly listed corporation or real estate investment trust.
104 See subsection 104(8).
105 See subsection 104(16).
106 See paragraph (b) of the definition of “eligible dividend” in subsection 89(1).
107 See subparagraph 122(1)(b).
108 See subsection 104(1).
not discourage a unitholder from requesting redemption and was given as an absolute payment of the redemption price.

- Except for the restricted undertakings imposed on all mutual fund trusts, the Act imposes no other investment conditions on open-ended trusts.

- Paragraph 108(2)(b) sets out the requirements of a closed-end unit trust with non-reredeemable interests:

  - The trust must meet tests relating to the nature of its income and property:
    - At least 80% of property must consist of "good basket" assets, i.e., a combination of shares (including property exchangeable for, or which confers a right to acquire, shares), cash, bonds, debentures, mortgages, notes or similar obligations, marketable securities, real property situated in Canada and certain Canadian natural resource properties;
    - Not less than 95% of the trust’s income must generally be derived from, or from the disposition of, good basket assets; and
    - Not more than 10% of the property of the trust may consist of bonds, securities or shares in the capital stock of any single corporation or debtor (other than the Government of Canada, a province or a Canadian municipality).

- 1996 amendments permitted “real property” holdings. If a trust’s real property holdings enable the trust to be a closed-end unit trust under paragraph 108(2)(b), the units must also be listed on a designated Canadian exchange in the year or the following year.

- If a closed-end unit trust holds an interest in a limited partnership, the CRA expressed its views\(^ {111} \) that:
  - The unit trust can generally invest in a limited partnership and, if necessary, can rely upon section 253.1 which provides that a trust would not be considered to be carrying on the business of the partnership solely by virtue of its ownership of a limited partnership interest;
  - When testing whether the closed-end trust has complied with the 80% good basket property and 95% good basket income requirements, the trust may look-through to its proportionate share of the property held and income earned by the limited partnership;
  - Where a limited partner’s interest in a limited partnership is also a “marketable security,” the CRA would accept that the interest of the limited partner is itself a good basket asset for purposes of determining whether the 80% test has been met; and,

- More than 10% of the property of a closed-end unit trust can be invested in a single limited partnership, as the interest of a limited partner in a limited partnership would not be in respect of “any one corporation or debtor.” However, the limited partnership must be looked-through in determining whether the trust’s proportionate share of the property held by the limited partnership meets this condition.

- In complying with the 80% and the 10% property tests\(^ {112} \) of a closed-end unit trust, the CRA has stated that “cost” should normally be used as the unit of measurement. FMV could be used as the unit of measurement if sufficient evidence is available to demonstrate that the trust qualified on this basis throughout the year.\(^ {113} \)

### Mutual Fund Trust

Benefits of mutual fund trust status include:

- Units are eligible investments for deferred income plans (Registered Retirement Savings Plans, Tax-Free Savings Accounts, Registered Education and Disability Savings Plans and Deferred Profit-Sharing Plans);

- No AMT;

- No Part XII.2 tax for non-resident or tax-exempt investors (however, Part XIII.2 imposes a 15% tax on otherwise non-taxable distributions to non-resident holders of "Canadian property mutual fund investments");

- No deemed disposition after 21 years;\(^ {114} \)

- A flow-through vehicle if income of the trust is paid or made payable to unitholders, unless it is a SIFT trust; and

- Eligible for the “REIT Exemption” (discussed below) if the five REIT conditions are met.

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\(^ {112} \) Numerous statements on the application of subparagraphs 108(2)(b)(iii) and (v) permitted percentage determinations to be made on the basis of cost (see CRA documents 5-8243 dated July 6, 1989 and 9726153 dated 1997).


\(^ {114} \) By virtue of the exemption to the application of subsection 104(4) in paragraph (i) of the definition of “trust” in subsection 108(1).
To qualify as a mutual fund trust, a trust must be a unit trust resident in Canada, comply with investment restrictions, and meet requirements for public distribution.\(^{115}\)

A mutual fund trust must:
- Be a unit trust resident in Canada;
- Not be maintained primarily for non-residents (i.e., less than 50% of its units may be owned by non-residents);\(^{116}\)
- Restrict its undertakings to:
  - Investing of funds in property, or
  - Acquiring, holding, maintaining, improving, leasing or managing of real property and/or immovable property that is capital property of the trust.\(^{117}\)
- Comply with minimum distribution requirements:
  - Units must be qualified for distribution to the public;
  - There must be at least 150 beneficiaries;
  - Each beneficiary must hold at least one block of units:
    - 100 units if FMV is less than $25 per unit;
    - 10 units if FMV is greater than or equal to $100 per unit; or
    - 25 units in other cases.
  - Each of the 150 beneficiaries must hold units with an aggregate FMV of not less than $500.

Where a trust meets all the conditions to be a mutual fund trust before the 91st day after the end of its first taxation year, the trust may elect under subsection 132(6.1) to be a mutual fund trust from the beginning of that first year. The trust then retroactively obtains “qualified investment” status for an investment in the trust by a deferred income plan.\(^{118}\)

**Taxation of a Mutual Fund Trust (That is Not a SIFT Trust)**

**Basic Rules**

A mutual fund trust that is not a SIFT trust for a particular year is taxed as follows:
- mutual fund trust is taxed as an individual subject to tax at the highest personal marginal tax rate.
- Trust income is reduced by amounts paid or payable as distributions to unitholders.
- Distribution of all income to the unitholders eliminates the tax liability of the trust.
- To the extent tax credits and refundable income taxes are available, the mutual fund trust can retain some taxable income without creating a cash tax liability because the credits can eliminate tax otherwise payable.
- A mutual fund trust may elect to have a December 15th taxation year-end (often done to facilitate tax compliance, particularly when a unitholder of the mutual fund trust is also a trust).

**Nature of Income Distributed**

Income distributed by a trust to unitholders is, in general, considered income from property under paragraph 108(5)(a) and does not retain its character.

However, taxable dividends and taxable capital gains distributed by the trust to unitholders may retain their character for tax purposes to the extent the trustees make the proper designations (i.e., under subsections 104(19) and 104(21), respectively).

Although active business income earned by a trust does not retain its character when paid to the beneficiaries, a corporate beneficiary of a trust does not include in “aggregate investment income” under subsection 129(4) any portion of a trust distribution that would otherwise not be income from property and therefore active business income of a trust distributed to a corporate beneficiary is not subject to refundable tax treatment.

\(^{115}\) Public distribution is referred to as “qualified for distribution to the public” and is used in Regulation 4801(1)(l) and defined in regulation 4803(2)(a).

\(^{116}\) If a trust is established or maintained primarily for the benefit of non-resident persons, paragraph 132(7)(a) provides that the trust will be deemed not to be a mutual fund trust unless at such time all or substantially all of the trust's property is not taxable Canadian property.

\(^{117}\) The CRA has issued a number of rulings that a mutual fund trust may provide a guarantee for no consideration in respect of the borrowings of its wholly or partially owned subsidiary partnerships and wholly or partially owned underlying properties. See for example, Ruling 2010-0386081R3—“Guarantee provided by mutual fund trust to sub-partnership” dated 2011, Ruling 2008-0217501R3—“Guarantee by a mutual fund trust” dated 2008, Ruling 2007-0298981R3—“Mutual fund trust issues guarantee notes issued by wholly owned limited partnership” dated 2007, Ruling 2004-0097111R3—“Real estate investment trust providing a guarantee on co-owned property” dated 2006, and Ruling 2003-0054221R3—“Investing of funds” and guarantees dated 2004, to name a few.

\(^{118}\) Regulation 4900(1)(id), as confirmed in Technical Interpretation 2002-0159245 dated December 31, 2002.
A taxable capital gain of a mutual fund trust distributed and designated by the trustees in the year to non-resident unitholders may be considered income from property if the mutual fund trust has a “taxable Canadian property” (“TCP”) gains balance for that year (i.e., a net capital gains balance from the disposition of taxable Canadian properties; subsections 132(4) to (5.2)). If so, withholding tax under Part XIII may apply to the distribution. As well, where the units of a mutual fund trust (including a REIT) are listed on a designated stock exchange and more than 50% of the fair market value of the units is attributable to Canadian real property, any distributions on the units to non-residents which are not subject to ordinary income tax or withholding tax under Part XIII will be subject to a 15% tax under Part XIII.2.

Planning for Over Distributions

Subsection 132.11(6) can be useful when a mutual fund trust has made cash distributions for a taxation year in excess of its taxable income.

This provision allows a mutual fund trust to designate an amount to be added in computing its income for the year. There is no prescribed form to make this designation.

Subsection 132.11(7) then allows such additional income allocated by the trust to its unitholders for a taxation year to be deducted in computing the trust’s income for the following taxation year.

This deduction is subject to an anti-avoidance rule in subsection 132.11(8) which denies the deduction where it is reasonable to consider that the designation of additional income in the preceding year was part of a series of transactions or events that includes a change in the composition of beneficiaries under the trust (for example, by an unusually large amount of income being allocated to tax-exempt investors as a consequence of the designation).

ACB of a Mutual Fund Trust Unit

The ACB of a unitholder’s mutual fund trust unit is reduced by the amount of any capital distributions paid to the unitholder, except to the extent the distributions relate to income (including taxable capital gains) and/or the non-taxable portion of capital gains allocated to the unitholder (see paragraph 53(2)(h)).119

The CRA issued a technical interpretation which clarifies that a mutual fund trust may distribute to a beneficiary (i.e., a unitholder) the non-taxable portion of capital gains realized in a previous year, to the extent such amount was not already distributed and the taxable portion of the gain was designated under subsection 104(21) in respect of that beneficiary.120

KPMG Observations

This interpretation provides flexibility where the distributions by a mutual fund trust in a year are not sufficient to allocate the full amount of non-taxable capital gains by allowing portions of subsequent-year distributions that would otherwise reduce ACB (e.g., as a return of capital) to be classified as distributions of the non-taxable portion of capital gains realized in a prior year. To the extent both distributions were made to the same unitholders, there will be no grind to the ACBs of those unitholders in respect of such portion of the distributions.

If the ACB of a unitholder’s mutual fund trust units become negative, the unitholder must recognize a capital gain equal to that negative amount. The capital gain will then be added to the unitholder’s ACB of the units, bringing the ACB back to nil.

119 The regular income and taxable capital gains distributed to a unitholder avoid an ACB grind by virtue of clause 53(2)(h)(i.1)(A). Similarly, clause 53(2)(h)(i.1)(B) allows the non-taxable portion of the capital gain to be distributed without reducing the ACB to the unitholder of its mutual fund trust units.

**Second Generation REITs**

The next generation REITs were structured as open end unit trusts that are not restricted in the nature of the assets or property they can own, or the income that can be earned from those assets, other than the normal restrictions imposed on all mutual fund trusts.

**Third Generation REITs**

With the elimination of the foreign property limits for deferred income plans for the 2005 and subsequent taxation years, the REIT structure has been further simplified.

In fact, a number of second generation REITs have obtained CRA rulings to eliminate their subsidiary trust on a tax-deferred basis (in a structured manner, relying on the qualifying exchange provisions in section 132.2).

The use of a subsidiary limited partnership is optional.

**SIFT Rules**

The structure and tax considerations governing REITs changed substantially after the announcement of the SIFT rules on October 31, 2006.

Generally, the SIFT rules subject the SIFT entity to tax at corporate income tax rates on certain SIFT income. A SIFT trust cannot deduct distributions of such income for tax purposes. Investors are taxed as though the distributions were eligible dividends from a taxable Canadian corporation.

Certain REITs (now codified in section 122.1) are exempt from the SIFT tax.

The final legislation provides a viable framework for modern Canadian REITs to operate in Canada and globally.
### Legislative Chronology

<table>
<thead>
<tr>
<th>Date</th>
<th>Legislative Event</th>
<th>Changes Favourable to REITs</th>
</tr>
</thead>
<tbody>
<tr>
<td>October 31, 2006</td>
<td>Tax Fairness Plan announced</td>
<td>Qualifying REITs were exempted from SIFT tax</td>
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<tr>
<td>December 22, 2006</td>
<td>Tax Fairness Plan draft legislation released</td>
<td></td>
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<tr>
<td>March 29, 2007</td>
<td>2007 Bill C-52 Budget Implementation Bill and revised REIT rules introduced</td>
<td>– Wider CCA classes&lt;br&gt;– Rent includes ancillary income&lt;br&gt;– Revenue test clarified&lt;br&gt;– Qualifying REIT subsidiaries can perform management or hold legal title</td>
</tr>
<tr>
<td>June 22, 2007</td>
<td>Bill C-52 Budget Implementation Bill received Royal Assent</td>
<td></td>
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<tr>
<td>December 20, 2007</td>
<td>Technical amendments to the REIT rules announced</td>
<td>– Foreign property restriction removed&lt;br&gt;– Qualifying assets expanded&lt;br&gt;– Trust-on-trust structure facilitated&lt;br&gt;– Nominee subsidiaries permitted to hold legal title to properties of the REIT or another subsidiary&lt;br&gt;– Excluded subsidiary entities not subject to SIFT tax</td>
</tr>
<tr>
<td>July 14, 2008</td>
<td>Draft REIT technical amendments released</td>
<td></td>
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<tr>
<td>November 28, 2008</td>
<td>REIT technical amendments included in Notice of Ways and Means Motion</td>
<td></td>
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<tr>
<td>March 12, 2009</td>
<td>REIT technical amendments included in Bill C-10. The Budget Implementation Act, 2009 survived Third Reading in the House of Commons on March 4, 2009 and is considered substantively enacted for generally accepted accounting principles (&quot;GAAP&quot;) purposes. This Act received Royal Assent on March 12, 2009</td>
<td></td>
</tr>
<tr>
<td>December 16, 2010</td>
<td>Draft REIT legislation released</td>
<td>– REITs can hold up to 10 percent of its non-portfolio property that is not qualified REIT properties&lt;br&gt;– Passive revenue restriction decreased to 90 percent&lt;br&gt;– Qualifying revenues clarified and expanded&lt;br&gt;– Certain foreign currency gains treated as qualifying revenues</td>
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### REIT Exemption

A REIT is not a SIFT trust and therefore is not subject to the SIFT rules if it is resident in Canada and meets five tests throughout the taxation year:

1. **Property Test**
2. **90% Passive Revenue Test**
3. **75% Real Property Revenue Test**
4. **Qualifying Property Value Test**
5. **Publicly Traded Test**

**Property Test**, requiring that the FMV of all non-portfolio property ("NPP") that are "qualified REIT properties" ("QRP") held by the trust is at least 90% of the total FMV at that time of all NPP held by the trust.
**COMMON FORMS OF REAL ESTATE OWNERSHIP**

**OWNERSHIP AND OPERATING ISSUES**

**NON-RESIDENTS INVESTING IN CANADIAN REAL ESTATE**

**U.S. VACATION PROPERTY**

**GOODS AND SERVICES TAX/HARMONIZED SALES TAX**

**APPENDICES**

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**KPMG Observations**

A REIT may hold up to 10 percent of its NPP in assets that are not “qualified REIT property” as long as such property does not exceed 10 percent of the FMV of all NPP at any time in the taxation year. Therefore, a REIT has a reasonable safe harbour for unintended issues resulting from the ownership of non-qualifying property and may conduct a degree of business activity beyond traditional rental activity.

**90% Passive Revenue Test**, requiring that at least 90% of the trust’s “gross REIT revenue” for the taxation year be derived from:
- Rent from real or immovable properties;
- Interest;
- Dispositions of real or immovable properties that are capital properties;
- Dividends;
- Royalties; and
- Dispositions of “eligible resale properties”.

**KPMG Observations**

A REIT may earn up to 10 percent of gross REIT revenue from non-qualifying activities. Any business activity must be carefully structured to ensure that the parent entity of a public REIT structure, typically a mutual fund trust, is able to comply with its restrictive permitted undertakings.

**75% Real Property Revenue Test**, requiring that at least 75% of the trust’s gross REIT revenue for the taxation year be derived from:
- Rent from real or immovable properties;
- Interest from mortgages, or hypothecs, on real or immovable properties; and
- Dispositions of real or immovable properties that are capital properties.

**KPMG Observations**

The CRA has ruled that an entity may comply with the 90% Passive Revenue Test and the 75% Real Property Revenue Test if it does not have any revenues for the year (which is often the case for a single purpose entity during the development of new real estate rental property).¹²¹

**Qualifying Property Value Test**, requiring that the total FMV of all trust properties, each of which is real or immovable property that is capital property, eligible resale property, bankers’ acceptances of a Canadian corporation, money, certain deposits with financial institutions, or certain government debt, must be at least 75% of the trust’s equity value throughout the taxation year.

**Public Traded Test**, requiring that investments in the trust are publicly listed or traded on a stock exchange or other public market.

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¹²¹ CRA Ruling 2014-0547491R3—“REIT entering into new limited partnership” dated 2014.
KPMG Observations

If a trust does not meet all five conditions to qualify for the REIT exemption in a particular year, it may restructure in order to qualify as a REIT in a subsequent year.

The geographic location of the real or immovable property is not relevant in complying with the REIT conditions.

For securities of a subsidiary entity to be “real or immovable property” and therefore “qualified REIT property,” the subsidiary need only comply with the first four REIT conditions. Investments in the subsidiary entity do not need to be publicly listed or traded.

A publicly listed partnership cannot qualify as a REIT. Therefore, a publicly listed vehicle to hold Canadian real or immovable property must be structured as a trust in order to meet the REIT Exemption.

It is very difficult for REITs with significant operating components or separate business activities other than the earning of rent on real or immovable properties, such as hotels and seniors’ housing operators, to qualify for the REIT Exemption.

Key Definitions

To understand the REIT Exemption, a number of intertwined and interdependent defined terms must be understood.

The definitions are set out below in context, not in alphabetic order.

Property Definitions

“Property” is defined in subsection 248(1) as property of any kind whatever whether real or personal, immovable or movable, tangible or intangible, or corporeal or incorporeal. For greater certainty, “property” includes a right of any kind whatever and a share, among other things.

“Non-portfolio property” of a particular entity includes:

– “Security” of a “subject entity” (other than a “portfolio investment entity”) when the particular entity holds:

  – Securities that have a FMV greater than 10% of the “equity value” of the subject entity; or
  – Securities that (together with securities of affiliates of the subject entity) have a value greater than 50% of the equity value of the particular entity;
  – Canadian real, immovable or resource property if at any time in the year the FMV of such property is greater than 50% of the “equity value” of the particular entity; and
  – Property used by the particular entity or a non-arm’s length person or partnership in carrying on a business in Canada.123

123 In Ruling 2014-0547491R3—“REIT entering into new limited partnership” dated 2014, consistent with favourable rulings that a mutual fund trust may provide a guarantee in support of one of its investments without compromising its restrictive undertakings, the CRA ruled that the provision by one subsidiary property limited partnership of a REIT (the “Property LP”) of a guarantee of construction loans to its sister development limited partnership in consideration for annual guarantee fees did not represent the carrying on by the Property LP of a business (and therefore the value of the rights created under the guarantee agreement did not represent non-portfolio property).
**KPMG Observations**

Mortgages and mezzanine loans may represent “securities” of a “subject entity”, especially where the debt is owed by a single-purpose entity.

Furthermore, the 2013 technical amendments make clear that a mortgage, such as a vendor take-back mortgage, cannot be qualified REIT property solely if it was ancillary to the earning of rent from, or proceeds received or receivable from the disposition of, real or immovable property unless the debtor is able to satisfy the REIT conditions, other than the public trading requirement.

Effective for taxation years ending after July 20, 2011, the definition of NPP was clarified that it has the same meaning whether the NPP was held by a trust, partnership or corporation, consistent with the CRA’s application of the rules.

Property used in carrying on a business outside of Canada is not NPP.

“Canadian real, immovable or resource property” is defined in subsection 248(1) as:

- Real or immovable property situated in Canada (without regard to the expanded definition of “real or immovable property” for purpose of the REIT Exemption);
- Canadian resource property;
- Timber resource property;
- Share of a corporation, or an interest in a trust or partnership - other than a taxable Canadian corporation, a SIFT trust or a SIFT partnership (determined without reference to the 2006-2010 transition period), or a REIT - if more than 50% of the value of the share or interest is derived from one or any combination of the properties described above; or
- Right to or interest in any property described above.

“Qualified REIT property” means:

- “Real or immovable property” that is capital property, “eligible resale property”, bankers’ acceptances of a Canadian corporation, money, or certain government debt or deposits with a financial institution;
- [Property management subsidiaries] securities of a subject entity, if the entity derives all or substantially all (generally, 90% or more) of its gross REIT revenue for its taxation year that ends in the trust’s taxation year that includes that time, from maintaining, improving, leasing or managing real or immovable properties that are capital properties that are owned or co-owned by the trust or by an entity in which the trust holds a share or an interest;
- [Title subsidiaries] securities of a subject entity, if the entity holds no property other than legal title to owned or co-owned real or immovable property or ancillary property of the trust or of a wholly-owned subsidiary of the trust; and
- [Ancillary property] property ancillary to the earning of rent from, or amounts received or receivable from the disposition of, real or immovable properties that are capital properties, other than an equity of an entity, or a mortgage, hypothecary claim, mezzanine loan or similar obligation.

**KPMG Observations**

The exclusion of taxable Canadian corporations, SIFT trusts, SIFT partnerships or REITs from this definition allows an entity to hold investments in such entities without those investments being treated as “Canadian real, immovable or resource property” in determining whether the entity is a SIFT. This relieving measure ensures that a publicly traded mutual fund trust is not a SIFT trust merely because it invests in a portfolio of REITs, for example.
KPMG Observations

Title Subsidiaries
The shares of a nominee corporation are most safely held by the entity which also holds beneficial ownership of the related real or immovable property.

Ancillary Property
The term “ancillary” is not defined in the Act. Given its ordinary meaning and comments from the CRA, ancillary property (or ancillary revenue) must be related or auxiliary to the rental of such property, but it must also be less significant and subordinate to the rental activity and it must not constitute a separate undertaking.

Equity of another entity, or a mortgage, hypothecary claim, mezzanine loan or similar obligation (including, for example, a vendor take-back mortgage) cannot be qualified REIT property unless that entity or debtor meets all the REIT conditions (other than the public trading requirement).

Accordingly, a REIT must ensure that:
(i) A security held by a REIT is not NPP; or
(ii) The FMV of such a security and all other NPP that is not qualified REIT property is less than 10 percent of all NPP held by the REIT.

Management Subsidiary
The qualifying management subsidiary must only satisfy a revenue test; there are no property restrictions.

Property management activity is “good” revenue of the management subsidiary if the real property under management is owned by either the parent or a sister entity of the property management subsidiary. The sister entity does not need to be wholly owned by the parent.

A REIT is permitted to derive 10% of its total revenue from active business sources, other than rent from real or immovable properties. However, as a mutual fund trust, a REIT cannot hold any property (e.g., computers, furniture and equipment) used in carrying on a business in Canada. Therefore, commercial third-party management activity may be conducted by a qualifying management subsidiary, the shares of which are qualified REIT property, but the revenue from such activity should represent less than 10% of the gross REIT revenue of the management subsidiary.

These issues are illustrated in the following diagrams.
“Real or immovable property” means:

- Securities of an entity that meets the REIT conditions, other than the public trading requirement;
- Real or immovable property under property law; or,
- Certain depreciable property, including:
  - Buildings in CCA Class 1, 3 or 31;
  - Property ancillary to the ownership or use of such buildings; or,
  - Lease, or leasehold interest, in land or Class 1, 3 or 31 buildings.

KPMG Observations

“Depreciable property” generally refers to the various types of capital property described in Schedule II of the Regulations.

“Eligible resale property” of an entity is real or immovable property of the entity that is:

- Not capital property;
- Contiguous to a particular real or immovable property that is capital property or eligible resale property of the entity or an affiliated entity; and,
- Ancillary to the holding of that particular real or immovable property or eligible resale property.

KPMG Observations

“Gross REIT revenue” means the amount, if any, by which the total of all amounts received or receivable in the year by the entity exceeds the total cost to the entity of properties disposed of in the year.

KPMG Observations

For purposes of the 75% Real Property Revenue Test and the 90% Passive Revenue Test, it is clear that the gross amounts received or receivable are relevant, not the net income of the entity.

Gross REIT revenue does not include recaptured CCA and certain benefits deemed to be included in the income of a taxpayer unless such amount is also deemed to be received by the taxpayer, and is not reduced by the selling costs of dispositions or losses sustained on the disposition of real or immovable property that is capital property or eligible resale property. Consistently, such amounts are not included in the 75% Real Property Revenue Test or the 90% Passive Revenue Test and therefore do not affect a REIT’s ability to satisfy these conditions.

124 Section 253.1.
“Rent from real or immovable properties” includes:

- Rent or similar payments for the use or right to use real or immovable properties; and,
- Payment for services ancillary to and customarily supplied or rendered in connection with the rental of such properties.

Rent from real or immovable properties does not include:

- Payment for any other services supplied or rendered to tenants of such properties;
- Fees for managing or operating such properties;
- Payments for use of hotel rooms or other lodging facilities; or
- Rent based on profits.

KPMG Observations

A relieving flow-through rule is provided in subsection 122.1(1.2) for amounts received or receivable by a REIT from its subsidiary entities. (Discussed below).

The definition of “rent from real or immovable properties” may not be sufficiently broad to capture common amounts received in respect of rent, such as termination fees or damages for unpaid rent. However, such amounts received may be considered payments similar to rent.

The revenue from parking ancillary to the rental of “real or immovable property” and customarily supplied to building tenants, their clients and customers, is generally “rent from real or immovable property”. However, this view may not be applicable if the parking activity does not support the REIT’s rental buildings, but constitutes the operation of a separate parking business.

In a ruling released in 2011, the CRA agreed that the guaranteed price received by a participant in the Feed-in Tariff Program offered by the Ontario Power Authority for electricity generated from a renewable energy facility (solar panels) was qualifying revenue for the 90% and 75% gross REIT revenue tests. Furthermore, the solar photovoltaic systems were considered “real or immovable property” as they were ancillary to the ownership or utilization of qualifying buildings.

KPMG Observations

A Canadian resident partnership controlled by a SIFT, REIT or public company is not an “excluded subsidiary entity”, and may be a SIFT partnership and subject to SIFT tax if an individual holds an interest in the partnership which is exchangeable into the publicly traded units or shares of the SIFT, REIT or public company.

125 Ruling 2010-0376801R3—“FIT program (solar): revenue”.

Entity Definitions

“Entity” means a corporation, trust or partnership.

“Subject entity” means a person or partnership that is:

- A corporation resident in Canada;
- A trust resident in Canada;
- A “Canadian resident partnership”; or
- A non-resident person or partnership with principally Canadian income sources;
- But does not include an individual.

“Excluded subsidiary entity” means an entity, the equity of which is not at any time in the taxation year:

- Listed or traded on a stock exchange or other public market; or
- Held by any person or partnership other than:
  - A REIT;
  - A taxable Canadian corporation;
  - A SIFT trust;
  - A SIFT partnership;
  - A person (including, for example, an individual, trust, tax-exempt entity or non-resident) or partnership that does not have, in connection with the holding of a security of the entity, property the value of which is determined, all or in part, by reference to a publicly-traded security; or
  - An excluded subsidiary entity.
**Portfolio investment entity** means an entity that does not hold any NPP.

**KPMG Observations**
A REIT may, for example, implement a common cross border ownership structure by owning the shares of a Canadian corporate subsidiary which holds the shares of its foreign subsidiary. If the foreign subsidiary only carries on business outside of Canada, it should be a portfolio investment entity.

**Investment, Security and Equity Definitions**

**“Investment”** in a trust or partnership means:
- Property that is a “security” of the trust or partnership, or
- A right which may reasonably be considered to replicate a return on, or the value of, a security of the trust or partnership.
- Investment in a trust or partnership does not include:
  - An unaffiliated publicly traded liability of the trust or partnership, or
  - Regulated innovative capital.126

**“Security”** of a particular entity means:
- Any right, whether absolute or contingent, conferred by the particular entity or by an entity affiliated with the particular entity, to receive, either immediately or in the future, an amount that can reasonably be regarded as all or any part of the capital, of the revenue or of the income of the particular entity, or as interest paid or payable by the particular entity.
- For greater certainty, a “security” includes a liability of the particular entity.
- In the case of a particular entity that is a corporation, a “security” includes a share of the corporation, and a right to control in any manner the voting rights of a share of the corporation.
- A security includes an income or capital interest in a trust or an interest as a member of a partnership, or a right to, or to acquire, anything described above.
- Securities of an entity are meant to be viewed very broadly.

**“Equity”** of an entity means:
- A share of the capital stock of a corporation;
- An income or capital interest in a trust;
- An interest as a member of a partnership;
- A liability convertible into, or exchangeable for, equity;
- A liability, any amount paid or payable in respect of which is contingent or dependent on the use of or production from property, or is computed by reference to revenue, profit, cash flow, etc. (i.e., participating debt); and
- A right to, or to acquire, anything described above.

**“Equity value”** of an entity means the FMV of all shares, trust interests, or partnership interests of the entity, and is relevant for valuation testing in the Qualifying Property Value Test and the determination of NPP (securities of a subject entity).

**“Unaffiliated publicly-traded liability”** of an entity means a liability of the entity, that is not “equity”, and that is listed or traded on a stock exchange or other public

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126 The exclusion to the definition of an “investment” for “regulated innovative capital” applies to financial institutions.
market, and persons or partnerships that are not affiliated with the entity hold at least 90 percent (measured at fair market value) of all such liabilities.

**KPMG Observations**

This relieving definition ensures that a REIT’s partnership or trust subsidiary is not subject to the SIFT tax regime solely because debt of the subsidiary entity trades on a stock exchange or externally organized market.

**Revenue Character Flow-through Rules**

For purposes of determining the gross REIT revenue of an entity (referred to as the “parent entity”) for a taxation year, amounts received or receivable from certain entities that can reasonably be considered to be derived from revenues of a particular character in the source entity will retain that character when included in the gross REIT revenue of the parent entity.

These character preservation rules in subsections 122.1(1.1) and (1.2) apply to amounts received or receivable from a source entity, if at any time in the taxation year, the parent entity:

- Is affiliated with the source entity, or
- Holds equity securities of the source entity (namely, shares if the entity is a corporation, an income or capital interest if that entity is a trust, or a partnership interest if the entity is a partnership) that have a total fair market value that is greater than 10% of equity value of the source entity.

These character preservation rules apply to the revenue received or receivable by a parent entity from a subject entity that is described in the qualified REIT property definition (i.e., a management subsidiary) only where that revenue cannot reasonably be considered to be derived from certain property management revenue (i.e., revenue from maintaining, improving, leasing or managing real or immovable properties that are capital properties of the parent entity, or an entity in which the parent entity holds a share or interest).

The explanatory notes that accompanied the new rules state that these character preservation rules are intended to work iteratively through a chain of ownership of several levels of subject entities.

**Subsidiary Trust Structure**

- Before the enactment of relieving amendments, one Canadian REIT obtained a favourable ruling to eliminate its subsidiary trust on a tax-deferred basis (Ruling 2007-0244691R3) in order to meet the REIT revenue conditions.
- The revenue charter flow-through rules now accommodate these second generation REIT structures to qualify for the REIT exemption.

**KPMG Observations**

The scope of the revenue character preservation rules are limited to circumstances in which the REIT has a sufficient equity investment in the source entity. Therefore, for example, this prevents the recharacterization of interest received by a REIT on a loan to an entity in which it does not have a significant equity interest.

The exclusion of the REIT’s internal property management revenue from the character preservation rules is helpful. For example, a dividend received by a REIT from its property management subsidiary corporation would retain its character as a dividend, which is qualifying revenue under the passive revenue test.
Interest Rate and Foreign Currency Hedging

REITs may choose to manage the risk from the fluctuation of the interest rate on debt by entering into hedging arrangements with a financial intermediary (for example, to swap a variable interest rate for a fixed interest rate).

REITs holding foreign real or immovable property may finance the acquisition of such property using debt denominated in a foreign currency. Also, given the potential foreign currency risk in holding foreign assets, REITs may choose to enter arrangements that hedge that risk.

Subsection 122.1(1.3) deems certain amounts included in gross REIT revenue of a trust to have the same character as gross REIT revenue in respect of the underlying real or immovable property that result from:

- Interest-rate hedges entered into by the REIT in respect of debt incurred by the REIT to acquire or re-finance real or immovable property; and
- Foreign currency gains in respect of real or immovable property situated in a country other than Canada recognized on:
  - Revenue in respect of such non-Canadian real or immovable property;
  - Debt incurred by the trust for the purpose of earning such non-Canadian revenue; or
  - Foreign currency hedges entered into by the trust to reduce its risk from currency fluctuations on rent or debt described above.

The explanatory notes accompanying these rules state that these hedging provisions are intended to work in complementary fashion with the revenue character preservation rules.

KPMG Observations

A loss sustained on a hedging transaction is not an amount received or receivable and is therefore not relevant in the computation of gross REIT revenue.

For an interest-rate hedge or a foreign currency hedge on debt, the revenue characterization rules do not appear to apply if the hedge is entered into by an entity other than the entity which incurred the debt.

However, the revenue characterization rules work properly on a gain realized on a foreign currency cash flow hedge on a REIT’s direct or indirect non-Canadian real property rental revenue, regardless of which entity within the REIT structure enters into the agreement.

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127 CRA View 2010-0369251E5—“Revenues of a real estate investment trust,” dated October 26, 2010.
Retroactive Application

Under the 2013 technical amendments, a REIT may have elected, in writing on or before its filing due-date for its taxation year that includes June 26, 2013 (the date on which the 2013 technical amendments received Royal Assent) for such amendments to apply after 2006 and before 2011.

The ability to elect to have these rules apply retroactively may have benefited a REIT that was not eligible for the grandfathered exemption from the SIFT tax (for example, a REIT that became publicly traded after October 31, 2006 or a REIT that exceeded its normal growth guideline).

Exchangeable Units of Subsidiary Limited Partnerships

Because there is no tax-deferred rollover in connection with the transfer of property to a trust, a REIT purchaser may propose that the properties are not transferred by the vendor directly to the REIT but to a limited partnership in which the REIT is a limited partner. The vendor may then be entitled to transfer the properties to the limited partnership on a tax-deferred basis within the limitations of subsection 97(2).

The REIT will typically own the general partner of the acquisition limited partnership and will also hold the Class A units of the limited partnership.

The vendor will usually receive a combination of consideration, including cash, promissory note(s), the assumption of indebtedness, and Class B units of the limited partnership.

The Class B units are intended to be economically equivalent to the publicly-traded REIT units and are generally exchangeable on a one-for-one basis with the units of the public REIT. Special Voting Units may also be authorized under the terms of the REIT’s Declaration of Trust and will be issued only in conjunction with the issuance of Class B limited partnership units of the subsidiary limited partnership. These Special Voting Units normally have no economic entitlement and are designed to give the holder of the Class B units of the limited partnership the right to vote on any matter on which a REIT unitholder is entitled to vote on the basis of one vote per issued Class B unit.

When the vendor exercises its exchange right, the exchange of Class B units for the publicly-traded REIT units will be a taxable disposition and the deferral of tax on the original gain is ended. The Special Voting Units will be cancelled upon exercise of this exchange right.

Distribution and Income Allocation Issues

Distributions on a Class B unit are the same amount per unit as distributions on a publicly-traded REIT unit.

However, unless all the properties of the REIT are owned by, and all the activities conducted by, the limited partnership, the character of the taxable income on the cash distributions on the Class B units may not be identical to that of the REIT units.

Generally, ignoring the income allocated to the general partner, the income of the limited partnership for tax purposes is allocated to the Class A and Class B limited partners pro rata to the cash distributions made to the limited partners during the fiscal year.

The Class B units are normally given a priority entitlement over the REIT’s Class A units on cash distributions. Furthermore, the REIT is normally obligated to contribute cash to the limited partnership (as an additional capital contribution on
its Class A units) if the limited partnership has insufficient cash to fund the required distributions on the Class B units.

**Derivative Forward Agreement Rules (Character Conversion Issues)**

The derivative forward agreement ("DFA") rules are a set of anti-avoidance rules (often referred to as character conversion rules) that are intended to address certain structures that have the effect of transforming income into capital gains.

In the technical notes to this legislation, Finance considered the applicability of the DFA rules to exchangeable shares. In a typical exchangeable share structure, by virtue of the redemption and retraction rights attaching to the exchangeable shares, the value of the shares of the Canadian corporation tracks the value of the shares of a publicly listed foreign corporation. The technical notes stated that where the exchange right is embedded in the share terms, the arrangement would not be a DFA.

These rights are analogous to the exchange rights in the Class B limited partnership arrangement, discussed above.

**KPMG Observations**

The DFA rules are complex. In testing the application of the DFA rules to a Class B limited partnership arrangement, the exception provided in subparagraph (c)(ii) of the DFA definition is often cited. The exception is available where the vendor retains the majority of the risk of loss and opportunity for gain in respect of the property disposed of. Because the exchangeable securities derive their value initially from the property disposed of, and thereafter fluctuate in value based on the market price of a publicly-traded REIT unit, as in the exchangeable share example, the vendor should retain financial exposure by the holding of Class B units. There are concerns, however, if the exchange right is contained in a separate agreement, and therefore it is generally recommended that the exchange right is embedded in the terms of the limited partnership agreement.

**Stapled Securities**

In general terms, a stapled security involves two or more separate securities that are stapled together such that the securities are not freely transferable independently of each other.

Section 12.6 provides a series of anti-avoidance rules that operate in conjunction with section 18.3 to tighten the SIFT tax regime by restricting the deductibility of payments related to publicly traded stapled securities.

Section 12.6 provides an anti-avoidance rule to disregard any unstapling that is not carried out on a permanent and irrevocable basis.

Section 18.3 denies the deduction of certain amounts, including, interest paid or payable on a debt obligation that is a stapled security, or rent paid or payable to an entity that is part of a stapled security structure that includes a REIT.

**Pension Plans**

In Canada, the investments that a pension plan is permitted to make are governed by the rules in the Act as well as in applicable pension benefits standards legislation. That said, most pension plans that are regulated under the Pension Benefits Act (Ontario) (the "PBA") (or the equivalent legislation in another province) are required to invest their assets in accordance with the investment rules set out in the Pension Benefits Standards Regulations (the federal investment rules) made under the federal Pension Benefits Standards Act, 1985 (the "PBSA").

**Permitted Investments for Pension Plans**

The federal investment rules apply in addition to those established by the pension plan itself, and impose both qualitative and quantitative limitations on the investment of pension fund assets. These limitations generally fall into three categories: those established by the prudent-person standard, those set out in the plan's statement of investment policies and procedures, and those provided for by statute, such as the PBA or the PBSA.

The federal investment rules are important for purposes of the Act because, as summarized below, the Act and its Regulations recognise and allow for investments that a pension plan is permitted to make under the PBSA or similar provincial legislation.
Income Tax Rules for Pension Plans

Registered Pension Plans

Generally, pension plans and their wholly-owned subsidiaries are exempt from tax under the Act, provided that they satisfy certain conditions. In particular, no tax is payable by a trust governed by a registered pension plan.128

A corporation that administers a pension plan will also be exempt from tax if it is incorporated and operated throughout the relevant period:

– Solely for the administration of a registered pension plan; or
– For the administration of a registered pension plan and, with one minor exception relating to retirement compensation arrangements, for no other purpose;

and is accepted by the Minister of National Revenue as a funding medium for the purpose of the registration of the pension plan.129

A corporation incorporated before November 17, 1978 solely in connection with, or for the administration of, a registered pension plan is also exempt.130

The final category of exempt corporations in the pension context are sometimes referred to as pension investment corporations. To qualify, at all times since the later of November 16, 1978 and the date of its incorporation, all of the shares and rights to acquire shares of the corporation must be owned by:

– One or more registered pension plans;
– One or more trusts, all the beneficiaries of which are registered pension plans;
– One or more segregated funds, all the beneficiaries of which are registered pension plans; or
– One or more persons prescribed under Regulation 4802 (the “Shareholder Test”).

In addition to the Shareholder Test, the Act restricts the activities and investments such corporations may make. These restrictions are described in more detail below under “Pension Realty Corporation and Pension Investment Corporation”.

Income Tax Regulations Applying to Registered Pension Plans

In addition to the foregoing requirements, the Act and Regulations to the Act impose certain restrictions on the permitted investments and activities of a plan that is a registered pension plan under the Act.131 For these purposes, a registered pension plan is defined to mean a pension plan that has been registered by the Minister of National Revenue for the purposes of the Act (where such registration has not been revoked).132

The rules in the Regulations complement the federal investment rules discussed above. For example, a pension plan's investments cannot include a “prohibited investment” or any investment not permitted under the pension legislation governing the plan.133 The definition of “prohibited investment”134 parallels the related party investment restrictions found in the federal investment rules. The restrictions are essentially designed to prevent a registered pension plan from investing in securities of an employer or certain other persons connected with the employer, subject to certain exceptions including, among other things, publicly-traded shares and debt of publicly-traded companies.

In addition, a trustee or other person that holds property in connection with a registered pension plan is prohibited from borrowing money for the purposes of the plan, except in limited circumstances, primarily where the borrowing is short-term (90 days or less) or relates to the acquisition of real property that may reasonably be considered to be acquired for the purpose of producing income from property.135

Pension Realty Corporation and Pension Investment Corporation

Certain direct or indirect subsidiaries of registered pension plans also qualify for exemption from tax (i.e., “pension Realty corporations” (“PRCs”)) and “pension investment corporations” (“PICs”).136 The requirements in the Act closely follow the federal investment rules that apply to PRCs and PICs.

128 Paragraph 149(1)(o).
129 Paragraph 149(1)(o.1).
130 Subparagraph 149(1)(o.2)(i).
131 See Regulations 8501 and 8502.
132 See definition in subsection 248(1).
133 See Regulation 8502(h).
134 See Regulation 8514(1).
135 See Regulation 8502(i).
136 Subparagraph 149(1)(o.2)(ii).
137 Subparagraph 149(1)(o.2)(iii).
Specificially, for a corporation to qualify as a PRC under the Act, it must satisfy the Shareholder Test as well as the following tests relating to its activities, investments and borrowings:

1. **Activities test**: The corporation’s activities must be limited to acquiring, holding, maintaining, improving, leasing or managing capital property that is real property or an interest in real property owned by the corporation, another PRC or a registered pension plan, or investing its funds in a partnership that limits its activities to acquiring, holding, maintaining, improving, leasing or managing capital property or an interest in real property owned by the partnership.

2. **Investments test**: The corporation can make no investments other than in real property or an interest in real property or investments that a pension plan is permitted to make under the PBSA or a similar law of a province (such as the PBA).

3. **Borrowing test**: The corporation can borrow money only for the purpose of earning income from real property or an interest in real property.

Each of the foregoing tests must be satisfied at all times since the later of November 16, 1978 and the date on which the corporation was incorporated.

A corporation will qualify as a PIC if it satisfies the Shareholder Test as well as the following tests relating to its investments, assets, income and debt obligations:

1. **Investments test**: The corporation can make no investments other than investments that a pension fund or plan is permitted to make under the PBSA or a similar law of a province (such as the PBA).

2. **Asset test**: The assets of the corporation must be at least 98% cash and investments.

3. **Income test**: The corporation must derive at least 98% of its income in its taxation year from, or from the disposition of, investments.

4. **Debt Obligation test**: The corporation cannot issue debt obligations or accept deposits.

**KPMG Observations**

Pension plans continue to be significant players in real estate. Because of their tax-exempt status, if feasible, they usually prefer not to hold property in taxable entities. Because they generally prefer not to be partners, joint ownership of property can be difficult to arrange if the other participant’s contribution to a joint venture is appreciated assets.

Alternatives that may address this issue include participating lease arrangements in which rents approximate ownership of an undivided interest in a property, with a large prepayment of rent upfront that can be amortized into income by the other participant over the term of the lease. This arrangement allows the “vendor” to have cash and at the same time defer recognition of the income using reserves allowed for tax purposes.

Other alternatives may include a pooling of interests of various parties so that the operating income from a group of properties can be shared with no disposition of the property. However, there is a risk that a partnership could be considered to exist in connection with the operations.

Where the pension plan wishes to participate in the development of real estate (an activity that cannot be undertaken by a PRC), it may be possible for it to do so through a PIC. A typical structure in these circumstances would involve the PIC investing directly or indirectly in a limited partnership that carries on a real estate development business.

**Note**: This or any other planning idea should only be acted on with appropriate professional advice after a thorough examination of the particular situation.
Ownership and Operating Issues
Ownership and Operating Issues

Property Additions

Acquisitions

Land/Building Allocation

Where property is acquired, the allocation of the purchase price between land and building (and potentially other assets) may be specified in purchase and sale documents. If an allocation is not specified in the agreement, consideration might be given to the following alternatives:

- Allocate to land based on comparable vacant land with the balance allocated to building;
- Allocate to land and building based on recent appraisals;
- Allocate based on property tax assessments; and
- Adopt the allocation used for accounting purposes (if the method is reasonable).

In addition to buildings, it might be appropriate to allocate a portion of the cost to paving, furniture and fixtures, automotive equipment, signage and other classes of depreciable property with CCA rates greater than 4% per annum.

The purchase price allocation between land and building and other components should be supported by a valuation report, cost segregation study or other documentation.

Retail sales tax implications must be considered in certain provinces if an allocation is made to tangible personal property (not affixed to real property).

The GST/HST implications of the acquisition of real property are discussed in detail in a later section of this Handbook.

Intangible Assets and Below-market Leases

Under Accounting Standards for Private Enterprises ("ASPE"), where operating leases are acquired in either an asset acquisition or a business combination, an entity is required to allocate a portion of the purchase price to intangible and tangible assets. Intangible assets include the value of “in-place” operating leases, the differential between original contractual rents and market rents for in-place leases, and tenant relationships.

Under International Financial Reporting Standards ("IFRS"), the intangible assets and liabilities are also recognized, but the presentation of such amounts differs from ASPE. The value of “in-place” operating leases and favourable ("above market") or unfavourable ("below market") contractual terms are incorporated into the carrying cost of the investment property. An intangible asset for customer relationships is recognized separately. The depreciation or amortization of each intangible asset or liability is computed separately.

IFRS and ASPE defer and amortize these intangible costs, generally over the term of the lease.

For tax purposes, no value is generally allocated to the intangible assets (e.g., leases and tenant relationships). In Income Tax Technical News No. 38 (archived), dated September 22, 2008, CRA confirmed its view that the full amount of the purchase price is allocated to the tangible assets (i.e., land and building).

Purchase Price Discount Due to Non-market Rate Debt

Under IFRS and ASPE, a purchase price discount received due to the assumption of a high-interest rate debt obligation in conjunction with the purchase of real property is deferred and amortized as a reduction to interest expense over the remaining life of the obligation.

For tax purposes, the discount is generally included in the income of the purchaser in the year of purchase either under section 9 or as an inducement payment under paragraph 12(1)(x). No amortization of the income is allowed.

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140 Where raw land is acquired for development or where an income-producing property is acquired as inventory, the purchase price allocation among the various components acquired (if any) will be of little significance for income tax purposes.

141 For buildings used in manufacturing and non-residential properties the CCA rate is 10% and 6%, respectively, for additions after March 18, 2007.

142 See for example, the findings of the Tax Court of Canada in Sunrise Realty Investments Limited v. The Queen (2013 TCC 9).

Alternatively, where paragraph 12(1)(x) applies, an election can be made under subsection 13(7.4) to reduce the capital cost of the depreciable property acquired by the amount of the discount. A similar election under subsection 53(2.1) is available for non-depreciable capital property. Where paragraph 12(1)(x) applies on the purchase of real property, the discount amount should be allocated between depreciable property (building) and non-depreciable capital property (land) or such other property to which the discount relates.

Conversely, if the assumed debt has a stated interest rate that is less than the current rate, a portion of the purchase price may represent a cost of incurring indebtedness. In such case, the purchaser should be able to deduct the amount as a paragraph 20(1)(e) financing cost, generally over five years.

Building On Leased Land

Building or modifying a building or other structure on leased land may not be eligible for class 13 treatment (acquiring a leasehold interest). Rather, regulation 1102(5) requires this cost to be treated as a building or other structure (e.g., class 1). Regulation 1102(5.1) provides the same result when a building is acquired on leased land.

The CRA has ruled that where a taxpayer finishes a building, such as the interior fit, as a tenant under a lease, the cost of the interior work is subject to Regulation 1102(5) and therefore added to class 1.

The acquisition cost in respect of a leasehold interest in land would be considered a class 13 asset. A taxpayer may be able to claim CCA in respect of this depreciable asset.

Corporate Acquisition and Land Bump

Where a corporation engaged in a land development business acquires all of the shares of a corporation holding a parcel of land as capital property, CRA accepts that the cost of the land can be bumped under paragraph 88(1)(d) if the target corporation is wound-up into (or amalgamated with) the acquiring corporation, even if the land will be acquired by the developer as inventory and even if the wind-up (or amalgamation) occurs years later. The land must be capital property to the target at the time of the acquisition of control.

