Tax: What a real estate lawyer wants to know - Tips, Traps, Concerns and Some Stories

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What is the HST Status of the Green Apple?

HST and Real Property
- Starting Point, What is taxable?

- Supplies of real property (sale, lease, etc.) are taxable transactions.
  - Exceptions:
    - used residential property;
    - vacant land sold by individuals –beware of subdivision rule;
    - property sold by NPO/charity/public sector – planning opportunity available;

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HST and Real Property - What is exempt?

Used Residential Property – exempt of HST

- Possible exception:
  - 'Substantially renovated' property
    - more than 90% of pre-existing property replaced
    - new window, flooring, insulation, electrical, plumbing etc.
    - treated as a new home, therefore sale is taxable

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Real Property – Subdivision Rule

General rule: vacant land sold by individual is exempt of HST

- Exception: unless subdivided into MORE than two parts, then sale of parts attracts HST

- Exception to the Exception: unless sold to related person or was subject to expropriation

- Takeaway: consider subdivision rule for all sales or vacant land by individuals

Real Property – MUSH/NPO/Charity

Varying rules: Ex.

- municipality = taxable except used homes
- charity = exempt but not vacant land sold to individual
- others = generally exempt, but can file election to make them taxable
  - filing of election is planning opportunity

Takeaway: seek clarification on tax status of sales and leases of real property by MUSH/NPO/Charity

HST and Real Property
- Self-Assessment

- For taxable supplies of real property where (i) Purchaser is a registrant or (ii) Vendor is non-resident:
  - Purchaser is required to self-assess and remit applicable HST. – S.221(2).
    - Does not apply to personal property sold with the realty – fixture vs. chattel
    - Not an exemption to the Vendor – shifting of the burden of paying tax.

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HST and Real Property - Reporting

- Purchasers that are registered for HST must account for tax on self-assessment basis
- Where vendor is non-resident of Canada, purchaser must account for tax on self-assessment basis regardless of purchaser's registration status

- Takeaway: Confirm registration status of purchaser. Is a declaration sufficient? Indemnification re interest? GST/HST Registry at CRA's website.

HST and Real Property - Common Issue

- Agreement states: 'HST included, if applicable'
- What is the sale price?
- How much does purchaser owe if it is registered and sale is taxable
- Ex $100,000 'HST included if applicable'
  - purchaser registered and sale is taxable
  - cheque to vendor is $88,495.57 (balance is HST to be reported on self-assessment by purchaser)
  - Expectation of purchaser

Takeaway: confirm HST status before acceptance of agreement

HST and Real Property
- Risk

- Section 194 of the Excise Tax Act
  - If sale is taxable but vendor indicates sale is exempt
  - Proceeds deemed to be tax-inclusive
  - No recourse to collect from purchaser

- Takeaway: who is determining tax status of supply? Is lawyer at risk?

HST and Real Property

- Agreements should:
  - Confirm whether HST is applicable or not.
  - Reps & warranties re registration status
  - Purchaser provides stat. dec. re registration including an indemnity
  - Registration status should be confirmed as of closing date online – Negligence?
    - http://www.cra-arc.gc.ca/esrvc-srvce/tx/bsnss/gsthstrgstry/menu-eng.html

HST Hot Topics

- Residential Rental Construction:
  - 3 steps for HST (good news, bad news, good news)
    - 1) recover all HST on construction – good news
    - 2) at time of initial occupancy, must self-assess HST on fair market value – really bad news
    - 3) based on amount self-assessed, able to claim a rebate for 36% of 5/15ths of tax paid

Above is mandatory, is not optional.

HST Hot Topics

- Bed and Breakfast sales
  - HST application is dependent upon extent of use in the business
  - check T1's to see extent of business use reported
  - if > 50% in business, HST applies proportionately
  - reduces pool of potential purchasers

HST Hot Topics

- Long Term Care Homes
  - long history, involving Tax Court of Canada Rulings
  - most think such sales are exempt
  - they can be taxable if:
    - built post 1991 and never went through a self-assessment

HST Hot Topics

- Cottages – what if rented out in the summer time?
  - Application of tax …. 'it depends'
  - was there personal use
  - how long was it rented
  - are you selling a cottage or are you selling a 'hotel'
  - likely is exempt of HST but ask questions to determine to what extent used in a business

HST Hot Topics

- Nominee Corporations and Joint Ventures
  - CRA policy, in order to do reporting of JV, must be a 'participant'
  - often definition not met = assessments
  - administrative tolerance to end of 2014
  - unsure of current situation
  - Takeaway: if using a JV or nominee, seek guidance on appropriate HST reporting

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Asset Sale Considerations

When assets are disposed of the taxpayer must determine two calculations:

1. The capital gain and
2. The effect on the UCC class

Capital Gain (if applicable)

Proceeds less ACB, Selling Cost = Capital Gain

There are <u>NO</u> capital losses on depreciable property

Asset Sale Considerations

Recapture

- If the balance of the class becomes negative then the negative amount is included in income as recapture

Terminal Loss

- If the class still has a balance and there are no longer any assets in the class then the remaining balance is a terminal loss and reduces income

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Asset Sale Considerations

13(21.1) Ensures that there can never be a terminal loss on a building and a capital gain on land.

Asset Sale Considerations

Adjusts the proceeds on sale of a building:

- If the proceeds from the sale of the building are less than the lesser of:
    - Cost of building and
    - UCC
  - And taxpayer owns land prior to disposition
- If land is disposed during year then the terminal loss is reduced by the capital gain on sale of land.
- Terminal loss is only reduced to zero. It is only reduced to a maximum of the capital gain
- If land is not disposed of the terminal loss is reduced by ½.

Asset Sale Considerations

Capital Cost Allowance

- Acquisitions from Non-Arm's Length Parties
  - No ½ year rule
  - If Gain - Proceeds less ½ cap gain and ½ ECGE claimed
  - If Loss – deemed original cost and recapture exposure

Questions?