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Get tax advice on real estate purchases

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Unless specifically exempted, the supply of real property situated in Canada is generally taxable under the *Excise Tax Act*. Unlike most other supplies covered by the ETA, there is no small-supplier exception for the collection of GST/HST on taxable real estate transactions – even those not otherwise required to be registered for GST/HST must still collect and remit the tax on any taxable real estate transactions in which they are involved, barring certain special non-collection provisions in section 221 of the ETA.

One area of continued focus is the supply of newly constructed residential property, which is always generally taxable, and the line between new and used residential property (the latter of which is often exempt under Part I of Schedule V to the ETA). That said, determining whether a residential property is “new” or “used” is not always straightforward. Determining whether a real estate transaction will be subject to GST/HST can also be further complicated based on intended usage. For example, where a residential property is purchased with the intention of tearing down an existing residential structure on the property, the tax status of the real estate transaction can actually change depending on how the transaction is structured.

2137691 Ontario Limited. v Lucia Pessoa Park, 2018 ONSC 4218 is a recent example of the problems that can arise where a residential real estate transaction is entered into without formally assessing the potential sales tax implications.

In *2137691 Ontario*, the vendor corporation sold a recently subdivided lot to a buyer. The property was listed as the “sale of vacant lot” and the Agreement of Purchase and Sale required that any existing structure on the property be demolished at the vendor’s expense. However, at the time of closing, a pool house and hallway structure connecting to a home located on another lot remained. These structures were demolished by the vendor about 45 days after closing.

Despite obtaining no formal sales tax opinion, on the day of closing, the vendor signed a Statutory Declaration indicating that the property was a “used residential complex” and the “sale of the property is exempt from HST.” The Statutory Declaration also indicated that it was intended to “be relied upon by the purchaser in claiming such exemption as a statement in writing or certificate delivered to the purchaser pursuant to Section 194 of the Act.”

A year after the closing date, the vendor's lawyer informed the buyer that the transaction was subject to HST and asked the buyer to pay \$364,000 in GST/HST. When the buyer refused, the vendor commenced an action and brought a summary judgment motion where the ONSC was tasked with answering, inter alia, the following questions:

1. Whether a summary judgment motion was appropriate and/or premature under the circumstances; and
2. Whether HST was owing on the sale of property and if so, who was liable to pay it?

The vendor also then filed a GST/HST return for the \$364,000 in GST/HST that it said was owing. (At the time that the summary judgment motion was argued, this late-filed GST/HST return had not yet been assessed by the CRA and the vendor had not yet remitted any GST/HST in respect of same.)

In considering whether to rule on the matters in dispute, the ONSC reasoned that while the *Tax Court of Canada Act* removes the jurisdiction of provincial superior courts from determining matters relating to assessments under the ETA, it does not limit the jurisdiction of a superior court to determine contractual rights and obligations between private citizens. While it acknowledged that determining the matters in dispute would require interpretation of certain sections of the ETA, the ONSC held that this was permissible because it was doing so in the context of determining contractual issues and obligations between the parties (i.e., under the APS), which was within the jurisdiction of the ONSC.

In regards to the sale of real property, the ONSC noted that the sale of real property, including a vacant lot, is generally a taxable supply when the sale is made by an independent company. The issue was therefore whether the used residential property exemption set out in Part I of Schedule V to the ETA applied to the real estate transaction in question, which required an interpretation of the terms "residential unit" and "residential complex" as defined in subsection 123(1) of the ETA. The ONSC held that the material time for making this determination was on closing because this was the time when the sales transaction was completed.

In determining whether the real estate transaction in question involved the sale of a "residential unit" and/or "residential complex," the ONSC noted that the definition of residential complex in the ETA included appurtenances to a building. Since the pool house was attached to the house by a permanently covered stone hallway, the ONSC found that the pool house was a part of the greater residential complex. Even though the house and the pool house were located on separate lots, the ONSC held that there was no requirement in the ETA that the used residential property exemption involve the transfer of an entire residential unit or a complete residential complex. When considered in isolation of the remainder of the residence and looking only at the subject lot, the ONSC determined that the pool house, as a permanent, insulated, dry-walled, stone structure, was itself a residential unit.

The fact that the vendor had a contractual obligation to demolish the structure on the subject lot was held to be inconsequential because the ONSC reasoned that the parties' expectations with regard to the future demolition did not change the fact that at the time of closing there was still a building on

the property. The ONSC therefore concluded that the pool house and hallway on the subject lot were a "part of" a residential unit as defined in subsection 123(1) so the sale constituted an exempt transaction under Part I of Schedule V to the ETA.

That said, even if GST/HST was in fact payable on the real estate transaction in question, the ONSC concluded that the buyer would in any event not be liable to pay the sales tax due to the Statutory Declaration that the vendor signed. This Statutory Declaration was held to be a requisition made under Clause 7 of the APS which stated that if GST/HST was not payable, the vendor agreed to certify this. The ONSC emphasized the fact that this Statutory Declaration not only stated that the sale of the property was exempt from GST/HST, thus linking it to the APS, but also that it was delivered pursuant to section 194 of the ETA.

Based on the clear wording of section 194, which was held to have been enacted to protect buyers, the ONSC concluded that if a "vendor makes a mistake in the Statutory Declaration, the buyer is entitled to rely on it based on the deeming provisions. The GST/HST is deemed to have been collected by the vendor and paid."

This decision certainly demonstrates the importance of getting tax advice before entering into a real estate transaction because the vendor's execution of the Statutory Declaration was fatal to its case – and appeared to have been done all without such advice. The fact that this Statutory Declaration was executed by the vendor without proper tax advice is even more surprising when one considers that the \$364,000 in potential GST/HST at issue in this case suggests that this was a \$2.8 million transaction!

It must also be noted that while the ONSC held that the real estate transaction in this case was not subject to GST/HST, this finding is likely not binding on the CRA or the Tax Court of Canada. The fact that the vendor filed a GST/HST return indicating that the real estate transaction was subject to GST/HST (and even argued this before the ONSC) is also quite problematic for the vendor. This will likely result in a compounding of the problem, as the CRA is likely to confirm the GST/HST return (i.e., it will not on its own initiative say that no GST/HST is payable) and begin collections actions on same – requiring additional, and potentially costly steps to be taken by the vendor to finally resolve matters.

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