Non-arm’s Length Transfers

When a depreciable asset is disposed of by a person (i.e., corporation, trust or individual) or partnership to a person or partnership affiliated with the transferor and there would otherwise be a terminal loss on the transfer, the terminal loss is suspended.

The transferee is deemed to acquire the property at the transferor’s capital cost and is deemed to have claimed CCA in previous taxation years equal to the amount by which the transferor’s capital cost exceeded the FMV of the property at the time of transfer.

The transferor may claim the terminal loss when there is a change of control of the transferor, or the transferee, or a subsequent change in ownership of the asset to a person or partnership that is not affiliated with the transferor. Until such time, the transferor is deemed to own depreciable property of that class with an undepreciated capital cost (“UCC”) equal to the terminal loss and may continue to claim CCA in respect of such property at the relevant rate. In such case, the terminal loss, once realized, will be reduced by any CCA claimed by the transferor.

These rules are contained in subsection 13(21.2) and should be reviewed based on the specific facts prior to the transaction to ensure there are no anomalous results.

Similar rules apply to a loss on a non-arm’s length disposition of non-depreciable capital property. When a depreciable asset is acquired by a person or partnership (the “Acquirer”) from another person or partnership (the “Transferor”) with whom the Acquirer did not deal at arm’s length, the amount that would otherwise form the UCC to the Acquirer may be reduced. Paragraph 13(7)(e) limits the Acquirer’s UCC to an amount equal the capital cost of the asset to the Transferor plus 50% of the amount, if any, by which the proceeds of disposition to the Transferor exceed the

144 A payment (or purchase price allocation) to assume debt with a stated interest rate that is below the market interest rate may not be deductible by the purchaser since the amount is a capital outlay. The amount may be deductible under subparagraph 20(1)(e)(ii.1) since it arose in the course of incurring indebtedness.

146 ee paragraph 20 of Interpretation Bulletin IT-464R.

147 See subsections 40(3.3) and (3.4) (stop-loss rules) and section 54 (superficial loss rules).


149 See subsections 40(3.3) and (3.4) (stop-loss rules) and section 54 (superficial loss rules).
Transferor’s capital cost.\(^{150}\) Effectively, this rule prevents the Acquirer from claiming CCA on the amount of the Transferor’s gain that was not subject to tax on the sale.

The adjustment to the capital cost of the Acquirer is only for purposes of computing the Acquirer’s future CCA claims and recaptured CCA; the capital cost is not adjusted for the purpose of computing the Acquirer’s adjusted cost base.\(^{151}\)

Therefore, when the Acquirer ultimately disposes of the property, its capital gain will be computed with reference to the Acquirer’s actual capital cost and not the capital cost adjusted by paragraph 13(7)(e).

A similar provision in paragraph 13(7)(f) adjusts the capital cost when a capital gain has been realized from an election under paragraph 111(4)(e) as a consequence of a loss restriction event (e.g., an acquisition of control).

**Affiliated Persons**

Affiliated persons are defined in subsection 251.1(1) to include certain individuals, corporations, trusts, beneficiaries, partners and partnerships, depending on their relationships.

The rules for affiliated persons differ from the rules for associated corporations but are just as complex (the concept of associated corporations is not discussed in this Handbook).

Affiliated persons are defined as:

- An individual and his or her spouse or common law partner.
- A corporation and:
  - A person by whom the corporation is controlled,
  - Each member of an affiliated group of persons by which the corporation is controlled, or
  - A spouse or common law partner of a person described above.
- Two corporations if:
  - Each corporation is controlled by a person and those controlling persons are affiliated,
  - One corporation is controlled by one person and the other corporation is controlled by a group of persons, each of whom is affiliated with that one person, or
  - Each corporation is controlled by a group of persons and each member of each group is affiliated with at least one member of the other group.
- A corporation and a partnership if the corporation is controlled by a particular group of persons and each member of that group of persons is affiliated with at least one member of a majority interest group of partners (defined in subsection 251.1(3)) in the partnership and each member of that majority interest group is affiliated with at least one member of the particular group.
- A partnership and a majority interest partner (defined in subsection 248(1)) in the partnership.
- Two partnerships if:
  - The same person is a majority interest partner in both partnerships,
  - A majority-interest partner in one partnership is affiliated with each member of a majority-interest group of partners in the other partnership, or
  - Each member of a majority-interest group of partners of each partnership is affiliated with at least one member of a majority-interest group of partners in the other partnership.

Persons are affiliated with themselves, so, for example, if an individual controls two corporations, the two corporations are affiliated.

It is important to note that siblings, and children and their parents, are not considered affiliated persons.

### Affiliation Between a Person and a Trust

Paragraph 251.1(1)(g) sets out certain circumstances in which a person and a trust are affiliated. A trust is affiliated with any beneficiary who is entitled to a majority of the trust income or capital (a “majority-interest beneficiary”, defined in subsection 251.1(3)) and generally with any person affiliated with such a beneficiary.

For the purpose of determining affiliation, the discretionary power to determine the amount of income or capital that a person may receive from a trust is deemed to be fully exercised.

Paragraph 251.1(1)(h) provides that two trusts are affiliated if a contributor to one of the trusts is affiliated with a contributor to the other trust, and:
- A majority-interest beneficiary of one of the trusts is affiliated with a majority-interest beneficiary of the other trust, or
- A majority-interest beneficiary of one of the trusts is affiliated with each member of a majority-interest group of beneficiaries of the other trust, or
- Each member of a majority-interest group of beneficiaries of each of the trusts is affiliated with at least one member of a majority-interest group of beneficiaries of the other trust.

Paragraph 251.1(4)(c) provides that a reference to a trust does not include a reference to the trustee or other persons who own or control the trust property. This provision is useful in situations in which an estate or a corporation controlled by the estate could otherwise have been affiliated with the trustee or a corporation controlled personally by the trustee.

**Available for Use**

**Building Available for Use—Subsection 13(28)**

Depreciation for tax purposes will only be available when the property is considered to be available for use.

A building is considered available for use only at the earliest of:
- The time at which all or substantially all (i.e., 90% or more) of the building is used for its intended purpose; ¹⁵³
- The time at which construction is complete;
- Two years after acquisition (and in some cases earlier), although:
  - A two-year rolling start rule applies for long-term construction projects, and
  - The half-year rule does not apply for construction expenditures incurred before the current year; ¹⁵⁴
- Immediately before disposition of the property; and,
- The time at which all or substantially all of the building is used for its intended purpose; ¹⁵³

For “replacement property,” when the replacement property is acquired, although:
- The property has to be used by the end of the first taxation year following year of disposition of the replaced property; and
- This provision applies only for involuntary dispositions (e.g., expropriations, fires and floods).

For the purposes of this provision, a renovation, alteration or addition to an existing building is considered to be a building separate from the existing building.

**Long Term Project Election—Subsection 13(29)**

The election is available for properties used in long-term projects but is not available for rental properties. This election allows for:
- A two-year rolling start; ¹⁵⁶
- Expenditures in year 1 and year 2 to be fully applied in year 3 and year 4;
- Expenditures in year 3 to be applied in year 5 but limited to expenditures in year 1; and
- Expenditures in year 4 to be applied in year 6 but limited to expenditures in year 2 plus unused expenditures in year 1.

However, in the development of multiphase properties, it is important to note that each phase is usually considered a separate property. Therefore, subsection 13(28) applies to bring the earlier phases into the UCC pool prior to the completion of the overall project.

**Non-arm’s Length Transfers—Subsections 13(30) and 13(31)**

Property transferred in a non-arm’s length transaction (e.g., through non-arm’s length purchases and corporate reorganizations) is treated as if it had been acquired by the transferee at the time it was in fact acquired by the transferor (i.e., the available-for-use rules flow through).

¹⁵² Subsection 13(27) contains the general rules for determining when property other than buildings becomes available for use.

¹⁵³ Technical Interpretation 2003-003S347, “Available for use rules”: The CRA’s view is the time referred to in subsection 13(28)(a) is not the time that the construction phase of a building is “all or substantially all” complete. The CRA’s view is that the “all or substantially all” requirement will be met when 90% or more of the building’s square footage is used for its intended purpose.

¹⁵⁴ Regulation 1100(2)(a)(vi).

¹⁵⁶ An election pursuant to subsection 13(29) allows a taxpayer to apply the available-for-use rules to costs incurred during a long-term construction contract in years subsequent to the first two years (and, where the second taxation year is less than 368 days, the first taxation year that commences more than 367 days after the end of the first taxation year) where they exceed the costs incurred in the first two taxation years. The election does not affect the application of the available-for-use rules to costs incurred during the first two taxation years.

¹⁵⁷ Paragraphs 13(27)(b) and 13(28)(c) and subsection 13(29).
Regulation 1100(2.2)(j)(iv) deems “available for use” to be at the earlier of the time the property is acquired by the transferee and the time it became available for use by the transferor. Therefore, in a non-arm’s length transfer, the half year rule does not apply where the transferor owned the property at least 364 days prior to the end of the transferee’s taxation year in which the property was acquired.

Anti Avoidance—Subsection 13(32)

Subsection 13(32) includes an anti-avoidance rule intended to prevent any benefits a taxpayer may achieve by accelerating write-offs through a lease of property to a non-arm’s length person before the property is otherwise available for use.

The rent paid by the non-arm’s length person before the property is otherwise available for use is not deductible as ordinary rent but is depreciable under Class 13 as a cost of acquiring a leasehold interest.

Determination of available for use and/or capable of use depends on the facts of each case.

It is essential that all documentary support relevant to the asset be retained (for example, an architecture or engineer certificate of completion).

Current vs. Capital Expenditure

When a business incurs expenditures related to a property, it is important to determine whether the expenditures are current or capital in nature. There are no specific provisions in the Act for determining whether an expenditure is on account of income or capital. Rather, the determination will depend on the specific facts and the particular circumstances surrounding the nature and context of the expenditure. As summarized by the CRA, jurisprudence suggests that there are four guidelines that are relevant in the determination: enduring benefit, maintenance or betterment, integral part or separate asset, and relative value.157

Generally, an expenditure for the maintenance or repair of a property is a current expense that is deductible in the period. Some of the elements that support current expense are:

- It is a recurring expense for the replacement or renewal of a specific item;
- The useful life of the acquired property is relatively short (generally does not exceed a year) and provides little long-term benefit; and
- It repairs, maintains or restores an asset to its condition when originally acquired by the taxpayer.

Generally, a capital expenditure is made to acquire or improve depreciable or non depreciable capital property. Some of the elements of a capital expense are:

- It provides a lasting or enduring benefit;
- It improves or enhances the property beyond its original condition;
- A separate asset is acquired;
- The amount of the expenditure is high in relation to the value of the whole property or in relation to previous average maintenance and repair costs;
- The costs are incurred to repair property acquired so that it is in a suitable condition for use; and
- The repairs were made in anticipation of the sale of the asset.

For additional information, see paragraph 4 of Interpretation Bulletin IT 128R, “Capital Cost Allowance—Depreciable Property” (Archived).

Current vs. Capital Expenditure

When expenditures include both current and capital elements and these can be distinguished, an appropriate allocation of the expenditures is necessary. When only an insignificant part of the expenditure is of a capital nature, the CRA may be prepared to treat the whole amount as a current expense.

Leaky Condominiums—Technical Interpretation 2001-0104217

The cost of maintaining and repairing the original building envelope (including the method originally used for rain penetration control) of such property may be considered deductible as a current expense.

The cost of repairing damage to internal components of a building (such as mouldy insulation and rotted framing) as a result of water penetration to restore them to their original condition using identical or equivalent quality materials (without improving them beyond their original condition) may generally be considered currently deductible.

Redesigning a building envelope to improve its effectiveness to control water penetration (such as adapting the structure to incorporate a new method for rain penetration control) appears to constitute a material improvement to the property

157 CRA Views 2010 – 03824041E5 – Capital or current expenditures.
beyond its original condition based on relevant case law, and related costs may be considered capital expenditures.

**Repairs to Newly Acquired Rental Property**

The FCA confirmed the decision of the TCC in John Hare v. The Queen\(^\text{158}\) against the taxpayer. The taxpayer acquired a property requiring certain renovations and claimed these costs as current rental expenses. It was determined, however, that these costs were capital in nature as they were necessary to ready the property for rental.

**Failed Land Development**

In Denis Beauregard et al. v The Queen,\(^\text{159}\) the TCC ruled in favour of the taxpayers and allowed business losses to be claimed in connection with an unsuccessful land development project. The taxpayers abandoned their venture due to inability to obtain financing. The business losses were allowed notwithstanding that the rental property was never built.

**Replacement Property Rules**

Subsection 13(4) allows a taxpayer to elect to defer tax on the recaptured CCA resulting from the disposition of certain depreciable property to the extent that the taxpayer reinvests the proceeds of disposition in a replacement property within the following timeframe:

- In the case of certain involuntary dispositions (e.g., theft, fire or expropriation), before the later of the end of the taxpayer’s second taxation year that begins after the former business property was disposed of, and 24 months after the end of the taxation year in which the former business property was disposed of; or
- In other situations, before the later of the end of the taxpayer’s first taxation year that begins after the former business property was disposed of, and 12 months after the end of the taxation year in which the former business property was disposed of.\(^\text{160}\)

The replacement property rules are available for:

- Property unlawfully taken, destroyed or taken under statutory authority (i.e., expropriated); or
- Former business property as defined in subsection 248(1).

Former business property is capital property that is real property or an interest in real property that is used by the taxpayer or a person related to the taxpayer primarily for the purpose of gaining or producing income but generally does not include rental property.

However, an involuntary disposition of rental property may qualify for the replacement property rules.

The definition of former business property was extended to include a franchise, concession or license for a limited period to carry on a business in a fixed place which was disposed of or terminated after December 20, 2002. A valid election under subsection 13(4.2) must be jointly made by the purchaser and the vendor for this expanded definition to apply.

A new property is considered a replacement property only if:

- It is reasonable to conclude that the property was acquired by the taxpayer to replace the former property;
- It is acquired by the taxpayer and used by the taxpayer or a person related to the taxpayer for a use that is the same as or similar to the use to which the taxpayer or a person related to the taxpayer put the former property;
- Where the former property was used by the taxpayer or a person related to the taxpayer for the purpose of gaining or producing income from a business, it is acquired for the purpose of gaining or producing income from that or a similar business or for use by a person related to the taxpayer for such a purpose;
- Where the former property was TCP of the taxpayer, the particular depreciable property is TCP of the taxpayer; and
- Where the former property was TCP (other than treaty-protected property) of the taxpayer, the particular depreciable property is TCP (other than treaty-protected property) of the taxpayer.

Subsection 44(1) provides similar rules and conditions for a deferral of a capital gain on the disposition of certain capital property (other than shares of a corporation).

\(^{158}\) John Hare v. The Queen (2013 FCA 80).  
\(^{159}\) See Denis Beauregard et al. v The Queen (2013 TCC 287). Costs included construction permits, contractor deposits, advertising for tenants, property valuation, and building plans.  
\(^{160}\) For taxation years that end before December 20, 2001 the period of time in which the property could be acquired may have been shorter because it was based solely on taxation years.  
A business expansion does not automatically preclude the use of the replacement property rules, but there must be a correlation or causal relationship between the acquisition of the replacement property and the disposition of the former property.

**Tax Treatment of Bargain Purchase Option Leases**

The CRA withdrew Interpretation Bulletin IT 233R, “Lease Option Agreements; Sale Leaseback Agreements”, effective June 14, 2001. This IT stated that the substance of the agreement rather than its form determined whether a transaction was a sale or a lease. Since the CRA cancelled this IT, its position has generally been that the taxpayer’s legal relationship created by the agreement determines the nature of the transaction rather than the underlying reality. In other words “a lease is a lease and a sale is a sale”.

In Ruling 2003-0028033, “Lease – Bargain purchase option”, the CRA ruled that a lease with a bargain purchase options (“BPO”) (i.e., an option to buy the leased property at a low price) may continue to be treated as a lease for tax purposes rather than a purchase and sale agreement. However, each lease payment may have the following result: the lessor will receive rental income and an amount deemed to be proceeds of disposition for granting the BPO, and the lessee will pay rent expense and an amount that is the cost of the BPO.

Consistent with that ruling, the CRA also has stated that where a BPO exists, a portion of the lease payments could be considered in respect of the right to purchase the property in the future and will be treated as an “option” under section 49. The option amount may be subject to a valuation. Further, where the facts indicate that all or a proportion of the lease payments are for the option, such amount would not be a deductible expense to the lessee.

The CRA is likely to require taxpayers to allocate a portion of a lease payment to a BPO only in certain situations, such as real estate leasing or other types of lease agreements involving assets that tend to appreciate in value. Lease agreements involving lower-priced equipment in which the industry practice is to include BPOs may not be reassessed by the CRA. Ultimately, this issue is a question of fact. Furthermore, the CRA may be less concerned by a requirement to allocate a portion of the lease payment to a BPO as a consequence of subsection 13(5.2) which requires the recapture of previously deducted rental payments to the extent that the property is sold for proceeds in excess of the BPO amount.

When the leased property would have been depreciable property to a taxpayer if acquired, the taxpayer and an arm’s length lessor may elect under subsection 16.1(1) to allow the lessee to be treated for income tax purposes as having acquired the property at its FMV and as having financed the purchase through a loan at a prescribed rate of interest.

**Acquisition of Previously Rented or Leased Property**

Subsection 13(5.2) governs the treatment when a taxpayer acquires property the taxpayer or a person who did not deal at arm’s length with the taxpayer previously leased or rented.

In this circumstance, the taxpayer is deemed to acquire the property at a cost equal to the lesser of:

- The fair market value of the property; and
- The amount paid to purchase the property (the “buyout amount”) plus all previous rental/lease payments made by the taxpayer or a non-arm’s length person.

If the buyout amount (if any) is less than the cost as determined above, the difference is considered to be previously claimed CCA and may be subject to recapture upon disposition of the property.

**Contingent Liabilities**

Section 143.4 was introduced to target certain expenditures not otherwise caught under the general limitation in paragraph 18(1)(e). In particular, this legislation was introduced to address the decision in Collins v. The Queen where the FCA held that the taxpayers could deduct interest expenses as they accrued even though the taxpayers had a right to reduce the amount payable in respect of the interest expenses. The FCA indicated that it was not the interest amounts payable that were contingent; but rather, what was contingent was whether the taxpayers would exercise their right to reduce the amount they were required to pay. In response, under subsection 143.4(2), the amount of a taxpayer’s expenditure, that is otherwise deductible for the purposes of the Act or that otherwise forms part of...
the cost of a capital property to the taxpayer, is reduced by the amount, if any, by which the total amounts each of which is a “contingent amount” of the taxpayer in respect of the expenditure exceeds the total of all amounts each of which is an amount paid by the taxpayer to obtain a “right to reduce” an amount in respect of the expenditure.

A “contingent amount”\(^\text{167}\) of a taxpayer at any time (other than a time at which the taxpayer is a bankrupt) is broadly defined to include an amount to the extent that the taxpayer, or another taxpayer that does not deal at arm’s length with the taxpayer, has a right to reduce the amount at that time.

“Right to reduce”\(^\text{168}\) an amount in respect of an expenditure at any time is also broadly defined to mean a right to reduce or eliminate the amount including, for greater certainty, a right to reduce that is contingent upon the occurrence of an event, or in any other way, if it is reasonable to conclude, having regard to all the circumstances, that the right will become exercisable. As noted by the Joint Committee,\(^\text{169}\) it is understood that generally any change to a taxpayer’s obligation is intended to be caught (including automatic contractual adjustments and adjustments arising from legal proceedings). The Joint Committee expressed concern that the intended broad application of the “right to reduce” definition goes “well beyond the sort of situation at issue” in the Collins case, and could apply to any expenditure adjustment.

In addition, the Joint Committee was concerned with the “reasonable to conclude” aspect of the definition of “right to reduce”. Finance’s intention is understood to require a taxpayer to review all circumstances in which an adjustment may be required and then to determine whether, in the particular taxation year, it is reasonable to conclude that an adjustment will be made at a future time.

If the taxpayer subsequently pays all or a portion of the contingent amount, the taxpayer is considered to have incurred the previously reduced expenditure to the extent it was paid. The amount paid is considered to be incurred in the year paid for the same purpose and to have the same character as the expenditure that was previously reduced.\(^\text{170}\)

If a taxpayer, or a person with whom the taxpayer does not deal at arm’s length, has a right to reduce in respect of an expenditure in a year subsequent to the taxation year in which the expenditure occurred, the taxpayer is deemed to have received a “subsequent contingent amount” included in income under paragraph 12(1)(x).\(^\text{171}\) This applies only if the original expenditure was not otherwise subject to a reduction under subsections 143.4(2) or 143.4(4). The “subsequent contingent amount” is equal to the amount by which the amount in respect of an expenditure may be reduced under the right to reduce exceeds the amount paid to obtain such right.\(^\text{172}\) However, if it is reasonable to conclude that one of the purposes of having the right to reduce an amount in respect of an expenditure after the end of the taxation year in which an expenditure is incurred was to avoid a reduction under subsection 143.4(2) of the Act, an anti-avoidance rule would apply to deem the right to reduce to exist in the taxation year in which the expenditure arose\(^\text{173}\) (i.e., subsection 143.4(2) would reduce the amount of the expenditure instead of an income inclusion under paragraph 12(1)(x)).

The Minister of National Revenue has the authority to make assessments, determinations and redeterminations that are necessary to give effect to section 143.4 notwithstanding that the taxation year in question is otherwise statute-barred.\(^\text{174}\)

A taxpayer includes a partnership for purposes of this section.\(^\text{175}\)

Section 143.4 applies in respect of taxation years ending on or after March 16, 2011.

\(^{167}\) Subsection 143.4(1).

\(^{168}\) Ibid.

\(^{169}\) Joint Committee on Taxation of the Canadian Bar Association and the Canadian Institute of Chartered Accountants dated November 7, 2011 regarding Proposed Income Tax Amendments on Contingent Liabilities – Section 143.4.

\(^{170}\) Subsection 143.4(3).
Capital Cost Allowance

Capital Cost Allowance—Paragraph 20(1)(a)

Tax depreciation deductions permitted in computing business or property income (see paragraph 20(1)(a)) include:

- Class 1 (4%)\(^{176}\)
  - For residential buildings (such as apartment buildings and retirement homes), used non-residential buildings acquired after March 18, 2007, and buildings acquired after 1987 and before March 19, 2007.
- New Class 1 (6% and 10%)\(^{177}\)
  - For newly constructed buildings and newly acquired buildings that were neither used by anyone nor acquired for use before March 19, 2007, a taxpayer may claim a declining-balance deduction as follows:
    - 6% for property acquired after March 18, 2007 that is an “eligible non-residential building,” 90% of the floor space of which is used for a non-residential use; and
    - 10% for property acquired after March 18, 2007 that is an “eligible non-residential building,” 90% of the floor space of which is used by the taxpayer or a lessee of the taxpayer for the manufacturing or processing (“M&P”) of goods in Canada for sale or lease.

To qualify for these rates, the taxpayer must elect to place the building in a separate class under subsection 1101(5b.1) of the Regulations.

The CRA has stated that this election cannot be late filed and cannot be made by simply identifying a building in the CCA schedule.\(^{178}\) The election must be made by sending a letter to the CRA for the year in which the building is acquired. Alternatively, the CRA allows elections to be included in the notes section for efiled tax returns.

- An “eligible non-residential building” of a taxpayer is defined in subsection 1104(2) of the Regulations as a building:
  - Located in Canada;
  - Included in Class 1;
  - Not previously used, or acquired for use, by any person (including a partnership) before March 19, 2007; and
  - Acquired by the taxpayer on or after March 19, 2007 to be used by the taxpayer, or a lessee of the taxpayer, for a non-residential use.
  - Buildings used for M&P that do not meet the 90% usage threshold at the end of the taxation year are still eligible for the 6% CCA rate for other non-residential buildings (provided the building meets the conditions of “an eligible non-residential building” and 90% of the building is used for non-residential purposes).
  - The cost of an addition to or an alteration of an existing building is deemed to be the capital cost of a separate building if the existing building was not included in a separate class under Regulation 1101(5b.1).\(^{179}\) Therefore, as long as 90% of the floor space of the addition or alteration\(^{180}\) are used for eligible use and an election is made, the cost of the addition or alteration is eligible for the enhanced CCA rates.
  - Class 3 (5%):
    - Buildings acquired before 1988; and
    - Post-1987 additions to buildings to the extent the cost does not exceed the lesser of:
      - $500,000 for each building; and
      - 25% of the capital cost of the building (including additions or alterations) included in class 3, 6 or 20 before 1988.
  - Class 6 (10%):
    - Fencing; and
    - Irrigation ponds (golf course).
  - Class 8 (20%):
    - Furniture and fixtures;
    - Irrigation equipment (golf course); and
    - Outdoor advertising poster panel or bulletin board.

\(^{176}\) For CCA purposes, the cost of real estate, other than the portion allocated to land, is generally allocated to Class 1. However, a portion of the purchase price may qualify as an addition to a class other than Class 1 for CCA purposes.

\(^{177}\) See Regulations 1100(1)(a.1) and (a.2).


\(^{179}\) Regulation 1102(23).

\(^{180}\) Regulation 1102(24), confirmed by Technical Interpretation 2013-0489101E5, dated June 10, 2013.
- Class 10 (30%):
  - Automotive equipment that is not a passenger vehicle in Class 10.1;
  - Contractor’s movable equipment acquired for use in a construction business; and
  - Separate CCA class for computers.
- Class 10.1 (30%):
  - Passenger vehicles costing more than $30,000.
- Class 12 (100%):
  - Software other than systems software.
- Class 13 (straight-line):
  - Leasehold interest;
  - Straight-line over the greater of:
    - Five years, and
    - The term of the lease plus the first renewal term.
- Class 14 (straight-line)
  - Generally, a limited life patent, franchise, concession or license.
- Proposed Class 14.1\textsuperscript{181} (5%)
  - However, for incorporation expenses incurred after December 31, 2016, a maximum amount of $3,000 per corporation may be deducted under paragraph 20(1)(b). Incorporation expenses in excess of $3,000 will be included in class 14.1.
  - Transitional rules exist for intangible property acquired before January 1, 2017, including:
    - The transfer of a pre-existing cumulative eligible capital balance to Class 14.1 on January 1, 2017, and
    - 7% declining balance CCA for taxation years ending before 2027.

- For taxation years that end prior to 2027, a taxpayer will be allowed to deduct as CCA, expenditures incurred before 2017, the greater of $500 per year and the amount otherwise deductible for that year. In this manner, small initial balances may be eliminated quickly.
- Class 17 (8%):
  - Paving, sidewalks; and
  - Golf course greens, tees and fairways.
- Class 42 (12%):
  - Fibre-optic cable; and
  - New telephone or data communications wiring or cabling.
- Class 43.2 (50%):
  - Equipment acquired after February 22, 2005 and before 2020 that generates or conserves energy by:
    - Using a renewable energy source;
    - Using fuels from waste; or
    - Making efficient use of fossil fuels.
- Class 46 (30%):
  - Broadband, internet and data network infrastructure equipment.
- Class 50 (55%):
- Rental Property Separate CCA Class—Regulation 1101(1ac)

A separate CCA class is prescribed for each rental property\textsuperscript{182} with a cost of $50,000\textsuperscript{183} or greater. See below for the definition of rental property. This provision is also extended to leasehold interests in real property.\textsuperscript{184} By requiring a separate

\textsuperscript{181} Proposed in the March 22, 2016 Federal budget and included in Bill C-29, the Budget Implementation Act, 2016, No.2. This CCA class is meant to replace the previous eligible capital property regime.

\textsuperscript{182} Acquired after 1971 – see Regulation 1101(ac).

\textsuperscript{183} The $50,000 was introduced as part of the tax return for 1972 and future years and has not been indexed for inflation.

\textsuperscript{184} See Regulation 1101(5h).
CCA class for each property, these rules preclude the deferral of recaptured CCA when only one property has been disposed.

**Rental Property CCA Restriction—Regulation 1100(11)**

Rental property of a taxpayer or partnership is:

- A building owned by a taxpayer or partnership or a leasehold interest in real property if the leasehold interest is property of Class 1, 3, 6 or 13 and is owned by the taxpayer or partnership, and
- The property was used by a taxpayer or partnership principally (i.e., more than 50%) to earn gross revenue that is rent (see Regulation 1100(14)).

CCA on rental properties cannot exceed:

- Net income for the year from renting or leasing rental property before any CCA deductions; and
- If applicable, the partner’s share of net income of a partnership from renting or leasing rental property.

If the restriction applies, total CCA on rental properties cannot exceed net rental income.

Annual allowable CCA can be taken on any of the rental properties as long as the aggregate CCA does not exceed the aggregate net rental income of those properties.

**Exceptions—Regulation 1100(12)**

The rental property restriction does not apply to:

- A life insurance corporation;
- A corporation whose principal business was the leasing, rental, development or sale of real property it owns; and
- A partnership each member of which was a corporation described above or another partnership of such corporations.

CCA restrictions must be considered when:

- A partnership, trust, or individual is involved; and
- A corporation has incidental rental operations.

**Green Buildings Tax Incentives**

**Summary of Class 43.1 and 43.2**

Certain asset classes may qualify for accelerated CCA. Assets that do not qualify for the accelerated CCA are included in their respective CCA class depending on the type of asset (e.g., building, equipment, furniture).

Note that the information below is only applicable to equipment that is not a part of a building or structure and is based on the current rules and the proposed amendments to the Act and the Regulations. ¹⁸⁵

Class 43.1 provides a 30% accelerated CCA (on a declining balance basis) for certain energy generation and conservation equipment. The property must be situated in Canada and cannot be reconditioned or remanufactured equipment. ¹⁸⁶

Class 43.2 provides accelerated CCA (50% per year on a declining-balance basis) for specified clean energy generation and energy efficiency equipment acquired after February 22, 2005 and before 2020. The class incorporates by reference a detailed list of eligible equipment that generates or conserves energy in the form of electricity or heat, by:

¹⁸⁵ Alberta and Quebec may not follow these federal rules.
¹⁸⁶ Used equipment may qualify if it meets certain requirements, including that the equipment must not be more than five years old.

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**Historical Note**

In Fredette (2001 DTC 621) and Rousseau Houle (2001 DTC 250), the TCC held that placing rental property in a partnership to circumvent Regulation 1100(11) by deducting interest at the partner level avoided this rule and that the GAAR did not apply because GAAR did not apply to an abuse or misuse of the Regulations.

However, the 2004 federal budget “clarified” that the GAAR applies beyond the Act to a misuse or abuse of the Income Tax Regulations, Income Tax Application Rules and Canada’s income tax treaties. This “clarification” was retroactive to September 13, 1988 and overruled Fredette and Rousseau Houle.
COMMON FORMS OF REAL ESTATE OWNERSHIP

OWNERSHIP AND OPERATING ISSUES

NON-RESIDENTS INVESTING IN CANADIAN REAL ESTATE

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– Using a renewable energy source (e.g., wind, solar, small hydro);
– Using a fuel from waste (e.g., landfill gas, wood waste, manure); or
– Making efficient use of fossil fuels (e.g., high efficiency cogeneration systems, which produce electricity and heat simultaneously).

The eligibility criteria for these classes are generally the same except that cogeneration systems that use fossil fuels must meet a higher efficiency standard in the case of fossil fuel for Class 43.2 than for Class 43.1. Moreover, the eligibility criteria must generally be determined annually based on the use of the property in the particular taxation year.

Note that the accelerated depreciation is available if the equipment was used by either the taxpayer or by a lessee of the taxpayer.

The following types of depreciable property may be included in Class 43.1 (and 43.2 subject to the exception mentioned above).

Solar Heating Equipment

Solar heating equipment that is used primarily for the purpose of heating an actively circulated liquid or gas and is:

– Active solar heating equipment including above ground solar collectors, solar energy conversion equipment, solar water heaters, energy storage equipment, control equipment and equipment designed to interface solar heating equipment with other heating equipment, or
– Equipment that is part of a ground source heat pump system that transfers heat to or from the ground or groundwater, and at the time of installation meets the standards set by the Canadian Standards Association for the design and installation of earth energy systems. Equipment includes piping (above and below ground), energy conservation equipment, energy storage equipment, control equipment and certain other interface equipment.

The equipment cannot be part of the building (other than a solar collector that is not a window and that is integrated into a building), equipment used to heat water in a swimming pool, energy equipment that backs up the above noted equipment, nor equipment that distributes heated or cooled air or water in a building.

Wind Turbines

Wind turbines:

– Must be a fixed location device that is a wind energy conversion system that is used primarily for the purpose of generating electrical energy;
– Must consist of a wind-driven turbine, electrical generating and related equipment including:
  – Control, conditioning and battery storage equipment;
  – Support structures;
  – A powerhouse complete with other ancillary equipment; and
  – Transmission equipment; and
– Do not include:
  – Distribution equipment;
  – Auxiliary electrical generating equipment; and
  – Electrical generating equipment acquired after February 27, 2000 that was not used for any purpose prior to February 28, 2000.

Fixed Location Photovoltaic Equipment

Fixed location photovoltaic equipment:

– Must be fixed to a location and used primarily for the purpose of generating electrical energy from solar energy.
– Includes inverters, control, conditioning and battery storage equipment, support structures and transmission equipment.
– Does not include a building or a part of a building (other than a solar cell or module that is integrated into a building), or auxiliary electrical generating equipment and distribution equipment.

187 Class 43.1(d)(i).
188 Class 43.1(d)(v).
189 Class 43.1(d)(vi).
**Geothermal Energy**\(^{190}\)

Geothermal energy equipment:

- Includes above ground equipment used primarily for the purpose of generating electrical energy solely from geothermal energy, including such equipment that consists of piping (both above and below ground), pumps, heat exchangers, steam separators, electrical generating equipment and ancillary equipment used to collect the geothermal heat.
- Does not include buildings, transmission equipment, distribution equipment, or equipment designed to store\(^{191}\) electrical energy.

**Electric Vehicle Charging Stations**

The 2016 Federal Budget proposed to expand Classes 43.1 and 43.2 to include certain electric vehicle charging stations and electrical energy storage equipment (previously generally included in Class 8 which provides a CCA rate of 20% on a declining balance basis).

**Electric Vehicle Charging Stations**\(^{192}\)

Equipment used for the purpose of charging electric vehicles, including charging stations, transformers, distribution and control panels, circuit breakers, conduits and related wiring if:

- The equipment is situated on the load side of an electricity meter used for billing purposes by a power utility, or on the generator side of an electricity meter to measure electricity generated;
- More than 75 percent of the electrical equipment capacity is dedicated to charging electric vehicles; and
- The equipment is an electric vehicle charging station that supplies more than 10 KW of continuous power or is used primarily in connection with one or more electric vehicle charging stations each of which supplies more than 10 KW of continuous power.

\(^{190}\) Class 43.1(d)(vii).

\(^{191}\) The Federal Budget 2016 proposes to remove the exclusion of equipment designed to store electrical energy.

\(^{192}\) Class 43.1(d)(xvii) as proposed in the Federal Budget 2016.

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**Electrical Energy Storage Equipment**\(^{193}\)

Fixed location energy storage property that is:

- Used primarily for the purpose of storing electrical energy including batteries, compressed air energy storage, flywheels, ancillary equipment (including control and conditioning equipment) and related structures but does not include buildings, pumped hydroelectric storage, hydroelectric dams and reservoirs, property used solely for backup electrical energy, batteries used in motor vehicles, fuel cell systems where the hydrogen is produced via steam reformation of methane and property otherwise included in Class 10 or 17;
- Meets the condition that the efficiency of the electrical energy storage system that includes the property is greater than 50%; and

Class 43.1 is also proposed to be expanded to include certain stand-alone electrical energy storage equipment.

**CCA Restriction**

For passive investors, CCA on specified energy property cannot exceed:

- Net income for the year from specified energy property (before CCA); and,
- If applicable, the partner’s share of net income of the partnership from specified energy property.

Specified energy property of a taxpayer or a partnership is generally property of Class 34 acquired by the owner after February 9, 1988 and property of Class 43.1, 43.2, 47 and 48.

No such restriction generally applies if the property is used by the owner primarily for the purpose of gaining or producing income from a business in Canada, or if the property is leased in the ordinary course of carrying on a business of the owner in Canada to a person that is carrying on a business in Canada.

**Other Incentives and Programs**

There are numerous incentive programs that may be applicable to the real estate sector, and these programs change frequently as new priorities are identified and program funding is distributed. Given the constantly evolving nature of these
Incentive programs, it is recommended that you consult your provincial and municipal government websites to get details on current programs.

Some incentive websites that may be of interest are:
http://www.nrcan.gc.ca/energy/funding/efficiency/4947
https://saveonenergy.ca/Business.aspx
https://www.ontario.ca/page/green-investment-fund
http://www.ecohome.net/guide/green-building-financial-incentives

**Financing**

**Interest Deductibility**

For income tax purposes, there is a presumption that interest is a capital expenditure and therefore only deductible as specifically provided for in the Act (see paragraphs 18(1)(b) and 20(1)(c)).

To be deductible, interest must be:

- Paid in the year or payable in respect of the year; and
- Paid or payable pursuant to a legal obligation to pay interest on:
  - Money borrowed for the purpose of gaining or producing income from a business or property; or
  - An amount payable for property acquired for the purpose of producing income from the property or income from a business; and
- Reasonable.

**Related Court Cases**

Court cases relating to interest deductibility include rulings from the SCC issued September 28, 2001:

- The decision in Ludco Enterprises Ltd., et al v. The Queen (2001 SCC 62) validated interest deductions wherever there is a reasonable expectation of receiving income, considering all the circumstances (i.e., gross income, not net income, is sufficient to satisfy this criterion). Absent sham or window dressing, a taxpayer’s ancillary purpose to earn income may meet the income-earning purpose requirement.

- The decision in The Queen v. Singleton (2001 SCC 61) can support taxpayers’ entitlement to restructure their financial affairs so that they can directly link borrowing to income-earning assets to claim an interest deduction.

- The decision in Lipson, E., et al v. The Queen (2009 SCC 1, 2009 CSC 1) was not favourable to the taxpayer, as it was determined that GAAR applied to an abuse of the attribution rules. However, the decision confirmed that the Singleton decision still constitutes good law. Thus, structuring indebtedness to obtain an interest deduction, which had been in doubt as a result of the FCA decision, was confirmed as acceptable under the GAAR.

Reasonable expectation of profit (“REOP”):

- In Stewart v. R. (2002 SCC 46), the SCC ruled that, because the taxpayer’s rental activity was clearly commercial with no personal element involved, such an endeavour necessarily involved the pursuit of profit. Thus, the REOP test did not apply to disallow the deduction of the taxpayer’s rental losses.

Thus, a taxpayer may derive a tax loss by deducting interest expenses, even if, under any objective standard, there is little reasonable expectation that the taxpayer would earn any income (as opposed to capital gains) but the presence or the prospect of revenue (as opposed to income net of expenses) is sufficient to conclude that an expenditure was incurred “for the purpose of earning income”.

**CRA’s Positions On Interest Deductibility**

The CRA’s positions on interest deductibility are outlined in Income Tax Folio S3-F6-C1 “Interest Deductibility,” and are consistent with the decisions reached by the SCC.

**Withdrawal of the Proposed “Reasonable Expectation of Profit” Test**

In response to Ludco and Stewart, on October 31, 2003, Finance proposed draft legislation to add section 3.1 to the Act (and other related amendments), requiring a reasonable expectation of profit (“REOP”) to claim a loss from a business or property. These REOP proposals raised significant concerns from the tax, business and investment communities and would have severely impacted the tax treatment of borrowing for investment.

In November 2014, Finance withdrew these proposals.
Potential for Restricted Interest Deductibility in Other Situations

Deductibility of interest expense is limited by subsections 18(2) and 18(3.1), as discussed later in this section. Other situations where interest deductibility may be restricted are as follows:

Refinancing—in real estate, it is common to finance new projects by increasing the amount of debt on existing properties, effectively realizing the appreciation in their value without any immediate income tax consequences. Existing properties may be refinanced and the borrowed funds distributed to another entity in the group to fund other operations or new property acquisitions. Difficulties may arise when the amount of the distribution exceeds the debtor entity’s equity (paid-up capital or retained earnings).

Participating debt—Historically, interest has been viewed as a capital expenditure deductible for income taxes only as permitted by paragraph 20(1)(c). The courts have required that, to be interest, amounts have to accrue daily and be calculated by reference to the principal. The charges arising from participation features may not meet these criteria.

The FCA decision in The Queen v. Sherway Centre Limited (98 DTC 6121 (FCA)) challenged the conventional wisdom and went against rulings of higher courts with the purpose of bringing the rules up-to-date with current market realities. The FCA concluded that the daily accrual requirement can be satisfied by viewing interest as capable of being ascertained on a daily basis, rather than expressed on a daily basis as previously suggested by the courts. The reference to principal requirement would be satisfied because the interest was payable only as long as there was a principal amount outstanding.

In Income Tax Technical News No. 16 (now cancelled), the CRA stated that, while the Sherway decision has caused it to expand its published position, the decision does not mean that all participating payments are considered interest. When all the published criteria are not satisfied but the evidence shows, as it did in Sherway, that the participating payments are intended to increase the interest rate of the loan to the prevailing market rate, the payments will be considered interest.194

To meet the prevailing market rate test in the CRA's guidelines, evidence of the fixed rate of interest at which the taxpayer could have borrowed and the anticipated effective interest rate resulting from the participating loan terms should be documented.

Compound interest—Interest on interest is deductible only when paid. Interest on compound interest may not be deductible at any time. Presumably, such situations are rare under current market conditions.

Thin capitalization rules—These rules may restrict interest deductions for interest payable to certain non-residents. These rules are discussed below in the section titled “Non-Residents Investing in Canadian Real Estate”.

KPMG Observations

Capitalizing interest for accounting and tax purposes

The Real Property Association of Canada (“REALpac”) Handbooks under ASPE and IFRS recommend the capitalization of interest to qualifying assets during the development period to the extent that the interest costs incurred could have been avoided if the expenditures for the assets had not been made. The amount of interest to be capitalized is determined by first using the actual interest rate on the actual borrowed funds used specifically for development, and, to the extent of excess expenditures, by applying the entity’s weighted cost of borrowing on other financial liabilities to the average amount of expenditures for the asset accumulated during the period.

IFRS 23 requires the capitalization of interest on the development of qualifying assets.

The accounting treatment of interest charges can cause capitalization of general corporate borrowings to development properties by the allocations described above.

For income tax purposes, whether funds borrowed have been used to earn income from a business or property (as required for deductibility by paragraph 20(1)(c)) is determined by tracing the funds. To the extent that interest on general borrowings has been capitalized for accounting purposes to development projects, it may be possible to argue that subsections 18(2) and 18(3.1) should not apply.

Interest on specific construction financing, however, must be capitalized for income tax purposes (discussed below).

Borrowing Costs—Paragraphs 20(1)(e) and 20(1)(e.1)

General Rule

Expenses incurred in the course of issuing securities and borrowing money are deferred and amortized over five years.

194 The CRA expressed a consistent view in Technical Interpretation 2012-04881317, “Participating debt interest”, dated June 3, 2013. In Income Tax Folio S3-F6-C1, the CRA states that subject to Sherway, participating interest is not generally considered interest.
Amortization of borrowing costs is not permissive. If not claimed, such amount is permanently lost.

Amortization is prorated based on the number of days for short taxation years. The half-year rule does not apply.

Borrowing costs may include hybrid payments, such as a payment to maintain a ceiling on the interest rate on a floating rate loan for a period of time to be invoked at the borrower’s option over a defined period (i.e., an interest rate insurance policy payment).

An unamortized balance is written off only when all of a taxpayer’s debts that gave rise to the expense are repaid unless:

– The repayment is part of a series of borrowings and repayments (paragraph 20(1)(e)(vi)); and
– The balance is repaid with a unit, interest or share or debt obligation of the taxpayer.196

CRA has expressed the view that it considers a bona fide repayment not to have been made where a loan or debt is repaid near the end of the year and shortly after the end of that year is re-borrowed from the same or a related lender or re-incurred with the same or a related creditor or if a repayment is of a temporary nature.197

On the dissolution of a partnership, an unamortized balance is deductible by the partners over the remainder of the five-year period (but reduces the ACB of the partnership interest under paragraph 53(2)(c)(x)).

Ongoing Costs

Expenses that relate solely to the year are deductible in the year (under paragraph 20(1)(e.1)), such as:

– Service fees;
– Commitment fees; and
– Standby charges.

196 All debt obligations in respect of borrowings described in subparagraphs 20(1)(e)(ii) and 20(1)(e)(ii.1).


Borrowing Costs to Secure Financing for Construction Activities

In the CRA’s view, the deductibility of borrowing costs to secure financing for construction activities is subject to construction period restrictions in subsection 18(3.1) (discussed below).

The amount of financing expense to capitalize in a taxation year under subsection 18(3.1) is equal to the amount of the financing expense that is deductible in the taxation year (i.e., where a financing expense of $50,000 would be deductible under paragraph 20(1)(e) over a five-year period, subsection 18(3.1) would apply to capitalize $10,000 in each of the five years).

Borrowing costs relating to financing for servicing land are likely to receive the same treatment as borrowing costs for construction activity.

Borrowing costs to arrange permanent financing—unrelated to the construction—should not subject to subsection 18(3.1).

Loan guarantee fees which are paid to the guarantor either periodically during the term of the loan or as a one-time payment at the commencement of the loan and which are incurred in the course of borrowing money and not otherwise deductible are deductible under subparagraph 20(1)(e)(ii) over five years.199

An election to capitalize borrowing costs to depreciable property is available under section 21.

The CRA’s positions in this area are outlined in Interpretation Bulletin IT-341R4, “Expenses of issuing shares, units in a trust, interests in a partnership or syndicate and expenses of borrowing money,” dated February 26, 2007 (Archived).

Penalties, Bonuses and Rate Reduction Payments—Subsection 18(9.1)

When a payment relating to borrowed money is made to a person or a partnership in the course of carrying on a business or earning income from property:

– As consideration for a reduction in the interest rate being charged on a debt obligation (“a rate reduction payment”), or
– As a penalty or bonus paid because of the early repayment or partial repayment of the debt obligation before its maturity,


The payment will have to be treated as interest expense over the term of the original borrowing for income tax purposes but only to the extent that:

– The payment can reasonably be considered to relate to an amount that would otherwise have been paid or payable by the taxpayer as interest in a future taxation year on such debt, and

– The payment does not exceed the value, at the time of the payment, of the future interest obligation (i.e., it cannot exceed the present value of the future interest obligation).

The payment should be deducted on a present-value basis (i.e., to reflect the interest that would have been paid over time).

As a practical matter, given the difficulty in determining the present-value amounts and given that only the timing of deductions is affected, straight line amortization is often used because the ultimate impact is not significantly different.\(^{200}\)

Deductibility of penalties and rate reduction payments exceeding the present value of interest otherwise payable is governed by case law. If they are related to capital borrowings, they may be non-deductible but may qualify for amortization as financing costs under paragraph 20(1)(e), depending on the circumstances.

A taxpayer may switch the method of amortization of such penalties and rate reduction payments in mid-stream, provided that it is reasonable in the circumstances, does not result in any undue tax advantage, and is in accordance with GAAP and the Act.\(^{201}\)

Subsection 18(9.1) requires that where the taxpayer has incurred a penalty on the early repayment of a debt in full, the amortization of the payment is deemed to be interest on a debt obligation:

a) Where the original proceeds of the debt were used for business purposes other than to acquire property, incurred for the same purpose of the original debt obligation; and

b) Where the original proceeds were used to acquire property, to the extent that the property, or the substituted property (in the case of a disposition), used by the taxpayer in the year for the purpose of earning income therefrom.

While (a) above is generally not thought to be an issue for taxpayers, (b) may cause an issue where the taxpayer has repaid the debt as a result of the disposition of the property and the taxpayer uses the proceeds for general business purposes (but not necessarily to acquire another property). The CRA has issued technical interpretations that suggest that, in this situation, the penalty will not be deductible. However, the context of the interpretations seems to be directed to individual taxpayers when the proceeds are not used to acquire income producing property or for another income-earning purpose.

When a corporation (or other entity) that is otherwise carrying on a business of renting property disposes of a property, the substituted property is the money received on the disposition. Provided that the money is used for the purpose of earning income, or for another deductible purpose, then the penalty should be deductible under subsection 18(9.1).

A payment made to obtain an extension of the term of a debt obligation or as consideration for the substitution or conversion of a debt obligation into another debt obligation or into a share is specifically excluded from the ambit of subsection 18(9.1). The CRA has stated that this exclusion includes a refinancing with the same lender or a different lender.\(^{202}\) Such expenses may be deductible under paragraph 20(1)(e) if it can be considered to be incurred in connection with the “new” financing and not the settlement of the old debt.

In certain circumstances, subsection 18(9.2) rather than 18(9.1) may apply to rate reduction payments.\(^{203}\)

**Interest Prepayments—Subsections 18(9.2) to (9.8)**

The rules for interest prepayments should be considered when holders of long term debt obligations provide borrowers with an option, exercisable within a defined period after issue, to make a prepayment of interest for future years (e.g., a corporation borrows $1 million for 99 years and in year 10 prepays the interest obligation for years 11 to 99).

In short, the prepayment, equal to the present value of the future interest obligation for years 11 to 99).

In short, the prepayment, equal to the present value of the future interest obligation, effectively repays a portion of the principal amount of the obligation. The economic effect is the conversion of non-deductible principal repayments into deductible interest expense.

\(^{200}\) Technical Interpretation 9503766, “Present value or straight line”, dated October 23, 1995.


Under subsection 18(9.2), the lump sum is to be treated as a payment of principal and the amount of deductible interest is based on what the interest would have been on the lower deemed principal balance.

These calculations can be complicated and it is advisable to involve professional advisors early in the process.

These rules only apply to taxpayers that are corporations, partnerships or trusts.

Novation

When terms of a loan agreement have been altered so that there is effectively a new agreement, the implications of subsection 18(9.3) should be considered. Debt forgiveness issues under section 80 may also arise, as well as the potential for capital gains or losses when the loans are denominated in foreign currency.

A disposition and reacquisition of a debt will occur where there is a “novation” of the debt or the substitution of a new debt for the existing debt.

Novation generally occurs where a third party replaces one of the original parties to the contract. Thus, in National Trust Co. v. Mead, the SCC described a novation as “a trilateral agreement by which an existing contract is extinguished and a new contract brought into being in its place.”

Under common law, a party to a contract may assign rights, but not contractual obligations or liabilities, to a third party. Where the original obligor is released from its obligations and those obligations are assumed by a third party in circumstances in which the original obligor is released, the contract is novated. However, it is possible for a novation to occur where the new contract is between the same parties.

The SCC in National Trust emphasized that the finding of novation will be rare:

In the absence of express agreement, the court should be loath to find novation unless the circumstances are really compelling. Thus, while the court may look at the surrounding circumstances, including the conduct of the parties, in order to determine whether a novation has occurred, the burden of establishing novation is not easily met.

Further, the SCC stated that determining whether novation has occurred will depend on the analysis of the relevant facts and the intention of the parties. In the analysis, the terms of the agreement may carry significant weight.

In General Electric Capital Equipment Finance Inc. v. R., the FCA recognized that changes to a contract between the same parties may be so fundamental that they may give rise to a new agreement and therefore result in a disposition of the old agreement for income tax purposes notwithstanding that a “novation” may not have occurred for legal purposes. It concluded that a new obligation would arise where “substantial changes have been made to the fundamental terms of the [original] obligation.”

The Court in General Electric considered whether a new debt obligation had been created by amendments to the terms of promissory notes. If there was a new debt obligation, withholding tax consequences would arise under the Act. The Court concluded that new notes arose because three of the four fundamental terms of each of the notes had been changed (the principal amount of the note, the amount of interest under the note, and the maturity date of the note). The Court reasoned that the amendments so materially altered the relevant legal agreement that new obligations had been created for the purposes of the Act. In coming to its decision, the Court considered its earlier decision of Wiebe v. The Queen, in which it held that a new agreement is created when the changes to an agreement, which substantially affect the basic elements of the agreement, are inconsistent with the continuing existence of the original agreement.

In Income Tax Technical News 14 dated December 9, 1998 (now cancelled), the CRA effectively adopted the standard set out in General Electric:

[A] Rescission of a debt obligation will be implied when the parties have effected such an alteration of its terms as to substitute a new obligation in its place, which is entirely inconsistent with the old, or, if not entirely inconsistent with it,
inconsistent with it to an extent that goes to the very root of it. In such a case, it is appropriate to view the original obligation as having been disposed of for income tax purposes.

The CRA has stated that General Electric represents the “current standard” for determining whether amendments to debt obligations will give rise to a new obligation for purposes of the Act.211

**Interest and Property Taxes on Vacant Land**

**Subsection 18(2)**

Subsection 18(2) overrides paragraph 20(1)(c) to prohibit a deduction on account of or in lieu of:

- Interest on debt relating to the acquisition of land; and
- Property taxes in respect of land.212

Unless the land can reasonably be considered to have been, in the year:

- Used in the course of a business other than a business in which, in the ordinary course, land is held for resale or development carried on by the taxpayer213; or
- Held primarily for the purpose of gaining or producing income of the taxpayer from the land.214

Subsection 18(2) applies to “land” which is defined for this purpose and does not include:

a) Any property that is a building or other structure affixed to land,

b) The land subjacent to such buildings or other structures, or

c) A parking area, driveway, yard or garden necessary for the use of such buildings or other structures and that is contiguous to the land described in (b), except land used for the provision of parking facilities for a fee or charge.

Interest on debt relating to the acquisition of land is defined in subsection 18(3) as:

- Interest that may reasonably be considered as interest on borrowed money relating to the acquisition of land; and
- Interest on borrowings to acquire land to assist:
  - A non-arm’s length person;
  - A corporation of which the taxpayer is a specified shareholder (i.e., by virtue of owning 10% or more of any class of shares); or
  - A partnership in which the taxpayer has a 10% interest, or more; and
  - Unless the assistance is in the form of a loan and a reasonable interest rate is charged.216

Regarding interest on money borrowed to service land, the CRA’s view is that the acquisition of land includes installation of services.217

An alternative position is that interest on money borrowed to service land is not interest relating to the acquisition of land. Interest on money borrowed for land servicing that does not create a building or other structure may not be subject to capitalization under subsection 18(3.1).218

However, interest and property taxes on vacant land are deductible to the extent that gross revenue from the land for the particular year exceeds the total of all amounts deducted in computing income from the land for that year (i.e., to the extent of the net operating income from the land). Income from the sale of land is excluded from this determination.

For this purpose, the CRA stated219 that the determination of net operating income from the land should include the deduction of expenses of representation under paragraph 20(1)(cc) and site investigation costs under paragraph 20(1)(dd).

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211 Technical Interpretation 2006-015908117 dated December 15, 2006. In Interpretation Bulletin IT-448, “Changes in terms of securities”, dated June 6, 1980 (Archived), the CRA provided views about changes to terms of debt obligations that, in CRA’s view, are considered so fundamental as to almost always result in a disposition. However, more recently, as noted above, the CRA has agreed that General Electric is the appropriate standard to apply.

212 Paragraph 18(2)(b) only restricts the deduction for property taxes paid to a municipality or province in Canada. The paragraph specifically excludes i) income and profits taxes (which presumably are not otherwise deductible), and ii) taxes computed by reference to the transfer or property (e.g., land transfer taxes) (as such taxes are likely capital in nature).

213 Paragraph 18(2)(c).

214 Paragraph 18(2)(d).

215 A “specified shareholder” is defined in subsection 248(1) and includes a shareholder that holds 10 percent or more of the issued shares of any class of the capital stock of the corporation (with rules to include shares held directly or indirectly by related persons).

216 Pursuant to the subsection 18(3) definition of “interest on debt relating to the acquisition of land”.


A taxpayer may defer the deduction of interest and property taxes by treating them as an addition to the cost of land inventory, provided the taxpayer does so on a consistent basis.220

**Base Level Deduction**

Corporations whose principal business is the leasing, rental or sale of real property (or the development of real property for leasing, rental or sale) are entitled to claim a deduction equal to the lesser of their base level deduction and actual interest and property taxes capitalized under subsection 18(2).221

Under subsection 18(2.2), the base level deduction of a corporation is the amount that would be the amount of interest, computed at the prescribed rate in Regulation 4301 – Benefits, for the year in respect of a debt of $1 million outstanding throughout the year (see the example below).

The $1 million is to be allocated among associated corporations by filing a prescribed form (T2005); otherwise, the Minister is permitted to make the allocation under subsection 18(2.4).

Partnerships are not eligible for the base level deduction even where all the members are corporations and the business of the partnership and its members is real estate development.224

The calculation of the base level deduction is illustrated as follows:

<table>
<thead>
<tr>
<th>Assumptions</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Net revenue from land</td>
<td>$ 15,000</td>
</tr>
<tr>
<td>Base level deduction ($ 1,000,000 x 1.00%)</td>
<td>$ 10,000</td>
</tr>
<tr>
<td>Interest and property taxes</td>
<td>$ 2,000,000</td>
</tr>
<tr>
<td>December 31, 2016 fiscal year end</td>
<td></td>
</tr>
</tbody>
</table>

**Application of subsection 18(2)**

| Interest and property taxes                                 | $ 2,000,000|
| Minus: Net revenue from land                                | (15,000)  |
| Minus: Base level deduction                                 | (10,000)  |

**Costs added to cost**

|$ 1,975,000|

**Average prescribed rate used is 1.00%**

<table>
<thead>
<tr>
<th>2016 quarterly prescribed rates225</th>
</tr>
</thead>
<tbody>
<tr>
<td>First quarter</td>
</tr>
<tr>
<td>Second quarter</td>
</tr>
<tr>
<td>Third quarter</td>
</tr>
<tr>
<td>Fourth quarter</td>
</tr>
<tr>
<td><strong>Average</strong></td>
</tr>
</tbody>
</table>

**Treatment of Deductions Denied Under Subsection 18(2)**

Costs denied under subsection 18(2) are added to the ACB of land that is capital property (paragraph 53(1)(h)) and the cost of land that is inventory (subsection 10(1.1)).

Denied costs are also added to ACB of:

- Shares when the taxpayer is a specified shareholder226 of the corporation owning the land (see paragraph 53(1)(d.3)); and
- Partnership interests when the interest expense is incurred by a partner holding a 10% or greater interest (see subparagraph 53(1)(e)(xi)).

Interest capitalized to the ACB of shares or a partnership interest is also capitalized to the underlying land held by the corporations or partnership.228

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221 Paragraph 18(2)(i).
222 This amount has not been indexed for inflation since subsection 18(2.2) was implemented in 1988.
223 Paragraph 18(2.5) requires a corporation whose taxation year is less than 51 weeks to prorate the base level deduction based on the proportion that the number of days in the corporation’s taxation year is of 365.
225 Regulation 4301 calculates the prescribed rate for a quarter based on the average rate of the Government of Canada Treasury Bills that mature approximately three months after the date of issue sold during the first month of the previous quarter. The prescribed rate is rounded up to the nearest whole percent.
226 A “specified shareholder” is defined in subsection 248(1) and includes a shareholder that holds 10 percent or more of the issued shares of any class of the capital stock of the corporation (with rules to include shares held directly or indirectly by non-arm’s length persons).
227 Paragraph 53(1)(b).
Timing of Application of Subsection 18(2)

Subsection 18(2) applies until construction begins. During the construction period, subsection 18(3.1) (discussed below) applies to restrict the deduction of interest and property taxes.

Subsection 18(2) does not apply in a year in which the land is used in a business. Therefore, if construction begins on land during a year and is completed in the same year and if the completed property is used in a business in the same year, then subsection 18(2) should not apply in that year.229

Payment of property taxes by a tenant on leased vacant land is additional rent paid and should therefore be fully deductible by the tenant. However, the CRA’s view has been that subsection 18(2) applies to deny the deduction to the tenant.

Cost Accumulation in Accounting Records

Common classification stages during the construction period are:

– Land under development;
– Property under construction; and
– Income producing property or completed inventory.

229 Paragraph 18(2)(c).

Construction Period Costs

In order to identify expenditures with accelerated CCA rates for depreciable property or accelerated deductibility, costing records should be reviewed to identify:

– Assets other than the building (e.g., paving and equipment that are not part of the building); and
– Deductible items, e.g., landscaping on capital properties, demolition of a building230 being used to earn income as capital property, and operating or marketing costs.

Building costs may be accumulated with varying levels of detail, depending on the accounting system. Site investigation costs, architects’ fees, interest and property taxes, financing costs, and other fees may be incurred while the property is classified as land held for development.

As the project moves through the construction phase, additional costing detail should be maintained. Initial marketing, tenant inducements, interest and property taxes, development fees, architects’ costs, and construction costs may be incurred.

Once construction is complete, for accounting purposes, the property may be reclassified as income-producing properties allocated between land and building.

Accounting records should be reviewed in detail in both the land under development and property under construction categories to determine which, if any, costs may be identified as soft costs or deducted as incurred. Once construction has commenced, accounting records and contractor invoices should be reviewed in detail to identify deductible soft costs and costs that may be classified as other than building, such as paving, landscaping, furniture or equipment (see Appendix A).

Subsections 18(3.1) and (3.2)

Under subsection 18(3.1), a current-period deduction is denied for:

– Costs reasonably attributable to the period of construction, renovation or alteration of building, and relating to the construction, renovation or alteration of a building, (i.e., a two-part test), and

230 Where a taxpayer acquires land with a building with the intent to demolish the building in the near future, any proceeds allocated to the building and the demolition cost (net of any salvage value) generally form part of the cost of the land to the taxpayer.
Costs relating to ownership, during that period, of land subjacent or immediately contiguous to the building, including land used, or intended to be used, for a parking area, driveway, yard, garden or similar use.

Costs relating to the ownership of side-yards or set backs required for construction or zoning may not be subject to this limitation (subject to the limitations of subsection 18(2) discussed above).

Denied costs are typically added to the cost of the building.231

Subsection 18(3.1) does not restrict the deduction of interest and realty taxes for land on which a building is being constructed by an arm’s length person (i.e., when a building is on leased land, the landowner is able to deduct interest and property taxes).

Under paragraph 18(3.2)(a), interest in respect of borrowed money that can reasonably be considered to have been used to construct, renovate or alter a building or acquire land must be capitalized even if not specifically allocated to a particular building or particular land.

Under paragraph 18(3.2)(b), interest on borrowed money is capitalized when the borrowed funds were used to assist, directly or indirectly, the construction, renovation or alteration of a building or the purchase of land by:

- A non-arm’s length person;
- A corporation in which the taxpayer was a specified shareholder232 (10% or more of any class of shares), or
- A partnership in which the taxpayer had a 10% or greater interest in the profit or loss.

These provisions also apply when interest is incurred in Canada to assist directly or indirectly a foreign subsidiary to construct a building on purchased land in the foreign country.

The limitation on the deductibility of interest in paragraph 18(3.2)(b) does not apply when the assistance is in the form of a loan bearing interest at a reasonable rate as the interest on that loan will be subject to subsection 18(3.1) from the borrower’s perspective.

If the cost is incurred by a specified shareholder of a corporation or a partner with a 10% or greater interest in a partnership, the denied cost is capitalized to the shares of the corporation233 or the interest in the partnership234 and to the cost or capital cost of the underlying building held by the corporation or partnership.235

In a tiered partnership structure, special care must be exercised to ensure that the application of subsection 18(3.1) does not result in the capitalization of certain development period costs without a corresponding addition to the adjusted cost base of an interest in one or more partnerships in the tier since the capitalization provisions may only apply to a taxpayer’s interest in the top tier partnership.

**Deductions Not Affected by Subsection 18(3.1)**

Deductions not affected by subsection 18(3.1) include:

- CCA (subject to available-for-use rules, though subsection 20(28) overrides those rules and permits the deduction of CCA to the extent of net rental income);
- Outlays or expenses in respect of a building that would be deductible but for subsection 18(3.1) (including construction period soft costs) are deductible where the building generates income, but only to the extent of the taxpayer’s income from the building for the year;236
- Landscaping costs;
- Disability related modifications to buildings;
- General and administrative expenses, accounting and bookkeeping expenses, advertising costs or current insurance expenses incurred to rent or sell a building; and
- Any other cost not attributable to the period of construction, renovation or alteration of a building, such as:
  - Representation expenses (only if incurred prior to the period of construction, in the CRA’s view);

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231 Paragraph 18(3.1)(b) provides that where an otherwise deductible amount is denied pursuant to subsection 18(3.1), that amount is added to the capital cost of a building. There is no provision to add amounts denied under subsection 18(3.1) to land.

232 A “specified shareholder” is defined in subsection 248(1) and includes a shareholder that holds 10 percent or more of the issued shares of any class of the capital stock of the corporation (with rules to include shares held directly or indirectly by non-arm’s length persons).

233 Pursuant to paragraph 53(1)(d.3).

234 Pursuant to subparagraph 53(1)(e)(vi).

235 Paragraph 18(3.1)(b).

236 Subsection 20(29) allows a taxpayer to deduct costs otherwise capitalized under subsection 18(3.1) to the extent the taxpayer earned income from renting the property. See the discussion of subsections 20(28) and (29).
Once the building is complete or all or substantially all of the building is used for its intended purposes, it appears that costs that are not capital in nature may be deductible as incurred.

Note: This or any other planning idea should only be acted on with appropriate professional advice after a thorough examination of the particular situation.

Marketing Costs

For accounting purposes, marketing costs relating to property under construction may be capitalized and carried in the balance sheet as costs included in:

- Land under development (as inventory and for capital investment purposes);
- Building under construction; or
- Housing inventory under construction.

For tax purposes, when there is no enduring benefit to the costs incurred and they do not relate to the acquisition of tangible property, these costs may be deductible because they are:

- Period costs of a recurring nature with an immediate and short-lived benefit;
- Not of a capital nature because capital property is not acquired or created;
- Not subject to the limitations in subsection 18(2) because they are not interest or property taxes; and
- Not subject to the limitations in subsection 18(3.1) because they are not related to the construction, renovation or alteration of a building.

Costs to look for include:

- Media advertising;
- Brochures;
- Signs; and
- Sales office operating costs.

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238 Alan R. Morris v. The Queen, 2014 TCC 142.


Costs that may have to be included in inventory or deducted on a deferred basis (generally over the life of the development project if inventory of the taxpayer, or as CCA under the applicable class if used for multiple development projects) are:

- Model home furnishings; and
- Sales office construction.

**Soft and Indirect Cost Deductions**

**Landscaping—Paragraph 20(1)(aa)**

Landscaping costs are specifically excluded from the subsection 18(3.1) construction period limitations.

Amounts must be paid in year for landscaping around a building or other structure of the taxpayer used primarily in a business. The amounts must not be applicable to inventory, the building must be owned, and the work must be done with aesthetic considerations in mind. Examples include amounts paid for:

- Planting trees and flower beds and laying sod;
- Changing the contour or slope of the land;
- Landscaping courtyards within a building; and
- Related professional fees such as landscape architects and other consultants.

However, amounts paid in the year for greens, tees and fairways of a golf course related professional fees such as landscape architects and other consultants.

Representations relating to a business carried on by the taxpayer must be made to a government body or agency to obtain a license, permit, franchise or trademark.

Expenses of representation are not specifically excluded from subsection 18(3.1) and, therefore, to be deductible, the representation costs should not relate to the period of construction, renovation or alteration of a building. Based on the CRA’s comments that site development usually starts with the installation of services, expenses of representation arguably must be incurred before the construction period since they are typically incurred to obtain permission to start the construction, renovation or alteration of the building. However, any expenses of representation that are incurred during the construction period should generally be capitalized under subsection 18(3.1).

Eligible costs include:

- Legal fees and other representative’s fees to assist with rezoning submissions and obtaining permits;
- Architects’ and engineering fees incurred for the purpose of making representations for zoning amendments; and
- Salaries and other expenses of employees whose primary duties are to lobby the government.

A number of CRA technical interpretations are relevant:

- Legal costs incurred in connection with an Ontario Municipal Board ("OMB") hearing for the rezoning of farm property from rural to agricultural status were deductible under paragraph 20(1)(cc) on the basis that the expenses were incurred by the taxpayer in making representations relating to its business and the OMB is a municipal or public body performing a function of government.
- For an amount to be deductible under paragraph 20(1)(cc), the taxpayer must actually make representations to the government or public body (i.e., a mere intention to do so is not sufficient).

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241 Paragraph 1(b) of Interpretation Bulletin IT-296, “Landscaping of Grounds”, March 1, 1976 (Cancelled). Presumably, certain landscaping costs listed in the IT would be deductible under subsection 9(1) if incurred by a tenant of a building.


243 ITTN No. 20 has been cancelled and not yet replaced with an Income Tax Folio.

244 The CRA states in Technical Interpretation - Memo 2000-0001737, dated May 12, 2000, that costs incurred in making a representation to the Ontario Municipal Board regarding the rezoning of property are deductible under paragraph 20(1)(cc).


Alternative Election

In lieu of deducting the full amount of representation costs, an election is available to claim a 10-year straight-line deduction under subsection 20(9).\(^{248}\)

The election is made by filing a letter with the Minister specifying the amount. For corporations, a certified copy of the resolution of the directors authorizing the election is also required (see Regulation 4100).

The deduction is not prorated for short taxation years.

Recapture on Depreciable Property

When representation costs, in whole or in part, qualify both as a deduction under paragraph 20(1)(cc) and as the capital cost of “depreciable property” (i.e., representation to acquire a franchise), subsection 13(12) provides that any such amount that is on account of the capital cost of depreciable property and deducted under paragraph 20(1)(cc) shall be deemed to have been allowed as CCA under paragraph 20(1)(a).

The result of this rule is that a double deduction is not available (i.e., as a paragraph 20(1)(cc) deduction and as CCA) and, if the depreciable property is later disposed of for proceeds in excess of the UCC, the excess proceeds will be included in income as recaptured depreciation under subsection 13(1).

Site Investigation Costs—Paragraph 20(1)(dd)

To qualify as a site investigation cost, the amount must be incurred to investigate the suitability of a site for a building to be used in connection with a business carried on by the taxpayer. The amount is deductible by the taxpayer in the year it is paid.

This deduction does not apply to inventory.

Qualifying expenditures include costs incurred in the course of investigating a site, such as:

- Surveying;
- Soil testing;
- Architects’ and engineers’ reports;

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\(^{248}\) Pursuant to subsection 20(9), the taxpayer may elect to deduct one-tenth of the cost in the first year and an equal amount in each of the next nine taxation years.

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Utilities Service Connections—Paragraph 20(1)(ee)

To qualify as utilities service connection costs, amounts must be paid in the year to an arm’s length person and relate to a connection to a place of business for the supply of services by the arm’s length person who made the connection.

The cost of most connections does not qualify if they are installed by contractors other than the utility.

Expenditures must not be for the acquisition of property\(^{250}\) or for goods or services to be supplied by means of the connection.

These costs are subject to the construction period restrictions in subsection 18(3.1).

Disability-Related Modifications—Paragraph 20(1)(qq)

Paragraph 20(1)(qq) permits the deduction of prescribed renovation or alteration costs paid relating to eligible disability-related modifications to a building primarily used to earn income from a business or property.

The amount is deductible by the taxpayer in the year it is paid.

Prescribed renovations or alterations include:\(^{251}\)

- Installation of interior and exterior ramps;
- Installation of hand activated power door openers; and
- Modifications to bathrooms, elevators, and doorways impairment to accommodate use by a person in a wheelchair.

The building need not be owned by the taxpayer making the expenditure.
The deduction of these costs is not affected by subsection 18(3.1) construction period limitations.

**Disability-Related Equipment—Paragraph 20(1)(rr)**

Paragraph 20(1)(rr) permits the deduction of prescribed disability-specific devices or equipment.

The amount is deductible by the taxpayer in the year it is paid.

The deduction includes amounts paid for prescribed devices or equipment acquired primarily to assist individuals who have a sight or hearing impairment.

Prescribed devices include:

- Braille panels and audio indicators in elevators;
- Visual fire alarm indicators, telephone devices and listening devices for people with a hearing impairment; and
- Disability-specific computer software and hardware attachments.

The deduction of these costs is affected by subsection 18(3.1) construction period limitations.

**Demolition Costs**

Where a taxpayer acquires land with a building with the intent to demolish the building in the near future, any purchase price allocated to the building, and the demolition costs (net of any salvage value), generally form part of the cost of the land to the taxpayer.

Consider a situation in which a building that had value to the vendor is demolished by the purchaser shortly after acquisition. The purchaser may have acquired the land and building for an amount greater than what it would have paid for a comparable parcel of land with no building. In this case, the building is not depreciable property to the purchaser, and the cost of the building is excluded from class 1. However, the building is capital property to the purchaser. When the building is demolished, the purchaser may recognize a capital loss.

Where a taxpayer acquires land with a building and operates the building for a period of time after acquisition, it is a question of fact whether the taxpayer acquired the building to earn income from it. If the facts show that the taxpayer’s intent was to earn income from the building for a period of time, then the building may be considered to have been acquired by the taxpayer for the purpose of earning income, and the cost of the building will form part of the depreciable capital cost of the building to the taxpayer.

When the building is subsequently demolished, the taxpayer’s proceeds of disposition are nil. However, whether the taxpayer may claim a terminal loss depends on whether the taxpayer or a non-arm’s length person owns the land subjacent to, or immediately contiguous to and necessary for the use of, the building.

If the taxpayer retains the land for future use, then the taxpayer is deemed to have proceeds of disposition of nil (that is, the actual proceeds), plus half the amount by which the greater of the cost amount of the building and its FMV immediately before disposition exceeds the proceeds of nil. Effectively, the terminal loss is reduced to reflect the capital gain inclusion rate. The deductible terminal loss may be claimed against ordinary income.

If the taxpayer or a non-arm’s length person disposes of the land that is subjacent to, or immediately contiguous to and necessary for the use of, the building during the year in which the building is demolished, the proceeds of disposition of the building are increased by the lesser of any terminal loss on the building and any capital gain on the land. The proceeds of disposition of the land are reduced by the same amount. This adjustment reduces the terminal loss on the building by the capital gain on the land. No adjustment results if a capital gain is not realized on the land.

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252 Regulation 8801.
253 Regulation 1102(1)(c) deems an amount not to be included in a CCA class where the property was not acquired by the taxpayer for the purpose of gaining or producing income.
254 Paragraph 7 of Interpretation Bulletin IT-220R2, “Capital Cost Allowance—Proceeds of Disposition of Depreciable Property,” dated May 28, 1990, suggests that where the purchase and sale agreement between a vendor and purchaser is silent as to the allocation of the purchase price between land and building, section 68 may apply to allocate a portion of the purchase price to the building where the building had value to the vendor, even if it had no value to the purchaser.
255 Pursuant to subparagraph 39(1)(b)(i), a taxpayer may not claim a capital loss on depreciable property. Since the building was deemed by Regulation 1102(c) not to be depreciable property of the taxpayer, the taxpayer may be entitled to a capital loss on the demolition of the building.
256 If the building is pooled with other buildings, either because it was previously included in class 3 of the taxpayer or because the capital cost of the building was less than $50,000, then a terminal loss may only be available, subject to subsection 13(21.1), if it is the last building in that pool.
257 Pursuant to paragraph 13(21.1)(b).
258 Pursuant to paragraph 13(21.1)(a).
Soft Cost Deductions and CCA for Post-1989 Costs—Subsections 20(28) and 20(29)\textsuperscript{259}

Subsection 20(28) provides a special rule that enables a CCA deduction where a taxpayer acquires or constructs a building, or part thereof, and earns rental income from the building before the building or part is available for use by the taxpayer.

The application of this rule is illustrated with the following example:

<table>
<thead>
<tr>
<th>Building not complete (less than 90%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rental income for the year</td>
</tr>
<tr>
<td>Construction period soft costs</td>
</tr>
<tr>
<td>CCA (ignoring available-for-use rule)</td>
</tr>
</tbody>
</table>

**Soft cost deduction (subsection 20(29))**

Lesser of:

- Soft costs: $150,000 (A)
- Rental income (before CCA): $200,000

**CCA deduction (subsection 20(28))**

Lesser of:

- CCA otherwise: $200,000
- Rental income (before CCA): $200,000

Subsection 13(7.1) states that when the government provides funding to a taxpayer for the acquisition or construction of property, the treatment of the government funding must be considered. Two options may be available: (1) include the assistance in income, or (2) reduce the capital cost of the property by the amount of the funding received.\textsuperscript{260}

Subsection 13(7.1) clearly provides that the starting point for the determination of capital cost of the property is determined without reference to subsection 13(7.4).\textsuperscript{261}

Alternatively, subsection 13(7.4)\textsuperscript{262} is an elective provision, within strict time limits, to reduce the capital cost of depreciable property for assistance received that would otherwise be included in taxable income under paragraph 12(1)(x). (Paragraph 12(1)(x) covers a broader range of receipts than government assistance.) Note that paragraph 12(1)(x) does not apply to the extent that the particular amount otherwise reduces the capital cost of the property (e.g., under subsection 13(7.1)). There is no prescribed form; the election is made by attaching a signed letter to the applicable income tax return.\textsuperscript{263} The related depreciable property must be acquired in the year or in the three taxation years preceding the year or in the immediately following taxation year.

**Treatment of Grants and Assistance**

**Government Assistance**

When the government provides funding to a taxpayer for the acquisition or construction of property, the treatment of the government funding must be considered. Two options may be available: (1) include the assistance in income, or (2) reduce the capital cost of the property by the amount of the funding received.\textsuperscript{260}

Subsection 13(7.1) provides that where a taxpayer received or is entitled to receive assistance from a government in respect of, or for the acquisition of, depreciable property, whether as a grant, subsidy or as any other form of assistance, the capital cost of the depreciable property to the taxpayer at any particular time shall be deemed to be the amount, if any, by which the total of the capital cost of the property to the taxpayer, otherwise determined, exceeds the total of the amount of assistance the taxpayer has received or is entitled, before the particular time, to receive.

For example, funding provided by the Ontario Ministry of Health and Long-Term Care for the new construction of long-term care facilities may be considered government assistance subject to subsection 13(7.1), which must be applied to reduce the capital cost of the related building.

In paragraph 12 of Interpretation Bulletin IT-273R2, “Government Assistance – General Comments”, dated September 13, 2000, the CRA states that the election must be filed no later than the day on which the income tax return for the relevant year is due and is made by means of a signed letter accompanying the applicable income tax return which states:

- (a) the subsection under which the election is being made;
- (b) the elected amount;
- (c) the amount of assistance and the date it was received;
- (d) the date the property was acquired; and
- (e) the ACB or the capital cost of the property as determined before it is reduced by the elected amount.

\textsuperscript{259} Based on the wording of subsection 20(29), it overrides subsection 20(28). The deduction under subsection 20(29) is limited to the income of the taxpayer before a deduction under subsection 20(28) or subsection 20(29), while the deduction under subsection 20(28) is limited to the income of the taxpayer before the deduction under subsection 20(28) only.


\textsuperscript{261} Subsection 13(7.1) is amended by adding a reference in paragraph (c) thereof to new subsection 13(7.4) to avoid a circularity problem in determining the order of adjustments to be made in determining the capital cost of depreciable property. Accordingly the capital cost of depreciable property will be adjusted under subsection 13(7.1) before any adjustment is made under subsection 13(7.4).”

\textsuperscript{262} Subsection 13(7.4) is consequential upon the enactment of paragraph 12(1)(x) in 1986.

\textsuperscript{263} In paragraph 12 of Interpretation Bulletin IT-273R2, “Government Assistance – General Comments”, dated September 13, 2000, the CRA states that the election must be filed no later than the day on which the income tax return for the relevant year is due and is made by means of a signed letter accompanying the applicable income tax return which states:
receiving that would otherwise be included in taxable income under paragraph 12(1)(x). An election is required by paragraph 53(2.1).264

Tenant and Leasing Issues

Tenant Inducements
Tenant inducements are alternative arrangements between landlords and tenants under which landlords provide incentives for tenants to enter into leases. Generally, on a present-value basis, both parties will be in the same financial position as if no inducement had been given.

In general, the tenant trades higher future rents for a rent-free period or cash, such that the present value of the higher portion of future rents equals the cash inducement received or the present value of the rent deferral.

Payments to Tenants
Payments to tenants may include:

- Direct cash payment for the tenant to use at its discretion;
- Compensation for moving costs and costs of cancelling prior leases; and
- Cash payments in connection with the construction and fixturing of the space (i.e., a fixturing allowance).
- The landlord’s contribution may have an upper limit.

Payments to Third Parties
Payments to third parties may include:

- Direct payment to third parties in connection with improvements to premises; and
- Direct payments by the landlord to the tenant’s prior landlord as a result of the assumption of the tenant’s prior lease obligation.

Other Potential Inducements
Other potential inducements may include:

- Rent-free periods;
- Below-market rents during all or part of the lease term; and
- Loans at less than market interest rates.

Treatment of Inducements
Tenant inducements are not specifically addressed in the Act. Their deduction for tax purposes arises from the inclusion of the costs in the determination of profit.

GAAP and REALpac provide that tenant inducements should be deferred and amortized over the lease term.

The CRA allows amounts paid as tenant inducements to be treated as follows:

- Capital expenditures added to the UCC of the building;
- Amounts deductible over the lease term; or
- Amounts deductible as incurred in limited circumstances.265

To be deductible in the year incurred:

- Payments must arise under the lease;
- There must be an identifiable benefit to the landlord in the period the inducement payment is made; and
- Payments must not be for capital improvements to the building.

In light of the SCC decisions in Canderel266 and Toronto College Park,267 tenant inducements with respect to buildings with multiple tenants should generally be deductible in the year incurred for most real estate landlords that incur such costs in the ordinary course of their operations.

For buildings with a single tenant, tenant inducements should generally be amortized over the lease term to provide a more accurate matching of revenue and expenditure, as the expense can be viewed as incurred with the specific purpose of producing an identifiable future income.

264 A prescribed form has not been specified but is made in the same manner as the election under subsection 13(7.4).
266 Canderel Limited v. The Queen, 98 DTC 6100 (SCC).
267 Toronto College Park Limited v. The Queen, 98 DTC 6088 (SCC).
Canderel and College Park Cases

In the Canderel and Toronto College Park decisions, the SCC determined that, in the circumstances in those cases, tenant inducements paid were “running expenses” whose expenditure could not be related to any particular item of revenue. The benefits of the expenditures were realized in the year incurred. The amounts were therefore considered deductible in the year paid. The SCC decided that deducting the expenditures in the years incurred provided an accurate picture of profit for the year in accordance with “well-accepted business principles,” and that the onus was on the CRA to prove its proposed treatment provided a more accurate picture of profit.

The CRA has stated that it does not feel the Canderel and College Park decisions have changed the law regarding deductibility of tenant inducements but indicated that it will follow the decisions in identical fact situations.268

For tenant inducements that should not otherwise be capitalized to the building, when amounts are deducted in the year paid, the onus is on the CRA to show that amortization, rather than the immediate deduction, presents a more accurate picture of profit.

Amortized Tenant Inducements

The CRA has indicated that it will administratively allow landlords to amortize inducements over the term of the underlying lease.

When tenant inducements are amortized, the unamortized balance can be deducted if the tenant vacates before the end of the lease term269 or if the landlord sells the property.

Treatment of Other Inducements

The excess of rent paid by the landlord under a lease for a tenant’s prior premises over the rent received for the new premises is deductible as incurred over the term of the new lease.

Consistent with the treatment of an inducement for the initial lease of space, the treatment of an inducement for the re-leaseing of space should result in an accurate picture of profit. Loans at below-market interest rates result in lower income to the landlord. Inclusion of the loan in the lease may be advisable to ensure the landlord can deduct interest on amounts borrowed to lend to the tenant.

Treatment of Inducements to Renew a Lease

The CRA has stated that there is no compelling reason to distinguish the treatment of costs related to an initial lease from those relating to the re-leaseing of space.270 Based on the FCA decision in Canderel, the CRA stated in 1996 that such inducement payments are clearly related to particular items of income and that the amortization method is the only method acceptable for income tax purposes. Although there has been no subsequent statement on the treatment of inducement payments to re-lease space, the lower court decision in Canderel was reversed by the SCC in 1998 and CRA issued Income Tax Technical News ITTN-16 on March 8, 1999271 stating:

“Yes, given the Supreme Court’s pronouncement, the Department accepts that the matching principle is not a rule of law although it remains an important consideration in the determination of the most accurate picture of profit.

It is critical to note that the particular findings of fact in Canderel regarding benefits generated by the inducement payments played a significant role in the Supreme Court’s decision that the payments were running expenses to which the matching principle did not apply.

Before these decisions, determining whether or not an outlay was a running expense was a difficult judgment based on the particular facts and this remains the case today. These cases do not mean that all instances of tenant inducement payments would be deductible up front. A difficult decision has to be made whether the expenditure is incurred for the specific purpose of earning an identifiable item of revenue which results in the application of the matching principle or whether there are sufficient current benefits from the expenditure to justify treatment as a running expense.”

268 Previously indicated in Income Tax Technical News ITTN-16 dated March 8, 1999 – The CRA allowed a “catch-up deduction” for tenant inducement expenditure costs incurred in 1996 and 1998. When these costs would be eligible for immediate deduction under the Canderel criteria, the CRA permitted a deduction of the remaining unamortized balance of tenant inducement costs in the first tax return filed after February 1998. This ITTN has been cancelled and not yet replaced with an Income Tax Folio.


270 Income Tax Technical News ITTN-7 dated February 21, 1996. This ITTN has been cancelled and not yet replaced with an Income Tax Folio.

271 This ITTN has been cancelled and not yet replaced with an Income Tax Folio.
picture of profit for the year in accordance with well-accepted business principles. Depending on the particular facts, the taxpayer may be entitled to deduct such cost as a running expense or defer and amortize it over the term of the related lease.

Is a Tenant Inducement a Matchable Expenditure?

The tax treatment of tenant inducement payment may be impacted by the matchable expenditure rules in section 18.1 which were added in 1998, applicable to expenditures made after November 17, 1996.

These provisions restrict the deductibility of certain otherwise deductible “matchable expenditures” incurred in respect of a “right to receive production” by pro-rating the deduction of such amount over the economic life of the related right. The intent of these rules is generally to restrict the use of royalty-type arrangements to effect tax-assisted financing by structuring the arrangements as tax shelters or as debt substitutes.

Section 18.1 will not apply to improvements that are otherwise capitalized to Class 1.

Where an amount was paid as an inducement to a tenant to enter into a lease, the CRA expressed the view that a lease for the use of property would be considered a “right to receive production” since the lessor “has a right under the lease in which it is entitled to an amount all or a portion of which is computed by reference to the use of property, or revenue, and the amount is in respect of another taxpayer’s (the tenant’s) activity.” Although a question of fact, the CRA also expressed the view that a tenant inducement payment “could well qualify” as a matchable expenditure.

Under a standard fixed rent lease, a landlord is entitled to receive an amount (rent) computed by reference to the use of property (the leased premises) but it may be argued that the amount should not be considered to be in respect of another person’s activity, property or business—rather the amount of rent is in respect of the use of the landlord’s own property. On this basis, the tenant inducement payment may not be a matchable expenditure and may not be impacted by these rules.

The particular lease reviewed by the CRA contained a participating rent clause under which a portion of the monthly rents were computed as a percentage of the tenant’s monthly revenue. Under a participating lease, the CRA could argue that the amount of rent is in part computed by reference to the tenant’s revenue, and thus the amount of rent, while payable for the use of the landlord’s property, could be considered to be in respect of another taxpayer’s (i.e., the tenant’s) activity or business. Similarly, it is conceivable that under a sublease or other similar arrangement, the sublease may fall within the wording of these rules on the basis that the rent amount received by the sub-lessee from the sub-tenant may be in respect of the lessor’s property in which the sub-lessee has a leasehold interest.

It is noteworthy that the CRA’s written assessment practice on the deductibility of tenant inducement payments was issued after the enactment of the matchable expenditure rules and after the above technical interpretation, yet made no mention of these rules. In determining the tax treatment of a tenant inducement payment, the real estate industry generally follows CRA’s guidance issued on December 6, 2000.

Treatment of Tenant Reimbursements to the Landlord

When a tenant pays an amount to the landlord to obtain or extend a lease or sublease, the CRA has expressed the view that from the tenant’s perspective the amount is considered as a capital expenditure to acquire property that is a leasehold interest. Therefore, a tenant may be entitled to claim capital cost allowance on the payments either under Class 13, or if applicable, under Class 1, 3, 6, 31, or 32 where the conditions of subsection 1102(5) of the Regulations are met, provided the leasehold interest was acquired for the purposes of gaining or producing income.

Shareholder Benefit for Improvements by Corporate Tenant

Where a corporation is renting a building owned by a shareholder, the CRA has expressed the view that the corporation may be considered to have conferred a benefit on the shareholder pursuant to subsection 15(1) where it incurs the cost of additions or improvements that vest in the owner of the building. The particular facts are relevant, including the nature of the addition or improvement, the term of the lease, provisions for the extension of the lease, provisions of the lease regarding leasehold improvements and the amount of rent being charged. The benefit, if any, is equal to the present value of the amount, if any, by which the addition or improvement increases the value of the building to the shareholder at the time the building reverts to the shareholder (at the termination of the lease unless the leased is annulled earlier).274


The CRA also expressed the view that this shareholder benefit can be mitigated where the shareholder/landlord reimburses his corporate tenant for the value of such leasehold improvement costs at the end of the lease.275

Leasing Commissions
The CRA’s position is to treat leasing commissions paid by the landlord in the same manner as lease inducement payments (1989 Corporate Management Tax Conference).

For reference, GAAP recognizes a leasing commission as an initial direct cost of a specific lease which is deferred and amortized over the term of the lease (including renewal options that the lessee is reasonably certain to exercise).276

An alternative position was to treat leasing commissions as a period cost, fully deductible in the year incurred (see Baker Lovick Ltd. v. MNR, 91 DTC 1041 (TCC) and Cummings v. R., 81 DTC 5207 (FCA)).

In light of the Canderel and Toronto College Park decisions on the treatment of tenant inducement payments, lease commissions may generally be deductible when incurred.

More recently, the CRA has expressed the view that leasing commissions were generally fully deductible.277

For buildings with a single tenant, a taxpayer may choose to amortize leasing commissions over the lease term to provide a matching of revenue and expenditure, on the basis that the expense was incurred with the specific purpose of producing an identifiable future income.

Landlord Lease Cancellation Payments—Paragraph 20(1)(z) and 20(1)(z.1)
Payments to a tenant to allow the landlord to break a lease are not currently deductible by the landlord (see paragraph 18(1)(q)).

If the landlord continues to own the property, the payment is amortized over the remaining term of the lease, including renewal terms (not exceeding 40 years) (see paragraph 20(1)(z)).

If the landlord disposes of the property, 50% of the unamortized payment is deductible (see paragraph 20(1)(z.1)).

Lease Cancellation Receipts
When a landlord receives a payment from a tenant to cancel the tenant’s lease obligations, the landlord has to include the amount received in income.

When amounts included in income under paragraph 12(1)(a) relate to goods or services that will be provided after the end of the year or rent for periods after the end of the year, a reserve of a reasonable amount, i.e., the part of the rent received in advance that relates to a period after the end of the tax year, is available under subsection subparagraph 20(1)(m)(iii) (see Interpretation Bulletin IT 261R, “Prepayments of Rent”).

Because the landlord has no further obligation to provide facilities, a paragraph 20(1)(m) reserve would not be available for lease cancellation receipts, such that the net amount has to be included in income.278

Inducement Receipt—Tenant Treatment—Paragraph 12(1)(x)

Paragraph 12(1)(x) requires the recipient of a tenant inducement payment to include the amount in income if it would not otherwise be included in income (see Ikea Ltd. v. The Queen (98 DTC 6092)).

If an inducement is attributable to leasehold improvements or fixtures, a subsection 13(7.4) election can be made to reduce the capital cost of the related depreciable property.

Repayment of Inducements
A deduction is allowed for the repayment of an amount previously included in income under paragraph 12(1)(x).

If the repayment previously applied to reduce the capital cost of related depreciable property under the subsection 13(7.4) election, the repayment is added back to the capital cost of such depreciable property.

276 This position is confirmed in the REALpac, IFRS and ASPE handbooks.
277 Technical Interpretation 2014-083592117, “Commission d’agent de location”, dated December 23, 2014 concluded that it is a question of fact but that leasing commissions are generally currently deductible.
278 It is unclear whether the amount will be included in income pursuant to paragraph 12(1)(a) or (x) or section 9. However, this should not be relevant to the landlord, since a reserve pursuant to paragraph 20(1)(m) (in the case of an inclusion under paragraph 13(1)(a) is not available because there is no further obligation to provide space to the tenant. Paragraph 4 of Interpretation Bulletin IT-359R2, “Premiums and Other Amounts with Respect to Leases,” dated December 20, 1983, states only that the receipt of a lease cancellation payment is always income to the taxpayer.
Free Rent

Economically, there should be no difference to the landlord and the tenant between a lease inducement and a rent free period. The present value of the amount received by the landlord over the lease term should be the same under both scenarios, but the timing of the cash flow may differ.

Rent-free Periods

Rent-free leases allow the tenant a rent holiday for some portion of the lease term, usually the beginning. The lease is normally structured so that the tenant does not have a legal obligation to pay rent during the rent-free period.

Similarly, stepped rent allows the landlord to increase rent in stages over the term of the lease (for inflation or otherwise).

Since no rent is receivable by the landlord for the rent-free period, no amount is included in income for tax purposes. Consistently, the tenant has no expense for tax purposes during the rent-free period (see Buck Consultants Limited v. R. 2000 D.T.C. 6015).

For accounting purposes, rent is usually recognized evenly over the entire term of the lease, so that rental income includes amounts not yet received or receivable.

The difference between the treatment for tax and accounting would provide the landlord with a deferral of the recognition of income for tax purposes, but over time, the same amount of income would be recognized for both over the lease term. However, if a tenant’s tax position can accommodate a reduction of its rent expense for a period of time, a rent-free period may be a negotiable alternative to a cash inducement.

Rental Income From Stepped Rent Leases

For all existing leases, the rent to be received over the remaining term of the leases should be accounted for on a straight line basis.

An “accrued rent receivable/payable” is recorded from the tenants for the current difference between the straight-line rent recorded as rental revenue and the rent that is contractually due from the tenant.

For an operating lease, the recognition of rental income and expense under CPA Handbook sections 3065.28 and 3065.55 requires the use of the straight-line basis “unless another systematic and rational basis is more representative of the time pattern” of the user’s benefit. This position is confirmed in the REALpac, IFRS and ASPE Handbooks.

Similar to free rent, the tenant does not have a legal obligation to pay the “accrued rent receivable”, and so the rental income for accounting purposes should include amounts not yet received or receivable. Since no rent is receivable by the landlord, no amount would have to be included in income for tax purposes.279

Percentage Rents

The tenant’s obligation for percentage rent under the lease arises monthly based on the prior month’s sales.

If a landlord has collected more percentage rent than a tenant owes, the landlord will recognize a liability on its books.

The net credit is included in income for tax purposes (see paragraph 12(1)(a)). Because no future service is to be provided, no reserves are available, and so the landlord will have an inclusion in income. However, a deduction is available when the landlord refunds the credit balance to the tenant.

Deferred Major Repairs

Deferred major repairs are repairs that are charged to tenants through common area maintenance billings.

For tax purposes, such costs are generally repairs and maintenance and are deductible in the year incurred.

Deferred major repairs that are capital in nature should generally be classified and/or depreciated according to the nature of the expenditure.

However, when deferred recoverable costs are considered capital in nature, an argument exists that the tax and accounting treatments should be the same. For accounting purposes, the expenditures may be amortized over the terms of the leases and charged back to the tenants as recoverable costs. Based on Canderel, a position can be taken that amortization may present a more accurate picture of profit as the amortized costs are directly matched to the revenue from tenant recoverables.

Change in Use of Property

Personal Use Versus Commercial Use

Where a taxpayer holds property that is used for the purpose of gaining or producing income (an “income earning purpose”) and at a later time uses it for some other purpose, the taxpayer is deemed to have disposed of the property at that later time for proceeds equal to its FMV at that later time and immediately thereafter reacquired it at a cost equal to that FMV. These rules do not apply where there is change from one income earning purpose to a different income earning purpose.

There are exceptions. For example, the CRA has expressed the view that the deemed disposition rules in subsection 45(1) do not apply where a homebuilder, who initially held a property as inventory, commences to use it as a principal residence. Consistently, the CRA also expressed the view that “Where a taxpayer permanently converts real estate from inventory to capital property which is a personal-use property, the ultimate sale of real estate will not give rise to a gain or loss on income account.”

On the reverse, where the use of a property changes to an income earning purpose, the property is also deemed to be disposed of and reacquired at its FMV at that later time. For depreciation purposes, however, the capital cost of the property is the lesser of the FMV of the property at that later time and the actual cost of the property to the taxpayer, plus one-half of the excess of such FMV over that actual cost plus twice any capital gains exemption claimed under section 110.6 in respect of such excess.

An election is available under subsection 45(2) to defer the application of the deemed disposition and reacquisition rules when the use of a property changes to an income earning purpose. This election is often made to allow the property to qualify as the taxpayer’s principal residence for up to four taxation years during which the election remains in force and the taxpayer is resident, or deemed to be resident, in Canada.

The deemed disposition rules also apply where there has been a change of use of a property that is partially used for an income earning purpose based on the cost of the income earning component relative to the cost of the whole property. The increase or decrease in the income earning portion will trigger a deemed disposition for the increase or decrease as the case may be.

Change in Commercial Use

Where capital property used for an income earning purpose is converted into inventory of a business, or vice-versa, there are no specific rules in the Act which provide for a deemed disposition. CRA has in the past suggested that such a conversion of capital property to inventory or vice versa will not constitute a “disposition” for tax purposes, but the taxpayer would have a “notional disposition” which would reset the notional cost basis of the property without triggering immediate tax consequences.

The CRA more recently advised that it will not be changing its general position on the change in use rules as currently presented in Interpretation Bulletins IT102R2 and IT-218R and its view that subsections 45(1) and 13(7) do not apply where property is converted from inventory to (income-earning) capital use and vice versa.

It is CRAs view that the notional gain or loss will only be triggered in the year in which the property is actually sold at which point the determination of the nature of the gain or loss would be made in view of the notional disposition. Therefore, according to the CRA, it will be necessary to report the notional sale on account of capital and the actual sale on account of inventory which may give rise to both a capital gain or loss as well as an income gain or loss as the case may be depending

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280 Paragraph 13(7)(a) and subsection 45(1).
282 Interpretation—external 2015-0986921E5—“Conversion from inventory to capital” dated September 25, 2015.
283 CRA document 9335765—“Conversion from inventory to capital” dated February 21, 1994.
284 Subsection 45(1).
285 Paragraph 13(7)(b).
on the particular circumstances and in view of how real estate values fluctuated during the relevant holding periods.

Change in Plans

In Robert Peluso et al v. The Queen,290 the taxpayer was unsuccessful in attempting to argue a change in use and was denied capital gain treatment on a sale of land. The taxpayer initially purchased land as inventory. Subsequently, the taxpayer planned to develop the land as capital property. However, these plans were abandoned and the unserviced land was sold.

The gain on sale of the land was determined to be an income gain as there was only a change in plans and not a change in use. The TCC indicated a requirement for “a clear and unequivocal positive act implementing the change”.

Tax-Deferred Rollovers Into Development Partnerships

A taxpayer holding capital property with an accrued capital gain may transfer the property into a partnership for development. The property becomes inventory to the partnership. Upon electing to defer the gain pursuant to a subsection 97(2) election, it would appear that the accrued capital gain may become an income gain when such “deferred gain” is allocated to a member of the development partnership.291

Real Property Consolidation

Where one or more divided interests in real property are consolidated under applicable property laws resulting in one or more persons holding undivided interests in the property immediately after the consolidation, it is unclear whether a “disposition” would result from the consolidation. There are no specific provisions under the Act which would result in a deemed disposition and hence it would appear that it is a question of fact whether consolidation could give rise to a disposition. In the context of a single person holding two divided interests that are subsequently consolidated under applicable property laws into a single parcel of land, it may be argued that a disposition has not taken place within the meaning of subsection 248(1) given that the taxpayer would not be entitled to any proceeds of disposition.

Partition and Subdivision of Real Property

A partition is a subdivision of the property among the co-owners. For example, land may be divided into separate distinct parcels with each co-owner exchanging an undivided interest in the entire land for full ownership of a distinct parcel of land.

Subsection 248(20)—partition of property—applies where the FMV of the separate parcel of property received by a co-owner upon partition is less or greater than the FMV of the co-owner’s previous interest.292

Subsection 248(21)—subdivision of property—applies when a co-owner receives, upon the partition of property, title to a separate parcel of property the FMV of which equals the FMV of the co-owner’s previous interest.293

Where more than one property is acquired under one deed, the CRA has expressed a view that such properties would be considered one property for purposes of the partitioning rules even if the properties were not adjacent.

Partition of Real Property

Where property owned by two or more persons is the subject of a partition, notwithstanding any retroactive or declaratory effect of the partition, each person who had an interest in the property immediately before the partition, is deemed not to have disposed of that interest at the time of partition to the extent that the FMV of the interest immediately before partition is equal to the FMV of that interest immediately after the partition.294

For this purpose, where an interest in the property is an undivided interest, the FMV of that interest is deemed to be equal to that proportion of the FMV of the property at that time that the interest is of all the undivided interests in the property.

If the FMV of the taxpayer’s interest in the property before the partition does not equal the FMV after the partition, a deemed disposition may result in a taxable gain.

This partition rule does not apply to fungible tangible property (i.e., freely exchangeable property that has physical substance, which generally excludes land).

292 Subsection 248(20).
293 Subsection 248(21).
Subdivision of Real Property

Where a property that was owned by two or more persons is subdivided in a manner that each person has a new interest the FMV of which immediately after the subdivision is equal to the FMV of the interest held by that person immediately before the subdivision, the general partition rules described above do not apply and the new interest is deemed to be a continuation of that person’s undivided interest in the property immediately before subdivision.295

For this purpose, subdivisions of a building or of a parcel of land that are established in the course of or in contemplation of a partition and that are co-owned by the same persons shall be regarded as one property.

If an interest or a right in the property is or includes an undivided interest or right, the FMV of the interest or right shall be determined without regard to any discount or premium that applies to a minority or majority interest or right in the property.

Air and Density Rights296

A developer may acquire rights to the air space above a property or piece of land. The reasons for acquiring the air rights may be to allow for the construction of a building or structure in the air space, or to have the ability to negotiate with a municipality to transfer surplus density from one site to another so as to maximize the permitted density in the desired site.

For tax purposes, a developer who acquires air rights has acquired “property” as defined in subsection 248(1) because air rights are integral to the use and enjoyment of the land itself. The air rights acquired would generally be either capital property or inventory to the developer. This determination would depend on the purpose for which such rights are acquired and would likely follow the treatment to the development of the project in question.

Acquisition of Air Rights

Inventory

If air rights are considered inventory, they would not be depreciable property by reason of Regulation 1102(1)(b).

Capital Property

If air rights are considered capital property to the developer, they would not be depreciable property since air rights are intangible property for which there is no prescribed CCA class. However, it could be argued that air rights could form part of the cost of capital property because they enhance an existing asset (either land or building). In allocating air rights to land or building, it could be argued that the air rights were acquired in order to construct a particular building, and, accordingly, the cost of the rights can be added to the capital cost of the building.297 In other cases, it may be more appropriate to add the cost of the air rights to the land. Further, a taxpayer who leases air rights for a specified period could record the cost of obtaining the air rights for this period as a leasehold interest in Class 13.

Dispostion of Air Rights

The tax treatment of the gain or loss on the disposition of air rights would depend on the characterization of the air rights when they were acquired by the taxpayer (i.e., inventory, capital property or ECE).

If the air rights were considered to form part of the land or building, but the land or building itself has not yet been disposed of, the sale of the rights would be a partial disposition of the underlying property. The vendor would be required to determine the appropriate portion of the original tax cost of the underlying property, for example, by comparing the FMV of the property with air rights to the FMV of the

295 Subsection 248(21).
297 Cadillac Fairview Corporation Limited v. The Queen, 97 DTC 405 (T.C.C.) and Sun Life Assurance Company of Canada v. The Queen, 97 DTC 422 (T.C.C.) present a conflicting view and cast doubt on this argument.
298 For acquisitions beginning on or after January 1, 2017, these indefinite life intangible assets will be considered depreciable capital property (proposed class 14.1). CCA will be available at a rate of 5% per annum on a declining balance basis.
property without the air rights. Such calculated tax cost would then be reported against the proceeds receivable for the disposition of the air rights.

If the air rights were originally considered as inventory to the vendor, the vendor would record the tax gain or loss as business income or loss.

An easement is commonly granted to the purchaser of air rights. Administratively, the CRA states in Document 2008-0296741E5, “Proceeds from Easement on Land,” dated December 17, 2008, that, in the event of a partial disposition of property, the CRA will accept an amount equal to the proceeds from such disposition as being the reasonable portion of the ACB of the whole property attributable to the partial disposition provided that:

– The area or the portion of the property that was expropriated or in respect of which an easement was granted is not more than 20% of the area of the total property, and
– The amount of the compensation received is not more than 20% of the amount of the ACB of the property.

This administrative position may also be applied to the disposition of air rights on the basis that it is a partial disposition of the underlying property.

Density Rights

Density rights are restrictions on the size or height of buildings. They are usually established by municipal by-laws, and some planning statutes allow density rights to be transferred between sites on municipal approval. A developer may agree with the municipality to build a higher density building than otherwise permitted in one site by reducing or eliminating the density of another property owned by the same developer. These rights can also be acquired from third parties with municipal approval.

The tax consequences of density transfers between taxpayers are basically the same as discussed for air rights; however, the cost to a developer of acquiring density rights is allocable to the land only and not the building, since such rights determine what a landowner can do with the land. These rights would continue to exist if the building was demolished and the land left vacant, or another building was constructed on the site.

The tax determinations related to the acquisition and disposition of air rights and density rights depend greatly on the specific facts and should only be acted on with appropriate professional advice.

Tax Considerations on Disposition of Real Property

General Considerations

Gains Accrued up to December 31, 1971

It is important to maintain records of the V day values of land and building (i.e., properties held on December 31, 1971 and continuously thereafter). Unrealized gains accrued up to December 31, 1971 are exempt from capital gains tax.

Recaptured CCA and Terminal Loss

The lesser of proceeds and original capital cost is credited to the applicable UCC pool. If the UCC pool has a net positive balance and no assets remain in that UCC pool, there is a terminal loss (see subsection 20(16)). If the UCC pool has a negative balance, even if assets remain, there will be recaptured CCA (see subsection 13(1)).

The CRA has confirmed that the recapture of CCA on the disposition of a rental property should be added to active or passive income on the same basis that CCA was claimed.300

Capital Dividend Account301

For private corporations, a capital dividend account is a very useful tool for shareholders to extract corporate funds. The capital dividend account302 is computed at any time and includes the non-taxable portion303 of capital gains (net of capital losses) earned after 1971 and capital dividends received. A private corporation and its shareholders may elect304 to treat a dividend as a capital dividend. A capital dividend payment is not taxable to the shareholder and will reduce the capital dividend account.

300 Technical Interpretation—external 2012-0440781E5—“Recapture of capital cost allowance” dated May 9, 2012.
302 Capital dividend account is defined in subsection 89(1).
303 Current inclusion rate is 50% - see paragraph 38(1).
304 Prescribed election form – T2054 “Election for a Capital Dividend Under Subsection 83(2)”. 
Beware that subsection 184(2) charges an excessive 60% penalty on the payment of a capital dividend exceeding the capital dividend account balance. Subsection 184(3) is a relieving provision that allows an election to be filed to treat the excess payment as a separate dividend.

The CRA is able to verify a corporation’s capital dividend account balance every three years.305

Suspended Losses on Prior Transfers to Non-arm’s Length Parties

When assets have previously been transferred between non-arm’s length entities, it is important to maintain records of any losses that have been deferred by the original transferor. These losses will become deductible to the original transferor on the ultimate disposition of the property to an arm’s length party.

Replacement Property Rules for Rental Properties

Relieving provisions that would otherwise allow a deferral of capital gains and recapture of CCA when a taxpayer voluntarily replaces a capital property are not available for rental properties. However, the rules could apply for an involuntary disposition as a result of a fire, condemnation, flooding, or expropriation. The replacement property rules are discussed above.

Mortgage Repossession

When a mortgagor repossesses a property, the mortgagee is deemed to realize proceeds of disposition in the amount of the outstanding mortgage at the time of the repossession. Proceeds also include any other debts, such as second or third mortgages, for which the lender has no recourse.

Allocating Gross Proceeds between Land and Building

The allocation of proceeds between land and building may be specified in the purchase and sale agreement. The Supreme Court decision in Golden v. R (86 DTC 6138), demonstrates that considerable latitude will be given to allocations decided between arm’s length parties when there is evidence of “hard bargaining.”306

If an allocation is not specified in the purchase and sale agreement, consider the following alternatives:

– Allocate a portion of gross proceeds to the land based on comparable vacant land and allocate the balance of gross proceeds to the building.
– Follow the allocation used on the property tax assessments.
– Follow the allocation used for accounting purposes (if the method is reasonable).
– Follow the allocation used on the original acquisition of the property.

Allocation Under Subsection 13(21.1)

If the amount of the disposal proceeds allocated to a building is less than the building’s UCC, subsection 13(21.1) may re-determine the proceeds allocable to the building if a capital gain is recognized on the land.

In this situation, building proceeds will be the lesser of:

A. The excess of the total combined FMV of the land and building over the lesser of the FMV of the land and the original cost of the land; and

B. The greater of:
   i. The FMV of the building immediately before the disposal date; and
   ii. The lesser of the UCC and original cost.

Example of Subsection 13(21.1) Allocation

To illustrate, consider the following example: Taxpayer A disposes of a rental property to Taxpayer B for proceeds of $1.7 million. In the purchase and sale agreement, both taxpayers have agreed to a 25/75 split between land and building, respectively. Taxpayer A’s land ACB is $300,000, building ACB/capital cost is $1.6 million, and building UCC is $1.45 million.

Taxpayer A’s income/loss before the application of subsection 13(21.1):

– Taxpayer A’s Capital Gain = (25% × $1,700,000) - $300,000 = $125,000; and
– Taxpayer A’s Terminal Loss = (75% × $1,700,000) - $1,450,000 = ($175,000).

The building proceeds will be deemed to be the lesser of the following two amounts:

– Total FMV ($1,700,000) less Land ACB ($300,000) = $1,400,000; and
– The greater of Building FMV ($1,275,000) and Building UCC ($1,450,000).

305 T2 Schedule 89 – “Request for Capital Dividend Account Balance Verification”.
Therefore, after the reallocation under subsection 13(21.1), Taxpayer A's capital gain will be reduced to nil and Taxpayer A's terminal loss will be reduced to $50,000 from $175,000.

**Capital Gains Reserve—Subparagraph 40(1)(a)(iii)**

Subparagraph 40(1)(a)(iii) allows a taxpayer to claim a discretionary reserve for capital gains realized during a taxation year when a portion of the sales proceeds is not due until after the end of the taxpayer's taxation year.

The capital gains reserve must be reasonable and is subject to a minimum recognition of at least 1/5th of the capital gain in each taxation year, on a cumulative basis. The capital gains reserve in any particular taxation year is calculated as follows:

The lesser of:

- (i) \( \frac{\text{Amount not yet due}}{\text{Gross proceeds}} \times \text{Total capital gain} \)
- (ii) \( \frac{\text{Total capital gain}}{4 - \# \text{ of preceding taxation years ending after the disposition}} \times \frac{5}{5} \)

Total capital gain = Gross proceeds less ACB of asset less selling costs

Under subparagraph 40(1)(a)(iii), a taxpayer must add back any reserve claimed in a prior taxation year.

Administratively, the CRA permits a reserve to be claimed when the due date has been extended. However, the due date must be extended before the end of the taxation year for which the reserve is being considered and preferably before the original due date of the note.307

The reserve is no longer available if the uncollected portion of the proceeds of disposition (e.g., mortgage receivable) has been transferred to a third party.308

A capital gains reserve is not allowed if:

- The vendor was not resident in Canada or was exempt from tax at the end of the year or at any time in the immediately following year,
- The purchaser is a corporation that controlled or was controlled by the vendor, or
- The purchaser is a partnership in which the vendor was, immediately after the sale, a majority interest partner.309

The capital gains reserve is not available to the vendor where there is an earn-out/reverse earn-out clause in the share purchase agreement.310

When a partnership that was claiming a reserve under subparagraph 40(1)(a)(iii) dissolves and subsection 98(3) applies (property distributed to former partners), the former partners may continue to claim the reserve.311

**Income Reserve for Property Sold—Paragraph 20(1)(n)**

A discretionary reserve is permitted when an amount has been included in computing the taxpayer’s income for the year or a preceding taxation year for property, that is real or immovable property,312 sold in the course of the business when a portion of the gross proceeds is payable to the taxpayer after the end of the year.

A reasonable reserve can be calculated as follows:

\[
\text{Reasonable reserve} = \frac{\text{Gross profit}}{\text{Gross proceeds}} \times \text{Amount due after end of taxation year}.
\]

Paragraph 20(8)(b) limits the period for which a reserve can be claimed to not more than 36 months after the sale of the property.

Subparagraph 12(1)(e)(ii) requires a taxpayer to include any prior year reserve claimed under paragraph 20(1)(n) in its taxable income for the current taxation year.

Reserves may not be claimed if the vendor was not resident in Canada or if the vendor was exempt from tax at the end of the year or at any time in the immediately following year.313

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309 Paragraph 40(2)(a).


311 CRA Views, RCT 85-339 -- Sale of rental property by partnership for consideration of a mortgage assumption and issuance of a second mortgage.

312 This reserve is permitted on the sale of other property. However, an additional restriction in utilizing this reserve requires all or a portion of the proceeds to be due at least 2 years following the sale. See paragraph 20(1)(n).

313 Paragraph 20(8)(a).
Subsection 20(8) provides that a reserve will not be available to a taxpayer in certain non-arm’s length situations. A reserve is not available if the purchaser of the property was:

- A corporation directly or indirectly controlled by the taxpayer,
- A corporation directly or indirectly controlled by a person or group of persons that also controlled the taxpayer,
- A corporation that controlled the taxpayer, or
- A partnership in which the taxpayer was, immediately after the sale, a majority-interest partner.

Paragraphs 20(1)(n) and 20(1)(l) reserves are claimed independently of each other. (The CRA has challenged this treatment based on the view that the gross margin should be reduced by the amount of a paragraph 20(1)(l) reserve in the reserve formula).

When a partnership that was claiming a reserve under paragraph 20(1)(n) dissolves and subsection 98(5) applies (the business of the partnerships carried on as sole proprietorship), the former partner who carries on the proprietorship may continue to claim the reserve, provided the sole proprietor is responsible for the original obligations.

Characterization of Gain From Sale on Account of Income or Capital

In paragraph 3 of Interpretation Bulletin IT 218R, the CRA lists the factors that the courts have considered when determining whether gains from the sale of real estate are on account of income or capital. These factors are summarized as follows:

- The taxpayer’s intention, both primary and secondary, for the real estate at the time of its purchase and the feasibility of the intention;
- The extent to which the intention was carried out;
- Evidence that the intention changed after the purchase of the real estate;
- The location and zoned use of the real estate;
- The nature of the taxpayer’s business;
- The extent to which borrowed money was used to finance the acquisition of the real estate and the terms of the financing arranged, if any;
- The length of time the real estate was held;
- Whether other persons share interests in the real estate;
- The occupation of the other persons who have an interest in the real estate, their stated intentions and their conduct;
- Factors that motivated the sale of the real estate; and
- Evidence of extensive experience in real estate.

While the courts have considered all of the above factors, the question of motive or intention has been developed the most. In addition to the consideration of the taxpayer’s whole course of conduct while possessing the real estate, the taxpayer’s intention generally influences the court’s finding.

Doctrine of Secondary Intention

As noted above, the taxpayer’s intention, both primary and secondary, is relevant in determining the character of a gain from the sale of real estate.

The doctrine of secondary intention is summarized in paragraph 5 of IT 218R as follows:

A taxpayer’s intention at the time of purchase of real estate is relevant in determining whether a gain on its sale will be treated as business income or as a capital gain. It is possible for a taxpayer to have an alternate or secondary intention, at the time of acquiring real estate, of reselling it at a profit if the main or primary intention is thwarted. If this secondary intention is carried out any gain realized on the sale usually will be taxed as business income.

To be successful under this principle, the Minister must specifically allege that a secondary intention to sell the land in question for a profit was a motivating factor when the property was purchased.
Case Law

Generally, a review of case law is not conclusive in determining capital versus income treatment of a gain on the sale of real estate. Each case is fact specific and the outcome is determined based on the taxpayer’s conduct and intentions while possessing the property.

In fact, there are circumstances, when even the gain on the disposition of shares of a corporation which owned real property was determined to be income from business and not a capital gain.319

In Belcourt Properties Inc. v. The Queen,320 the TCC decided in favour of the taxpayer and recognized that the taxpayer had two distinct business operations (condominium development on income account and rental property on capital account). On the basis of the facts, it was determined that capital gain treatment was appropriate for the disposition of the rental property.

Sale of Condominium Units

Generally, condominium developers allow purchasers to occupy condominium units prior to the registration of the building under the relevant condominium statute. This practice generally involves two closings: one at the time the purchaser occupies the unit (the first closing date) and another at the time of registration of the building (the second closing date).

As set out in Technical Interpretation 9808665, dated October 13, 1998, in light of the decision in 141224 Canada Ltd. v. The Queen,321 the CRA’s view is that, if the vendor does not have the right to the payment of the sale price before the second closing date, the amounts do not have the characteristics of revenue. Thus, these amounts are not taxable until they are legally receivable.322

However, if the seller has a legal right to receive the proceeds at the first closing date, the CRA’s view is that the income from the sale of the condominiums should be reported at the first closing date.

Disposition of Land for No Proceeds

The CRA has stated324 that where parties contract in the normal course of business and property is transferred between the arm’s length parties for consideration that is considerably less than FMV, there is a general inference that the transaction is in the nature of a barter transaction. For the purpose of computing income to the taxpayer at the time of the disposition, the value of what is received has to be taken into consideration.

However, the CRA also expressed the view that they would not challenge the tax treatment when land is transferred by a developer to a municipality in order to obtain a development permit, and any costs incurred for such land are transferred to other lands retained by the developer and expensed as the developer sells the remaining parcels of land.

Disposition of Ecological Land

In Staltari v. The Queen,325 the TCC found that land gifted to a Canadian municipality was capital property and because the land qualified as ecological property, the...
taxable capital gain was equal to zero under the ecological gift provisions in subsection 118.1(1). Notwithstanding that the taxpayer was a real estate broker and developer, as a question of fact, the court concluded that the taxpayer had no primary intention for profit when he purchased the donated land. The court also found that the income tax savings from the non-refundable donation tax credit was not “profit” for purposes of the Act, and therefore, any secondary intention that the taxpayer might have had was not carried out, and was irrelevant to the income source analysis (i.e., capital gain versus business income).

### Donation of Real Estate

Subsection 69(1) deems a donor to have disposed of its property at fair market value. If capital property is donated, recaptured CCA and capital gains may apply. If inventory is donated, a taxpayer should have an income inclusion under subsection 9(1).226


Capital gains are not applicable227 on a gift of ecologically sensitive land228 donated to a qualified donee other than a private foundation.229 The Minister of the Environment, or a person designated by that minister, has to certify that the land is important to the preservation of Canada’s environmental heritage. The Minister will also determine the FMV of the gift and issue a certificate.230

### Disposition of a Partnership Interest to a Tax-exempt or Non Resident Entity—Subsection 100(1)

The rules in section 100 must be considered where, as part of a series of transactions or events, a partnership interest is disposed of to:

- A tax-exempt person;331
- A non-resident person;
- Another partnership to the extent that the interest can reasonably be considered to be held (on acquisition) indirectly through at least one partnership by a person that is tax-exempt, non-resident, or a trust resident in Canada with a direct or indirect beneficiary that is tax-exempt or is a trust and the total FMV of such beneficiaries’ trust interests is greater than 10% of the FMV of all the beneficiaries interests under the trust; or332
- A trust resident in Canada to the extent that the trust can reasonably be considered to have a beneficiary that is tax-exempt, that is a partnership if one or more direct or indirect partners is a tax-exempt person or are trusts and the total FMV of those partner’s interests is greater than 10% of all the interests in the partnership, or that is another trust if one or more beneficiaries of the other trust are a tax-exempt person, a partnership or a trust, and the total FMV of those beneficiaries is greater than 10% of the FMV of all the beneficiaries interests under the other trust.333

The rules in section 100 must also be considered in the event of a dilution, reduction, or alteration of an interest in a partnership if it is reasonable to conclude that one of the purposes of such event was to avoid the application of these rules, and as part of the transaction or series of transactions, there is an acquisition, increase or alteration of an interest in the partnership by a person or partnership specified above.

In such circumstances, the taxpayer’s taxable capital gain is not calculated under section 38, but rather is deemed to be the sum of:

- 50% of the capital gain that is reasonably attributable to increases in the value of any partnership property that is capital property, other than depreciable capital property, held directly or indirectly by the partnership (through one or more partnerships); and
- 100% of the remaining portion of the capital gain.

The purpose of subsection 100(1), is to ensure that the gain, to the extent it represents income that would be fully taxable if the partnership property (e.g., depreciable property or inventory) were sold, instead of the partnership interest, is taxed as ordinary income and not as a capital gain. This provision should not change the computation of the taxable capital gain realized on the disposition of capital property.

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226 Capital vs income treatment is a factual determination. See Staltari v. The Queen (2015 TCC 123) – the taxpayer was a real estate broker and was successful in its argument for capital treatment in donating ecological land.

227 Paragraph 38(1)(a.1) also exempts capital gains of publicly traded securities.

228 Does not apply to land held as inventory. See Technical Interpretation 2009-0330321C6, “Gift of Ecological Land in Inventory,” dated October 9, 2009.

229 See paragraph 38(a.2).


231 A tax-exempt person for the purpose of subsection 100(1) is any person that is exempt from tax under section 149.

232 Mutual fund trusts are not included in the type of persons subject to subsection 100(1).

233 Ibid.
a partnership interest to a tax-exempt or non-resident person, if all the property of the partnership is non-depreciable capital property.

Subsection 100(1) will not apply to a disposition to:

– Another partnership or a trust resident in Canada if tax-exempt entities or non-residents hold less than a 10% interest in the purchasing partnership or trust; or

– A non-resident person if the partnership, immediately before and immediately after the acquisition by the non-resident person, uses the property in carrying on business through one or more permanent establishments in Canada.

Prior to March 29, 2012, subsection 100(1) applied only to dispositions of partnership interests to tax-exempts. It was broadened to dispositions of partnership interests to non-residents occurring on or after that date, except for an arm’s length disposition of a partnership interest made before 2013 where the taxpayer was obligated to dispose of the interest pursuant to a written agreement entered into before March 29, 2012.

In the real estate context, where little recaptured CCA would be realized on the sale of the underlying depreciable property by the partnership, a separate sale of the depreciable assets, with tax payable on the recaptured CCA, may be desirable as a preliminary step. This preliminary asset transaction may eliminate the risk that the capital gain applicable to the depreciable property could be 100% taxable if subsection 100(1) applied.

**Development Project Costs/Costs to Complete**

For large, multiple-phase real estate development projects, such as residential land and housing developments, it is common that substantial costs are incurred after sales are recorded on initial phases. Costs to complete include subdivision amenities (e.g., landscaping, parks, recreation centres) and common costs that are not specific to individual residential lots (e.g., grading roads, utilities and sewers, streetlights).

In determining cost of sales for accounting purposes, real estate developers generally budget and accrue for all direct development costs and the allocable portion of all common project costs (incurred to the date of sale and estimated to be incurred in the future when the entire development is complete).

For income tax purposes, real estate developers generally deduct costs to complete on an accrual basis when such costs can be estimated with a reasonable degree of accuracy. The costs to complete represent future services to be rendered to the land/house buyer under the terms of the purchase agreement in order to finish the development project.

Where land is sold in the course of carrying on a business and the proceeds of disposition are in part payment for the land sold and in part a prepayment for future services, the CRA has stated at the Revenue Canada Round Table at the 1989 Canadian Tax Foundation Annual Conference that a reserve under paragraph 20(1)(m) may be available provided the following conditions are met:

– The costs to be incurred by the taxpayer after the taxpayer’s fiscal year end can be identified.

– The revenue related to the services has actually been received by the taxpayer prior to his fiscal year end.

– The revenue related to the services has been included in the taxpayer’s income pursuant to paragraph 12(1)(a).

Costs to complete which cannot be reasonably estimated or which are uncertain would generally be viewed as contingent and not deductible for income tax purposes (see paragraph 18(1)(e)).

**Real Property Inventory Valuation**

Real property inventory that is not held as an adventure or concern in the nature of trade is valued at the lower of acquisition cost and FMV under subsection 10(1).

Where a taxpayer has “written down” real property inventory on the basis that the FMV is lower than cost, the CRA interprets “cost” within the context of subsection 10(1) as being the original cost. Accordingly, it is the CRA’s view that any subsequent increase in FMV should be reflected in the valuation of inventory in subsequent years unless subsequent FMV exceeds original cost in which case the original cost should be used for inventory valuation.

Alternatively, Regulation 1801 permits valuation of all inventory at FMV. This alternative advances the recognition of profit and may be useful if the taxpayer has losses that are about to expire.
Income of Contractors

The policy for contractors’ income recognition for tax purposes applies to any prime contractor or sub-contractor who is engaged in the construction of a building, road, dam, bridge or similar structure and does not retain title to the structure constructed.338

The general rules for contractors’ income recognition cover the following types of construction contracts:

- Cost-plus;
- Unit-price;
- Fixed-fee; and
- Fixed-total-price (also known as firm-price, fixed-price or lump-sum contracts).

General Rules—Income

The amount of a progress billing, less the holdback if any, becomes receivable and must be included in the contractor’s income when the purchaser or the purchaser’s architect or engineer approves the progress bill for payment.

The aggregate of the holdbacks becomes receivable and must be included in the contractor’s income on the day that is the later of:

- The day on which the architect or engineer issues the final certificate of job completion, and
- The day of expiration of the lien period as stipulated in the applicable provincial statute.

The CRA will allow a contractor to choose to report income for tax purposes by including all amounts that have been billed to the purchaser, even though not approved for payment, provided that the contractor does so consistently from year to year.

When no construction contract exists or when the terms of a contract do not require formal approval of progress billings, the amount billed, net of holdbacks if any, will be considered receivable and included in the contractor’s income.

Any amount actually received in the course of business by a contractor must be included in the contractor’s income for the taxation year under paragraph 12(1)(a).

KPMG Observations

A taxpayer who has recognized the impaired value of significant land inventory may consider the transfer of the land inventory to another person or partnership.337 In this manner, the transferee acquires the land inventory at a new cost amount and the historical cost of the transferor should no longer be relevant for income tax purposes.

If the carrying cost of the land is equal to its FMV, the taxpayer should be able to transfer the land inventory in a non-arm’s length transaction at FMV to another corporation within the group. If the transferor wishes to transfer the land inventory under a protective tax election, the property could be transferred to a partnership under a subsection 97(2) election.

Other transaction costs including land transfer taxes should be considered.

Note: This or any other planning idea should only be acted on with appropriate professional advice after a thorough examination of the particular situation.

237 Under paragraph 96(1)(a), the income of a partnership for income tax purposes is computed as if the partnership was a separate person.

238 See IT-92R2 Income of Contractors for further details.
If the receivable amount relates to a payment in advance for work to be performed at a later date, a reserve under paragraph 20(1)(m) is available, provided that the costs to be incurred after the contractor’s fiscal year end can be identified.

**General Rules—Expenses**

All costs incurred in a taxation year by a contractor in the performance of a contract are deductible in computing income for the year, even though part of the revenue relating to work completed may not be included in income until a subsequent year.

Costs incurred in the year in the performance of a contract include:

- The cost of materials for a contract that have been delivered to the job site, whether put in place or not;
- All other direct and general costs and expenses;
- The gross amount, less holdback if any, of progress billings rendered by a subcontractor to the contractor that have been approved for payment; and
- The aggregate of holdbacks withheld from payments made by a contractor to a subcontractor that are paid or payable in the year by the contractor in accordance with the terms of the appropriate provincial statute or, in the absence of any such statute, the terms of the subcontract itself.

A cost is not considered to have been incurred in the performance of a contract in the year and is not deductible in the year when it is, for example:

- The cost of materials that have been merely ordered for future delivery;
- The cost of materials and supplies that are described in a contractor’s inventory, including those earmarked for a specific contract but not delivered to the job site;
- A holdback withheld by a contractor from a subcontractor if the contractor’s liability to the subcontractor in respect thereof has not been established by the issuance of a required certificate by an architect or engineer; and
- The gross amount of a billing rendered by a subcontractor to a contractor that requires, but has not received, approval prior to payment.

**Fixed Total Price Contracts (Use of “Completion Method”)**

When contracts may reasonably be expected to be completed within two years of their commencement, the CRA allows the taxpayer to take the whole revenue (including holdbacks) from each contract into income in the year in which construction is physically completed.

The CRA accepts the date on which the final engineer’s or architect’s certificate is issued as the date of physical completion.

When the contractor and the owner are not dealing at arm’s length, any unusual delay in the issuance of certificates is examined when deciding the date of completion.

Additions to a job requiring extra work that postpone completion of the job from one taxation year to a later one should be treated as a separate contract.

The contractor is required to adopt the completion method for all short-term contracts and is required to use the same method consistently from year to year.

- The method may be changed to the general method of reporting income but cannot revert to the completion method in a future year.
- The method may be changed from the general method to the completion method, provided the contractor has never previously adopted the completion method.

A contractor using the completion method must defer claiming all the direct costs of that contract incurred in a previous year to the year in which a short-term contract is completed.

A loss on a short-term contract is taken into account only in computing the income of the year in which the contract is physically completed. No provision is allowable in a year prior to that of completion for an anticipated loss on the contract.

**Construction Subcontractor Payment Reporting**

Section 238 of the Regulations requires a person or a partnership, whose business income is derived primarily (more than 50%) from construction activities, to file an information return, reporting all payments made in the course of construction activities. The CRA refers to this reporting as the Contract Payment Reporting System. Payments of less than $500 in the year to a subcontractor do not have to be reported.

“Construction activities” include the erection, excavation, installation, alteration, modification, repair, improvement, demolition, destruction, dismantling or removal of all or any part of a building, structure, surface or subsurface, construction, or any similar property. Ongoing maintenance is not included.

The CRA has stated that “derived primarily from those [construction] activities” could be interpreted broadly to include a real estate developer that derives
more than 50% of its business income from the construction of buildings or condominium units for sale.339

This reporting excludes:

– Goods for sale;
– Lease payments;
– Wages paid to employees;
– Payments made to non-residents for property income under Part XIII of the Act; and
– Payments for services rendered outside Canada by non-resident persons.

This reporting includes amounts “paid or credited” and therefore includes the fair market value of bartered goods and/or services. GST, HST and provincial sales taxes may be included in the total reported amount of payment.

The reporting period may be on a calendar year or fiscal year basis, but the payments must be reported on Form T5018 within 6 months from the end of the reporting period. Once a reporting period has been chosen, it can only be changed with the authorization of the Minister of National Revenue.

A penalty of $5 – $25340 per day, with a minimum penalty of $100 up to a maximum of $2,500 – $7500341 can be levied for each failure to file a T5018 information return. The CRA has an administrative policy to charge a $100 flat penalty if there are 5 or fewer contractor slips reported.

There is a requirement to electronically file the returns if there are more than 50 information slips.

Financial Difficulties

Various provisions in the Act can apply when a debt owing is forgiven by the creditor. These provisions apply in the following order:

1. Section 78—Unpaid Amounts—The most relevant part of this section in a real estate context is subsection 78(1), which can apply when a deductible expense (e.g., interest) is owing to a non-arm’s length person and remains unpaid. It provides that the debtor will have an income inclusion of such an unpaid amount in the third year after the expense was incurred, unless an election is made in the debtor’s return of income for that year to have the unpaid amount recharacterized as a loan.

– Subsection 78(2) applies to cause an income inclusion when a corporation owes an amount to a non-arm’s length party in respect of a deductible expense at the time the corporation is wound up; and
– Subsection 78(4) applies to deny a deduction for remuneration expense when it is unpaid for more than 179 days after the year in which the remuneration expense was incurred.

Subsections 6(1) and (15)—These subsections apply to deem an employment benefit when an employee’s debt to his or her employer is forgiven.

Subsections 15(1) and (1.2)—These subsections apply to cause an income inclusion where a shareholder’s loan is forgiven.

Section 9—This section applies where the debtor is required to include the forgiven amount in income for accounting purposes.

Section 79—Discussed in detail below.

Section 80—Discussed in detail below.

Section 79 – Foreclosure/Repossession

Section 79 applies when a creditor acquires property from:

– A debtor, or
– A purchaser under a conditional sales agreement who has failed to pay an amount owing to him or her.

The acquisition may take place by means of:

– A foreclosure order obtained through a court;
– Repossession under a conditional sales agreement; or
– A quit claim.

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340 Penalty per day varies based on the number of contractor slips reported.

341 Maximum penalty varies based on the number of contractor slips reported.
Section 79 does not apply where the creditor purchases property from the debtor merely in anticipation of the debtor’s default or where the debtor’s property is disposed of to a third party pursuant to a power of sale.

The acquisition of the property by the creditor results in a disposition to the debtor, and subsection 79(3) contains a formula that determines the debtor’s proceeds on such disposition. In general terms, the debtor’s proceeds are equal to the amount of debt (including interest) owing on the property that ceases to be owing as a consequence of the property being surrendered.

Section 79.1—Creditor’s Cost of Property Acquired On Foreclosure/Repossession

Section 79.1 sets out the tax consequences to a creditor where property has been acquired or reacquired as a consequence of a debtor’s failure to pay an amount owing to the creditor.

In general, the creditor’s deemed purchase price of the property acquired equals the principal amount owed by the debtor less any reserves (e.g., paragraph 20(1)(n), paragraph 40(1)(a)(iii)) claimed by the creditor with respect to the property in the immediately preceding year.

The amount of a reserve from the prior year to be included in current-year income is reduced by the amount of such reserve that is applied against the creditor’s cost of property reacquired.

There is a potential trap regarding a vendor take-back mortgage on inventory property. Where a vendor take-back mortgage has been accepted as consideration for the sale of a property and, in the same year, the creditor repossesses the property, the creditor is not able to claim or reserve on the sale. Accordingly, the creditor may end up in the anomalous situation of having to recognize a gain for tax purposes without actually realizing an economic gain. However, where the property was capital property to the creditor, subsection 79.1(5) will adjust the original proceeds of disposition by the amount of the unpaid proceeds at the time of reacquisition. No such relief exists for inventory property.

Section 80 – Debt Forgiveness

The debt forgiveness provisions in section 80 apply when a commercial debt obligation is settled for an amount less than the principal amount. For this purpose, unpaid accrued interest is considered a debt with a principal amount equal to the unpaid interest.

A commercial debt obligation is a debt obligation on which interest was actually paid or payable under a legal obligation, or, if interest had been paid or payable under a legal obligation, such interest was, or would have been, deductible in determining taxable income earned in Canada.

When the terms of a debt are changed so dramatically that a new obligation has been constructively created, section 80 may apply.

Where a debt is settled for an amount less than the amount owing, the excess of the principal amount over the settlement amount is a “forgiven amount.”

**Application of the Forgiven Amount**

The forgiven amount of a commercial debt obligation is applied to reduce the following tax attributes in order, until absorbed:

- Non-capital losses of the taxpayer (see subsection 80(3));
- Capital losses (see subsection 80(4));
- UCC of depreciable capital property (see subsection 80(5));
- Unamortized cumulative eligible capital (see subsection 80(7));
- ACB of non-depreciable capital property (see subsection 80(9));
- ACB of certain shares and debt (see subsection 80(10));
- ACB of certain shares, debt and partnership interests of related entities (see subsection 80(11)); and
- Capital losses realized in the year of forgiveness (see subsection 80(12)).

**Income Inclusion**

If any unapplied forgiven amount remains after the above applications, an amount is included in the taxpayer’s income (subsection 80(13)).

The income inclusion would be 50% of the unabsorbed forgiven amount plus 50% of any reduction under subsection 80(11) to the extent that the designated forgiven amount was not applied to the tax attributes of the related entities.
The income inclusion is generally limited to twice the FMV of the taxpayer’s net assets (an insolvency exception).

Section 61.3 allows a reduction in the amount otherwise included in income under subsection 80(13). The reduction is the inclusion less twice the taxpayer’s net assets, determined by deducting its liabilities from the FMV of its assets.

Assuming a 50% tax rate, a sale of all of the remaining assets would generate just enough cash to pay the tax resulting from the debt forgiveness inclusion. The formula in section 61.3 assumes that the ACB of assets will have been ground to zero through application of the forgiven amount.

Section 61.3 does not apply when property was transferred in the 12-month period before the year-end, or the corporation became indebted in that period, when one of the reasons for the transfer or the indebtedness was to increase the amount of the reduction.

**Transfer of Forgiven Amount to Related Person**

Section 80.04 allows a debtor to transfer the remaining unapplied forgiven amount (immediately before the income inclusion but after the application of subsections 80(5) to (10)) to certain related persons. The transferred amount becomes a forgiven amount of the transferee to which section 80 applies. The transfer of unapplied forgiven amounts avoids any income inclusion in the debtor’s hands and applies the forgiven amount to the tax attributes of the transferee, in the same order as would be the case for the transferor.
Non-residents Investing in Canadian Real Estate
Common Ownership Structures

Common ownership structures for non-residents investing in Canadian real estate include corporations, partnerships or trusts.

(i) Corporation

Non-Resident Investor

Foreign Corporation

Foreign Country

Canada

Real Estate

Advantages

- Income tax rate should be lower than the Canadian income tax rate payable by a trust.

Disadvantages

- Generally no flow-through of Canadian losses to home country.

Advantages

- Income is taxed only at Canadian marginal tax rates (i.e., as low as 15% federally plus relevant provincial tax or Federal surtax).
- Losses of the partnership flow through to the investor (subject to the at-risk rules), however, if the losses are from property (i.e., not business losses) the losses are not available to shelter future income.
- If certain financial thresholds are not met,342 and the partnership does not carry on business in Canada, a partnership information return is not required.

Disadvantages

- A capital gain is triggered when the cost basis of the limited partnership interest becomes negative and, under 2016 proposed amendments, the taxable capital gain is included in taxable income earned in Canada by a non-resident person.
- Thin capitalization restrictions apply.
- Tax rates for an individual are much higher than a corporation.

Non-Resident Investor (individual)

Foreign Partnership

Foreign Country

Canada

Real Estate

342 A partnership information return must be filed if:
- At the end of the fiscal period, the partnership has an absolute value of revenues plus an absolute value of expenses more than $2 million, or has more than $5 million in assets; or
- At any time during the fiscal period, the partnership is tiered, the partnership has a corporation or trust as a partner, the partnership invested in flow-through shares of a principle-business corporation that incurred Canadian resource expenses and renounced those expenses to the partnership, or the minister of National Revenue requests one in writing.
Two general tests have emerged from case law:

- Range of services—an assessment of the extent of services offered by the owner and whether such services are over and above those normally associated with the use of the property.
- Level of activity—an assessment of the amount of activity of the owner and implications of rental relative to other activities and income of the owner.

According to the CRA, important factors to consider include:

- The degree of activity expended by the taxpayer in earning the income (i.e., time, attention and labour); and
- The extent and nature of the services provided to the tenants.

The real estate owner’s delegation of its management and supervision to an agent/property manager does not alter the nature of the rental income (i.e., for purposes of the business vs. property determination, the CRA will consider the activities to have been carried on by the owner).

The CRA appears to generally assume that rental income is income from property unless the facts suggest otherwise.

See Interpretation Bulletins IT 420R3, “Non-residents—Income Earned in Canada” (Archived) and IT 434R, “Rental of Real Property by Individual” (Archived).

**KPMG Observations**

A head-lease arrangement may be used to increase the likelihood that rental income will be considered property income.

**Business Income**

Non-residents carrying on a business in Canada are subject to Canadian Part I income tax on the income earned in Canada and may also face the tax implications outlined below.

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**Advantages**

- N/A

**Disadvantages**

- Alternative minimum tax may apply.
- High rates of tax.
- Losses cannot be allocated to the beneficiary.
- Where the central management and control of the Foreign Trust can be considered to be exercised in Canada, the Foreign Trust may be deemed to be resident in Canada.\(^{343}\)

**Business Income vs. Property Income**

The starting point for the Canadian tax analysis of a non-resident’s investment in Canadian real estate is to determine whether the real estate investment will give rise to income from a business carried on in Canada or income from property. This determination is a question of fact (not a question of law).

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\(^{343}\) Income Tax Folio S6-F1-C1: Residence of a Trust or Estate and the Supreme Court decision in Fundy Settlement v. Canada.
Branch Tax

If the non-resident is a corporation, branch tax also applies on amounts not reinvested in businesses carried on in Canada.

Just as distributions of profit earned by a Canadian resident corporation are subject to non-resident withholding tax, branch tax applies to the after-tax profits earned by a branch of a non-resident corporation earning business income in Canada. The Canada-US tax treaty344 exempts the first $500,000 (Cdn) of profits from branch tax and reduces the branch tax rate to 5% (from 25%).

Waiver for Withholding Tax

While normally non-resident withholding tax is required on rents paid to a non-resident, a tenant is not required to withhold tax on its payments to a non-resident, where a waiver under Regulation 805 is obtained from the CRA.

The waiver is granted at the discretion of the CRA once it is satisfied that an amount is not taxable under Part XIII (i.e., the non-resident is carrying on a business in Canada through a permanent establishment (“PE”)).

Income Tax Rates

2016 tax rates range as follows:

- Corporation 26% – 31%   + branch tax (higher if provincial abatement is not available)
- Individual 19% – 54%
- Trust 39% – 54%

Property Income

Tax on Gross Rents

A non-resident that earns rental income in Canada that is not considered to be earned from carrying on a business is subject to a 25% withholding tax under Part XIII (unless reduced by a tax treaty) on the gross amount of rents paid or credited, pursuant to paragraph 212(1)(d).

Tenants making such rental payments to the non-resident are required to withhold and remit the tax to the CRA under subsection 215(1). However, often this responsibility (but not the obligation) is assumed by a property manager. If the tenant made the rental payments without withholding the tax, the agent is liable to withhold and remit the tax on behalf of the non-resident by virtue of per subsection 215(3).

Withholding tax on rents must be remitted to the CRA on or before the 15th day of the month following the month in which the tenant paid its rent.

Tax On Net Rents/Filing Canadian Tax Returns

A non-resident can file Form NR6, “Undertaking to File an Income Tax Return by a Non-Resident Receiving Rent from Real Property or Receiving a Timber Royalty” with the CRA and file a Canadian income tax return under subsection 216(4) to have tax computed on the net rental income at normal tax rates, rather than paying Part XIII withholding tax.

Form NR6 is due on or before the first day of each taxation year or when the first rental payment is due.

After Form NR6 is approved by the CRA, the non-resident is allowed to remit withholding tax based on the budgeted “net rents available” (i.e., net rental income before CCA) instead of the gross rental income.

The subsection 216(4) return must be filed within six months from the end of the non-resident’s taxation year. The CRA can extend the six month deadline under 220(3). The difference between the actual tax payable, which is computed based on net rental income (after CCA), and tax withheld throughout the year, which is based on budgeted “net rents available,” results in a balance owing or a refund, as applicable.

If a non-resident does not file Form NR6, withholding taxes must be calculated based on 25% of the gross rent. However, the non-resident still has the option to file an income tax return pursuant to subsection 216(1) within two years after the end of the taxation year to have the final tax liability computed on net rental income for the applicable year and recover excess tax paid.

When the Canadian agent files Form NR6, but the non-resident does not file a subsection 216(4) return by the six month deadline, the CRA will assess the agent and full 25% withholding requirements on the gross rental income, plus interest.

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Branch Tax

If the non-resident is a corporation, branch tax does not apply to income from property or the taxable capital gain on the disposition of real or immovable property situated in Canada that is not used by the taxpayer in a business carried on in Canada.

Partnership Implications

Non-resident Partners

A partnership that is not a Canadian partnership (as it has a non-resident partner) is deemed to be a non-resident person for purposes of withholding tax under the Act (subsection 212(13.1)).

Accordingly, certain types of payments (e.g., rent, interest, dividends) made to such a non-Canadian partnership may be subject to Part XIII withholding tax. As the Act does not provide any look-through relief for any Canadian partners of such a partnership, this leads to the anomalous requirement that Part XIII tax be withheld in respect of the portion of the payment applicable not only to the non-resident partner(s) but also to the Canadian partner(s).

This interpretation was confirmed by the CRA in paragraph 7 of Interpretation Bulletin IT-81R, “Partnerships—Income of Non-Resident Partners,” dated May 6, 1976 (Archived), in which the CRA indicated that any such tax withheld in respect of the Canadian resident would be credited against the Canadian resident’s tax otherwise payable. However, the CRA may grant relief from the requirement to withhold in respect of the Canadian partner(s) with a written request for withholding relief.

For partnerships, each non-resident partner is required to file Form NR6.

Use of Losses

Net losses from rental operations (that is filed as property income) can only offset income from the same year from other Canadian real estate. Unused losses are not available for carryforward for the purpose of calculating income under subsection 216(1).

Provincial Tax

If the non-resident corporation does not have a PE in Canada, double taxation may arise as the provincial abatement for federal tax purposes is only available if the non-resident has a PE in Canada. Land itself may not constitute a PE under Regulation 400. Without a PE, the provincial abatement will not be available for federal tax purposes yet provincial tax may still apply.

Income Tax Rates

2016 tax rates:

- Corporation 28% (higher if provincial tax also applies)
- Individual 22% – 49%
- Trust 49%

Interest

Withholding Tax

Paragraph 212(1)(b) provides generally that a withholding tax of 25% (unless reduced by a tax treaty) shall be paid on (i) interest paid by “a person resident in Canada” to a non-arm’s length non-resident, or (ii) participating interest paid to a non-resident. Prior to January 1, 2008, paragraph 212(1)(b) was much broader in scope and applied to all cross border interest payments including interest paid to an arm's length non-resident. Exceptions, however, were available in certain circumstances.

Participating debt interest is defined in subsection 212(3).

Withholding tax is also required when a non-resident pays interest to another non-resident in the following situations:

- When interest on a mortgage secured by real property situated in Canada is paid, to the extent the interest is deductible in computing the non-resident person's taxable income (see paragraph 212(13)(f));
- When a partnership pays or credits an amount to a non-resident person, the partnership shall, in respect of the portion that is deductible, be deemed to be a person resident in Canada (see paragraph 213(13.1)(a)); and
- When the interest is deductible by the payer in computing its income from a business carried on principally in Canada (see subsection 212(13.2)).
Withholding tax deducted from interest payments must be remitted to the CRA on or before the 15th day of the month following the month in which the non-resident withheld the tax (i.e., the time of the interest payment).

Pursuant to the 5th Protocol of the Canada-US Tax Treaty, which was ratified on December 15, 2008, the rate of withholding tax applicable to interest paid to non-arm’s length non-residents is reduced to 0% for 2010 and onwards.

**Thin Capitalization Rules**

The thin capitalization rules are intended to prevent non-residents from financing Canadian operations with excessive debt, the interest on which is deductible from the Canadian tax base, rather than financing with equity. The thin capitalization rules apply to corporations and trusts. For taxation years that began before 2014, the rules applied only to corporations.

The deduction for interest on debt owing to certain “specified non-residents” ("SNR") is disallowed when the corporation’s or trust’s debt-to-equity ratio in relation to the SNR exceeds 1.5:1. (For taxation years that began before 2013, the ratio was 2:1).

In the context of a corporation, SNRs are non-residents which, alone or together with non-arm’s length persons, own either:

- 25% or more of the voting shares of the corporation; or
- Shares having a FMV of 25% or more of the FMV of all the issued and outstanding shares of the corporation;

and includes a non-resident person who does not deal at arm’s length with such a shareholder.

For purposes of determining whether the share ownership test is satisfied, certain rights to acquire shares, to control voting rights of shares or to cause a redemption of shares must be taken into account.

In the context of a trust, SNRs are non-resident beneficiaries who, alone or together with non-arm’s length persons have interests as a beneficiary under the trust with a FMV not less than 25% of the FMV of all interests as a beneficiary under the trust and includes a non-resident person who does not deal at arm’s length with such a beneficiary. As in the case of shareholders, for purposes of determining whether the 25% FMV test is satisfied, certain contingent rights and discretionary rights must be taken into account.

The portion of the interest disallowed as a deduction is determined as follows:

\[
\text{Average outstanding interest-bearing debt to SNRs} = \frac{1.5 \times \text{average paid-up capital of the corporation at the beginning of each calendar month ending in the taxation year contributed by SNR shareholders; and}}{
\text{Average contributed surplus at the beginning of each calendar month ending in the taxation year of all shares of all classes owned by SNR shareholders of the corporation.}}
\]

Debt only includes interest-bearing debt, the interest of which would otherwise be deductible to the taxpayer (i.e., notwithstanding subsection 18(4)).

The average outstanding debt to a SNR is calculated as the average of the highest amount of debt owing to a SNR for each calendar month ending in the taxation year.

Equity of a corporation includes:

- The retained earnings (excluding deficits) at the beginning of the year;
- The average contributed surplus at the beginning of each calendar month ending in the taxation year contributed by SNR shareholders; and
- The average of the paid-up capital of the corporation at the beginning of each calendar month ending in the taxation year of all shares of all classes owned by SNR shareholders of the corporation.

Equity of a trust includes the total of the equity contributions to the trust by SNR beneficiaries; and the tax-paid earnings of the trust for the year, exceeding the average of all amounts which became payable by the trust to a beneficiary of the trust.

Equity of a corporation or trust that is not resident in Canada is 40% of the amount by which the average monthly cost in the year of property used in the Canadian business exceeds the average monthly debts owing other than debt owed to SNRs. Overall the equity amount is reduced to (1.5 x 40%):1.

In addition, the thin capitalization rules include the following rules:

- These rules will be expanded to apply to debts owed by partnerships of which a Canadian resident corporation or trust is a member. In this situation, the debt of the partnership will be allocated to its Canadian resident corporate members based on their proportionate interest in the partnership. These debts will then be included in the corporation's or trust's debt-to-equity ratio under the thin capitalization rules. Where this calculation results in an amount of non-deductible interest that is related to the debt allocated from the partnership, an amount equal to the interest on the portion of the allocated partnership debt that exceeds the permitted debt-to-equity ratio will be required to be included in

\[
\text{Interest expense relating to debt owing to SNRs} = \frac{\text{Average outstanding interest-bearing debt to SNRs}}{1.5 \times \text{company's or trust's equity in relation to SNRs}}
\]
computing the income of the Canadian resident taxpayer. The inclusion will be treated as either business or property income determined by the source against which the interest is deductible at the partnership level.

- The disallowed interest expense from the application of the thin capitalization rules is also recharacterized as a dividend for non-resident withholding tax purposes. This recharacterization includes any amount required to be included in computing the income of a corporation in respect of a disallowed interest expense of a partnership.

- Any disallowed interest expense of a corporation or trust will be allocated to SNRs in proportion to the corporation's or trust's debt owing in the taxation year to all SNRs, including debts owing by the partnerships of which a corporation or trust is a member. Withholding tax will then apply to the deemed dividend allocation. Withholding taxes on deemed dividends are due when applicable withholding taxes on interest payments are otherwise due. The corporation or trust may allocate the disallowed interest expense to the latest interest payments made to any particular SNR in the taxation year. Where the interest expense has not been paid by the end of the taxation year, the disallowed interest expense will be deemed to have been paid as a dividend to that SNR at the end of the taxation year.

- The thin capitalization rules will not include the interest expense of a Canadian-resident corporation that relates to interest that is taxable to the Canadian resident corporation as Foreign Accrual Property Income of a controlled foreign affiliate of the corporation. The potential for double taxation is thereby eliminated.

- Thin capitalization rules have been expanded to include back to back loan arrangements. The rules now apply when there is an arm's length intermediary between a resident payer and a SNR and the following conditions are met:
  - The taxpayer has an amount outstanding as debt owing to an intermediary;
  - An intermediary deals at arm's length with the taxpayer and;
    - Has an amount outstanding to a SNR;
    - Recourse in respect to the debt is limited; and
    - Receives a loan from a SNR with a condition that the loan be made to the taxpayer.
  - The total FMV of the debt or loan is at least 25% of the amount owing to the intermediary.

Where these conditions apply, the taxpayer will deemed to have paid interest to SNR equal to the portion of the interest paid or payable by the taxpayer on the amount owing to the intermediary.

**Capitalized Interest Not Subject to Non-resident Withholding Tax**

Interest paid to non-arm’s length non-residents is generally subject to withholding tax (subject to the exemptions under the 5th Protocol to the Canada-US Treaty).

Non-residents may not be subject to Canadian income tax withholding and remittance obligations in certain circumstances, based on the TCC decision in Easter Law Trust (2004 TCC 689). This or any other planning idea should only be acted upon with appropriate professional advice after a thorough examination of the particular situation.

In this case, a non-resident taxpayer was involved in a Canadian real estate development joint venture project. The CRA assessed the non-resident taxpayer Part XIII withholding tax at 25% on $2.4 million of interest paid to a non-resident lender. This interest was capitalized by the taxpayer as required during the construction period.

The TCC found that the taxpayer was not liable for the Part XIII tax because the capitalized interest was not deducted in computing the taxpayer’s taxable income but was instead included in the taxpayer’s cost of goods sold.

The TCC found that an amount included in the cost of inventory is a component of the taxpayer’s gross profit but is not considered to be “deductible” from taxable income earned in Canada for purposes of subsection 212(13.2).

**Non-Resident Disposition of Canadian Real Property**

For dispositions after March 4, 2010, TCP as defined in section 248 generally includes the following:

- Canadian real or immovable property;
- Canadian business property used in carrying on a business in Canada;
- Designated insurance property belonging to an insurer;
- Shares of corporations that are not listed on a designated stock exchange, an interest in a partnership, or an interest in a trust, if at any time in the previous 60
month period, more than 50% of the fair market value of the shares or interest was derived from one or any combination of the following sources:\textsuperscript{346,346}:

- Canadian real or immovable property;
- Canadian resource property;
- Timber resource property; and
- Options or interests in any of the above.

Shares of corporations listed on a designated stock exchange, a share of a mutual fund corporation or unit of a mutual fund trust, that at any time in the previous 60 month period satisfied both of the following conditions:\textsuperscript{347}

- 25% or more of the issued shares of any class, or 25% or more of the issued units, belonged to the taxpayer and persons with whom the taxpayer did not deal at arm’s length; and
- More than 50% of the fair market value of the shares or interest was derived from one or any combination of the following sources:
  - Canadian real or immovable property;
  - Canadian resource property;
  - Timber resource property; and
  - Options or interests in any of the above; and

An option or interest in any property listed above (whether or not the property exists).

The CRA considers the assignment of a right to purchase Canadian real estate to be a disposition of TCP:\textsuperscript{348} Such conclusion is supported by section 253 which deems the disposition of an option in real property to be a business carried on in Canada.

Recaptured CCA and capital gains earned by non-residents on dispositions of TCP are taxable in Canada.

When TCP is acquired from a non-resident, the purchaser is required to withhold 25% of the gross proceeds for non-depreciable capital property (50% of gross proceeds for inventory and depreciable property) unless the purchaser has taken steps to establish that the vendor has paid the tax or provided security for the tax.

Under current law, where a negative ACB deemed capital gain is realized by a non-resident on a limited partnership interest and the partnership interest would be considered TCP, the deemed gain is not considered a disposition of TCP. The non-resident is still required to file a Canadian tax return in respect of the capital gain, but no taxes would be payable. However, draft legislation was released in 2016 that would require the non-resident to include the gain under subsection 2(3) of the Act. These changes clarify that this deemed gain is subject to tax in Canada (unless the property is treaty protected, in which case, the deemed disposition will qualify as an excluded disposition for the purposes of section 150).

In proposed legislation, new subsections 87(8.4) and (8.5) allow tax-deferred rollover treatment for dispositions of TCP that are shares of a Canadian-resident corporation, if the disposition results from a foreign merger that meets the following conditions:

- There is a foreign merger of two or more predecessor foreign corporations that were, immediately before that time, resident in the same country and related to each other;
- Because of the foreign merger, a predecessor foreign corporation disposes of TCP that is a share of a corporation resident in Canada, and the subject share becomes property of a corporation that is a new foreign corporation;
- No consideration other than shares of the new corporation are received;
- The corporation resident in Canada is not—at any time in the 24-month period ending after that time, as part of a transaction or series of events—subject to a loss restriction event; and
- The new foreign corporation and the disposing predecessor foreign corporation jointly elect tax-deferred treatment under subsection 87(8.4) and (8.5).

The purpose of this is to provide a tax-deferred rollover on a disposition of shares of merging foreign corporations, not on property owned by the merging foreign corporations.

\textsuperscript{345} At the CRA Round Table at the 2011 Canadian Tax Foundation Annual Conference, the CRA stated whether a share derives its value principally from real or immovable property situated in Canada should be made by reference to the value of the properties of the company without taking into account its debts or other liabilities. This new gross asset value test will initially be applied to dispositions of properties acquired after 2011 and generally for dispositions of property after December 31, 2012.

\textsuperscript{346} When a non-resident disposes of shares of a parent corporation that has a subsidiary, the FMV of the shares of the subsidiary must be determined. Amendments are proposed in August 27, 2010 draft legislation to ensure that the indirect look-through rule does not extend through shares or other interests of the above.

\textsuperscript{347} At the CRA Round Table at the 2011 Canadian Tax Foundation Annual Conference, the CRA stated that both tests must be satisfied at the same time when determining whether a share listed on a designated stock exchange is TCP at any particular time during the 60-month period.

Section 116 Certificate of Compliance

To provide the purchaser with evidence to eliminate or reduce his or her withholding obligation, the vendor will have to apply to the CRA for a Section 116 Certificate of Compliance by filing Form T2062, “Request by a Non-Resident of Canada for a Certificate of Compliance Related to the Disposition of Taxable Canadian Property.” Form T2062A, “Request by a Non-Resident of Canada for a Certificate of Compliance Related to the Disposition of Canadian Resource or Timber Resource Property, Canadian Real Property (Other than Capital Property), or Depreciable Taxable Canadian Property” will also have to be prepared and filed for the disposition of depreciable TCP.

Forms T2062 and T2062A require the non-resident vendor to state the name and address of the purchaser, the date of the transaction, a description of the property, and the expected gain and recapture of CCA as a result of the disposition.

The request may be made in advance of the transaction at least 30 days before or no later than ten days after the transaction.

Before the CRA will issue a certificate of compliance, the non-resident vendor is required to make payment or post security on account of tax. The amount of payment/security for capital gains is equal to 25% of the capital gain. The amount of payment/security for recaptured CCA is computed at the non-resident federal tax rates applied to the amount of recapture.

Failure to comply with section 116 may result in a penalty pursuant to subsection 162(7) plus any applicable interest, and/or imprisonment.

A Part I return must be filed for the year of disposition to report the amount of the actual capital gain from the disposition. Some non-residents may also have to file a subsection 216(1) return to report the amount of recaptured CCA from the disposition and any rental income earned from TCP during the year.

A non-resident vendor that holds land located in Canada as inventory and obtains a “qualified business exemption” letter from the CRAs local tax service office does not need to acquire a clearance certificate. The vendor should provide a copy of the letter to the purchaser in order to have no taxes withheld under section 116 of the Act.

Dispositions of taxable Quebec property as defined in section 1094 of the Quebec Taxation Act are subject to an additional withholding of 12%.

As a result of recent legislative changes (subsections 116(5.01) and (5.02)), the section 116 certificate of compliance procedures have been simplified for post-2008 dispositions.

The legislative changes provide that the requirement to withhold tax and obtain a clearance certificate will be eliminated where:

– The purchaser has made reasonable efforts to determine that the vendor is a resident of a country that has a tax treaty with Canada;
– The gain on the disposition is exempt from tax under a tax treaty with Canada; and
– A notice setting out the particulars of the transaction is filed with the CRA by the purchaser within 30 days of the disposition. This notice obligation can be satisfied by submitting Form T2062C, “Notification of an Acquisition of Treaty Protected Property from a Non-Resident Vendor”.

However, transactions involving real estate (the disposition of either the real estate or an entity which derives its value from real estate) will not qualify for the simplified procedures.

Non-Resident Tax Compliance

When rental income is considered income from property and the non-resident wishes to reduce withholding tax on rent receipts, the non-resident must file forms and returns according to the following schedule:

**Before the beginning of year**—Form NR6 is filed as an undertaking that the non-resident will file a tax return. Form NR6 includes an estimate of net rental income, excluding depreciation and other non-cash expenses.

**Within three months after end of the calendar year**—Form NR4 is filed to report the amount of non-resident withholding tax credited to the non-resident during the calendar year.

**Within six months after year end**—A section 216 return is filed to report the amount of non-resident withholding tax remitted (Form NR4) and the Part I income tax liability (section 216 return) will result in a refund or balance owing to the non-resident.
The appropriate income tax returns must be filed as follows:

Individuals  
Form T1159 (simplified T1 personal income tax return)

Corporations  
T2 return

Trusts  
T3 return

**Services Rendered in Canada**

Under Regulation 105, every person who pays a fee, commission or other amount to a non-resident person for services rendered in Canada of any nature whatever is required to withhold and remit 15% of such a payment to the CRA.

If the service is rendered in Quebec, a further 9% must be withheld and remitted.

The Canadian tax withheld on payments to non-residents does not represent the final Canadian tax liability but is considered to be a tax instalment of the non-resident. As such, non-residents must determine whether they are taxable in Canada and are required to file a tax return after the end of each calendar year.

The CRA may grant a waiver when it is established that a non-resident is not subject to Canadian tax or, if it is, when the ultimate tax liability would be lower than the withholding tax.

Generally any person paying remuneration is an employer and is required to withhold taxes under Regulation 102. A withholding exemption is available as of 2016 under 153(1)(a)(ii) for payments made by a “qualified non-resident employer” (“QNEr”) to a “qualified non-resident employee” (“QNEe”). To qualify as a QNEr, the non-resident employer will apply to the CRA to be certified using form RC 473. To qualify as a QNEe the following conditions must be met:

– Is resident in a country with which Canada has a tax treaty at the time of the payment;
– Is not liable to tax on the payment because of a provision in the tax treaty; and
– Either works in Canada for less than 45 days in the calendar year that includes the time of the payment, or is present in Canada for less than 90 days in any 12-month period that includes the time of the payment.

The new process replaces the more complicated Regulation 102 waiver.
U.S. Vacation Property
U.S. Vacation Property

Canadians holding US real estate, shares in US corporations, or other “US situs” assets at the time of their death are generally subject to US estate tax at rates of up to 40% of the gross value of such assets. The Treaty significantly reduces the US estate tax impact for many Canadians holding US property—generally those with total estates under US $5.45 million (or $10.9 million if married and property transferred to a spouse on death). The Canada-US Treaty does not provide complete relief for larger estates as the maximum credit must be pro-rated by the value of the individual’s US estate over the value of his or her worldwide estate. Canadians are also generally subject to US gift tax if they gratuitously transfer certain US situs assets.

The first step for Canadians who own or are acquiring US real estate is to determine the potential exposure to US estate tax. In many cases, there will be no or limited exposure on the death of the first to die. In cases where the exposure is significant, the following alternatives should be considered for the ownership of the property. Some structures can be used for property already owned and others only for new purchases.

The following section reviews some planning ideas to reduce the exposure to US estate tax for Canadians who are not US citizens. These or any other planning ideas should only be acted upon with appropriate professional advice after a thorough examination of a particular situation.

Ownership by Spouse with Lower Net Worth

An individual Canadian resident with an estate valued at less than US $5.45 million will not be subject to US estate tax. The formula in Article XXIX-B of the Treaty pro-rates this unified credit with the result that there is no US estate tax liability if the Canadian decedent has worldwide assets of less than $5.45 million in 2016. Transfers of assets between spouses can be undertaken to ensure that the spouse acquiring the US property has worldwide assets below the threshold. The Canadian attribution rules must be taken into consideration when transferring assets between spouses. The spouse acquiring the property should use their own funds (not funds gifted from the spouse) in order to avoid potential gift tax.

Joint Ownership

Where property is held as joint tenants with right of survivorship, probate is not applicable on the death of the first joint tenant to die. For US estate tax purposes property held as joint tenants is deemed to be 100% owned by the first joint tenant to die unless the executor can prove that the surviving joint tenant paid for their interest with their very own funds. This rule does not apply if the property is owned by spouses who are both joint tenants. If each spouse paid for their share of the property with their own funds then only their share will be subject to estate tax on the death of the first to die. The survivor will own the entire property after the death of the first to die and may need to undertake some additional planning at that time.

Split Interest

US estate tax is reduced if there is a split interest ownership of the property. Under such an arrangement, an individual acquires a life interest in US property, and his or her children acquire the remainder interest in the property. The children must have their own funds to invest (not gifted from their parents). On the death of the individual, there would be no estate tax on the life interest, since the life interest would have no value upon death. However, should the children die while holding a remainder interest, the estate tax would be assessed on the value of the remainder interest. The children may consider obtaining term life insurance to fund any estate tax exposure.

A split interest arrangement usually may result in significant complexities. However, the tax savings may be worthwhile for certain family situations.

Non-recourse Debt Financing

A non-recourse mortgage outstanding on US real estate reduces the value of the property included in an individual’s taxable estate. A non-recourse mortgage is one that entitles the lender to have recourse only against the property mortgaged. If an individual defaults on payment, the mortgaged property can be seized, but there will be no further liability if the value of the property does not satisfy the debt. Most US lenders are reluctant to provide a mortgage on a non-recourse basis to
Canadians and will only lend 50% of the value of the property. Consequently, it may be necessary to seek other sources of financing.

One possible source of non-recourse financing may be a spouse. For example, assume a wife has $1,000,000 of cash available for investment. Instead of investing directly, she could loan her husband $1,000,000 on a non-recourse basis to acquire a property with a value of $2,000,000 (the remainder of the funds coming from him). Should he die, the net value subject to estate tax would be $1,000,000, since he will deduct the non-recourse debt from the value of the property situated in the US. If she dies, there will be no value in the estate since the loan is not property situated in the US.

In order to be respected as true debt, the debt should be registered and have commercial characteristics such as a market rate of interest and repayment terms. The loan to value ratio must also reflect arm’s length standards. An estate return filed on death would report the debt and may be subject to IRS scrutiny.

Additional planning is necessary to minimize the tax inefficiency of the husband making a non-deductible interest payment to his wife who is subject to Canadian tax on that interest received.

With non-recourse debt, the principal amount of the debt generally decreases while the value of the property generally increases. Consequently, as the property appreciates in value and/or the principal of the debt is repaid, the exposure to US estate tax increases.

**Canadian Trust**

A properly established Canadian trust can be used to acquire a US property. The trust should be established long before the property is acquired in order to avoid US gift tax. The settlor of the trust cannot be a beneficiary of the trust. The spouse can have a life interest with the children as remainder beneficiaries. The settlor has to settle the trust and cannot reclaim such cash or property. The value of the property would not be included in the settlor or the spouse’s estate for US estate tax purposes provided that they had no rights to the capital of the trust.

**Partnership Structure**

Although this is an unsettled area of tax law, it is arguable that an interest in a Canadian limited partnership holding personal-use US real property is not property situated in the US and therefore may shelter the Canadian partner from US estate tax.

The partnership structure has the following advantages over a corporate structure:

- The Canadian shareholder benefit rules under subsection 15(1) do not apply to partnerships.
- The income of the partnership is considered to be that of its partners and thus the partners would be subject to lower Canadian taxes compared to owning the property in a corporation. Combined Canadian and US corporate tax on the earnings (i.e., on investment income, rental income and any potential capital gains) and personal tax on dividends paid from the corporation currently exceeds the personal tax on an individual’s direct US holdings. Income tax integration does not work precisely for foreign investment earnings.
- The individual partners benefit from the lower US federal tax rates on long term capital gains. The lower capital gains rates do not apply to corporations.

**Reverse Hybrid Structure**

The term “reverse hybrid” refers to an entity that is treated as a partnership in Canada but which has elected to be taxed as a corporation for US tax purposes. This structure provides additional comfort over the Canadian partnership structure as shares of a foreign (non-US) corporation are not considered property situated within the US; neither the “shares” of the “entity” nor any assets held by the entity should be subject to US estate tax provided the entity is the legal and beneficial owner of the property.

In order to make this election, the partnership must have some business activities beyond just the holding of personal-use real estate. One of the attractive features of this structure is that the partnership will continue to be recognized as a partnership for Canadian tax purposes and the Canadian partner will not have a “shareholder benefit” (as this only applies to shareholders of a corporation). However, since the partnership will be considered a corporation for US tax purposes, the tax arising from the sale of the property will not be eligible for the lower individual long term capital gains tax rates.

Under certain circumstances it may be possible to elect “corporate status” for US tax purposes after the date of death of the partner. This will allow individual income tax rates on the sale of the property before death and also provide insulation from the estate tax upon death. This is a complex strategy that requires extreme care in both planning and implementation and should only be pursued with professional tax advice.
### Single-Purpose Corporations

Before 2005, US vacation property was often held in a single-purpose Canadian corporation. A single purpose corporation ("SPC") is an undefined term used by the CRA to describe a corporation the shareholders of which will not be subject to the shareholder benefit rules under subsection 15(1). This relief was formerly available to Canadian corporations whose only objective is to hold a residential real property in the US provided certain strict rules were met.349

As announced in Income Tax Technical News No. 31R2, effective January 1, 2005, the CRA changed its administrative policy of not assessing a taxable benefit. The CRA said the policy was no longer needed since changes to the Canada US tax treaty have mitigated certain US estate tax problems that the policy was designed to prevent by allowing the US applicable credit amount for residents of Canada.

The new policy applies for:

- Any new property acquired by an SPC; or
- A person who acquires shares of an SPC, unless the shares are acquired due to the death of the individual’s spouse or common law partner.

The old administrative policy continues to apply:

- To any renovation or addition to a dwelling that was acquired before January 1, 2005; and/or,
- To a dwelling that was under construction on December 31, 2004 (a dwelling is considered to be under construction when the foundation or other support has been put in place). This transitional relief is not provided if vacant land was acquired but the foundation or other support was not put in place or if land with an existing building was acquired before January 1, 2005 with the intention to demolish the existing building and construct a new dwelling on the land.

The CRA will not extend this grandfathering rule where the shares of the single purpose corporation are transferred between spouses due to divorce or marriage breakdown.350

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Goods and Services Tax/ Harmonized Sales Tax
Overview and General Principles

The Goods and Services Tax/Harmonized Sales Tax ("GST/HST") legislation contains many provisions specific to the acquisition, development, rental and sale of real property.

A common misconception is that most supplies of real property are GST/HST exempt. In fact, the general rule is that all supplies of real property in Canada are taxable, even where made by a non-resident, unless a specific exemption is provided in Schedule V to the Excise Tax Act (the "ETA"), the GST/HST legislation.

Generally, only "used" residential property and most supplies of real property made by charities, non-profit organizations, universities, schools and hospital authorities are specifically exempt under the ETA.

Supplies of real property by individuals are also exempt, subject to a variety of exceptions.

As of January 1, 2016, GST and HST apply to real property located in the various Canadian provinces and territories as follows:

- Ontario: HST at 13%
- New Brunswick: HST at 13%
- Nova Scotia: HST at 15%
- Newfoundland and Labrador: HST at 13%
- Prince Edward Island (P.E.I.): HST at 14%

The above provinces are referred to as the “harmonized provinces."

GST at 5% applies to real property located elsewhere in Canada.

B.C.—Transition from HST to GST and PST

B.C. adopted the HST effective July 1, 2010. However, a subsequent referendum resulted in a decision to return to the GST and provincial sales tax ("PST") structure effective April 1, 2013. A summary of the transitional rules that applied is available at the end of the chapter (see “B.C.—Transition from HST to GST and PST”).

Any person receiving revenues from taxable supplies of real property (or any other taxable supplies) exceeding $30,000 per year is required to register for GST/HST purposes. (However, revenues from sales of capital real property are excluded when calculating this $30,000 GST/HST registration threshold).

Some examples of exempt supplies of real property:

- Sales of “used” (i.e., previously occupied) residential property;
- Sales of most personal-use property when the vendor is an individual (note that most time-share property, if placed in a rental pool, becomes taxable when resold);
- Long-term residential leases (more than one month);
- Low-cost (less than $20 per day) residential rental accommodation (e.g., rooming houses);
- Condominium or co-op fees or common expenses;
- Transfers of farmland by farmers to a related individual; and
- Most supplies of real property by charities, non-profit organizations, universities, schools and hospital authorities.

Different forms of ownership of real property (e.g., partnerships, joint ventures, co-ownerships) have different results in terms of which entity must register and account for the GST/HST.
Special Case—Partnerships

A partnership is a “person” for GST/HST purposes. As such, the partnership registers for GST/HST, rather than the general or limited partners.

The partnership, rather than the partners, is considered to be engaged in commercial activities relating to the partnership’s property and is required to register for GST/HST purposes, account for tax on taxable supplies and claim input tax credits (“ITC”).

For GST/HST registration to be available, the entity must be a partnership at law, not a joint venture.

Anything done by a partner in his or her capacity as such is deemed to have been done by the partnership, not the partner. Consequently, partners are not required to register separately for GST/HST purposes (unless otherwise engaged in a commercial activity).

The related-party election to relieve the GST/HST on supplies between members of closely related groups has been extended to include partnerships under certain circumstances.

Special Case—Joint Ventures

A joint venture is not a “person” for GST/HST purposes, and so it cannot register for GST/HST in its own right.

Under the normal GST/HST rules, each participant in a joint venture engaged in a commercial activity must register for GST/HST, account for the tax charged on its pro-rata share of purchases made by the joint venture and claim ITCs on its pro-rata share of purchases made by the joint venture.

The administrative burden of having to account for GST/HST individually can be relieved by all of the parties making the “GST/HST joint venture election” to have the “operator” of the joint venture account under its own GST/HST registration number for all GST/HST in respect of purchases and supplies made by the operator on behalf of the participants.

The party that will act as the “operator” of the joint venture must be a “participant” therein; however, it is not required to have an actual financial interest in the joint venture. Administratively, the CRA considers a “participant” to be a person who does not have a financial interest in the joint venture, but who is designated as the operator of the joint venture under a written agreement, and is responsible for the managerial or operational control of the joint venture. Therefore, a third party management company that does not have a financial interest in the joint venture can be appointed as the operator and handle the joint venture’s GST/HST accounting on behalf of the other parties.

It is the CRA’s policy that a bare trustee cannot act as the operator of a joint venture. As discussed in the “Special Cases—Trusts/Nominee Corporations” section below, a bare trustee cannot register for GST/HST purposes because it has no commercial activities. A trustee that has independent or discretionary powers and responsibilities is not a bare trust. However, the “operator” of a joint venture must be responsible for managerial or operational control of the joint venture.

Nevertheless, in February 2014 the CRA issued Notice 248, “Bare Trusts, Nominee Corporations and Joint Ventures”, announcing temporary administrative tolerance for reporting periods through the end of 2014 where a bare trust or nominee corporation had made the joint venture election, and been incorrectly reporting the GST/HST for the joint venture. The Notice states that auditors have been advised not to assess for any GST/HST owing where an assessment could be raised because the bare trust or nominee corporation is not a “participant” in the joint venture. This administrative tolerance is contingent upon all returns having been filed, all amounts remitted, and the joint venture participants otherwise being fully compliant. Effective January 1, 2015 the joint venture was required to arrange its affairs to ensure that a “participant”, as administratively defined by the CRA, is the operator of the joint venture.

Another advantage to making the joint venture election is that GST/HST will not apply to the revenues distributed to the participants by the operator, to reimbursements to the operator for expenses incurred on behalf of the participants, or to the fees payable to the operator for operating the joint venture.

However, the joint venture election may not preclude the participants from having to register and account for GST/HST on the initial acquisition of real property. Based on the wording of the legislation, and on the CRA’s published administrative material, the joint venture election for real property can only cover post acquisition real property activities on the basis that the actual acquisition of the real property itself is not among the “prescribed activities” to which the joint venture election applies.
Only the following real estate-related activities, which are prescribed by regulation, qualify for the joint venture election:356

- Construction of real property, including feasibility studies, design work, development activities and tendering of bids, when undertaken to further a joint venture for the construction of real property.
- Exercising the rights and privileges, or performing the duties and obligations, of ownership of an interest in real property, including related construction or development activities whose purpose is to derive revenue from the property by sale, lease, etc., except if the property is non-residential real estate and one of the joint venture participants, or a related person, uses part of the property otherwise than in commercial activities, and does not pay rent at FMV.
- Marketing by the joint venture operator, under an agreement between the operator and a participant, of the participant’s share of the output of the joint venture, provided that the output arises from an activity conducted under a written joint venture agreement.
- Transporting natural gas liquids by means of a pipeline that operates as a common carrier of natural gas liquids.
- Operating an electricity generation facility.
- Operating an electrical power transmission line.

- Processing the output of the exploration or exploitation of a timber resource, including any jointly conducted exploration or exploitation activity of which the output is processed under a joint venture agreement, and the marketing of the related processed or unprocessed output.
- Producing and marketing fertilizer.
- Waste disposal, including the associated collection and transportation.
- The exercise of rights or privileges, or the performance of duties or obligations, of ownership of an interest in an animal for the purposes of deriving revenue from prizewinning, stud service fees or sale.
- Road maintenance, other than exempt maintenance.
- Operating and maintaining the North Warning System.
- Operating a farming business within the meaning of the Act.
- Producing liquid methanol from natural gas.
- Generating and recording seismic data.
- Operating a lumber, plywood, shake and shingle, pulp, paper or similar wood processing facility.

It is not necessary to file the joint venture election form with the CRA; the election is made by all parties and retained on file for audit purposes.

Joint venture participants that make the GST/HST joint venture election are jointly and severally liable with the operator for GST/HST obligations in relation to the joint venture’s activities.

A new participant that acquires an interest in an existing joint venture is deemed to have made the joint venture election that was made by the original participants. A new election form is not required.

KPMG Observations

Finance has announced that it is conducting a review of the special rules in the GST/HST legislation relating to joint ventures. Finance has not yet released proposals relating to the results of its review, including any changes to the scope of the election.

Note that the requirement to recapture the provincial component of ITCs on certain “specified expenses,” discussed below under “Temporary Partial Recapture of Input Tax Credits (“RITC”), also applies where a participant in a
joint venture is a large business that has made the joint venture election with the operator. If the operator acquires or brings into Ontario a restricted item on behalf of the participant, the operator would be considered to be a large business for the purposes of that acquisition or bringing in, and the “recaptured input tax credit” rules would apply.

**Special Case—Trusts/Nominee Corporations**

A trust is a “person” for GST/HST purposes and is subject to GST/HST registration if it is engaged in a commercial activity. However, the CRA distinguishes between a “true trust” and a “bare trust” for GST/HST registration purposes.

**True Trust**

The CRA considers that a “true trust” exists if independent decision-making powers and responsibilities relating to the management and administration of the trust property, such as the authority to contract, lease or sell, are given to the trust. In such cases, the trust itself is considered to be engaged in commercial activities relating to any taxable supplies related to the trust property. A supply made by the trustee of the trust property will be an activity of the trust, not the trustee or the beneficial owners of the trust property.

The “true trust” is required to register for GST/HST purposes, collect and remit GST/HST on taxable supplies, and is entitled to claim ITCs on costs relating to making such supplies.

**Bare Trust**

On the other hand, the CRA considers a trust to be a “bare trust” if the beneficial owner retains the powers and responsibilities to manage and/or dispose of the trust property, with the sole duty of the trustee or nominee corporation being to convey legal title to the trust property according to the instructions of the beneficial owner. In such cases, the trust itself is considered to be engaged in commercial activities relating to the trust property and will thus be required to register and account for GST/HST.

If the bare trust/nominee corporation has no activity other than the holding of legal title, it cannot register for GST/HST purposes because it is not engaged in a commercial activity relating to the trust property. (See comments in the “Special Cases—Joint Ventures” section above concerning the CRA’s policy regarding the use of a bare trust/nominee corporation as the “operator” of a joint venture, and the CRA’s Temporary Administrative Tolerance Policy, announced in February 2014, that applied to reporting periods ending before January 1, 2015.)

When there is more than one beneficial owner of commercial real property held in a bare trust, each would be required to account for the GST/HST and to claim ITCs on costs relating to making such supplies.

**KPMG Observations**

- The amount of the recapture is proportional to the large business participant’s interest in the joint venture, unless the operator itself is a large business. In the latter case, the recapture would be for the full amount of the provincial component of the ITC claimed.

**Special Case—Co-ownerships**

A co-ownership is not a “person” for GST/HST purposes. As such, a co-ownership cannot register for GST/HST purposes in its own right.

GST/HST registration is at the level of the co-owners/tenants-in-common.

If a co-ownership makes taxable supplies of the property held in the co-ownership, the tenants-in-common are normally required to register for GST/HST purposes and remit tax and claim ITCs on a pro rata basis proportional to their interest in the co-ownership.

Although this policy may create a significant administrative burden, there is no provision in the ETA to simplify the accounting for GST/HST unless the co-ownership is in fact a joint venture, with an operator appointed and the joint venture election in place as described in the previous section.

**KPMG Observations**

- The term co-ownership may be applied to arrangements that are joint ventures. If this is the case, the joint venture election discussed above in the section “Special Cases—Joint Ventures” may be available. This will simplify GST/HST compliance.
ITCs on costs proportional to its interest in the trust property. These beneficial owners should consider making a joint venture election to simplify the GST/HST administration (see “Special Cases—Joint Ventures” above).

**GST/HST Place of Supply Rules—Real Property and Services in Relation to Real Property**

The discussion that follows focuses on the rules which determine whether GST or HST applies to any given supply of property or services (“place of supply” rules) as they apply to real property, and to services in respect of real property.267

The first step in determining whether GST/HST applies on a supply of real property or a service in relation to real property is to determine if the supply is made in Canada.268 If the supply is made in Canada, the next step is to determine what rate will apply based on the province in which the supply is considered to be made.

**(i) Supplies of Real Property—Sale or Lease**

A supply of real property by way of sale, lease or rental is considered to be made in the province in which the property is situated. It will therefore be subject to GST/HST according to the rate in effect in that province.

For example, an Ontario company sells a commercial building situated in Ontario to a purchaser in B.C., the sale would be subject to the 13% Ontario HST.

Assume that a Quebec company, as landlord, leases a commercial building situated in Ontario, and another situated in Quebec, to a B.C. company. Each building is considered to be a separate supply, made for the portion of the total consideration reasonably attributable to the building situated in each province. The lease of the building situated in Ontario would be “made in Ontario” and subject to HST at 13%, whereas the lease of the building situated in Quebec would be “made in Quebec” and subject to GST at 5%.269

**(ii) Supplies of Services in Relation to Real Property**

Supplies of services in relation to real property (e.g., property management services) are subject to GST/HST based on where the property, or the greatest portion of the property, is situated. For example, an Ontario property manager that manages properties only in Quebec will charge 5% GST.

Where the service is in relation to real property situated in more than one province, the services are subject to GST/HST based on where the greatest proportion of the property is situated. If the property to which the service relates is situated primarily (i.e., greater than 50%) in the HST provinces, the service is subject to HST rather than GST, and at the rate applicable in the province where the greatest proportion of the property is situated. For example, property management services provided in relation to real property situated 60% in Ontario and 40% in Quebec will be considered to be “made in Ontario” for HST purposes, and subject to 13% HST on the entire amount.

However, if the greatest proportion of the real property is situated equally in two or more HST provinces, but not “primarily” in any single HST province, HST applies at the rate that is highest among those HST provinces. For example, assume that a property management company provides property management services for buildings situated 40% in Nova Scotia, 20% in Alberta and 40% in Ontario. The real property is situated primarily (80%) in the HST provinces, the greatest proportion of the real property is situated equally in two HST provinces, and the highest rate among those two provinces is the Nova Scotia rate of 15%. The supply is considered to be “made in Nova Scotia”, and the property management company will charge HST at 15% on the entire charge, i.e., in relation to the buildings in all three provinces.

Finally, if the services relate to real property situated primarily in the non-HST provinces, or situated equally in non-HST and HST provinces, the supply will be subject to the 5% GST. For example, services relating to two identical buildings, one in Quebec and the other in Ontario, would be “made in Quebec” for GST/HST purposes, and the property manager would charge 5% GST on the full amount.

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267 All of the GST/HST “place of supply” rules, with examples of their application, can be found in the CRA’s Technical Information Bulletin B-163, “Place of Supply Rules for Determining Whether a Supply is Made in a Province”.

268 The general place of supply rules for determining whether a supply is made in or outside Canada are set out in Section 142 of the ETA.

269 The QST applies generally to the same GST-taxable property (i.e., goods, real estate and intangibles) and services. The current QST rate is 9.975%.
KPMG Observations

If the property management services are considered to be a single supply in relation to properties in multiple provinces, and HST applies at the highest rate, consideration should be given to reviewing whether the services could be supplied separately for separate consideration. This would be particularly helpful to reduce otherwise unrecoverable HST if the property owners are engaged in providing exempt residential rentals.

Acquisitions

Purchase of Bare Land

The purchase of bare land is generally subject to GST/HST. However, if the vendor of such land is an individual (including a trust, all of the beneficiaries of which are individuals), charity, non profit organization, university, school or hospital authority, the supply is exempt, subject to certain exceptions.

Ultimately, only the vendor can determine with certainty whether GST/HST applies.

Purchase of an Existing Building or Other Facility

The purchase of property with an existing building or other facility (other than a residential property) is generally subject to GST/HST.

Again, however, if the vendor is an individual, charity, non profit organization, university, school or hospital authority, the acquisition may be exempt.

The purchase of residential property is generally exempt if it is currently occupied as a place of residence or was last so used.

However, the purchase of new residential property is taxable.

Used residential property that has been substantially renovated, and non residential property that has been converted into residential use, may also be taxable.

Mixed Purchase

In certain situations, the purchase of a single legal parcel of property may be partly taxable and partly exempt.

For example, a building that includes both residential and commercial rental units will be taxable (for the commercial units) and exempt (for the residential units).

In such cases, GST/HST is payable only on the consideration attributable to the taxable portion of the property.

Accounting for GST/HST on Taxable Purchases

The general rule under the ETA is that the supplier making a taxable supply collects the GST/HST from the purchaser and remits it to the CRA.

This rule does not apply when a person purchasing taxable real property is registered for GST/HST purposes, unless the purchaser is an individual and the property being acquired is a residential complex (or a cemetery plot). Note that it is not sufficient for the purchaser to have applied for registration or to be required to be registered. The purchaser must in fact be registered effective as of the date of acquisition, otherwise the vendor must collect the GST/HST.

The general rule also does not apply when the vendor of the property is a non-resident.

In these cases, the purchaser self-assesses the GST/HST payable and reports it on the purchaser’s GST/HST return for the period in which the taxable purchase is made.

To the extent that the purchaser is entitled to claim an ITC or rebate for some or all of the GST/HST payable, the purchaser claims that amount on its GST/HST return as well, so that only the net amount of GST/HST, if any, is remitted to the CRA.

KPMG Observations

To protect itself, the vendor should obtain a warranty from the purchaser acknowledging that the purchaser is registered for GST/HST purposes, backed up by an undertaking to indemnify the vendor against any amounts for which the vendor may later become liable if, in fact, the criteria for the purchaser to self-assess the GST/HST, rather than paying it to the vendor, were not met. The vendor should also request a copy of the purchaser’s letter from the CRA confirming its GST/HST registration, and verify using the CRA’s web-based “GST/HST Registry” (http://www.cra-arc.gc.ca/esrvc-srvce/tx/bsnss/gsthstrgstry/menu-eng.html) that the purchaser’s registration is valid as of the closing date of the transaction.
Recovering GST/HST on Taxable Real Property Purchases

GST/HST-registered purchasers of taxable real property that self-assess the GST/HST payable may be able to offset that tax by claiming an ITC for the tax payable.

Generally, developers of real property (commercial and residential) are entitled to claim a full ITC for the GST/HST payable on any taxable purchase of real property, such that there is no net tax cost or cash flow effect in accounting for GST/HST on the purchase.

Individuals and persons acquiring property for use in exempt activities (e.g., financial institutions) may not be entitled to claim an ITC for the GST/HST payable. Generally, the extent to which an ITC is available depends on the extent to which the property is used in the purchaser’s commercial activities.

When real property is acquired (other than by a financial institution (“FI”) or a public sector body (“PSB”) for use exclusively (generally, 90% or more) in commercial activities, a full ITC is available.

When the use of the property (other than property of an FI or a PSB) in commercial activities is more than 10% but less than 90%, the ITC that can be recovered is equal to the percentage to which the property is used in commercial activities. When use in commercial activities is 10% or less, no ITC is recoverable.

ITC Rules for Financial Institutions

Special ITC recovery rules apply to FIs.

Beginning in 2008, FIs are subject to new and very complex rules for calculating the ITCs to which they are entitled. A discussion of these rules is beyond the scope of this Handbook.

ITC Rules for Public Sector Bodies

Special ITC recovery rules also apply to PSBs.

Absent the special election discussed below, ITC recovery on the acquisition of capital real property by a PSB is “all or nothing,” and is based on a “primary use” test. If real property is acquired primarily (i.e., greater than 50%) for use in the PSB’s commercial activities, a full ITC is available, otherwise, no ITC at all is available.

Thus, if the PSB acquired the real property for use otherwise than primarily (i.e., 50% or less) in commercial activities, no ITC can be claimed, even if the PSB uses the property 50% in commercial activities.

Most supplies of real property (e.g., leases, sales) by a PSB are exempt of GST/HST, and therefore as noted above, the PSB cannot claim any ITCs in respect of the expenses relating to the property unless it is used primarily (i.e., greater than 50%) in the PSB’s commercial activities. However, a PSB can file a special election (the Section 211 election) for its supplies of real property to be treated as taxable, rather than exempt. The effect of making the Section 211 election is that the supply (e.g., the lease) of the real property by the PSB would be taxable, rather than exempt, and the PSB would be entitled to claim ITCs based on the actual percentage of use of the property in commercial activities, as long as that use is at least 10%.

KPMG Observations

For example, assume that a PSB owns a 4-storey building. The PSB uses the top three floors in its own activities and leases the ground floor to a dry cleaning business. Under the normal rules, this supply by the PSB would be exempt, so the PSB would not charge GST/HST to the dry cleaner on the lease charges. Since the building is not used more than 50% in commercial activities, the PSB cannot claim any ITCs in respect of its expenses relating to the ground floor.

However, if the PSB made the Section 211 election in respect of the building, the lease would become taxable and the PSB would charge GST/HST to the dry cleaner. (The dry cleaner would be entitled to a full offsetting ITC.) The building would now be used 25% in the PSB’s commercial activities (i.e., the extent of the ground floor), since the lease is now taxable. The PSB would now be entitled to claim ITCs for 25% of the GST/HST it incurs on expenses attributable to the ground floor (electricity, other utilities, maintenance, etc.).

Certain PSBs are entitled to claim partial rebates of the GST/HST that cannot be claimed as an ITC. Specific details concerning the rebate percentages available to the various categories of PSBs for the GST, and the federal and provincial components of the HST, are beyond the scope of this Handbook.
Provincial Sales Tax and Acquisitions of Real Property

Land and buildings are not subject to PST. However, where some portion of the purchase price is allocated to tangible personal property (e.g., furnishings in a rental property), the PST implications need to be considered since such assets are generally subject to PST.

This area is complicated by the fact that the three provinces that still have PST systems are not uniform in what they consider to constitute real property, and, in some cases, they have deemed certain items that would otherwise be real property at law to be tangible personal property for PST purposes.

Therefore, in a real property acquisition (and sale), it is important to determine what particular province considers to be real property, which is not subject to PST, and what it considers to be tangible personal property, which may be subject to PST.

Development Costs

Generally, the development of land for residential or commercial purposes is a commercial activity for GST/HST purposes and any GST/HST incurred on the development and construction costs will be fully recoverable as an ITC.

Exceptions to this general rule include the development of personal use property by an individual, and persons developing property for use in exempt activities (other than residential developments discussed below).

As outlined in the next section, there is also a temporary exception to this general rule for full ITC recovery in respect of certain expenses incurred in Ontario and P.E.I. (as well as in B.C. when it had harmonized its sales tax).

Temporary Partial Recapture of Input Tax Credits

Ontario adopted the HST on July 1, 2010, and P.E.I. adopted it on April 1, 2013. For the first eight years of the HST, however, “large businesses” in Ontario and P.E.I. are required to ‘recapture’ (repay) the provincial component (8% in Ontario, 9% in P.E.I.) of the ITCs they claim on specific categories of expenses (“specified expenses”) incurred in Ontario and P.E.I.

This is a two-step process: the full ITC is claimed, including on any specified expenses, and then the ITC claimed for the provincial portion of the HST paid on specified expenses is repaid. Both steps are performed in the GST/HST return for the same reporting period. It is important to note that it is not sufficient to simply forego claiming the provincial portion of the ITC in relation to specified expenses; the “claim and repay” process must be followed.

The specified expenses to which the RITC requirement applies are the following:

- Energy (e.g., electricity, natural gas, steam), except for use directly in the production of goods for sale (note that real property is not a ‘good’);
- Telecommunication services, except Internet and toll-free services;
- Licensed motor vehicles weighing under 3,000 kg., and parts and services acquired within 21 months of the vehicle’s acquisition, other than for routine repair/maintenance;
- Fuel (other than diesel fuel) for use in motor vehicles; and
- Meal and entertainment expenses.

However, the RITC requirement does not apply to “specified goods” or services that a large business acquires solely for resupply (e.g., sale or lease), or to property to be manufactured into other goods for sale by the large business.

The RITC requirement also applies to the ITC claimed for allowances paid and expenses reimbursed to employees.

A large business that brings “specified goods” into Ontario or P.E.I. from another province or country is generally required to self-assess the provincial component of the HST. For example, if a large business purchased a passenger car in Alberta and brought it into Ontario, the large business would self-assess the 8% provincial component of the 13% Ontario HST.

The RITC regime is to be temporary. For the first five full years of the HST (in Ontario, July 1, 2010 – June 30, 2015; in P.E.I., April 1, 2013 – March 31, 2018), 100% of the provincial component of the ITC claimed on “specified expenses” must be recaptured. Beginning July 1, 2015 in Ontario, the RITC requirement will be phased out in 25% increments over 3 years, and eliminated completely as of July 1, 2018. In P.E.I., the RITC requirement will also be phased out over a three-year period beginning April 1, 2018, and eliminated completely as of April 1, 2021.

260 As of January 1, 2016, these are B.C., Saskatchewan and Manitoba.
261 B.C. transitioned back from HST back to GST and PST effective April 1, 2013. The RITC requirements applied in B.C. during the period July 1, 2010 to April 1, 2013.
262 Canadian-source revenues from taxable supplies made by the person and its associates > $10 million p.a.
Note that the RITC regime does not apply to public service bodies, e.g., non-profit organizations, charities, municipalities, school authorities, hospital authorities, public colleges, or universities.

Completion of Construction—Single-unit Residential Complex (House) for Sale

No GST/HST remittance liability is triggered for the builder until the house is actually sold to a purchaser, unless the builder occupies it first as his or her place of residence, in which case the builder must self-assess and remit GST/HST based on the FMV of the house at that time (see next section).

When the house is sold, GST/HST applies to the sale price of the house, with a “New Housing Rebate” available to the purchaser to partially offset the GST/HST cost provided that the relevant conditions are met. For a discussion of the rebate amounts and mechanics, please see the section “GST/HST Rebates” at the end of this “Completion—Residential Property” section.

The GST/HST becomes payable on the earlier of the date ownership of the house is transferred to the purchaser and the date possession of the house is transferred to the purchaser under the purchase and sale agreement.

The rebate application must be filed within two years of the date that ownership of the house is transferred to the purchaser.

Completion of Construction—Residential Condominium Unit for Sale

Essentially the same rules apply to residential condominium units as to individual houses—for each condominium unit is treated as a separate residential property. However, the timing of the GST/HST liability on the sale of a condominium unit is different.

Normally, GST/HST is collectible on a supply of real property once either possession or ownership of the property is transferred to the purchaser.

A different rule applies to condominiums:

– When possession of a condominium unit is transferred before registration of the condominium, the GST/HST liability is postponed until the ownership is transferred as well.

– However, once the condominium complex is registered, if 60 days go by without ownership (of the sold condominium unit) being transferred, the GST/HST liability arises at that point.

For full details concerning the mechanics of the RITC regime in Ontario and P.E.I., please refer to the CRA’s Technical Information Bulletin B-104, “Temporary Recapture of Input Tax Credits in Ontario and British Columbia” [sic], and P.E.I. Revenue Tax Guide 186, “Temporary Recapture of Certain Provincial Input Tax Credits”.

For details concerning the recovery of the RITC expense from tenants, see the “Ongoing Operations—Lease/Rental of Commercial Real Property—Additional Rents” section later in this Handbook.

Completion—Non-residential Property

No particular GST/HST consequences arise on the completion of the development of a property that is not a residential property.

Completion—Residential Property

The completion of the construction of residential real property may trigger a GST/HST liability for the builder, depending on whether the completed property will be sold or used in exempt activities of rental or leasing (see below).

If the property is sold before being leased or rented to residential tenants, the sale is taxable and the builder must collect GST/HST from the purchaser (unless the purchaser is registered for GST/HST and not an individual, in which case the purchaser must self-assess the GST/HST).

If the property is leased or rented as a place of residence, then the builder becomes liable for GST/HST under the so-called “self-supply rule” or the “self-assessment requirement.”

The purpose of the “self-supply” rules is to eliminate any advantage that may exist for someone that builds residential accommodation for the purpose of renting it out versus someone who purchases (and pays GST/HST on) new residential accommodation for the same purpose.

In the first situation, without the “self-supply” rules, the builder would be at a competitive advantage because the salary, financing and profit components of the property would have escaped GST/HST, while these same costs would form part of the GST/HST base for new residential accommodation that was purchased from a third party.
GST/HST applies to the sale price of the unit and the “New Housing Rebate” is available to the purchaser to partially offset the GST/HST cost. For a discussion of the rebate amounts and mechanics, please see the section “GST/HST Rebates” at the end of this “Completion—Residential Property” section.

The rebate application must be filed within two years of the date that ownership of the unit is transferred to the purchaser.

The self-supply rules that apply to the completion of the construction of rental buildings are not triggered if the rental of the building or a unit in it is made under an agreement to purchase the building or a unit.

However, if the purchase agreement is terminated, the builder is deemed to have sold and repurchased the property under taxable conditions at the time the agreement is terminated and to have collected GST/HST on the sale and paid GST/HST on the repurchase, based on the FMV of the property at that time.

The builder is therefore required to self-assess GST/HST in such cases, but any subsequent sale of that unit would be exempt as real property on which GST/HST has already been paid.

Completion of Construction—Single-unit Residential Complex (House) or Residential Condominium Unit for Rental

When a house or condominium unit is substantially complete and rented as a place of residence, the builder must self-assess and remit GST/HST based on the FMV of the house/unit at the time the house is occupied as a place of residence. (As noted, the self-supply rule does not apply if the rental is made pursuant to an agreement to purchase the house/unit.)

A partial rebate of the GST/HST may be available to the builder if the house/unit is rented for occupancy by an individual as his or her primary place of residence, provided that the relevant conditions are met. For a discussion of the rebate amounts and mechanics, please see the section “GST/HST Rebates” at the end of this “Completion—Residential Property” section.

The rebate application must be filed within two years of the date the house/unit is substantially complete.

When the builder is an individual (registered for GST/HST and engaged in the business of building residential properties) and the builder occupies the house/unit as his/her place of residence, the builder must self-assess and remit GST/HST based on the FMV of the house/unit at the time the builder first occupies it, unless the builder did not claim an ITC in respect of the construction of the house/unit. A rebate as noted above may be available for a portion of the GST/HST self-assessed.

The FMV determination should be based on a professional appraisal or by comparison with the sale price of similar properties.

The lease of the house/unit to the tenant is exempt, as will be any subsequent lease or sale of the house/unit (unless the house/unit is substantially renovated prior to its sale).

Completion of Construction—Rental Apartment Building

Once a rental apartment building is substantially completed (see below), the builder must generally self-assess GST/HST on the FMV of the entire building at the time that possession or use of the first unit is given to an individual for occupancy as a place of residence under a lease, license or similar arrangement.

“Substantial completion” generally occurs before occupancy is given to the first individual.

For GST/HST purposes, the CRA considers “substantial completion” to mean that the construction is at a stage of completion (generally, 90% or more) so that an individual can reasonably inhabit the premises, even though minor repairs, adjustments, upgrades, etc. may still be outstanding.

Notwithstanding the above, substantial completion is deemed to occur when 90% of the units in the complex are occupied, thereby triggering the GST/HST self-assessment requirement at that time.

However, if possession or use is given to the first tenant before substantial completion, the GST/HST self-assessment liability does not arise until the time of substantial completion.
A partial rebate of the GST/HST may be available to the builder to the extent the apartments are or are expected to be occupied by individuals as their primary place of residence for at least one year, provided that the relevant conditions are met. For a discussion of the rebate amounts and mechanics, please see the section “GST/HST Rebates” at the end of this “Completion—Residential Property” section.

The rebate application must be filed within two years of substantial completion.

**Completion of Construction—Owner Built Homes**

Individuals who construct or substantially renovate their own primary residence (or hire someone else to do so) qualify for a rebate of a portion of the GST/HST paid on the land and the construction materials and services, provided that the relevant conditions are met. For a discussion of the rebate amounts and mechanics, please see the section “GST/HST Rebates” at the end of this “Completion—Residential Property” section.

The rebate application must be filed within two years of substantial completion and first occupancy.

**GST/HST Rebates**

When the GST was introduced in 1991, it provided for a rebate of a portion of the tax payable on new residential housing below a certain price threshold. This rebate of the federal GST has been maintained through the introduction of the HST in 1997, and the adoption of the HST by Ontario in 2010 and P.E.I. in 2013.

Ontario also introduced a rebate for a portion of the provincial component of the HST on new residential housing. However, the amounts and the thresholds for the rebate of the provincial component of the HST differ considerably both from that of the federal component, and also from one another.

P.E.I. offers no new housing rebate for the provincial component of the HST. The only rebate in respect of the purchases of new housing in P.E.I. is the federal rebate.

The amounts and thresholds for the new housing rebate of the GST or the 5% federal component of the HST, and for the Ontario component of the HST, are summarized in the table below.
Specifically, the jurisdictions differ in the percentage of tax rebated, the maximum dollar amount rebated, and whether the rebate is phased out beyond a certain price threshold. While the amount of the federal rebate is 36% of the GST or the federal component of the HST, Ontario is more generous, with a rebate of 75% of the Ontario component of the HST, up to a maximum rebate of $24,000. Furthermore, while the federal rebate is gradually reduced to $0 after the maximum rebate ($6,300) is reached, the Ontario provincial rebate is not phased out once the maximum rebate amount of $24,000 has been reached.365

<table>
<thead>
<tr>
<th>Type of Housing</th>
<th>GST, or 5% Federal Component of HST</th>
<th>Rebate</th>
</tr>
</thead>
<tbody>
<tr>
<td>House for Sale</td>
<td>36% Maximum rebate $6,300 then phased out</td>
<td>75% Maximum rebate $24,000 366 No phase-out. No maximum price threshold.</td>
</tr>
<tr>
<td>Residential Condo Unit for Sale</td>
<td>36% Maximum rebate $6,300 then phased out</td>
<td>75% Maximum rebate $24,000 367 No phase-out. No maximum price threshold.</td>
</tr>
<tr>
<td>House for Rental</td>
<td>36% Maximum rebate $6,300 then phased out</td>
<td>75% Maximum rebate $24,000 368 No phase-out. No maximum price threshold.</td>
</tr>
<tr>
<td>Rental Apartment Building</td>
<td>36% Maximum rebate $6,300 per rental unit then phased out</td>
<td>75% Maximum rebate $24,000 per rental unit 369 No phase-out. No maximum FMV threshold.</td>
</tr>
</tbody>
</table>

365 The Liberal government elected in October 2016 has indicated a priority the removal of all GST on new capital investments in affordable rental housing, and modernization of the existing Home Buyers’ Plan. At the time of writing no details have been provided, nor has there been any public statement from Ontario concerning the provincial component of the HST.

366 The rebate for the Ontario provincial component of the HST may still be claimed even though the price or FMV exceeds the maximum threshold amount for a rebate of any amount of the 5% federal component of the HST.

367 The full rebate (36% of the GST, or the 5% federal component of the HST, to a maximum of $6,300) is available for houses costing $350,000 or less. For houses costing more than $350,000, the GST/federal rebate is gradually phased out (at 63 per additional $1,000 in price), so that no rebate is available for houses costing $450,000 or more.

368 The maximum rebate corresponds to a house costing $400,000.

369 The full rebate (36% of the GST, or the 5% federal component of the HST, to a maximum of $6,300) is available for condominium units costing $350,000 or less. For units costing more than $350,000, the GST/federal rebate is gradually phased out (at 63 per additional $1,000 in price), so that no rebate is available for units costing $450,000 or more.

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372 The maximum rebate corresponds to a unit having an FMV of $400,000.

373 The full rebate (36% of the GST, or the 5% federal component of the HST, to a maximum of $6,300) is available for units having an FMV of $350,000 or less. For units having an FMV of more than $350,000, the GST/federal rebate is gradually phased out (at 63 per additional $1,000 in price), so that no rebate is available for units having an FMV of $450,000 or more.

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B.C. — Transition from HST to GST and PST

B.C. transitioned from the HST back to the GST and PST structure effective April 1, 2013. The following summarizes the transitional rules which applied. The HST continued to apply where tax became payable, or was paid without having become payable, before April 1, 2013.

For the sale of a single home, the GST/HST becomes payable on the earlier of the date ownership of the house is transferred to the purchaser and the date possession of the house is transferred to the purchaser under the purchase and sale agreement.

For the sale of a condominium unit where possession of the unit is transferred before the condominium complex is registered as a condominium, the GST/HST becomes payable on the earlier of the date ownership is transferred and 60 days after the complex is registered as a condominium.

New Enhanced Rebates

B.C. provided new and expanded relief measures for purchasers and builders of new homes during the period from April 1, 2012 to March 31, 2013. The B.C. new housing rebate threshold was increased to $850,000, such that qualifying newly built homes were eligible for a provincial HST rebate of up to $42,500 (previously $26,250). The new rental housing rebate was also enhanced to the same limit of $42,500.

B.C. also provided a rebate for purchasers of new secondary vacation and recreational homes outside the Greater Vancouver and Capital Regional Districts priced up to $850,000 who were eligible to claim a provincial grant of up to $42,500 effective April 1, 2012.

375 The full rebate (36% of the GST, or the 5% federal component of the HST, to a maximum of $6,300) is available for units having a FMV of $350,000 or less. For units having a FMV exceeding $350,000, the GST/federal rebate is gradually phased out (at 63 per additional $1,000 of FMV). No rebate is available for units having a FMV of $450,000 or more.

376 The maximum rebate corresponds to a rental unit having an FMV of $400,000.

377 The full rebate (36% of the GST, or the 5% federal component of the HST, to a maximum of $6,300) is available for units having a FMV of $350,000 or less. For units having a FMV exceeding $350,000, the GST/federal rebate is gradually phased out (at 63 per additional $1,000 of FMV). No rebate is available for units having a FMV of $450,000 or more.

378 The maximum rebate corresponds to a unit having an FMV of $400,000.
April 1, 2013 — Temporary Transitional Provincial Tax and Housing Transitional Rebates

B.C.'s portion of the HST ceased to apply to newly built homes where construction began on or after April 1, 2013. Builders will once again pay 7% PST on their building materials. On average, about 2% of the home's final price will again be embedded PST.

For newly built homes, where construction began prior to April 1, 2013 but ownership and possession was transferred after March 31, 2013, the purchaser will pay the GST but not the 7% provincial portion of the B.C. HST. However, where such properties were purchased prior to April 1, 2015, the purchaser was required to pay a temporary transitional provincial tax of 2% on the full house price. Builders that were required to self-assess GST on a self-supply made on or after April 1, 2013 and before April 1, 2015 where the construction or substantial renovation of the housing was more than 10% completed as of April 1, 2013 were also required to pay the temporary transition provincial tax of 2%.

Where the transition tax applied, builders were entitled to claim a transitional rebate to offset the PST paid on materials after April 1, 2013 to help prevent double-tax on homebuyers.

Double Straddling Transactions

Special transitional rules were provided for sales of new housing that were still subject to the original transitional rules of July 1, 2010 (i.e., transactions called “double-straddling transactions”). Such sales include the sale of new housing under a sale agreement entered into before November 19, 2009 or housing construction that began before July 1, 2010 and for which ownership and possession transferred after March 31, 2013.

Builder Disclosure Requirements

The transitional rules also included requirements for builders to make certain disclosures to purchasers and to the CRA in respect of purchase and sale agreements entered into after February 16, 2012 and before April 1, 2015 and included penalties on builders for failing to comply with those disclosure requirements: (1) up to 1% of home price to a maximum of $10,000 per home and (2) up to 4% of the home price to a maximum of $40,000 per home.

Ongoing Operations

Lease/Rental of Commercial Real Property

The leasing of non residential real property (other than by certain PSBs) is a commercial activity. As such, if the lessor exceeds the $30,000 “small supplier” threshold, it is required to register for and collect GST/HST on the lease charges.

An ITC is available to the lessee, depending on the extent to which the lessee uses the property in its commercial activities, as discussed above in the section titled “Recovering GST/HST on Taxable Real Property Purchases”.

Tax Planning for Closely Related Corporate Groups and Partnerships

Certain corporations can elect with other closely related corporations or with qualifying partnerships for leases and rentals of real property made between them not to be subject to GST/HST, thus removing the requirement to account for GST/HST on the rental or lease of real property within a closely related group.

For this election to be available, all of the parties must be registered for GST/HST purposes and in a position to have recovered full ITCs for their lease of the property if GST/HST were charged.

As such, FIs, PSBs and any other persons engaged in exempt activities generally cannot enter into this related party GST/HST-relieving election. However, FIs may make an alternative election within a related group of corporations that includes the FI.

KPMG Observations

Under legislation introduced on October 25, 2016, an additional condition was added to the “closely related” test that may affect corporations with Section 150 or 156 elections in place where there may be different voting rights for different classes of shares. As well as requiring 90% common ownership and 90% voting control, the voting control must apply to all corporate matters for the corporations to qualify as “closely related”. Corporations with previously-filed elections should review their circumstances to ensure that all of the corporations meet the new test.

Additional Rents

Additional rents (e.g., percentage rents) are regarded as additional consideration for the supply of the leased premises and are subject to GST/HST.

Additional rent payments are often generated by the lessee, but the lessor is responsible for accounting for the GST/HST on them, and should ensure that the lessee adds the GST/HST to the amount paid.

The lessee is entitled to recover an ITC proportional to its commercial use of the leased property.
Property taxes (which are GST/HST-exempt) and utility charges are often re-billed to lessees as additional rent. These charges lose their exempt status when the lessor re-charges them to the lessee. As such, they become additional rent on which the lessor must collect GST/HST, even though the lessor itself may not have paid GST/HST on these amounts.

Alternatively, the lessor may pay for the leasehold improvements directly, in which case the lessor will be entitled to recover the GST/HST payable on the improvements. In this case, no GST/HST arises between the lessor and lessee.

**Free or Reduced Rent**

When an inducement takes the form of a period of free or reduced rent, the lessor collects GST/HST only on the amount of rent actually paid, provided that the free or reduced rent periods are contemplated by the lease agreement.

If the lessor and lessee are not operating at arm’s length and the lessee is using the property in whole or in part in GST/HST-exempt activities, GST/HST is deemed payable on the FMV of the lease.

**Lease/Rental of Residential Real Property**

Residential property (e.g., apartments, condominiums, houses, rooming houses) leased or rented for a period of at least one month’s continuous occupancy as a place of residence or lodging by the same individual is GST/HST-exempt.

Residential property leased or rented for less than a month, when the consideration is $20 or less per day, are also exempt (i.e., rooming houses, daily or weekly rentals).

Otherwise such short term rentals (e.g., hotel rooms) are taxable.

**KPMG Observation**

As discussed above, “large businesses” in Ontario and PE.I. are temporarily required to recapture (repay) the provincial component of the ITC that they claim for the HST they incur on certain expenses. Energy is among these expenses. Energy, such as electricity, natural gas, etc., is often charged back by landlords to commercial tenants as additional rent. Therefore, when calculating the energy expenses to be charged to tenants in Ontario and PE.I., landlords should also take into account the RITC. Otherwise, the RITC on such expenses will represent an added energy expense to the landlord.

Note: This or any other planning idea should only be acted on with appropriate professional advice after a thorough examination of the particular situation.

**Tenant Inducements**

**Cash Inducement**

When a lessor pays a cash inducement to a lessee for entering into the lease, the CRA considers the lessee to have made a GST/HST-taxable supply of a service to the lessor of agreeing to lease the premises, for which the cash inducement represents consideration.

Thus, the lessee must remit GST/HST on the amount of the cash payment and the lessor is entitled to claim a corresponding ITC.

**Leasehold Improvements**

When the lessor reimburses the lessee for leasehold improvements, the reimbursement again represents consideration for a supply made by the lessee to the lessor. As such, the lessee must remit GST/HST on the amount of the reimbursement, with an ITC available to the lessor. The lessee can claim an ITC for the GST/HST paid in undertaking the improvements.

**KPMG Observation**

Where management or administration services are provided in respect of residential real property, non-recoverable GST/HST can be minimized by moving the employees that provide the management services into the entity that owns the exempt real property. Since management/administration fees are subject to GST/HST whereas salaries are not, such a restructuring would reduce the amount of non-recoverable GST/HST incurred by the entity that owns the real property.

**Lease Termination Payments**

A rental agreement may include a clause requiring the lessee to pay an amount to the lessor for terminating the lease early.
If the lease is taxable (i.e., for commercial property), any payment for the breach of the lease by the lessee is generally deemed to include GST/HST.

The lessor must therefore remit the “tax fraction” of the lease termination payment to the CRA. Where the lease is subject to the 5% GST, the amount to remit is 5/105ths of the termination payment. Likewise, if the lease payment was subject to the 12%, 13% or 15% HST, the amount to remit would be 12/112ths, 13/113ths, and 15/115ths, respectively, of the termination payment.

The lessee can claim an ITC for the GST/HST deemed to be included in the lease termination payment.

The lessor should bear this rule in mind when determining the amount of any lease termination payments to include in the lease agreement.

Maintenance, Repairs and Improvements

Charges for maintenance, repairs and improvements to real property are generally subject to GST/HST regardless of whether the property is commercial or residential.

Generally, the GST/HST incurred on such costs for commercial properties is fully recoverable as an ITC. No ITC can be claimed for costs incurred for residential rental properties.

The ITC recovery rules for maintenance and repair costs differ from those for “improvements,” as follows:

- An ITC for the GST/HST paid on general repairs, maintenance or services for real property is determined based on the percentage to which the repair, maintenance or service is used in the purchaser’s commercial activities.

Special rules apply to the recovery of GST/HST paid on “improvements” to real property.

For GST/HST purposes, an improvement is a cost that is capitalized as part of the property’s adjusted cost base for income tax purposes.

The amount of GST/HST that can be recovered on the cost of capital real property improvements is based on the extent to which the underlying property, not just the improvement, is used in commercial activity.

For example, a landlord owns a three-storey building with leased commercial premises on the ground floor (i.e., a commercial activity) and above it two storeys of residential rental accommodation (i.e., an exempt activity).

The property is therefore used 33% in commercial activity and 67% in exempt activity.

Therefore, the ITC available on the cost of an improvement to the property would be limited to 33% of the GST/HST paid, even if the improvement related solely to the commercial portion of the property.

However, the GST/HST incurred on any repairs to the commercial portion of the building would give rise to a full ITC, provided that the repairs do not qualify as an improvement.

Substantial Renovation of Residential Property

A “substantially renovated” residence or condominium unit is treated as a newly constructed residence/unit for GST/HST purposes.

For a renovation to be “substantial,” all or substantially all (generally, 90%) of the interior of the building, excluding the foundation, exterior walls, interior supporting walls, floors, roofs and staircases, must have been removed or replaced; essentially, the existing building must have been gutted.

Note that the concept of a “substantial renovation” for GST/HST purposes can differ significantly from what is commonly thought of as a “renovation,” which generally implies gutting followed by rebuilding. However, a residence/unit that has only had its interior elements removed as described above qualifies as “substantially renovated” for GST/HST purposes, even though it has simply been gutted with no further work done. Consequently, a residence/unit that has been gutted is considered to be "substantially renovated," and its sale will be subject to the rules outlined below.380

When the substantially renovated residential property is sold, it is subject to GST/HST, with a rebate possibly available to the purchaser for a portion of the GST/HST paid, subject to the normal rules. For a discussion of the rebate amounts and mechanics, please see the section “GST/HST Rebates” at the end of this “Completion—Residential Property” section.

380 Refer to the CRA’s Technical Information Bulletin B-092, “Substantial Renovations and the GST/HST New Housing Rebate” for a full discussion of the CRA’s administrative policy in this area.
COMMON FORMS OF REAL ESTATE OWNERSHIP
OWNERSHIP AND OPERATING ISSUES
NON-RESIDENTS INVESTING IN CANADIAN REAL ESTATE
U.S. VACATION PROPERTY
GOODS AND SERVICES TAX/HARMONIZED SALES TAX
APPENDICES

If the renovator rents the renovated property as a place of residence instead of selling it, the renovator must self-assess and remit GST/HST based on the FMV of the substantially renovated property under the “self-supply” rules discussed above.

Similarly, if the renovator is an individual who is a GST/HST registrant and occupies the property as his or her place of residence, the self-supply rules will apply unless the builder did not claim an ITC for the costs incurred in substantially renovating the property.

Depending upon the particular circumstances, a rebate may be available for a portion of the GST/HST incurred in the course of a substantial renovation.

A sale of a substantially renovated residential property to which the self-supply rules have applied would be exempt as “used” residential property.

Non-substantial Renovation of Residential Property
A special “self-supply” rule applies to persons that sell or lease residential property and that carry out a renovation that is not “substantial” as defined above (the “renovator”).

This rule is to ensure that renovators that use their own labour pay the same amount of GST/HST as those that use only third-party contractors.

The renovator is required to self-assess GST/HST on non-GST/HST-bearing renovation costs (excluding debt service costs), such as wages, salaries and employee benefits paid to the renovator’s own employees that are involved with the renovation work, or on costs paid to non-GST/HST-registered small suppliers, when the costs would be included in the building’s ACB for income tax purposes.

The renovator cannot claim ITCs for the self-assessed GST/HST since the sale or rental of the non-substantially renovated property is an exempt supply for GST/HST purposes.

Ordinary repair and maintenance costs do not trigger this self-supply rule because they would not be included in the building’s ACB.

Conversion of Commercial Property to Residential Use
A person that converts non-residential or commercial property (e.g., a warehouse or a hotel) into a residence without constructing or substantially renovating it is deemed to be a “builder” of the residential complex for GST/HST purposes and the conversion is deemed to be a “substantial renovation”.

Consequently, the “self-supply” rules are triggered and the person is required to self-assess GST/HST based on the FMV of the converted property if it is rented or leased or to collect GST/HST on the property if it is sold.

Excluded from the self-assessment requirement is an individual who converts commercial real property to a place of residence of the individual, a related person or the individual’s former spouse or common-law partner.

Also excluded from this self-assessment requirement is a personal trust that acquires the property to hold or use exclusively as a residence for an individual who is a beneficiary of the trust.

The self-supply rule is triggered when property is converted from commercial to residential use to ensure that this converted residential complex is treated the same way for GST/HST purposes as a newly constructed or substantially renovated residential complex.

Depending on the circumstances, a rebate may be available for a portion of the GST/HST incurred in the course of the conversion from commercial to residential use. For a discussion of the rebate amounts and mechanics, please see the section “GST/HST Rebates” at the end of this “Completion—Residential Property” section.

Disposition (Sale) of Real Property
Residential Property
Generally, a sale of a residential complex is GST/HST-exempt if it is currently occupied as a place of residence or it was last used as a place of residence.

Commercial Property
Unlike sales of used residential property, which are generally GST/HST-exempt, sales of commercial real property are generally taxable, regardless of whether the property is new or used.

The assignment of a leasehold interest is a sale of real property but, if the assignee is registered for GST/HST purposes, the assignor is not required to collect and
remit the GST/HST. Instead, the assignee self assesses and remits the applicable tax to the extent that an ITC is not recoverable by the assignee.

If the commercial property is sold together with all of the other assets of a business, an election can be made for GST/HST not to apply to the transaction, provided that the purchaser is registered, or required to be registered, for GST/HST purposes.

**Mixed Residential and Commercial Property**

When “mixed-use” property with a residential and a non-residential component is sold or leased, the ETA deems there to be two separate supplies: the supply of the residential property and of the non-residential property.

For example, in a sale of an apartment building with a first-floor shopping mall, the first floor would be one supply, subject to GST/HST with an ITC recoverable by the purchaser of the building. The remaining residential floors would be a separate supply, normally GST/HST exempt as a sale of used residential rental property.

**Key Terms**

Certain terms specifically defined in the ETA are commonly encountered when dealing with real property.

**Builder**

The term “builder”, which has an extended definition in the ETA, is relevant for determining the GST/HST status of a supply of residential housing as well as eligibility for rebates.

The GST/HST rules are intended to tax newly constructed residential property only once, with subsequent sales being exempt. This intention is achieved by providing a GST/HST exemption for sales of residential property by a person who either is not a “builder” of the property, or is a builder to whom the self-supply rules have previously applied for that property.

In simple terms, a builder is a person who has built a new home for sale. When the builder sells the home, GST/HST must be collected and remitted but ITCs are available to recover GST/HST paid on construction costs before the sale. If the builder rents out or moves into the home instead of selling it, the self-supply rules will trigger GST/HST, while a subsequent sale will be exempt. A person who builds a new home purely for personal use is not a builder. Instead, the person is simply a consumer.

“Builder” has the following meanings for GST/HST purposes:

- A person who has an interest in real property and who carries on, or engages someone else to carry on, the construction or the substantial renovation of a residential complex on that property;
- A person who acquires an interest in a residential complex before the construction or substantial renovation is finished;
- A person who supplies a mobile home or floating home before it has been occupied as a place of residence;
- A person who acquires an “unused” residential complex to resell or to rent out; or
- A person who owns and converts non-residential real property into a residential complex without constructing or substantially renovating the complex.

However, the following are not builders for GST/HST purposes:

- Individuals who construct or substantially renovate a property for personal use;
- Individuals who supply a mobile home or a floating home otherwise than in the course of a business or of an adventure or concern in the nature of trade; or
- Persons whose only interest in a residential complex is the right to acquire it.

**Commercial Activity**

“Commercial activity” triggers a GST/HST registration requirement unless the person is a small supplier (i.e., the person makes less than $30,000 in taxable supplies per annum).

A person who is engaged in a commercial activity in Canada is generally required to register for GST/HST purposes, collect and remit tax, and is entitled to recover any GST/HST paid on supplies acquired for consumption, use or supply in the course of its commercial activities.
Commercial activity is generally:
- A business;
- An adventure or concern in the nature of trade; and
- Any supply, including lease or rental, of real property (other than supplies that are specifically exempt) as well as anything done by the supplier in the course of, or in connection with, the making of the supply.

The inclusion of supplies of real property in the definition of commercial activity makes all supplies of real property, even those made by an individual that is not otherwise carrying on a business, subject to GST/HST unless the supply is specifically exempt (or the property is outside Canada).

An individual, personal trust or partnership of individuals does not have to have a “reasonable expectation of profit” from a supply (including lease or rental) of real property to be engaged in commercial activity with respect to the property.

As an exception, a person whose only commercial activity is the sale of real property, otherwise than in the course of a business, is not required to register, even though the sale is still taxable and GST/HST must still be remitted.

July 1, 2010 HST Transitional Rules—B.C. and Ontario; April 1, 2013 HST Transitional Rules—P.E.I.

Special rules apply for determining whether the 5% GST, or the 12% HST (B.C.)\(^{381}\) The 13% HST (Ontario) applies to transactions that straddle the July 1, 2010 HST implementation date. A full discussion of these rules is beyond the scope of this Handbook. The discussion below is confined to the HST transitional rules for supplies of real property. For the transitional rules that apply to other types of supplies, please refer to CRA Info Sheets GI-053 to GI-059.

In P.E.I., special rules also apply for determining whether the 5% GST, or the 14% HST applies to transactions that straddle the April 1, 2013 HST implementation date. A discussion of these rules is beyond the scope of this Handbook. For the transitional rules that apply to supplies of real property in P.E.I., please refer to the CRA publications listed in the “For Further Reference” section of this Handbook, under the section referring to P.E.I.

1. Taxable Leases of Commercial Real Property

The B.C. and Ontario HST transitional rules for commercial leases apply based on the earlier of the date the lease payment becomes due, and the date it is paid without having become due.

HST generally applies to any lease payment that becomes due, or is paid without having become due, on or after July 1, 2010, to the extent that the lease payment is attributable to a lease interval, or any part of a lease interval, that begins on or after July 1, 2010. However, if a lease interval begins before July 2010 and ends before July 31, 2010, HST does not apply to the lease payment, but the 5% GST would apply.

HST also applies to a lease payment that becomes due, or is paid without having become due, during the period after April 2010 and before July 2010, to the extent that the lease payment is attributable to a lease interval or any part thereof that begins on or after July 1, 2010 (other than a lease interval that begins before July 2010 and ends before July 31, 2010).

2. Taxable Sales of Bare Land, or of Property with an Existing (Non-residential) Building or Other Facility—B.C. and Ontario

For sales of real property other than housing, the date the agreement of purchase and sale is entered into does not affect the application of the HST. There is no grandfathering provision for sales of non-residential real property, as there is for certain sales of housing. Grandparenting in respect of housing is discussed below.

If either ownership or possession of (non-exempt) bare land transfers to the purchaser before July 2010, HST does not apply to the sale, but GST at 5% applies to the sale.

If both ownership and possession of (non-exempt) bare land transfer to the purchaser on or after July 1, 2010, HST applies to the sale.

\(^{381}\) Refer to the CRA’s Technical Information Bulletin B-092, “Substantial Renovations and the GST/HST New Housing Rebate” for a full discussion of the CRA’s administrative policy in this area.
3. Sales of New Housing Other Than Condominium Units—Ontario

The basic transitional rule provides that the 5% GST applies to sales of new homes if either title or possession is transferred to the purchaser before July 1, 2010. The 13% HST applies if both title and possession are transferred after June 30, 2010, unless the sale is grandparented as discussed below.

If the agreement of purchase and sale was signed before June 19, 2009, and possession and title transfer to the purchaser after June 30, 2010, the sale is grandparented, and is subject to only the 5% GST.

A mechanism of transitional tax adjustments and transitional rebates may also apply. These are discussed in the “Special Measures—Ontario and B.C. HST—Transitional Tax and Transitional Rebates” section below.

4. Sales of New Condominium Units—Ontario

The basic transitional rule provides that the 5% GST applies to sales of new condominium units if either possession (first closing) or ownership (second closing) is transferred to the purchaser before July 1, 2010. The 13% HST applies if both possession and ownership are transferred after June 30, 2010, unless the sale is grandparented as discussed below.

If the agreement of purchase and sale was signed before June 19, 2009, and possession and ownership transfer to the purchaser after June 30, 2010, the sale is grandparented, and is subject to only the 5% GST.

A mechanism of transitional tax adjustments and transitional rebates may also apply. These are discussed in the “Special Measures—Ontario and B.C. HST—Transitional Tax and Transitional Rebates” section below.

5. Sales of New Housing Other Than Condominium Units—B.C.

The basic transitional rule provides that the 5% GST applies to sales of new homes if either title or possession is transferred to the purchaser before July 1, 2010. The 12% HST applies if both title and possession are transferred after June 30, 2010, unless the sale is grandparented as discussed below.

If the agreement of purchase and sale was signed before November 19, 2009, and possession and title transfer to the purchaser after June 30, 2010, the sale is grandparented, and is subject to only the 5% GST.

A mechanism of transitional tax adjustments and transitional rebates may also apply. These are discussed in the “Special Measures—Ontario and B.C. HST—Transitional Tax and Transitional Rebates” section below.

6. Sales of New Condominium Units—B.C.

The basic transitional rule provides that the 5% GST applies to sales of new condominium units if either possession (first closing) or ownership (second closing) is transferred to the purchaser before July 1, 2010. The 12% HST applies if both possession and ownership are transferred after June 30, 2010, unless the sale is grandparented as discussed below.

If the agreement of purchase and sale was signed before November 19, 2009, and possession and ownership transfer to the purchaser after June 30, 2010, the sale is grandparented, and is subject to only the 5% GST.

A mechanism of transitional tax adjustments and transitional rebates may also apply. These are discussed in the “Special Measures—Ontario and B.C. HST—Transitional Tax and Transitional Rebates” section below.

7. Self-supply of New Multiple-unit Rental Properties (Apartment Buildings)—Ontario and B.C.

There is no grandparenting rule for the self-supply of new multiple-unit rental properties. (The self-supply rules are discussed in the section, “Completion—Residential Property” below.)

If possession or use of the first unit in a substantially completed rental apartment building is given to an individual after June 2010, for occupancy as a place of residence under a lease, license or similar arrangement, HST at the relevant rate (12% or 13%) applies to the deemed sale (i.e., the self-supply) by the builder/landlord, based on the FMV of the entire building.

A transitional rebate may be available to the builder/landlord. This rebate is discussed in the “Special Measures—Ontario and B.C. HST—Transitional Tax and Transitional Rebates” section below.
8. Sale of New Multiple-unit Rental Properties (Apartment Buildings)—Ontario and B.C.

Again, there is no grandparenting rule for sales of multiple-unit rental properties.

The transitional rule provides that the 5% GST applies if either title or possession is transferred before July 2010. If both title and possession are transferred after June 2010, the sale is subject to HST at the rate that applies in the province in which the building is situated.

A transitional rebate may be available to the builder. This rebate is discussed in the “Special Measures—Ontario and B.C. HST—Transitional Tax and Transitional Rebates” section below.

KPMG Observations

The 2016 federal budget proposed an election for new housing builders to correct a failure to report or errors in reporting on HST-grandparented housing sales. New housing builders have a short time to decide whether they should file this new election. Builders that want to take this opportunity must file the new election in a reporting period that ends on or after May 1, 2016 and before January 1, 2017.

Special Measures—Ontario, B.C. and P.E.I.

HST-Transitional Tax and Transitional Rebates

The implementation of the HST in Ontario and B.C. on July 1, 2010 required special measures in the area of the construction and sale of new residential housing, to prevent both loss of tax, and double tax.382 These measures take the form of a “Transitional Tax” (B.C.)/“Transitional Tax Adjustment” (Ontario) (collectively referred to below as “Transitional Tax Adjustment” or “TTA”), and “PST Transitional New Housing Rebates.” Both measures as they relate to Ontario and B.C. are discussed below, and summarized in tables at the end of this section.

P.E.I. also introduced a TTA and a “Provincial Transitional New Housing Rebate” as part of the implementation of the HST on July 1, 2013. A discussion of these measures is beyond the scope of this Handbook. For information on these rules as they apply to real property in P.E.I., please refer to the CRA publications listed in the “For Further Reference” section of this Handbook, under the section referring to P.E.I.

Transitional Tax Adjustment (“TTA”)

The TTA applies when newly constructed or substantially renovated grandparented housing is sold in Ontario or B.C. (See discussion above under “HST Transitional Rules” for conditions under which a sale of new housing is grandfathered.) The TTA is designed to prevent loss of tax.

The builder is not required to collect the provincial component of the HST on the sale of grandparented housing, even though both ownership and possession are transferred to the purchaser after June 2010. Only the 5% GST applies to the sale. In theory, PST should have applied to all of the materials used in the construction; however, the builder did not pay PST on materials purchased after June 30, 2010, and the builder can claim ITCs to recover the HST paid on such materials. As a result, some of the tax burden is “missing” from the cost of grandparented housing.

The B.C. and Ontario governments consider that the PST component of the cost of a home is approximately 2%. This is reflected in the TTA calculation, which is essentially a “top up” to bring the total PST paid by the builder to 2% of the sale price of the home.

Since the provincial component of the HST does not apply to the sale of grandparented housing, the TTA is intended to approximate the amount of the Ontario or B.C. PST that the builder would otherwise have paid on construction materials purchased after June 2010 under the PST regime, where the construction of the housing straddles the July 1, 2010 implementation date.

The mechanics for calculating the TTA for a single unit house differs from that for a residential condominium unit or a condominium complex.

TTA Calculation for Grandparented Sale of Single Unit House

The more complete the house on July 1, 2010, the more PST the builder has already paid on the materials. Consequently the amount of PST to be “topped up” is less. Conversely, if the house was less than 10% completed as of July 1, 2010, the full amount of TTA must be paid.
The table below provides the different rates of the TTA according to the degree of completion of the construction of a house as of July 1, 2010:

<table>
<thead>
<tr>
<th>Degree of Completion of Construction or Substantial Renovation as of July 1, 2010</th>
<th>Transitional Tax Adjustment Rate as a Percentage of Consideration</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less than 10%</td>
<td>2.0% of Consideration</td>
</tr>
<tr>
<td>Equal to or greater than 10% and less than 25%</td>
<td>1.5% of Consideration</td>
</tr>
<tr>
<td>Equal to or greater than 25% and less than 50%</td>
<td>1.0% of Consideration</td>
</tr>
<tr>
<td>Equal to or greater than 50% and less than 75%</td>
<td>0.5% of Consideration</td>
</tr>
<tr>
<td>Equal to or greater than 75% and less than 90%</td>
<td>0.2% of Consideration</td>
</tr>
<tr>
<td>Equal to or greater than 90%</td>
<td>0.0% of Consideration</td>
</tr>
</tbody>
</table>

However, where the consideration is less than what the FMV of the house would have been on the day the builder and purchaser entered into the written agreement of purchase and sale, had the housing been substantially complete on that date, the consideration for purposes of calculating the TTA will instead be “bumped” to that FMV.

### TTA Calculation for Grandparented Sale of Residential Condominium Unit or Condominium Complex

The TTA calculation for a grandfathered sale of a newly constructed or substantially renovated residential condominium unit or condominium complex differs from the TTA calculation for a grandfathered house, in that the TTA does not vary according to the degree of completion. The TTA for a grandfathered condominium unit/complex is always equal to 2% of the total consideration payable for the unit or complex.

However, for purposes of calculating the TTA, the consideration is “bumped” and deemed to be equal to the FMV, where the consideration payable for the unit or complex is less than the FMV of the housing on July 1, 2010, as if the housing had been substantially completed on that date.

The builder is entitled to claim a “PST transitional new housing rebate” if the construction of the condominium complex is at least 10% complete as of July 1, 2010 (see the section below on PST transitional new housing rebates).

The builder is considered to have collected the TTA, even though the builder does not actually collect it from anyone, and is required to include the TTA in the builder’s net tax calculation for the HST reporting period which includes the day that is:

- In the case of a detached house, semi-detached house, row house or residential condominium unit, the earlier of the day ownership or possession of the housing is transferred to the purchaser under the written agreement of purchase and sale for the housing; and
- In the case of a condominium complex, the earlier of the day ownership of the complex is transferred to the purchaser and the day that is sixty days after the day the complex is registered as a condominium.

The TTA does not apply to sales of traditional apartment buildings, duplexes, owner-built homes, mobile homes or floating homes.

### Ontario PST Transitional New Housing Rebate

The Ontario PST Transitional New Housing Rebate is designed to prevent double tax. It applies to sales of new housing that was not grandfathered because it was not sold under an agreement entered into before June 19, 2009, and is therefore subject to HST.

The Ontario PST Transitional New Housing Rebate also applies to rental housing. The builder of newly constructed or substantially renovated rental housing such as a single detached house, semi-detached house, attached house (row house), duplex, residential condominium unit, traditional apartment building or an addition to an apartment building is entitled to claim an Ontario PST Transitional New Housing Rebate where the construction or substantial renovation of the housing straddles the July 1, 2010 implementation date, and the HST is payable in respect of a self-supply of the housing. This is the case where possession of the housing, or a unit in the housing, is first given to an individual after the construction or substantial renovation is substantially completed and after June 2010, for occupancy as a place of residence. The construction or substantial renovation of the housing must be at least 10% complete as of July 1, 2010 for the builder to be entitled to claim this rebate.

Where the construction period straddles the July 1, 2010 HST implementation date, the builder will have paid non-recoverable PST on construction materials purchased before July 1, 2010. As noted above, the PST content of new housing is approximately 2% of its price. Therefore, depending upon the degree of completion of the housing on July 1, 2010, up to 2% of its sale price will be refunded under this rebate. The more complete the new housing is on July 1, 2010, the more PST was paid on construction materials, and therefore the higher the PST Transitional New Housing Rebate.
Two methods are available for calculating the Ontario PST content of new housing:
- 2% of the selling price; or
- $45 per square metre of interior floor space completed as of July 1, 2010.

The table below provides the different rates of the Ontario PST Transitional New Housing Rebate according to the degree of completion of the construction of housing as of July 1, 2010:

<table>
<thead>
<tr>
<th>Degree of Completion of Housing as of July 1, 2010</th>
<th>% of Estimated Ontario PST Content Rebated</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less than 10%</td>
<td>0%</td>
</tr>
<tr>
<td>Equal to or greater than 10% and less than 25%</td>
<td>25%</td>
</tr>
<tr>
<td>Equal to or greater than 25% and less than 50%</td>
<td>50%</td>
</tr>
<tr>
<td>Equal to or greater than 50% and less than 75%</td>
<td>75%</td>
</tr>
<tr>
<td>Equal to or greater than 75% and less than 90%</td>
<td>90%</td>
</tr>
<tr>
<td>Equal to or greater than 90%</td>
<td>100%</td>
</tr>
</tbody>
</table>

In the case of a new single home purchased by an individual, the individual can either claim the Ontario PST Transitional New Housing Rebate from the CRA, or assign it to the builder.

Note that where the builder of a residential condominium unit or condominium complex was required to pay the TTA (discussed above), the builder is entitled to claim the Ontario PST Transitional New Housing Rebate to offset a portion of the TTA paid.

To obtain the Ontario PST Transitional New Housing Rebate, a builder must first obtain from the Ontario Ministry of Revenue a “Letter of Good Standing”, certifying that the builder has no outstanding provincial debts. This letter, which is valid for one year, must be attached to the first rebate application that the builder files with the CRA.

**B.C. PST Transitional New Housing Rebate**

The B.C. PST Transitional New Housing Rebate is designed to prevent double tax. It applies to sales of new housing that was not grandfathered because it was not sold under an agreement entered into before November 19, 2009, and is therefore subject to HST.

The B.C. PST Transitional New Housing Rebate also applies to rental housing. The builder of newly constructed or substantially renovated rental housing such as a single detached house, semi-detached house, attached house (row house), duplex, residential condominium unit, traditional apartment building or an addition to an apartment building would be entitled to claim a B.C. PST Transitional New Housing Rebate where the construction or substantial renovation of the housing straddles the July 1, 2010 implementation date, and the HST is payable in respect of a self-supply of the housing (i.e., possession of the housing, or a unit in the housing, is first given to an individual after the construction or substantial renovation is substantially completed, and after June 2010, for occupancy as a place of residence). The construction or substantial renovation of the housing must be at least 10% complete as of July 1, 2010 in order to be entitled to claim this rebate.

Where the construction period straddles the July 1, 2010 HST implementation date, the builder will have paid non-recoverable PST on construction materials purchased before July 1, 2010. As noted above, the PST content of new housing is approximately 2% of its price. Therefore, depending upon the degree of completion of the housing on July 1, 2010, up to 2% of its sale price will be refunded under this rebate. The more complete the new housing is on July 1, 2010, the more PST was paid on construction materials, and therefore the higher the PST Transitional New Housing Rebate.

Two methods are available for calculating the B.C. PST content of new housing:
- 2% of the selling price; or
- $60 per square metre of interior floor space completed as of July 1, 2010.

The table below provides the different rates of the B.C. PST Transitional New Housing Rebate according to the degree of completion of the construction of new housing as of July 1, 2010:

<table>
<thead>
<tr>
<th>Degree of Completion of Housing as of July 1, 2010</th>
<th>% of Estimated B.C. PST Content Rebated</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less than 10%</td>
<td>0%</td>
</tr>
<tr>
<td>Equal to or greater than 10% and less than 25%</td>
<td>25%</td>
</tr>
<tr>
<td>Equal to or greater than 25% and less than 50%</td>
<td>50%</td>
</tr>
<tr>
<td>Equal to or greater than 50% and less than 75%</td>
<td>75%</td>
</tr>
<tr>
<td>Equal to or greater than 75% and less than 90%</td>
<td>90%</td>
</tr>
<tr>
<td>Equal to or greater than 90%</td>
<td>100%</td>
</tr>
</tbody>
</table>
In the case of a new single home purchased by an individual, the individual can either claim the B.C. PST Transitional New Housing Rebate from the CRA, or assign it to the builder.

Note that where the builder of a residential condominium unit or condominium complex was required to pay the Transitional Tax Adjustment (discussed above), the builder is entitled to claim the B.C. PST Transitional New Housing Rebate to offset a portion of the TTA paid.

To obtain the B.C. PST Transitional New Housing Rebate, a builder must first obtain from the B.C. Ministry of Finance a “Letter of Good Standing”, certifying that the builder has no outstanding provincial debts. This letter must be attached to the first rebate application that the builder files with the CRA.

Summary Tables
Appendices G and H summarize the TTA and the PST Transitional New Housing Rebate measures as they apply to sales of new single homes and new condominium units purchased by an individual in B.C. and Ontario, as well as the tax (GST or HST) that applies to the sale, and the federal and provincial new housing rebates available to the purchaser.

For Further Reference
The following CRA publications should be consulted for specific details, questions and answers, and examples of the application of the Ontario and B.C. transitional measures discussed above:

- GI-077—Harmonized Sales Tax: Purchasers of New Housing in Ontario
- GI-078—Harmonized Sales Tax: Purchasers of New Housing in British Columbia
- GI-079—Harmonized Sales Tax: Ontario New Housing Rebate
- GI-080—Harmonized Sales Tax: British Columbia New Housing Rebate
- GI-083—Harmonized Sales Tax: Information for Builders of New Housing in Ontario
- GI-084—Harmonized Sales Tax: Information for Builders of New Housing in British Columbia
- GI-088—Harmonized Sales Tax: Stated Price Net of GST/HST New Housing Rebates and the Ontario RST Transitional New Housing Rebate
- GI-089—Harmonized Sales Tax: Stated Price Net of GST/HST New Housing Rebates and the British Columbia PST Transitional New Housing Rebate
- GI-091—Harmonized Sales Tax: Information for Landlords of New Rental Housing
- GI-093—Harmonized Sales Tax: Ontario New Residential Rental Property Rebate
- GI-094—Harmonized Sales Tax: British Columbia New Residential Rental Property Rebate
- GI-095—Harmonized Sales Tax: Information on the Transitional Tax Adjustment for Builders of Housing in Ontario and British Columbia
- GI-096—Harmonized Sales Tax: Provincial Transitional New Housing Rebates for Housing in Ontario and British Columbia
- GI-098—Harmonized Sales Tax: Resales of New Housing in Ontario and British Columbia
- GI-099—Builders and Electronic Filing Requirements
- GI-101—Harmonized Sales Tax: Information for Non-registrant Builders of Housing in Ontario, British Columbia and Nova Scotia
- GI-105—How to Determine the Percentage of Completion for Purposes of the Provincial Transitional New Housing Rebates and the Transitional Tax Adjustment in Ontario and British Columbia
- GI-118—Builders and GST/HST NETFILE
- RC4052—GST/HST Information for the Home Construction Industry

The following CRA publications should be consulted for guidance concerning the rules governing P.E.I.’s transition to the HST effective July 1, 2013:

- GI-135, “Prince Edward Island: Transition to the Harmonized Sales Tax—Services” (February 2013)
- GI-136, “Prince Edward Island: Transition to the Harmonized Sales Tax—Intangible Personal Property” (February 2013)
- GI-144, “Harmonized Sales Tax: Purchasers of New Housing in Prince Edward Island” (March 2013)
- GI-146, “Harmonized Sales Tax: Information for Builders of New Housing in Prince Edward Island” (March 2013)
- GI-147, “Harmonized Sales Tax: Stated Price Net of the GST/HST New Housing Rebate in Prince Edward Island” (March 2013)
- GI-149, “Harmonized Sales Tax: Information for Landlords of New Rental Housing in Prince Edward Island” (March 2013)
- GI-150, “Harmonized Sales Tax: Information on the Transitional Tax Adjustment for Builders of Housing in Prince Edward Island” (March 2013)
- GI-151, “Harmonized Sales Tax: Provincial Transitional New Housing Rebate for Housing in Prince Edward Island” (March 2013)
- GI-152, “Harmonized Sales Tax: Assignment of Purchase and Sale Agreements for Grandparented Housing in Prince Edward Island” (March 2013)
- GI-153, “Harmonized Sales Tax: Builder Disclosure Requirements in Prince Edward Island” (March 2013)
Appendices
## Appendix A—Tax Treatment of Real Estate Project Costs

This schedule is intended to serve only as a guide and should be used in conjunction with the Canadian Real Estate Tax Handbook. The actual tax treatment of any specific cost may vary depending on the taxpayer’s particular circumstances and on the reasonableness of the expenditures incurred. This guide and any other planning idea should only be acted on with appropriate professional advice after a thorough examination of the particular situation.

### Cost Description

<table>
<thead>
<tr>
<th>Description</th>
<th>Resale Properties</th>
<th>Rental Properties/Capital Properties</th>
<th>Income Tax Act Section Reference</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Accounting fees</td>
<td>Deduct as operating expense if expenditures relate to general corporate governance or asset stewardship that recur year-to-year unless they are identifiable with one or more specific projects during the period of construction</td>
<td>Deduct as operating expense if expenditures relate to general corporate governance or asset stewardship that recur year-to-year unless they are identifiable with one or more specific projects during the period of construction</td>
<td>18(1)(a)</td>
</tr>
<tr>
<td>2. Architect’s fees</td>
<td>Include in cost</td>
<td>Capitalize as part of property costs</td>
<td>9(1); 18(1)(b)</td>
</tr>
<tr>
<td>3. Blueprints</td>
<td>Include in cost</td>
<td>Capitalize as part of property costs</td>
<td>9(1); 18(1)(b)</td>
</tr>
<tr>
<td>4. Building permits</td>
<td>Include in cost</td>
<td>Capitalize as part of property costs</td>
<td>9(1); 18(1)(b)</td>
</tr>
<tr>
<td>5. Buy-back fees—fee to ensure investment is paid back in certain circumstances</td>
<td>Include in cost</td>
<td>Capitalize as part of property costs</td>
<td>9(1); 18(1)(b)</td>
</tr>
<tr>
<td>Cash-flow and other revenue guarantee fees</td>
<td>Not applicable</td>
<td>Deduct as operating expense over the guarantee period</td>
<td>18(1)(a)</td>
</tr>
<tr>
<td>6. Charitable donations</td>
<td>Deduction or credit for officially receipted amounts</td>
<td>Deduction or credit for officially receipted amounts</td>
<td>110.1(1) or 118.1</td>
</tr>
<tr>
<td>7. Cleaning of completed units after construction has been completed</td>
<td>Deduct as operating expense or cost of sale</td>
<td>Deduct as operating expense</td>
<td>18(1)(a)</td>
</tr>
<tr>
<td>8. Clean-up of site after construction has been completed</td>
<td>Deduct as operating expense or cost of sale</td>
<td>Deduct as operating expense</td>
<td>18(1)(a)</td>
</tr>
<tr>
<td>9. Clearing or levelling land</td>
<td>Include in cost</td>
<td>Deduct as operating expense, capitalize as part of building costs or capitalize as part of land</td>
<td>20(1)(a); 20(1)(aa)</td>
</tr>
<tr>
<td>10. Condominium corporation formation costs</td>
<td>Include in cost</td>
<td>Include in cost</td>
<td>9(1); 18(3.1)</td>
</tr>
<tr>
<td>11. Deferred recoverable expenditures</td>
<td>Not applicable</td>
<td>Deduct as operating expense, amortize over term of related lease or capitalize to building or leasehold improvement, depending on the nature of the expenditure</td>
<td>18(1)(a); 20(1)(a)</td>
</tr>
<tr>
<td>Demolition costs (building)</td>
<td>Include in cost</td>
<td>Deduct as operating expense if the old building was used for a long period to earn income; alternatively, capitalize to the cost of the new building</td>
<td>9(1); 18(3.1)</td>
</tr>
<tr>
<td>12. Disability-related modifications/equipment</td>
<td>Include in cost</td>
<td>Deduct as operating expense</td>
<td>20(1)(q); 20(1)(r)</td>
</tr>
<tr>
<td>13. Engineering fees</td>
<td>Include in cost</td>
<td>Capitalize as part of property costs</td>
<td>9(1); 18(1)(b)</td>
</tr>
</tbody>
</table>

---

1. The CRA’s view in Interpretation Bulletin IT-485, “Cost of Clearing or Levelling Land” is that, where depreciable property of more than one class is built on the land or where part of the land is either used for extensive landscaping or is not put to use, a reasonable division of the costs should be made between each depreciable property, landscaping and land. The portion applicable to the landscaping is deductible and the portion applicable to each depreciable property is capitalized to the respective class if construction commences without undue delay; otherwise, the costs are capitalized to land.

2. The CRA states at paragraph 6 of IT-485 that the costs of demolishing a building incidentally acquired on obtaining a site, less the amount of any salvage, forms part of the cost of the land.

3. The CRA states at paragraph 6 of IT-485 that the costs of demolishing a building incidentally acquired on obtaining a site, less the amount of any salvage, forms part of the cost of the land.

4. Subsection 13(21.1) must also be considered, which may limit the terminal loss recognized on the demolition of a building.
<table>
<thead>
<tr>
<th>Cost Description</th>
<th>Resale Properties</th>
<th>Rental Properties/Capital Properties</th>
<th>Income Tax Act Section Reference</th>
</tr>
</thead>
<tbody>
<tr>
<td>15. Environmental land clean-up costs</td>
<td>Include in cost</td>
<td>Capitalize as part of the capital cost of land if present at the time the land was acquired, otherwise deduct as an operating expense</td>
<td>18(1)(b)</td>
</tr>
<tr>
<td>16. Equipment rental during construction</td>
<td>Include in cost</td>
<td>Capitalize as part of property costs</td>
<td>9(1); 18(1)(b)</td>
</tr>
<tr>
<td>17. Financing costs</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>– application fee</td>
<td>Amortize over five years</td>
<td>Amortize over five years</td>
<td>20(1)(e)</td>
</tr>
<tr>
<td>– commitment or standby fee</td>
<td>Amortize over five years</td>
<td>Amortize over five years</td>
<td>20(1)(e)</td>
</tr>
<tr>
<td>– consulting fee</td>
<td>Amortize over five years</td>
<td>Amortize over five years</td>
<td>20(1)(e)</td>
</tr>
<tr>
<td>– finder’s fee</td>
<td>Amortize over five years</td>
<td>Amortize over five years</td>
<td>20(1)(e)</td>
</tr>
<tr>
<td>– guarantee fee</td>
<td>Amortize over five years</td>
<td>Amortize over five years</td>
<td>20(1)(e)</td>
</tr>
<tr>
<td>– mortgage insurance fee</td>
<td>Amortize over five years</td>
<td>Amortize over five years</td>
<td>20(1)(e)</td>
</tr>
<tr>
<td>– legal fee</td>
<td>Amortize over five years</td>
<td>Amortize over five years</td>
<td>20(1)(e)</td>
</tr>
<tr>
<td>– processing fee</td>
<td>Amortize over five years</td>
<td>Amortize over five years</td>
<td>20(1)(e)</td>
</tr>
<tr>
<td>– letter of credit fee</td>
<td>Amortize over five years</td>
<td>Amortize over five years</td>
<td>20(1)(e)</td>
</tr>
<tr>
<td>18. Fines or penalties imposed by country or political subdivision (including, for example, municipal parking tickets)</td>
<td>No deduction and not included in cost</td>
<td>No deduction and not included in cost</td>
<td>67.6</td>
</tr>
<tr>
<td>19. General and administrative expenses not specifically identifiable with a real estate development project</td>
<td>Deduct as operating expense</td>
<td>Deduct as operating expense</td>
<td>9(1); 18(1)(b)</td>
</tr>
<tr>
<td>20. Golf courses, greens, tees and fairways</td>
<td>Include in cost</td>
<td>Capitalize as surface construction under Class 17</td>
<td>20(1)(a)</td>
</tr>
<tr>
<td>21. Guaranteed completion fee—undertaking by promoter to cover additional operating costs which may arise on account of delays in construction</td>
<td>Deduct as operating expense</td>
<td>Deduct as operating expense</td>
<td>18(1)(a)</td>
</tr>
<tr>
<td>22. Insurance—fire and other insurance</td>
<td>Include in cost unless it relates to general asset stewardship that would normally recur year-to-year (i.e., insurance on head office)</td>
<td>Capitalize as part of property costs during construction period unless it relates to general asset stewardship that would normally recur year-to-year (i.e., insurance on head office)</td>
<td>9(1); 18(9)</td>
</tr>
</tbody>
</table>

6 Interpretation internal 9413377, “Reclamation and clean-up costs”, dated April 13, 1995.
7 A standby charge, guarantee fee, registrar fee, transfer agent fee, filing fee, service fee or any similar fee that relates solely to the year is deductible in the year under paragraph 20(1)(e.1).
8 If the financing costs relate to securing financing for construction, then the costs should be capitalized during the period of construction under subsection 18(3.1). However, only the amount that is deductible in the taxation year should be capitalized (i.e., for a $500 financing expense deductible over five years, only $100 would be capitalized in each of the five years during the period of construction). See Technical Interpretation 2004-0056861E5, “Financing costs”.
9 Interpretation Bulletin IT-341R4, “Expenses of Issuing or Selling Shares, Units in a Trust, Interests in a Partnership and Expenses of Borrowing Money,” dated February 28, 2007 indicates at paragraph 17 that an amount paid to the guarantor of a loan on a periodic basis during the continuance of the loan, or as a one-time payment at the commencement of the loan is a deductible expense under subparagraph 20(1)(e)(ii).
11 In Income Tax Technical News No. 20, the CRA indicates that greens, tees and fairways of a golf course meet the characteristics of surface construction as outlined in The Queen v. Mont-Sutton Inc. (99 DTC 5733).
<table>
<thead>
<tr>
<th>Cost Description</th>
<th>Resale Properties</th>
<th>Rental Properties/Capital Properties</th>
<th>Income Tax Act Section Reference</th>
</tr>
</thead>
<tbody>
<tr>
<td>23. Interest re:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>– vacant land</td>
<td>Include in cost, net of rental income&lt;sup&gt;12&lt;/sup&gt; Capitalize as part of land costs, net of rental income&lt;sup&gt;13&lt;/sup&gt;</td>
<td></td>
<td>18(2)</td>
</tr>
<tr>
<td>– servicing vacant land</td>
<td>May be deductible as operating expense May be deductible as operating expense</td>
<td></td>
<td>20(1)(c) [not denied by 18(2) or 18(3.1)]</td>
</tr>
<tr>
<td>– during construction—attributable to construction and related land</td>
<td>Include in cost Capitalize as part of building costs</td>
<td></td>
<td>18(3.1) to 18(3.4); 20(29)</td>
</tr>
<tr>
<td>– after construction</td>
<td>Deduct as operating expense Deduct as operating expense</td>
<td></td>
<td>20(1)(c)</td>
</tr>
<tr>
<td>– participating debt</td>
<td>May be deductible&lt;sup&gt;13&lt;/sup&gt; May be deductible&lt;sup&gt;14&lt;/sup&gt;</td>
<td></td>
<td>20(1)(c)</td>
</tr>
<tr>
<td>– rate reduction payment</td>
<td>Deduct over remaining term of debt using present value amortization method; alternatively, straight-line Deduct over remaining term of debt using present value amortization method; alternatively, straight-line</td>
<td></td>
<td>18(9); (9.1)</td>
</tr>
<tr>
<td>– early debt repayment penalty (other than refinancing)</td>
<td>Deduct over eliminated term of debt using present value amortization method; alternatively, straight-line Deduct over eliminated term of debt using present value amortization method; alternatively, straight-line</td>
<td></td>
<td>18(9.1)</td>
</tr>
<tr>
<td>– early debt repayment penalty on sale of property&lt;sup&gt;15&lt;/sup&gt;</td>
<td>Deduct as cost of sale Deduct as cost of sale</td>
<td></td>
<td>9(1); 40(1)</td>
</tr>
<tr>
<td>– early debt repayment penalty on debt rescheduling or restructuring</td>
<td>Amortize over five years Amortize over five years</td>
<td></td>
<td>20(1)(e)(ii.2)</td>
</tr>
<tr>
<td>– prepaid interest</td>
<td>Deduct or capitalize, based on a notional reduced principal calculation Deduct or capitalize, based on a notional reduced principal calculation</td>
<td></td>
<td>18(9.2)</td>
</tr>
<tr>
<td>24. Improvements/construction by tenant on leased property</td>
<td>Not applicable</td>
<td>Capitalize as leasehold improvement under Class 13, unless building or other structure, then Class 1</td>
<td>20(1)(a); Reg. 1102(5)</td>
</tr>
<tr>
<td>25. Land servicing</td>
<td>Include in cost</td>
<td>Capitalize as part of land costs unless construction of the building has commenced then capitalize to building</td>
<td>18(2); 18(3.1)</td>
</tr>
<tr>
<td>26. Landlord leasing costs</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(a) Tenant inducements:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>– initial lease expense</td>
<td>Not applicable</td>
<td>Deduct over term of related lease or deduct as operating expenses&lt;sup&gt;15&lt;/sup&gt;;&lt;sup&gt;16&lt;/sup&gt;</td>
<td>18(1)(a)</td>
</tr>
<tr>
<td>– re-leasing to new or existing tenant</td>
<td>Not applicable</td>
<td>Deduct over term of related lease or deduct as operating expenses&lt;sup&gt;15&lt;/sup&gt;;&lt;sup&gt;16&lt;/sup&gt;</td>
<td>18(1)(a); 18(9)</td>
</tr>
</tbody>
</table>

<sup>12</sup> May be partly deductible under the “Base Level Deduction” rule.

<sup>13</sup> The CRA states, in Income Tax Technical News #25, that where evidence shows, as it did in Sherway Centre Limited (2003 DTC 5082), that the participating payments are intended to increase the interest rate of the loan to the prevailing market rate, the payments will be considered to be interest.

<sup>14</sup> See paragraph 1.22 of Income Tax Folio S4-F2-C1, “Deductibility of Fines and Penalties”, dated December 22, 2015. For clarity, however, section 67.6 generally denies the deduction of fines or penalties imposed under the laws of a country or political subdivision of a country by any person or public body that has authority to impose the fine or penalty.

<sup>15</sup> The Supreme Court decisions in Canderel Ltd. (98 DTC 6100) and Toronto College Park Ltd. (98 DTC 6088) support the deductibility of lease costs.

<sup>16</sup> The CRA has taken the position that to be deductible, an expenditure must meet the facts of Canderel creating a more accurate picture of profit for the year in accordance with “well-accepted business principles”, i.e., the payment must arise under the lease, there must be an identifiable benefit to the landlord in the period incurred (over and above the rental revenue from the particular lease), and the payment must not be for capital improvements to the property.
<table>
<thead>
<tr>
<th>Cost Description</th>
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<th>Rental Properties/Capital Properties</th>
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</tr>
</thead>
<tbody>
<tr>
<td>(b) leasing commissions/fees and other leasing costs</td>
<td>Not applicable</td>
<td>Same as tenants inducements&lt;sup&gt;15,16&lt;/sup&gt;</td>
<td>18(1)(a)</td>
</tr>
<tr>
<td>(c) Tenant improvements</td>
<td>Not applicable</td>
<td>Same as tenants inducements&lt;sup&gt;15,16&lt;/sup&gt;</td>
<td>18(1)(a)</td>
</tr>
<tr>
<td>(d) Landlord lease cancellation payments</td>
<td>Not applicable</td>
<td>Amortize over the remaining term of the lease, including renewal terms (not exceeding 40 years)</td>
<td>20(1)(z)</td>
</tr>
<tr>
<td>– if landlord continues to own property</td>
<td>Not applicable</td>
<td>50% of unamortized payment deductible</td>
<td>20(1)(z.1)</td>
</tr>
<tr>
<td>– if landlord disposes of property</td>
<td>Not applicable</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(e) Unit turnover costs</td>
<td>Not applicable</td>
<td>Generally deduct as an operating cost unless specifically capitalized (such as equipment)</td>
<td>18(1)(a)</td>
</tr>
</tbody>
</table>

27. **Landscaping**

Inventory as part of property costs per Qualico Developments Limited (84 DTC 6119)

Deduct amounts paid in the year for the landscaping of grounds around a building or other structure owned by the taxpayer, which may include expenditures for lawns, trees, shrubs, retaining walls, etc., expenditures for changing the contour of the land, and fees paid to a professional landscape architect

20(1)(aa)

28. **Legal fees**

Include in cost if pertaining to the acquisition of property or construction

Deduct if pertaining to rental operations; capitalize as part of property costs if pertaining to the acquisition of property

18(1)(a); 18(1)(b)

29. **Marketing and advertising**

Deduct as operating expense

Deduct as operating expense

18(1)(a)

30. **Meals and entertainment, excluding club dues**

Deduct 50% as operating expense; alternatively, include 50% in cost if related to construction

Deduct 50% as operating expense

67.1(1)

31. **Modifications made to meet building code requirements (e.g., smoke detectors, sprinklers, improved lighting in garages)**

Include in cost

Capitalize as part of property costs

9(1); 18(1)(b)

32. **Playground equipment**

Include in cost

Capitalize as part of property cost—generally Class 8

20(1)(a)

33. **Property taxes:**

(a) Regular – vacant land

– during construction

Include in cost<sup>17</sup>

Include in cost

Capitalize as land cost<sup>17</sup>

18(2)

– after construction

Deduct as operating expense

Capitalize as building cost

18(3.1)

(b) Levies – vacant land

Include in cost<sup>18</sup>

Include in cost<sup>14</sup>

9(1); 18(1)(b)

18(2)

34. **Real estate rental expenses, excluding interest and property taxes**

Deduct as operating expense

Deduct as operating expense

18(1)(a)

---

<sup>17</sup> May be partly deductible under “Base Level Deduction” rule.

<sup>18</sup> The decisions in Metropolitan Properties Co. Ltd. (85 DTC 5128), Edmonton Plaza Hotel (1980) Ltd. (87 DTC 5371), MHL Holdings Ltd. (88 DTC 6292) and Stursberg (90 DTC 1159) held that levies are added to cost. The Federal Court of Appeal decision in Urbandale Realty Corporation Limited (2000 DTC 6118), however, allowed the deduction of levies under pre-1988 legislation, contradicting the decision in Metropolitan Properties.
<table>
<thead>
<tr>
<th>Cost Description</th>
<th>Resale Properties</th>
<th>Rental Properties/Capital Properties</th>
<th>Income Tax Act Section Reference</th>
</tr>
</thead>
<tbody>
<tr>
<td>35. Representation costs</td>
<td>Include in cost if incurred during the period of construction</td>
<td>Deduct amounts paid for expenses incurred by making representations to a government or agency of a government in Canada concerning a business carried on by the taxpayer, including any representation made for the purpose of obtaining a license, permit, franchise or trademark relating to such business.</td>
<td>20(1)(cc)</td>
</tr>
<tr>
<td>36. Roads, sidewalks, bridges, parking areas and similar surface construction on land not owned (offsite costs)</td>
<td>Include in cost</td>
<td>Capitalize as depreciable property to prescribed class (Class 1 if bridge, otherwise generally Class 17)</td>
<td>13(75)</td>
</tr>
<tr>
<td>37. Sales commission on acquisition of real property</td>
<td>Include in cost</td>
<td>Capitalize as part of property costs</td>
<td>9(1); 18(1)(b)</td>
</tr>
<tr>
<td>38. Sales commission on disposition of real property</td>
<td>Deduct as operating expense in the year incurred and services rendered</td>
<td>Deduct as operating expense</td>
<td>9(1); 18(1)(b)</td>
</tr>
<tr>
<td>39. Service fee—provision of administration, off-site supervisory and management services</td>
<td>Deduct as operating expense if expenditures relate to general corporate governance or asset stewardship that recur year-to-year unless they are identifiable with one or more specific projects during the period of construction</td>
<td>Deduct as operating expense if expenditures relate to general corporate governance or asset stewardship that recur year-to-year unless they are identifiable with one or more specific projects during the period of construction</td>
<td>18(1)(a)</td>
</tr>
<tr>
<td>40. Site investigation</td>
<td>Include in cost if incurred during the period of construction</td>
<td>Deduct amounts paid in the year for investigating the suitability of a site for a building or other structure planned for use by the taxpayer in connection with a business carried on by the taxpayer, if incurred before construction commences</td>
<td>20(1)(dd)</td>
</tr>
<tr>
<td>41. Small tools</td>
<td>Capitalize as Class 12 if under $500; otherwise generally capitalize as Class 8</td>
<td>Capitalize as Class 12 if under $500; otherwise generally capitalize as Class 8</td>
<td>20(1)(a)</td>
</tr>
<tr>
<td>42. Utility service connections</td>
<td>Include in cost</td>
<td>Capitalize as part of building costs incurred during construction; otherwise deduct amounts paid by taxpayer directly to entity supplying the service for the connection if the service connection is to the property line of the taxpayer’s place of business and ownership of the connection does not pass to the taxpayer</td>
<td>20(1)(ee)</td>
</tr>
<tr>
<td>43. Warranty</td>
<td>Deduct as operating expense or cost of sale when not contingent</td>
<td>Not applicable</td>
<td>18(1)(e)</td>
</tr>
<tr>
<td>44. Website design</td>
<td>Deduct sales and marketing as operating expense</td>
<td>Deduct as operating expense</td>
<td>18(1)(a)</td>
</tr>
</tbody>
</table>

19 Whether the rental property is a business or an investment property is a question of fact that depends on the nature and extent of services provided to the tenants. 
20 The contract should be reviewed to determine if the sales commission is non-refundable (and therefore the services have been rendered) or refundable (and could be considered an advance or a contingent amount).
## Appendix B—Common Canadian Ownership Structures

This schedule is intended to serve only as a guide and should be used in conjunction with the Canadian Real Estate Tax Handbook. This guide and any planning idea should not be acted on without appropriate professional advice after a thorough examination of the particular situation. The tax rates noted below are for Canadian resident investors.

<table>
<thead>
<tr>
<th>Ownership Structure</th>
<th>Taxation</th>
<th>Income Distribution</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Canadian Controlled Private Corporation</strong></td>
<td>Subject to tax</td>
<td>Dividends, capital gains and foreign income distributed to beneficiaries retain their characteristic. All other amounts considered “other property income” from owning an interest in the trust. The Trust deducts income distributed to beneficiaries in its computation of taxable income.</td>
</tr>
<tr>
<td><strong>Unincorporated Joint Venture/Co-ownership</strong></td>
<td>Not subject to tax</td>
<td>Income (loss) retains its character at the participant level.</td>
</tr>
<tr>
<td><strong>Private Partnership/Private Limited Partnership</strong></td>
<td>Not subject to tax</td>
<td>Income (loss) allocated retains its character at the partner level.</td>
</tr>
<tr>
<td><strong>Private Intervivos Trust</strong></td>
<td>Subject to tax</td>
<td>Income allocated to the public unit holder is deemed to be an eligible dividend paid by the SIFT Partnership.</td>
</tr>
<tr>
<td><strong>Public SIFT Partnership</strong></td>
<td>Subject to tax</td>
<td>Income distributed to the public unit holder is deemed to be an eligible dividend paid by the SIFT Trust. The SIFT Trust deducts income distributed to beneficiaries in its computation of taxable income.</td>
</tr>
<tr>
<td><strong>Public SIFT Trust</strong></td>
<td>Subject to tax</td>
<td>Dividends, capital gains and foreign income distributed to beneficiaries retain their characteristics. All other amounts considered “other property income” received from a trust. The REIT deducts income distributed to beneficiaries in its computation of taxable income.</td>
</tr>
<tr>
<td><strong>Public Real Estate Investment Trust (“REIT”)</strong></td>
<td>Subject to tax</td>
<td>Dividends, capital gains and foreign income retain their characteristics. All other amounts considered “other property income” received from a trust. The Trust deducts income distributed to beneficiaries in its computation of taxable income.</td>
</tr>
<tr>
<td><strong>Public or Private Mutual Fund Trust</strong></td>
<td>Subject to tax</td>
<td>Dividends, capital gains and foreign income retain their characteristics. All other amounts considered “other property income” received from a trust. The Trust deducts income distributed to beneficiaries in its computation of taxable income.</td>
</tr>
<tr>
<td>Year-end</td>
<td>Capital Tax</td>
<td>Liability</td>
</tr>
<tr>
<td>----------</td>
<td>-------------</td>
<td>-----------</td>
</tr>
<tr>
<td>Any year-end date allowed. The first year-end has to be within 53 weeks from the date of incorporation. For taxation years ending after March 22, 2011, each participant must include its share of income from a joint venture based on its own fiscal period. Otherwise, year-end must be December 31. For taxation years ending after March 22, 2011, a corporate partner with a significant interest in a partnership must comply with rules which limit the tax deferral if the fiscal period of the partnership is different than the corporate partner’s taxation year. Any year-end is allowed. Intervivos trust must have December 31 year-end. Any year-end is allowed. Year-end must be December 31. May elect to have a December 15th taxation year-end. Year-end must be December 31. May elect to have a December 15th taxation year-end. Year-end must be December 31st. May elect to have a December 15th taxation year-end.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>By July 1, 2012, corporations other than financial institutions are no longer subject to capital tax in any province. Corporate participants are subject to provincial capital tax, if any, based on their proportionate share of the taxable capital of the joint venture or co-ownership. Corporate participants are subject to provincial capital tax, if any, based on their proportionate share of the taxable capital of the partnership. Corporate partners are only liable to the extent of their partnership capital. Corporate partners are subject to provincial capital tax, if any, based on their proportionate share of the taxable capital of the partnership. Corporate partners are subject to provincial capital tax, if any, based on their proportionate share of the taxable capital of the partnership. Corporate partners are subject to provincial capital tax, if any, based on their proportionate share of the taxable capital of the partnership. Not subject to capital tax. Not subject to capital tax. Not subject to capital tax.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Shareholders are not exposed to the liabilities of the corporation. Partners are jointly and severally liable. Participants are jointly and severally liable. Participant’s taxation year-end is the date of the taxation year-end. Partners are jointly and severally liable, except that limited partners are only liable to the extent of their partnership capital. Participants are jointly and severally liable, except that limited partners are only liable to the extent of their partnership capital. Participants are jointly and severally liable, except that limited partners are only liable to the extent of their partnership capital. Participants are jointly and severally liable, except that limited partners are only liable to the extent of their partnership capital. Participants are jointly and severally liable, except that limited partners are only liable to the extent of their partnership capital. Not subject to the liabilities of the trust. Not subject to the liabilities of the trust. Not subject to the liabilities of the trust.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Capital Tax: By July 1, 2012, corporations other than financial institutions are no longer subject to capital tax in any province. Corporate participants are subject to provincial capital tax, if any, based on their proportionate share of the taxable capital of the joint venture or co-ownership. Corporate participants are subject to provincial capital tax, if any, based on their proportionate share of the taxable capital of the partnership. Corporate partners are only liable to the extent of their partnership capital. Participants are jointly and severally liable, except that limited partners are only liable to the extent of their partnership capital. Participants are jointly and severally liable, except that limited partners are only liable to the extent of their partnership capital. Participants are jointly and severally liable, except that limited partners are only liable to the extent of their partnership capital. Participants are jointly and severally liable, except that limited partners are only liable to the extent of their partnership capital. Participants are jointly and severally liable, except that limited partners are only liable to the extent of their partnership capital. Not subject to the liabilities of the trust. Not subject to the liabilities of the trust. Not subject to the liabilities of the trust.</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
### Recipient Treatment

<table>
<thead>
<tr>
<th>Ownership</th>
<th>Recipient Treatment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Canadian Controlled Private Corporation</td>
<td>If the shareholder itself is a CCPC, it pays no tax on the dividends it receives unless it is a portfolio dividend or if the payor corporation receives a dividend refund. If the shareholder is an individual, the dividend is subject to a gross-up and dividend tax credit treatment, amount of gross-up and tax credit depends on whether the dividend is an eligible dividend.</td>
</tr>
<tr>
<td>Unincorporated/Joint Venture/Co-ownership</td>
<td>Income retains its character and is taxed at participants’ applicable rate based on the type of income earned by the joint venture/co-ownership.</td>
</tr>
<tr>
<td>Private Partnership/Private Limited Partnership</td>
<td>Income retains its character and is taxed at the partner’s applicable rate based on the type of income earned by the partnership.</td>
</tr>
<tr>
<td>Private Inter-vivos Trust</td>
<td>Income maintains its character as dividends, capital gain or foreign income. Taxed at applicable rates based on type of income.</td>
</tr>
<tr>
<td>Public SIFT Partnership</td>
<td>If the unitholder is a CCPC, it pays tax under Part IV on the eligible dividend it receives, unless it is &quot;connected&quot; with the payor. If the unit holder is an individual, the dividend is subject to a gross-up and dividend tax credit treatment as an eligible dividend.</td>
</tr>
<tr>
<td>Public SIFT Trust</td>
<td>Income maintains its character as either dividends, capital gain, foreign income, or other property income. Taxed at applicable rates based on type of income.</td>
</tr>
<tr>
<td>Public Real Estate Investment Trust (&quot;REIT&quot;)</td>
<td>Income maintains its character as either dividends, capital gain, foreign income, or other property income. Taxed at applicable rates based on type of income.</td>
</tr>
<tr>
<td>Public or Private Mutual Fund Trust</td>
<td>Income maintains its character as either dividends, capital gain, foreign income, or other property income. Taxed at applicable rates based on type of income.</td>
</tr>
</tbody>
</table>

### Residency

<table>
<thead>
<tr>
<th>Recipient Treatment</th>
<th>Residency</th>
</tr>
</thead>
<tbody>
<tr>
<td>None</td>
<td>Generally, where incorporated, but may be taxed in other jurisdictions with a “permanent establishment.”</td>
</tr>
<tr>
<td>None</td>
<td>None, however, to be a &quot;Canadian Partnership,&quot; all of the partners must be resident in Canada.</td>
</tr>
<tr>
<td>None</td>
<td>Where the majority of trustees are resident and/or where the &quot;central management and control&quot; takes place.</td>
</tr>
<tr>
<td>None</td>
<td>Where the majority of trustees are resident and/or where the &quot;central management and control&quot; takes place.</td>
</tr>
<tr>
<td>None</td>
<td>Where the majority of trustees are resident and/or where the &quot;central management and control&quot; takes place.</td>
</tr>
</tbody>
</table>

### Small Business Deduction

<table>
<thead>
<tr>
<th>Recipient Treatment</th>
<th>Small Business Deduction (&quot;SBD&quot;) on active business income</th>
</tr>
</thead>
<tbody>
<tr>
<td>No</td>
<td>Corporate partners entitled to SBD and treat income as if they earned it directly.</td>
</tr>
<tr>
<td>No</td>
<td>Corporate partners entitled to SBD on their share of the income.</td>
</tr>
<tr>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>No</td>
<td>None</td>
</tr>
<tr>
<td>No</td>
<td>None</td>
</tr>
<tr>
<td>No</td>
<td>None</td>
</tr>
</tbody>
</table>

### Eligible Investment for Registered Plans (RRSP, RESP, RRIF, DPSP, RDSR, TFSA)

<table>
<thead>
<tr>
<th>Recipient Treatment</th>
<th>Eligible Investment for Registered Plans (RRSP, RESP, RRIF, DPSP, RDSR, TFSA)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes, with ownership restrictions</td>
<td>Yes, if units are publicly listed or distributed, with ownership restrictions.</td>
</tr>
<tr>
<td>No</td>
<td>Yes, if units are publicly listed or distributed, with ownership restrictions.</td>
</tr>
<tr>
<td>No</td>
<td>Yes, if units are publicly listed or distributed, with ownership restrictions.</td>
</tr>
<tr>
<td>No</td>
<td>Yes, if units are publicly listed or distributed, with ownership restrictions.</td>
</tr>
</tbody>
</table>

### Allocation of Business Income from Multiple Jurisdictions

<table>
<thead>
<tr>
<th>Recipient Treatment</th>
<th>Allocation of Business Income from Multiple Jurisdictions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Based on permanent establishment</td>
<td>Allocation calculated using both gross revenue and wages attributable to a permanent establishment.</td>
</tr>
<tr>
<td>Allocation calculated using both gross revenue and wages attributable to a permanent establishment</td>
<td>Allocation calculated using both gross revenue and wages attributable to a permanent establishment.</td>
</tr>
<tr>
<td>Based on permanent establishment</td>
<td>Allocation calculated using both gross revenue and wages attributable to a permanent establishment.</td>
</tr>
<tr>
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<td>Allocation calculated using both gross revenue and wages attributable to a permanent establishment.</td>
</tr>
<tr>
<td>Based on permanent establishment</td>
<td>Allocation calculated using both gross revenue and wages attributable to a permanent establishment.</td>
</tr>
</tbody>
</table>

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### COMMON FORMS OF REAL ESTATE OWNERSHIP

<table>
<thead>
<tr>
<th>Ownership and Operating Issues</th>
<th>Non-Residents Investing in Canadian Real Estate</th>
<th>U.S. Vacation Property</th>
<th>Goods and Services Tax/Harmonized Sales Tax</th>
<th>Appendices</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Canadian Controlled Private Corporation</strong></td>
<td><strong>Unincorporated/Joint Venture/Co-ownership</strong></td>
<td><strong>Private Partnership/Private Limited Partnership</strong></td>
<td><strong>Private Inter-vivos Trust</strong></td>
<td><strong>Public SIFT Partnership</strong></td>
</tr>
<tr>
<td><strong>Property Rollovers</strong></td>
<td>Tax-deferred transfer of capital property (not real property inventory) into a corporation may be available</td>
<td>Tax-deferred transfer of capital property and real property inventory into a Canadian partnership may be available</td>
<td>Tax-deferred distribution of property may be available to a capital beneficiary of a personal inter-vivos trust</td>
<td>Tax-deferred transfer of capital property and real property inventory into a Canadian partnership may be available</td>
</tr>
<tr>
<td><strong>GST</strong>&lt;sup&gt;22&lt;/sup&gt;</td>
<td>GST registration required if engaged in commercial activity</td>
<td>A co-ownership is not a “person” for GST purposes; therefore a co-ownership cannot register for GST purposes in its own right</td>
<td>A partnership is a “person” for GST purposes and must register for GST in its own name and account for GST</td>
<td>A trust is a “person” for GST purposes and subject to GST registration if engaged in commercial activity</td>
</tr>
<tr>
<td></td>
<td>GST registration is at the level of the co-owners</td>
<td>Partners not required to register</td>
<td>The CRA distinguishes between “true trust” and “bare trust”</td>
<td>Partners not required to register</td>
</tr>
<tr>
<td></td>
<td>If a co-ownership makes taxable supplies of the property held in the co-ownership, the co-owners are normally required to register for GST purposes and remit tax and claim ITCs on a pro-rata basis, proportional to their interest in the co-ownership</td>
<td>Partnership, not partners, considered to be engaged in commercial activity and make supplies</td>
<td>True trust: the trust is person engaged in commercial activity relating to trust property and registers for GST purposes. Bare trust: cannot register for GST purposes and make supplies</td>
<td>True trust: the trust is person engaged in commercial activity relating to trust property and registers for GST purposes. Bare trust: cannot register for GST purposes and make supplies</td>
</tr>
</tbody>
</table>

<sup>22</sup> For simplicity, “GST” is used herein to refer to both the Goods and Services Tax and the Harmonized Sales Tax.
<table>
<thead>
<tr>
<th>Common Forms of Real Estate Ownership</th>
<th>Ownership and Operating Issues</th>
<th>Non-Residents Investing in Canadian Real Estate</th>
<th>U.S. Vacation Property</th>
<th>Goods and Services Tax/Harmonized Sales Tax</th>
<th>Appendices</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Other</strong></td>
<td>Canadian Controlled Private Corporation</td>
<td>Unincorporated Joint Venture/Co-ownership</td>
<td>Private Partnership/Private Limited Partnership</td>
<td>Private Inter-vivos Trust</td>
<td>Public SIFT Partnership</td>
</tr>
<tr>
<td>Subject to minimum tax in Ontario</td>
<td>Losses cannot be allocated from a corporation to its shareholders</td>
<td>Losses are claimed by the participants of a co-ownership or joint venture</td>
<td>Need at least two partners to form a partnership</td>
<td>Losses can be allocated to partners, however, in the case of a limited partner, the amount of the loss allocated is limited to the partner’s “at-risk” amount</td>
<td>Subject to 21-year deemed disposition rule</td>
</tr>
<tr>
<td>Losses cannot be allocated from a corporation to its shareholders</td>
<td></td>
<td></td>
<td>Subject to minimum tax</td>
<td>Losses cannot be allocated to the beneficiaries of a trust</td>
<td>Subject to minimum tax</td>
</tr>
<tr>
<td>Need at least two partners to form a partnership</td>
<td>Losses can be allocated to partners, however, in the case of a limited partner, the amount of the loss allocated is limited to the partner’s “at-risk” amount</td>
<td>Losses cannot be allocated to the beneficiaries of a trust</td>
<td>Subject to minimum tax</td>
<td>Losses cannot be allocated to the beneficiaries of a trust</td>
<td>Losses cannot be allocated to the beneficiaries of a trust</td>
</tr>
</tbody>
</table>
## Appendix C—Non-resident Investment in Canada—Tax Rates and Considerations

### Property Income—2016

<table>
<thead>
<tr>
<th>Property Income 2016</th>
<th>Non-resident Corporation</th>
<th>Non-Canadian Partnership</th>
<th>Non-resident Trust</th>
<th>Canadian Corporation</th>
<th>Canadian Partnership ¹</th>
<th>Canadian Intervivos Trust</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Federal Tax</strong></td>
<td>25%</td>
<td>Tax rates depend on Canadian tax status of each partner</td>
<td>48.84% (including federal surtax of 48% x 33%)</td>
<td>15%</td>
<td>Tax rates depend on Canadian tax status of each partner</td>
<td>33%</td>
</tr>
<tr>
<td><strong>Provincial Tax</strong></td>
<td>N/A</td>
<td>Tax rates depend on Canadian tax status of each partner</td>
<td>N/A</td>
<td>11% to 18%</td>
<td>Tax rates depend on Canadian tax status of each partner</td>
<td>11.5% to 25.75%</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Combined Rate</strong></td>
<td>25%</td>
<td>Tax rates depend on Canadian tax status of each partner</td>
<td>48.84%</td>
<td>26% to 31%</td>
<td>Tax rates depend on Canadian tax status of each partner</td>
<td>44.5% to 54%</td>
</tr>
<tr>
<td><strong>Branch Tax</strong></td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
</tr>
<tr>
<td><strong>Capital Tax</strong></td>
<td>N/A</td>
<td>Would depend on the status of the partner(s). By July 1, 2012, corporations other than financial institutions are no longer subject to capital tax in any province</td>
<td>N/A</td>
<td>By July 1, 2012, corporations other than financial institutions are no longer subject to capital tax in any province</td>
<td>Depends on status of the partner(s). By July 1, 2012, corporations other than financial institutions are no longer subject to capital tax in any province</td>
<td>N/A</td>
</tr>
<tr>
<td><strong>AMT</strong></td>
<td>N/A</td>
<td>Depends on partner</td>
<td>Yes</td>
<td>N/A</td>
<td>Depends on partner</td>
<td>Yes</td>
</tr>
<tr>
<td></td>
<td></td>
<td>AMT may apply if interest, CCA and/or other tax preference items exceed rental income or partnership income allocated to an individual or trust that is a “specified member” of the partnership</td>
<td>AMT may apply if interest, CCA and/or other tax preference items exceed rental income or partnership income allocated to an individual or trust that is a “specified member” of the partnership</td>
<td>AMT may apply if interest, CCA and/or other tax preference items exceed rental income or partnership income allocated to an individual or trust that is a “specified member” of the partnership</td>
<td>AMT may apply if interest, CCA and/or other tax preference items exceed rental income or partnership income allocated to an individual or trust that is a “specified member” of the partnership</td>
<td></td>
</tr>
<tr>
<td><strong>Thin Capitalization Rules</strong></td>
<td>1.5:1 debt-to-equity limitation</td>
<td>1.5:1 debt-to-equity limitation applies to partner based on partner’s debt and proportionate share of debt of the partnership</td>
<td>1.5:1 debt-to-equity limitation</td>
<td>1.5:1 debt-to-equity limitation</td>
<td>1.5:1 debt-to-equity limitation applies to partner based on partner’s debt and proportionate share of debt of the partnership</td>
<td>1.5:1 debt-to-equity limitation</td>
</tr>
<tr>
<td><strong>Withholding Tax on Distributions</strong></td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
<td>5% – 25% depending on whether treaty benefits are available</td>
<td>N/A</td>
<td>15% to 25% depending on whether treaty benefits are available</td>
</tr>
</tbody>
</table>

¹ Defined in subsection 102(1), a “Canadian partnership” is a partnership all of the members of which are resident in Canada. This status could apply in the context of a non-resident investment if the non resident(s) joins the partnership via a Canadian legal entity (e.g., a Canadian corporate or trust).
### Property Income 2016

<table>
<thead>
<tr>
<th>Property Income 2016</th>
<th>Non-resident Corporation</th>
<th>Non-Canadian Partnership</th>
<th>Non-resident Trust</th>
<th>Canadian Corporation</th>
<th>Canadian Partnership</th>
<th>Canadian Intervivos Trust</th>
</tr>
</thead>
<tbody>
<tr>
<td>Withholding Tax on Interest</td>
<td>N/A</td>
<td>Under revised paragraph 212(1)(b), withholding tax is no longer applicable to non-participating interest paid to an arm’s length party.</td>
<td>N/A</td>
<td>Under revised paragraph 212(1)(b), withholding tax is no longer applicable to non-participating interest paid to an arm’s length party.</td>
<td>0% to 25%</td>
<td>0% to 25%</td>
</tr>
<tr>
<td>Disposition of Property</td>
<td>Recapture of CCA</td>
<td>50% capital gains subject to income tax</td>
<td>Section 116 certificate of compliance required on disposition of assets</td>
<td>Recapture of CCA</td>
<td>50% capital gains subject to income tax</td>
<td>Section 116 certificate of compliance required on disposition of assets</td>
</tr>
<tr>
<td>Carryforward of Non-capital Losses</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
<td>N/A (partners able to carry forward losses)</td>
<td>Yes</td>
</tr>
<tr>
<td>Compliance in addition to annual tax return (not intended to be an exhaustive list)</td>
<td>NR6 filing: Section 216 election</td>
<td>Rents subject to monthly withholding tax</td>
<td>Section 116 certificate of compliance required on disposition of assets</td>
<td>NR6 filing: Section 216 election</td>
<td>Rents subject to monthly withholding tax</td>
<td>Section 116 certificate of compliance required on disposition of assets</td>
</tr>
<tr>
<td>Other</td>
<td>Capital gain is triggered when the cost base of a limited partnership interest becomes negative</td>
<td>Property can be transferred to a taxable Canadian corporation on a tax-deferred basis</td>
<td>CCA may create a loss if a principal business real estate corporation; simple to administer</td>
<td>Property can be transferred to a “Canadian partnership” on a tax-deferred basis</td>
<td>Capital gain is triggered when the cost base of a limited partnership interest becomes negative</td>
<td></td>
</tr>
</tbody>
</table>
### Business Income—2016

<table>
<thead>
<tr>
<th>Business Income 2016</th>
<th>Non-resident Corporation</th>
<th>Non-Canadian Partnership</th>
<th>Non-resident Trust</th>
<th>Canadian Corporation</th>
<th>Canadian Partnership</th>
<th>Canadian Trust</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Federal Tax</strong></td>
<td>15%</td>
<td>Tax rates depend on Canadian tax status of each partner</td>
<td>33%</td>
<td>15%</td>
<td>Tax rates depend on Canadian tax status of each partner</td>
<td>33%</td>
</tr>
<tr>
<td><strong>Provincial Tax</strong></td>
<td>11% to 16%</td>
<td>Tax rates depend on Canadian tax status of each partner</td>
<td>10% to 21%</td>
<td>11% to 16%</td>
<td>Tax rates depend on Canadian tax status of each partner</td>
<td>11.5% to 25.75%</td>
</tr>
<tr>
<td><strong>Combined Rate</strong></td>
<td>26% to 31%</td>
<td>Tax rates depend on Canadian tax status of each partner</td>
<td>44.5% to 54%</td>
<td>26% to 31%</td>
<td>Tax rates depend on Canadian tax status of each partner</td>
<td>44.5% to 54%</td>
</tr>
<tr>
<td><strong>Branch Tax</strong></td>
<td>0% to 25%</td>
<td>Depends on tax status of partners</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Branch tax will equal the lesser of 25% or the dividend withholding tax rate</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Under certain treaties the rate is reduced to 5%</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Canada-US Treaty exempts the first $500,000 of net after-tax earnings that are not reinvested in the Canadian branch</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Capital Tax</strong></td>
<td></td>
<td>Depends on tax status of partners</td>
<td>N/A</td>
<td>By July 1, 2012, corporations other than financial institutions are no longer subject to capital tax in any province</td>
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<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>AMT</strong></td>
<td>N/A</td>
<td>Depends on partner</td>
<td>Yes</td>
<td>N/A</td>
<td>Depends on partner</td>
<td>Yes</td>
</tr>
<tr>
<td></td>
<td></td>
<td>AMT may apply if interest, CCA and/or other tax preference items exceed rental income or partnership income allocated to an individual or trust that is a “specified member” of the partnership.</td>
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<td></td>
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</tr>
<tr>
<td><strong>Thin Capitalization Rules</strong></td>
<td>1.5:1 debt-to-equity limitation</td>
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<td>1.5:1 debt-to-equity limitation</td>
</tr>
<tr>
<td>Business Income 2016</td>
<td>Non-resident Corporation</td>
<td>Non-Canadian Partnership</td>
<td>Non-resident Trust</td>
<td>Canadian Corporation</td>
<td>Canadian Partnership</td>
<td>Canadian Trust</td>
</tr>
<tr>
<td>----------------------</td>
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<td>-------------------------</td>
<td>--------------------</td>
<td>----------------------</td>
<td>----------------------</td>
<td>-----------------</td>
</tr>
<tr>
<td><strong>Withholding Tax on Distributions</strong></td>
<td>N/A, but may be subject to branch profits tax of 5% to 25% if carrying on a business in Canada depending on whether treaty benefits are available</td>
<td>N/A</td>
<td>N/A</td>
<td>5% to 25%, depending on whether treaty benefits are available</td>
<td>N/A</td>
<td>15% to 25% depending on whether treaty benefits are available</td>
</tr>
<tr>
<td><strong>Withholding Tax on Interest</strong></td>
<td>0% to 25%</td>
<td>0% to 25%</td>
<td>0% to 25%</td>
<td>0% to 25%</td>
<td>0% to 25%</td>
<td>0% to 25%</td>
</tr>
<tr>
<td></td>
<td>Under revised paragraph 212(1)(b), withholding tax is no longer applicable to non-participating interest paid to an arm’s length party.</td>
<td>Under revised paragraph 212(1)(b), withholding tax is no longer applicable to non-participating interest paid to an arm’s length party.</td>
<td>Under revised paragraph 212(1)(b), withholding tax is no longer applicable to non-participating interest paid to an arm’s length party.</td>
<td>Under revised paragraph 212(1)(b), withholding tax is no longer applicable to non-participating interest paid to an arm’s length party.</td>
<td>Under revised paragraph 212(1)(b), withholding tax is no longer applicable to non-participating interest paid to an arm’s length party.</td>
<td>Under revised paragraph 212(1)(b), withholding tax is no longer applicable to non-participating interest paid to an arm’s length party.</td>
</tr>
<tr>
<td></td>
<td>Subsection 212(13.2), interest deducted in computing business income may be subject to withholding. If non-arm’s length loan is secured by real property situated in Canada, withholding tax will apply (treaty-specific).</td>
<td>Subsection 212(13.2), interest deducted in computing business income may be subject to withholding. If non-arm’s length loan is secured by real property situated in Canada, withholding tax will apply (treaty-specific).</td>
<td>Subsection 212(13.2), interest deducted in computing business income may be subject to withholding. If non-arm’s length loan is secured by real property situated in Canada, withholding tax will apply (treaty-specific).</td>
<td>Subsection 212(13.2), interest deducted in computing business income may be subject to withholding. If non-arm’s length loan is secured by real property situated in Canada, withholding tax will apply (treaty-specific).</td>
<td>Subsection 212(13.2), interest deducted in computing business income may be subject to withholding. If non-arm’s length loan is secured by real property situated in Canada, withholding tax will apply (treaty-specific).</td>
<td>Subsection 212(13.2), interest deducted in computing business income may be subject to withholding. If non-arm’s length loan is secured by real property situated in Canada, withholding tax will apply (treaty-specific).</td>
</tr>
<tr>
<td></td>
<td>Pursuant to the 5th Protocol, withholding tax on interest to non-arm’s length parties resident in the US is eliminated for 2010 and subsequent years provided the loan is not participating</td>
<td>Pursuant to the 5th Protocol, withholding tax on interest to non-arm’s length parties resident in the US is eliminated for 2010 and subsequent years provided the loan is not participating</td>
<td>Pursuant to the 5th Protocol, withholding tax on interest to non-arm’s length parties resident in the US is eliminated for 2010 and subsequent years provided the loan is not participating</td>
<td>Pursuant to the 5th Protocol, withholding tax on interest to non-arm’s length parties resident in the US is eliminated for 2010 and subsequent years provided the loan is not participating</td>
<td>Pursuant to the 5th Protocol, withholding tax on interest to non-arm’s length parties resident in the US is eliminated for 2010 and subsequent years provided the loan is not participating</td>
<td>Pursuant to the 5th Protocol, withholding tax on interest to non-arm’s length parties resident in the US is eliminated for 2010 and subsequent years provided the loan is not participating</td>
</tr>
<tr>
<td><strong>Withholding Tax on Rental Income</strong></td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
<td>No</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td></td>
<td>While withholding tax is not applicable to rents earned by a non-resident that is carrying on a business of earning rental income, a Regulation 805 certificate may be requested.</td>
<td>While withholding tax is not applicable to rents earned by a non-resident that is carrying on a business of earning rental income, a Regulation 805 certificate may be requested.</td>
<td>While withholding tax is not applicable to rents earned by a non-resident that is carrying on a business of earning rental income, a Regulation 805 certificate may be requested.</td>
<td>No</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td><strong>Disposition of Property</strong></td>
<td>Recapture of CCA</td>
<td>Recapture of CCA</td>
<td>Recapture of CCA</td>
<td>Recapture of CCA</td>
<td>Recapture of CCA</td>
<td>Recapture of CCA</td>
</tr>
<tr>
<td></td>
<td>50% capital gains subject to income tax</td>
<td>50% capital gains subject to income tax</td>
<td>50% capital gains subject to income tax</td>
<td>50% capital gains subject to income tax</td>
<td>50% capital gains subject to income tax</td>
<td>50% capital gains subject to income tax</td>
</tr>
<tr>
<td></td>
<td>Section 116 certificate of compliance required on disposition of assets</td>
<td>Section 116 certificate of compliance required on disposition of assets</td>
<td>Section 116 certificate of compliance required on disposition of assets</td>
<td>Section 116 certificate of compliance required on disposition of assets</td>
<td>Section 116 certificate of compliance required on disposition of assets</td>
<td>Section 116 certificate of compliance required on disposition of assets</td>
</tr>
</tbody>
</table>

2 To obtain a certificate stating that an amount is exempt from part XIII non-resident withholding tax under regulation 805, the payee may file an application with the CRA under regulation 805.1.
<table>
<thead>
<tr>
<th>Business Income 2016</th>
<th>Non-resident Corporation</th>
<th>Non-Canadian Partnership</th>
<th>Non-resident Trust</th>
<th>Canadian Corporation</th>
<th>Canadian Partnership¹</th>
<th>Canadian Trust</th>
</tr>
</thead>
<tbody>
<tr>
<td>Carryforward of Non-capital Losses</td>
<td>Yes</td>
<td>N/A (for non-resident partners, if income is business income, partners may be able to carryforward losses)</td>
<td>Yes</td>
<td>Yes</td>
<td>N/A</td>
<td>Yes</td>
</tr>
<tr>
<td>Compliance in addition to annual tax return (not intended to be an exhaustive list)</td>
<td>Reg. 805.1 application While withholding tax is not applicable to rents earned by a non-resident that is carrying on a business of earning rental income, a Regulation 805 certificate may be requested</td>
<td>Reg. 805.1 application While withholding tax is not applicable to rents earned by a non-resident that is carrying on a business of earning rental income, a Regulation 805 certificate may be requested</td>
<td>Reg. 805.1 application While withholding tax is not applicable to rents earned by a non-resident that is carrying on a business of earning rental income, a Regulation 805 certificate may be requested</td>
<td>NR4 filing for dividends and possibly interest</td>
<td>NR4 filing may apply regarding interest paid to a non-resident</td>
<td>NR4 filing may apply regarding interest paid to a non-resident</td>
</tr>
<tr>
<td>Other</td>
<td>Capital gain is triggered when the cost base of the limited partnership interest becomes negative</td>
<td>Property can be transferred to a taxable Canadian corporation on a tax-deferred basis CCA may create a loss if a principal business real estate corporation; simple to administer</td>
<td>Property can be transferred to a “Canadian partnership” on a tax-deferred basis</td>
<td>Capital gain is triggered when the cost base of the limited partnership interest becomes negative</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

¹ Changed to “Canadian Partnership” for consistency.

Income Tax Rates for General Corporations—2016 – 2017

Federal Income Tax Rates for Income Earned by a General Corporation

Effective January 1, 2016 and 2017

<table>
<thead>
<tr>
<th></th>
<th>M&amp;P Income</th>
<th>Active Business Income</th>
<th>Investment Income^2</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Federal rates</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>General corporate</td>
<td>38.0 %</td>
<td>38.0 %</td>
<td>38.0 %</td>
</tr>
<tr>
<td>rate</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Federal abatement</td>
<td>(10.0)</td>
<td>(10.0)</td>
<td>(10.0)</td>
</tr>
<tr>
<td></td>
<td>28.0</td>
<td>28.0</td>
<td>28.0</td>
</tr>
<tr>
<td>M&amp;P deduction^3</td>
<td>(13.0)</td>
<td>0.0</td>
<td>0.0</td>
</tr>
<tr>
<td>Rate reduction^4</td>
<td>0.0</td>
<td>(13.0)</td>
<td>(13.0)</td>
</tr>
<tr>
<td></td>
<td>15.0</td>
<td>15.0</td>
<td>15.0</td>
</tr>
<tr>
<td><strong>Provincial rates</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>British Columbia</td>
<td>11.0%</td>
<td>11.0%</td>
<td>11.0%</td>
</tr>
<tr>
<td>Alberta</td>
<td>12.0</td>
<td>12.0</td>
<td>12.0</td>
</tr>
<tr>
<td>Saskatchewan^5</td>
<td>10.0</td>
<td>12.0</td>
<td>12.0</td>
</tr>
<tr>
<td>Manitoba</td>
<td>12.0</td>
<td>12.0</td>
<td>12.0</td>
</tr>
<tr>
<td>Ontario</td>
<td>10.0</td>
<td>11.5</td>
<td>11.5</td>
</tr>
<tr>
<td>Quebec6</td>
<td>11.9/11.8</td>
<td>11.9/11.8</td>
<td>11.9/11.8</td>
</tr>
<tr>
<td>New Brunswick^7</td>
<td>12.0/14.0</td>
<td>12.0/14.0</td>
<td>12.0/14.0</td>
</tr>
<tr>
<td>Nova Scotia</td>
<td>16.0</td>
<td>16.0</td>
<td>16.0</td>
</tr>
<tr>
<td>Prince Edward Island</td>
<td>16.0</td>
<td>16.0</td>
<td>16.0</td>
</tr>
<tr>
<td>Newfoundland and Labrador^8</td>
<td>15.0</td>
<td>15.0</td>
<td>15.0</td>
</tr>
</tbody>
</table>

Notes

1. The federal and provincial tax rates shown in the tables apply to income earned by corporations other than Canadian-controlled private corporations (CCPCs). A general corporation typically includes public companies and their subsidiaries that are resident in Canada, and Canadian-resident private companies that are controlled by non-residents. For tax rates applicable to CCPCs, see the tables “Federal and Provincial/Territorial Tax Rates for Income Earned by a CCPC Effective January 1, 2016 and 2017” and “Combined Federal and Provincial/Territorial Tax Rates for Income Earned by CCPC Effective January 1, 2016 and 2017”.

2. The federal and provincial tax rates shown in the tables apply to investment income earned by general corporations other than capital gains and dividends received from Canadian corporations. The rates that apply to capital gains are one-half of the rates shown in the tables. Dividends received from Canadian corporations are deductible in computing regular Part I tax, but may be subject to Part IV tax, calculated at a rate of 38 1/3% (increased from 33 1/3% beginning January 1, 2016).

3. Corporations that derive at least 10% of their gross revenue for the year from manufacturing or processing goods in Canada for sale or lease can claim the
manufacturing and processing (M&P) deduction against their M&P income. General corporations that earn income from M&P activities are subject to the same rates as those that apply to CCPCs.

(4) A general tax rate reduction is available on qualifying income. Income that is eligible for other reductions or credits, such as small business income, M&P income, and investment income subject to the refundable provisions, is not eligible for this rate reduction. The general rate reduction does not apply to the portion of the taxable income of a corporation earned from a “personal services business”.

(5) Saskatchewan provides a tax rebate that generally reduces the general corporation income tax rate on income earned from the rental of newly constructed qualifying multi-unit residential projects by 10%. The rebate is generally available for a period of 10 consecutive years for rental housing that is registered under a building permit dated on or after March 21, 2012 and before January 1, 2015, and available for rent before the end of 2017.

(6) Quebec’s 2015 budget proposed to gradually reduce the general corporation income tax rate for active business, investment, and M&P income from 11.9% to 11.5% beginning in 2017. The rate will decrease to 11.8% in 2017, 11.7% in 2018, 11.6% in 2019 and 11.5% in 2020. The rate reductions will be effective January 1 of each year from 2017 to 2020.

(7) New Brunswick’s 2016 budget increased the general corporate income tax rate to 14% (from 12%) effective April 1, 2016.

(8) Newfoundland and Labrador’s 2016 budget increased the general corporate income tax rate to 15% (from 14%), retroactive to January 1, 2016. The budget also eliminated the manufacturing and processing profits tax credit, effective January 1, 2016.

Income Tax Rates for Canadian-controlled Private Corporations (CCPCs) —2016 – 2017

Federal Income Tax Rates for Income Earned by a CCPC

Effective January 1, 2016 and 2017

<table>
<thead>
<tr>
<th></th>
<th>Small Business Income up to $500,002</th>
<th>Active Business Income</th>
<th>Investment Income</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Federal rates</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>General corporate rate</td>
<td>38.0%</td>
<td>38.0%</td>
<td>38.0%</td>
</tr>
<tr>
<td>Federal abatement</td>
<td>(10.0)</td>
<td>(10.0)</td>
<td>(10.0)</td>
</tr>
<tr>
<td>Small business deduction</td>
<td>28.0</td>
<td>28.0</td>
<td>28.0</td>
</tr>
<tr>
<td>Rate reduction</td>
<td>(175)</td>
<td>0.0</td>
<td>0.0</td>
</tr>
<tr>
<td>Refundable tax</td>
<td>0.0</td>
<td>0.0</td>
<td>10.7</td>
</tr>
</tbody>
</table>

Combined Federal and Provincial Income Tax Rates for Income Earned by a CCPC

Effective January 1, 2016 and 2017

<table>
<thead>
<tr>
<th></th>
<th>Small Business Income up to $500,002</th>
<th>Active Business Income</th>
<th>Investment Income</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Provincial rates</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>British Columbia</td>
<td>13.0%</td>
<td>26.0%</td>
<td>49.7%</td>
</tr>
<tr>
<td>Alberta</td>
<td>13.5/12.5</td>
<td>27.0</td>
<td>50.7</td>
</tr>
<tr>
<td>Saskatchewan</td>
<td>12.5</td>
<td>27.0</td>
<td>50.7</td>
</tr>
<tr>
<td>Manitoba</td>
<td>10.5/22.5</td>
<td>27.0</td>
<td>50.7</td>
</tr>
<tr>
<td>Ontario</td>
<td>15.0</td>
<td>26.5</td>
<td>50.2</td>
</tr>
<tr>
<td>Quebec</td>
<td>18.5</td>
<td>26.9/26.8</td>
<td>50.6/50.5</td>
</tr>
<tr>
<td>New Brunswick</td>
<td>14.5/14.0</td>
<td>270/29.0</td>
<td>50.7/52.7</td>
</tr>
</tbody>
</table>
Income Tax Rates for Canadian-controlled Private Corporations (CCPCs)—2016 – 2017

Notes

(1) The federal and provincial tax rates shown in the tables apply to income earned by a Canadian-controlled private corporation (CCPC). In general, a corporation is a CCPC if the corporation is a private corporation and a Canadian corporation, provided it is not controlled by one or more non-resident persons, by a public corporation, by a corporation with a class of shares listed on a designated stock exchange, or by any combination of these, and provided it does not have a class of shares listed on a designated stock exchange. For tax rates applicable to general corporations, see the tables “Federal and Provincial/Territorial Tax Rates for Income Earned by a General Corporation Effective January 1, 2016 and 2017” and “Combined Federal and Provincial/Territorial Tax Rates for Income Earned by a General Corporation Effective January 1, 2016 and 2017.”

(2) See the table “Small Business Income Thresholds for 2016 and Beyond” for the federal and provincial small business income thresholds. Manitoba and Nova Scotia’s provincial small business income thresholds are the only thresholds below the federal amount. For these provinces, a median tax rate applies to active business income between the provincial and federal threshold. The median tax rate is based on the federal small business rate and the applicable provincial general active business rate. For example, in 2016, Nova Scotia’s combined rate on active business income between $350,000 and $500,000 is 26.5% (i.e., 10.5% federally and 16% provincially).

(3) The general corporate tax rate applies to active business income earned in excess of $500,000. See the table “Small Business Income Thresholds for 2016 and Beyond” for the federal and provincial small business income thresholds. CCPCs that earn income from manufacturing and processing activities are subject to the same rates as those that apply to general corporations (see the tables “Federal and Provincial/Territorial Tax Rates for Income Earned by a General Corporation Effective January 1, 2016 and 2017” and “Combined Federal and Provincial/Territorial Tax Rates for Income Earned by a General Corporation Effective January 1, 2016 and 2017”).

(4) The federal and provincial tax rates shown in the tables apply to investment income earned by a CCPC, other than capital gains and dividends received from Canadian corporations. The rates that apply to capital gains are one-half of the rates shown in the tables. Dividends received from Canadian corporations are deductible in computing regular Part I tax, but may be subject to Part IV tax, calculated at a rate of 38 1/3% (increased from 33 1/3% beginning January 1, 2016).

(5) Corporations that are CCPCs throughout the year may claim the small business deduction (SBD). In general, the SBD is calculated based on the least of three amounts—active business income earned in Canada, taxable income and the small business income threshold.

(6) The 2016 federal budget announced that the small business income tax rate would remain at 10.5% after 2016. The federal small business income tax rate was previously scheduled to decrease to 9% by January 1, 2019.

(7) A general tax rate reduction is available on qualifying income. Income that is eligible for other reductions or credits, such as small business income, M&P income and investment income subject to the refundable provisions, is not eligible for this rate reduction. The general rate reduction does not apply to the portion of the taxable income of a corporation earned from a “personal services business”.

(8) The refundable tax of 10 2/3% (increased from 6 2/3% beginning January 1, 2016) of a CCPC’s investment income and capital gains, as well as 20% of such income that is subject to regular Part I tax, is included in the corporation’s Refundable Dividend Tax on Hand (RDTOH) account. When taxable dividends (eligible and non-eligible) are paid out to shareholders, a dividend refund equal to the lesser of 38 1/3% (increased from 33 1/3% beginning January 1, 2016) of the dividends paid or the balance in the RDTOH account is refunded to the corporation.

(9) Alberta’s 2016 budget decreased the small business income tax rate to 2% (from 3%) effective January 1, 2017.

(10) Saskatchewan provides a tax rebate that generally reduces the general corporate income tax rate on income earned from the rental of newly constructed qualifying multi-unit residential projects by 10%. The rebate is generally available for a period of 10 consecutive years for rental housing that is registered under a building permit dated on or after March 21, 2012 and before January 1, 2015, and available for rent before the end of 2017.

(11) Manitoba increased the small business income threshold to $450,000 (from $425,000) effective January 1, 2016. Manitoba announced a further increase to the small business income threshold to $500,000 starting in 2017. Income greater than this threshold is subject to Manitoba’s general income tax rate of 12%.

(12) Quebec’s 2015 budget proposed to gradually reduce the general corporate income tax rate for active business, investment, and M&P income from 11.9% to 11.5% beginning in 2017. The rate will decrease to 11.8% in 2017, 11.7% in 2018, 11.6% in 2019 and 11.5% in 2020. The rate reductions will be effective January 1 of each year from 2017 to 2020.

(13) New Brunswick decreased its small business income tax rate to 3.5% (from 4%) effective April 1, 2016. In addition, the province’s 2016 budget increased the general corporate income tax rate to 14% (from 12%) effective April 1, 2016.

(14) Nova Scotia’s small business income threshold is $350,000. Income greater than this threshold is subject to Nova Scotia’s general income tax rate of 16%.

(15) Newfoundland and Labrador’s 2016 budget increased the general corporate income tax rate to 15% (from 14%), retroactive to January 1, 2016.
## Appendix E—Provincial Land Transfer Taxes and Registration Fees

<table>
<thead>
<tr>
<th>Jurisdiction</th>
<th>Legislation</th>
<th>Property Value</th>
<th>Rate of Tax or Fee¹</th>
</tr>
</thead>
<tbody>
<tr>
<td>British Columbia²</td>
<td>Property Transfer Tax Act</td>
<td>Up to $200,000</td>
<td>1.0%</td>
</tr>
<tr>
<td></td>
<td></td>
<td>200,001 – 2,000,000</td>
<td>2.0%</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Over 2,000,000</td>
<td>3.0%</td>
</tr>
<tr>
<td>British Columbia—Greater Vancouver Regional District²</td>
<td>Property Transfer Tax Act</td>
<td>All values of residential property acquired by foreign purchasers</td>
<td>15%</td>
</tr>
<tr>
<td>Alberta³</td>
<td>Land Titles Act</td>
<td>All values</td>
<td>$50 + 0.02%</td>
</tr>
<tr>
<td>Saskatchewan³</td>
<td>Land Titles Act</td>
<td>Up to $525</td>
<td>—</td>
</tr>
<tr>
<td></td>
<td></td>
<td>526–8,800</td>
<td>$25.97</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Over 8,800</td>
<td>0.3%</td>
</tr>
<tr>
<td>Manitoba³</td>
<td>Tax Administration and Miscellaneous Taxes Act</td>
<td>Up to $30,000</td>
<td>$87</td>
</tr>
<tr>
<td></td>
<td></td>
<td>30,001–90,000</td>
<td>0.5%</td>
</tr>
<tr>
<td></td>
<td></td>
<td>90,001–150,000</td>
<td>1.0</td>
</tr>
<tr>
<td></td>
<td></td>
<td>150,001–200,000</td>
<td>1.5</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Over 200,000</td>
<td>2.0</td>
</tr>
<tr>
<td>Ontario³</td>
<td>Land Transfer Tax Act</td>
<td>General</td>
<td>Up to $55,000</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>0.5%</td>
</tr>
<tr>
<td></td>
<td></td>
<td>55,001–250,000</td>
<td>1.0</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Over 250,000</td>
<td>1.5</td>
</tr>
<tr>
<td></td>
<td>Single Family Residence(s)</td>
<td>Up to $55,000</td>
<td>0.5%</td>
</tr>
<tr>
<td></td>
<td></td>
<td>55,001–250,000</td>
<td>1.0</td>
</tr>
<tr>
<td></td>
<td></td>
<td>250,001–400,000</td>
<td>1.5</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Over 400,000</td>
<td>2.0</td>
</tr>
<tr>
<td>Ontario—City of Toronto¹</td>
<td>Toronto Municipal Code, Taxation, Municipal Land Transfer Tax</td>
<td>General</td>
<td>Up to $55,000</td>
</tr>
<tr>
<td></td>
<td></td>
<td>55,001–400,000</td>
<td>1.0</td>
</tr>
<tr>
<td></td>
<td></td>
<td>400,001–40,000,000</td>
<td>1.5</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Over 40,000,000</td>
<td>1.0</td>
</tr>
<tr>
<td></td>
<td>Single Family Residence(s)</td>
<td>Up to $55,000</td>
<td>0.5%</td>
</tr>
<tr>
<td></td>
<td></td>
<td>55,001–400,000</td>
<td>1.0</td>
</tr>
<tr>
<td></td>
<td></td>
<td>400,001–40,000,000</td>
<td>2.0</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Over 40,000,000</td>
<td>2.0</td>
</tr>
<tr>
<td>Quebec—Other than City of Montreal</td>
<td>An Act Respecting Duties on Transfers of Immovables</td>
<td>Up to $50,000</td>
<td>0.5%</td>
</tr>
<tr>
<td></td>
<td></td>
<td>50,001–250,000</td>
<td>1.0</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Over 250,000</td>
<td>1.5</td>
</tr>
<tr>
<td>Quebec—City of Montreal</td>
<td>An Act Respecting Duties on Transfers of Immovables</td>
<td>Up to $50,000</td>
<td>0.5%</td>
</tr>
<tr>
<td></td>
<td></td>
<td>50,001–250,000</td>
<td>1.0</td>
</tr>
<tr>
<td></td>
<td></td>
<td>250,001–500,000</td>
<td>1.5</td>
</tr>
<tr>
<td></td>
<td></td>
<td>500,001–1,000,000</td>
<td>2.0</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Over 1,000,000</td>
<td>2.5</td>
</tr>
<tr>
<td>New Brunswick⁴</td>
<td>Real Property Transfer Tax Act</td>
<td>All values</td>
<td>$85 + 1.0%</td>
</tr>
<tr>
<td>Nova Scotia¹⁰</td>
<td>Land Registration Act</td>
<td>All values</td>
<td>$100 + 0% to 1.5%</td>
</tr>
<tr>
<td>Prince Edward Island¹¹</td>
<td>Lands Protection Act</td>
<td>All values</td>
<td>1.0% (Min $550)</td>
</tr>
<tr>
<td></td>
<td>Real Property Transfer Tax Act</td>
<td>All values, if over $30,000</td>
<td>$7725 to $463.65 +1.0%</td>
</tr>
<tr>
<td>Newfoundland and Labrador¹²</td>
<td>Registration of Deeds Act</td>
<td>Up to $500</td>
<td>$100 + 0.4%</td>
</tr>
</tbody>
</table>

¹ Rates are subject to change and are for informational purposes only.

² Rates vary by location within British Columbia.

³ Rates vary by location within Ontario.

⁴ Rates vary by location within New Brunswick.

¹⁰ Rates vary by location within Nova Scotia.

¹¹ Rates vary by location within Prince Edward Island.

¹² Rates vary by location within Newfoundland and Labrador.
Notes

1) The rates of tax shown in the table are graduated rates. For example, the land transfer tax levied on the transfer of a property in Manitoba valued at $150,000 is calculated as $87 + (0.5% × 60,000) + (1.0% × 60,000) = $987.

2) British Columbia levies land transfer tax on registered transfers or grants of land, based on the fair market value of the property being transferred.

Effective February 17, 2016, the property transfer tax rate on any type of taxable transactions will be increased to 3% on the portion of a property’s value in excess of $2 million.

Exemptions may apply to certain mortgages, leases under 30 years, amalgamations, first-time buyers of qualifying residential property, transfers of farmland to related individuals or family farm corporations, transfers of a principal residence or certain recreational residences between related individuals, transfers to registered charities of land used for charitable purposes, certain transfers in the course of subdivisions, certain transfers between joint tenants and tenants in common, transfers between minors and the Public Guardian and Trustee, transfers to and from Trust Companies or the Public Trustee, certain transfers following bankruptcy, transfers resulting from marriage breakdown, transfers under the Veterans’ Land Act (Canada), transfers to Status Indians and Indian Bands, transfers by which property reverts to the Crown, transfers to correct a conveying error, transfers to municipalities and other local governments, and registration of multiple leases on the same property. A refund of land transfer tax may be available where both land transfer and provincial sales taxes have been paid.

Effective February 17, 2016, newly constructed homes with a value of up to $750,000 when purchased for use as a principal residence will be exempt from property transfer tax. A partial exemption is also available for homes between $750,000 and $800,000. The buyer does not have to be a first-time owner of residential property, but must be a Canadian citizen or permanent resident, in order to qualify for this exemption. Effective June 10, 2016, citizenship information must be disclosed when registering a taxable transaction.

3) Effective August 2, 2016, British Columbia levies an additional land transfer tax on registered transfers of residential property located in whole or in part in the Greater Vancouver Regional District (excluding certain First Nations’ lands and prescribed areas), based on the fair market value of the property being acquired by foreign purchasers.

The additional tax is payable by a foreign entity (a foreign national and foreign corporation) and a taxable trustee (a trustee that is a foreign entity, or a beneficiary of the trust that is a foreign entity and that holds a beneficial interest in the residential property). The additional tax does not apply to trusts that are mutual fund trusts, real estate investment trusts or SIFT trusts.

Residential property includes land or improvements, or both, as defined in section 1(1) of the Assessment Act (British Columbia) that are used for residential purposes (class 1 property) including single-family residences, duplexes, multi-family residences, apartments, condominiums, manufactured homes, nursing homes, rest homes, summer and seasonal dwellings, bunkhouses and cookhouses, and applies to the residential component of mixed use property and certain farm lands.

This additional tax applies even when the transaction may normally be exempt from property transfer tax (such as a transfer between related individuals, a transfer resulting from an amalgamation, a transfer to a surviving joint tenant, or a transfer where the transferee is or becomes a trustee in relation to the property, even if the trust does not change).

An anti-avoidance rule applies to any transactions that result directly or indirectly in a tax benefit, or are structured to reduce or avoid this new tax.

4) Alberta and Saskatchewan levy a registration fee on transfers of interests in land, mortgages and other charges based on the value of the property being transferred. The fees indicated in the table apply to transfers of land. The fees applicable to mortgages and other charges generally differ from the land transfer fee.

5) Manitoba levies land transfer tax on registered transfers of land based on the value of the property being transferred.

Exemptions may apply to certain mortgages, leases, dissolutions or wind-ups of wholly owned subsidiaries, transfers to registered charities, transfers that facilitate a subdivision to or from a trustee where there is no change of beneficial ownership, transfers of farmland, certain transfers to veterans or the spouses or common law partners of veterans, and conveyances of title between spouses. The Registrar-General has the authority to exempt the transfer of property subject to retail sales tax, exempt a statutory easement the first time it is registered, provide tax relief for court ordered rescissions, or mutually agreed-upon sales reversals, and issue an assessment notice under general anti-avoidance rules where the conveyance of title is registered in order to reduce, avoid or defer tax in a manner that is an avoidance transaction.

6) Ontario levies land transfer tax (OLTT) on dispositions of beneficial interests in land, whether or not the transfer is registered, based on the value of the consideration furnished.

Exemptions may apply to certain mortgages, leases under 50 years, certain unregistered dispositions, transfers between spouses, transfers of farm land between family members or from a family farm corporation to individual family members, certain transfers of land from an individual to a family business corporation, certain transfers of land by registered charities after March 25, 2010, certain transfers of life lease interests, and certain conveyances of mineral lands. A deferral and ultimate cancellation of land transfer tax is available on certain transfers between affiliated corporations. A rebate, to a maximum of $2,000, is available to first-time buyers of newly constructed or resale residential property. A general anti-avoidance rule was enacted to deny a tax benefit for transactions completed after May 1, 2014 that unreasonably reduce, avoid, defer or cancel land transfer tax, unless undertaken or arranged primarily for bona fide purposes other than to obtain the tax benefit.
Ontario has amended the de minimis partnership exemption from land transfer tax for certain dispositions of a beneficial interest in land with retroactive effect to July 19, 1989 (although the Ontario Ministry of Finance has indicated that it will assess or reassess only affected dispositions that occurred on or after February 18, 2012. This exemption provides that small ownership changes (representing a profit entitlement of 5% or less) by a partner in a partnership holding land will not be subject to Ontario LTT. The de minimis exemption no longer applies when the partner who acquires an interest in a partnership that holds land is a trust or another partnership.

In the Ontario 2016 Fall Economic Statement, the following changes are proposed to the OLTT system:

- Increasing the maximum refund for first-time homebuyers from $2,000 to $4,000 and restricting such refund to Canadian citizens and permanent residents effective January 1, 2017;
- Collecting additional information about properties and purchasers which may include the intended use of property (e.g. principal residence or rental property), residency, citizenship and permanent resident status of purchasers, and type of property (e.g. residential, commercial, agricultural, industrial or recreational);
- Exploring a change to the basis of the LTT calculation from value of consideration to the fair market value of the property transferred; and,
- Updating LTT rates and brackets (although, as a transitional measure, purchasers who entered into agreements of purchase and sale on or before November 14, 2016 would not be subject to the increased rates of tax).

### Proposed Ontario LTT Rates and Brackets Effective January 1, 2017

<table>
<thead>
<tr>
<th>General</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Up to $55,000</td>
<td>0.5%</td>
</tr>
<tr>
<td>$5,001–250,000</td>
<td>1.0</td>
</tr>
<tr>
<td>250,001–400,000</td>
<td>1.5</td>
</tr>
<tr>
<td>Over 400,000</td>
<td>2.0</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Single Family Residence(s)</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Up to $55,000</td>
<td>0.5%</td>
</tr>
<tr>
<td>$5,001–250,000</td>
<td>1.0</td>
</tr>
<tr>
<td>250,001–400,000</td>
<td>1.5</td>
</tr>
<tr>
<td>400,001–2,000,000</td>
<td>2.0</td>
</tr>
<tr>
<td>Over 2,000,000</td>
<td>2.5</td>
</tr>
</tbody>
</table>

7) In addition to OLTT, Municipal Land Transfer Tax (MLTT) is levied under Chapter 760, Taxation, Municipal Land Transfer Tax, of the Toronto Municipal Code, passed under the authority of section 267 of the City of Toronto Act, 2006 (Ontario), as amended, on dispositions of beneficial interests in land located in the City of Toronto with closing dates on or after February 1, 2008.

Exemptions apply to a transferee which is the Crown or a Crown Agency, certain Ontario government bodies, school boards, universities, colleges, hospitals, nursing homes, the Toronto Community Housing Corporation, the Toronto Economic Development Corporation and the City of Toronto. All conveyances exempt from OLTT are also exempt from MLTT. A rebate to a maximum of $3,725 is available to first-time buyers of newly constructed or resale residential property. The City of Toronto is currently working the Ontario Ministry of Finance to understand and ensure a consistent application of the recent regulatory amendments for all applicable transactions since the February 2008 introduction of the MLTT.

8) Quebec levies land transfer duties (commonly referred to as “mutations tax”) based on the greatest of the consideration furnished, the consideration stipulated, and the market value of the immovable property at the time of its transfer.

Exemptions may apply to certain mortgages, leases under 40 years, amalgamations, transfers between family members or former spouses, between closely related corporations, where the transferee is a public body, where the transferee is an international government organization and where both the transferor and transferee are registered charities. Exemption conditions for certain transfers among family members and closely related corporations must be met for the 24 month period both preceding and following the date of the transfer, with specific disclosure requirements applying when these conditions cease to be met.

The amendments to tax unregistered transfers of immovable property and modifications to certain exemption provisions apply to transfers of immovable property after March 17, 2016.

In Quebec (contrary to the law in other provinces, such as Ontario), a partnership (general or limited) is characterized at civil law as having a separate patrimony distinct from that of its partners. On this basis, a partnership is subject to Quebec mutations tax on its acquisition of immovable property.

9) New Brunswick levies land transfer tax on registered transfers of land based on the greater of the value of the property being transferred and the value of consideration furnished. The real property transfer tax was increased to 1% (from 0.5%) effective April 1, 2016.

Exemptions may apply to certain mortgages, leases under 25 years, transfers to the Crown, a Crown agency or a Crown corporation, transfers to a registered charity, and transfers from an executor or administrator to beneficiaries under a will or from an administrator to heirs under intestacy.
10) Nova Scotia levies land transfer tax on deeds transferring land if required by municipal by-law, based on the rate stipulated by the municipality and the value of the property being transferred.

Exemptions may apply to certain mortgages, leases under 21 years, and transfers between family members.

11) Prince Edward Island levies a registration fee on applications for land-holding permits by resident corporations, or non-resident individuals or corporations, for the purchase of land if the aggregate land holdings exceed five acres or includes shore frontage exceeding 165 feet. The minimum fee is $550. The fee, however, is limited to $550 on certain transfers between non-resident related persons and corporations.

Registration of a deed transferring real property is subject to real property transfer tax based on the greater of the consideration for the transfer and the assessed value.

Exemptions may apply to property if the greater of these two amounts does not exceed $30,000.

Exemptions may also apply to:
- Certain transfers between family members
- Certain mortgages
- Transfers between persons and their wholly owned corporations
- Transfers between corporations if both corporations are wholly owned by the same person, either directly or through another wholly owned corporation
- Transfers of property to the Crown, a municipality or a registered non-profit organization
- Certain transfers to a trustee in bankruptcy
- Certain transfers to a spouse or former spouse pursuant to a written separation agreement or court order
- Transfers from an executor or administrator to beneficiaries under a will or from an administrator to heirs under intestacy
- Transfers from a registered non-profit organization to the recipient as a gift, donation or prize
- All first-time home buyers, effective October 1, 2016.

12) Newfoundland and Labrador levies a registration fee on transfers of interests in land, mortgages and other charges, based on the value of the property being transferred.
Appendix F—Purchases of Land, Multi-unit Residential Rental Buildings, Commercial Rental Buildings, and Mixed Multi-unit Residential and Commercial Rental Buildings

Assumption: Purchaser is registered for GST/HST purposes

<table>
<thead>
<tr>
<th>What is Purchased?</th>
<th>Vendor (Where Relevant)</th>
<th>What Does the Purchaser Do With the Property Purchased?</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>(a) Commercial Development</td>
</tr>
<tr>
<td>(1) Land, including serviced lots (if farmland, see 3 and 4 below)</td>
<td>Individual or personal trust</td>
<td>Exempt, unless the land is capital property used in a business with reason-able expectation of profit, or was used by a registrant to supply by lease, license or similar arrangement, or is sold in the course of a business, or has been previously subdivided into more than 2 lots, or is sold in course of an adventure or concern in the nature of trade and the vendor has filed an election to treat the sale as taxable. If not exempt, sale is taxable; Purchaser self-assesses tax and claims offsetting ITC in same return. Development and construction constitute commercial activity; ITCs available for expenses. Charge HST on sale or rental of completed commercial property.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>(b) Residential Rental Development</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Exempt, unless the land is capital property used in a business with reason-able expectation of profit, or was used by a registrant to supply by lease, license or similar arrangement, or is sold in the course of a business, or has been previously subdivided into more than 2 lots, or is sold in course of an adventure or concern in the nature of trade and the vendor has filed an election to treat the sale as taxable. If not exempt, sale is taxable; Purchaser self-assesses tax and claims offsetting ITC in same return. Development and construction constitute commercial activity; ITCs available for expenses. Self-assess and remit tax on FMV at self-supply date. Claim landlord’s rebate. Rent charges are exempt. No ITCs for expenses after self-supply date.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>(c) Builds New Homes for Sale</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Exempt, unless the land is capital property used in a business with reason-able expectation of profit, or was used by a registrant to supply by lease, license or similar arrangement, or is sold in the course of a business, or has been previously subdivided into more than 2 lots, or is sold in course of an adventure or concern in the nature of trade and the vendor has filed an election to treat the sale as taxable. If not exempt, sale is taxable; Purchaser self-assesses tax and claims offsetting ITC in same return. Development and construction constitute commercial activity; ITCs available for expenses. Charge HST on sale of new homes.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>(d) Rents Land to Farmer</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Exempt, unless the land is capital property used in a business with reason-able expectation of profit, or was used by a registrant to supply by lease, license or similar arrangement, or is sold in the course of a business, or has been previously subdivided into more than 2 lots, or is sold in course of an adventure or concern in the nature of trade and the vendor has filed an election to treat the sale as taxable. If not exempt, sale is taxable; Purchaser self-assesses tax and claims offsetting ITC in same return. Rental of land to farmer is taxable. ITCs available for related expenses, if any.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>(e) Continues Rental Operation</td>
</tr>
<tr>
<td></td>
<td></td>
<td>See 5, 6 and 7.</td>
</tr>
</tbody>
</table>

1 E.g., a shopping plaza, office building, etc.
2 A “personal trust” is a testamentary trust or inter-vivos trust whose beneficiaries are individuals and whose contingent beneficiaries are individuals, charities or public institutions.
3 Exempt status depends on vendor’s status and use of property. Purchaser may be unable to determine this so should request written statement from vendor that sale is exempt (Excise Tax Act s. 194) to protect purchaser against future assessment for failure to self-assess tax if conditions for exemption were not met and sale was actually taxable, unless purchaser “knows or ought to know” that no exemption applies. If sale was actually taxable, purchaser is deemed to have paid the tax to the vendor as part of the stated purchase price, thereby meeting purchaser’s GST/HST obligation, even if purchaser is registered and would normally be required to self-assess the tax.
<table>
<thead>
<tr>
<th>What is Purchased?</th>
<th>Vendor (Where Relevant)</th>
<th>What Does the Purchaser Do With The Property Purchased?</th>
</tr>
</thead>
<tbody>
<tr>
<td>(2) Land, including serviced lots if farmland, see 4 below, and Section III, “Other Questions”</td>
<td>Not an individual or personal trust; e.g. corporation.</td>
<td>Purchase is taxable. Purchaser self-assesses tax and claims offsetting ITC in same return. Development and construction constitute commercial activity; ITCs available for expenses. Charge HST on sale or rental of completed commercial property. Rent charges are exempt. No ITCs for expenses after self-supply date.</td>
</tr>
<tr>
<td>(3) Farmland</td>
<td>Individual or personal trust</td>
<td>Same as (1)(a) above. Same as (1)(b) above. Same as (1)(c) above. Same as (1)(a) above. See 5, 6 and 7.</td>
</tr>
<tr>
<td>(4) Farmland</td>
<td>Not an individual or personal trust; e.g., corporation</td>
<td>Same as (2)(a) above. Same as (2)(b) above. Same as (2)(c) above. Same as (2)(d) above. See 5, 6 and 7.</td>
</tr>
<tr>
<td>(5) Residential rental building, tenanted or previously-tenanted</td>
<td>N/A</td>
<td>N/A</td>
</tr>
<tr>
<td>(6) Commercial building (tenanted or vacant)</td>
<td>N/A</td>
<td>N/A</td>
</tr>
<tr>
<td>(7) “Mixed” commercial and residential rental building (tenanted or previously-tenanted)</td>
<td>N/A</td>
<td>N/A</td>
</tr>
</tbody>
</table>
## BC HST and Transitional Rules for New Housing—At a Glance
### Examples for Agreements of Purchase and Sale of New Single Homes and Condominiums Between Individual Purchasers and Builders

<table>
<thead>
<tr>
<th>Agreement entered into on</th>
<th>Possession transferred</th>
<th>Ownership transferred</th>
<th>Tax applicable</th>
<th>New Housing Rebate—B.C. Portion</th>
<th>New Housing Rebate—Federal GST portion</th>
<th>Transitional Tax Adjustment (TTA) (for grandfathered sales) to “bump” PST content to 2% of consideration</th>
<th>B.C. PST Transitional Housing Rebate to remove PST embedded in price</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>New Single Home Purchased By Individual</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>November 18, 2009 or earlier</td>
<td>After June 2010</td>
<td>After June 2010</td>
<td>5% GST (Grandfathered)</td>
<td>No B.C. HST</td>
<td>Yes if lower than pricing threshold</td>
<td>Yes – Paid by Builder; not charged to Purchaser (for home completed in full or in part after June 2010)</td>
<td>No</td>
</tr>
<tr>
<td>November 19, 2009 or later</td>
<td>After June 2010</td>
<td>After June 2010</td>
<td>12% HST</td>
<td>Yes—71.43% of B.C. portion to max. $26,250</td>
<td>Yes if lower than pricing threshold</td>
<td>No</td>
<td>Yes—To be claimed by Individual—File claim with CRA or through Builder</td>
</tr>
<tr>
<td>November 19, 2009 or later</td>
<td>Before July 1, 2010</td>
<td>Before July 1, 2010</td>
<td>5% GST</td>
<td>No</td>
<td>Yes, if lower than pricing threshold</td>
<td>Not applicable</td>
<td>Not applicable</td>
</tr>
<tr>
<td>November 19, 2009 or later</td>
<td>Before July 1, 2010</td>
<td>After July 1, 2010</td>
<td>5% GST</td>
<td>No</td>
<td>Yes, if lower than pricing threshold</td>
<td>Not applicable</td>
<td>Not applicable</td>
</tr>
<tr>
<td><strong>New Condominium Purchased By Individual</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>November 18, 2009 or earlier</td>
<td>After June 2010</td>
<td>After June 2010</td>
<td>5% GST (Grandfathered)</td>
<td>No B.C. HST</td>
<td>Yes if lower than pricing threshold</td>
<td>Yes—Paid by Builder; not charged to Purchaser 2% of consideration, regardless of percentage of completion</td>
<td>Yes, if TTA payable—To be claimed by Builder only</td>
</tr>
<tr>
<td>November 19, 2009 or later</td>
<td>After June 2010</td>
<td>After June 2010</td>
<td>12% HST</td>
<td>Yes—71.43% of B.C. portion to max. $26,250</td>
<td>Yes if lower than pricing threshold</td>
<td>No</td>
<td>Yes – To be claimed by Builder only</td>
</tr>
<tr>
<td>November 19, 2009 or later</td>
<td>Before July 1, 2010</td>
<td>Before July 1, 2010</td>
<td>5% GST</td>
<td>No</td>
<td>Yes, if lower than pricing threshold</td>
<td>Not applicable</td>
<td>Not applicable</td>
</tr>
<tr>
<td>November 19, 2009 or later</td>
<td>Before July 1, 2010</td>
<td>After July 1, 2010</td>
<td>5% GST</td>
<td>No</td>
<td>Yes, if lower than pricing threshold</td>
<td>Not applicable</td>
<td>Not applicable</td>
</tr>
</tbody>
</table>
### Appendix H—Special Measures—Ontario, B.C. and PE.I. HST-transitional Tax and Transitional Rebates

#### Ontario HST and Transitional Rules for New Housing—At a Glance

Examples for Agreements of Purchase and Sale of New Single Homes and Condominiums Between Individual Purchasers and Builders

<table>
<thead>
<tr>
<th>Agreement entered into on</th>
<th>Possession transferred</th>
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<th>Tax applicable</th>
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<th>Ontario RST Transitional Housing Rebate to remove PST embedded in price</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>New Single Home Purchased By Individual</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>June 18, 2009 or earlier</td>
<td>After June 2010</td>
<td>After June 2010</td>
<td>5% GST (Grandfathered)</td>
<td>No Ontario HST</td>
<td>Yes if lower than pricing threshold</td>
<td>Yes—Paid by Builder; not charged to Purchaser (for home completed in full or in part after June 2010)</td>
<td>No</td>
</tr>
<tr>
<td>June 19, 2009 or later</td>
<td>After June 2010</td>
<td>After June 2010</td>
<td>13% HST</td>
<td>Yes—75% of Ontario portion to max. $24,000</td>
<td>Yes if lower than pricing threshold</td>
<td>No</td>
<td>Yes – To be claimed by Individual – File claim with CRA or through Builder</td>
</tr>
<tr>
<td>June 19, 2009 or later</td>
<td>Before July 1, 2010</td>
<td>Before July 1, 2010</td>
<td>5% GST</td>
<td>No</td>
<td>Yes, if lower than pricing threshold</td>
<td>Not applicable</td>
<td>Not applicable</td>
</tr>
<tr>
<td>June 19, 2009 or later</td>
<td>Before July 1, 2010</td>
<td>After July 1, 2010</td>
<td>5% GST</td>
<td>No</td>
<td>Yes, if lower than pricing threshold</td>
<td>Not applicable</td>
<td>Not applicable</td>
</tr>
<tr>
<td><strong>New Condominium Purchased By Individual</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>June 18, 2009 or earlier</td>
<td>After June 2010</td>
<td>After June 2010</td>
<td>5% GST (Grandfathered)</td>
<td>No Ontario HST</td>
<td>Yes if lower than pricing threshold</td>
<td>Yes—Paid by Builder; not charged to Purchaser 2% of consideration, regardless of percentage of completion</td>
<td>Yes, if TTA payable—to be claimed by Builder only</td>
</tr>
<tr>
<td>June 19, 2009 or later</td>
<td>After June 2010</td>
<td>After June 2010</td>
<td>13% HST</td>
<td>Yes—75% of Ontario portion to max. $24,000</td>
<td>Yes if lower than pricing threshold</td>
<td>No</td>
<td>Yes—To be claimed by Builder only</td>
</tr>
<tr>
<td>June 19, 2009 or later</td>
<td>Before July 1, 2010</td>
<td>Before July 1, 2010</td>
<td>5% GST</td>
<td>No</td>
<td>Yes, if lower than pricing threshold</td>
<td>Not applicable</td>
<td>Not applicable</td>
</tr>
<tr>
<td>June 19, 2009 or later</td>
<td>Before July 1, 2010</td>
<td>After July 1, 2010</td>
<td>5% GST</td>
<td>No</td>
<td>Yes, if lower than pricing threshold</td>
<td>Not applicable</td>
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Appendix I—KPMG Real Estate Tax Contacts

If you require more information on the matters discussed in this publication, please contact us. We welcome the opportunity to meet with you to discuss how we can best assist you.

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<tr>
<th>COMMON FORMS OF REAL ESTATE OWNERSHIP</th>
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<th>GOODS AND SERVICES TAX/HARMONIZED SALES TAX</th>
<th>APPENDICES</th>
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The contributing editors would like to acknowledge the contributions of our colleagues: Jessica Ambler, Rachel Gold, Schuyler Levine, Mohammad Nadeem, Michael Pereira, Louise Siu, Joshua Walker and Barbara Warren.

Thank you.
### COMMON FORMS OF REAL ESTATE OWNERSHIP

### OWNERSHIP AND OPERATING ISSUES

### NON-RESIDENTS INVESTING IN CANADIAN REAL ESTATE

### U.S. VACATION PROPERTY

### GOODS AND SERVICES TAX / HARMONIZED SALES TAX

### APPENDICES

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

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