Sales of Land by Non-Residents

Where the vendor or transferor of land is a non-resident of Canada pursuant to the *Income Tax Act*, certain tax consequences arise that affect both the non-resident and the grantee. To avoid any impact on the grantee it is necessary to obtain a non-resident clearance certificate from Revenue Canada under s.116 of the Act. Under the current provisions, only fully in effect for 1986, this will usually require some payment on account of tax.

Requirement for Clearance

Section 116 provides that if a non-resident proposes to dispose of property that would be taxable Canadian property he may at any time before the disposition send the Minister (read local taxation office) a notice setting out to whom he proposes to sell the property, the description of the property, the proceeds of disposition, and the adjusted cost base. If he also sends 25% of the difference between the proceeds of disposition and the adjusted cost base, the Minister will issue a certificate, commonly referred to as a non-resident clearance certificate. If he doesn't do this before the sale he can do it after the sale.

Duty of Solicitor

Where a purchaser has acquired from a non-resident any taxable Canadian property, he is liable to pay 15% of the purchase price to Revenue Canada. The only way to avoid this penalty in the absence of a clearance certificate is to demonstrate that "after reasonable inquiry" he had no reason to believe that the non-resident person was not a resident of Canada. That puts solicitors representing a purchaser under the duty to make a reasonable inquiry.

The usual course of events is that the solicitor for the vendor is put on requisition to obtain a clearance certificate or undertakes to do so, and it is his or her responsibility to undertake the necessary steps. The transaction may close before the certificate is received, and the purchaser's solicitor normally maintains a holdback pending receipt of the certificate. Recording the certificate may not be essential because there is nothing in the Act that makes the tax a lien on the property, only a personal debt of the purchaser. Accordingly, it is not necessary to go back through a chain of title and determine whether somewhere along the way somebody was a non-resident and then try to find out whether or not the tax was paid or a clearance certificate received at that time.

Transactions included

The same provisions apply to transfers by gift, in as simple a situation as where a man owns a piece of property and wishes to put it in the name of himself and his wife as joint-tenants. The fair market value is substituted for proceeds of disposition. A certificate may be obtained in such cases as well, although the chances of fighting over the fair market value are probably higher.

A resident of Canada within the meaning of the *Income Tax Act* (s.250) is a person who has stayed in Canada for at least half a year, or who was at any time during the year member of the Canadian Forces or was in the diplomat services, or was performing services under an internation development assistance program of the government, or member of the Overseas Canadian Forces School staff, was the spouse or child of such a person. A corporatio can be non-resident, but usually it will be resident if it wa incorporated in Canada.

How to Apply for Clearance

In order to obtain the clearance certificate an applicatic must be made by the vendor on Form T2062 wi attachments, including calculation of the adjusted co base, gain, ownership interests in the property and i description. Revenue Canada also provides a set instructions on request.

In calculating the proceeds of disposition, the re estate commission and legal fees are not deductible. Ta adjustments or fuel adjustments are not relevant figure The proceeds of disposition would normally be the amou on the agreement of purchase and sale. This is not th same as an ordinary income tax return calculation.

Apparently, Canadian and American authorities hav agreed that the tax should be paid in the country in whic the property is situate, under Article XIII of the 1980 *Ta Convention* (in effect 1984). Probably they have discovere that not doing this has meant that they have missed a gre deal of it. Essentially, therefore, tax must be paid in a non-resident vendor situations, a very significant departu from past practice.

Special Considerations

Some special considerations in the applications follo One is that if you sign the application on behalf of th non-resident, then there has to be documentary evidenc of the authority, normally a power of attorney, filed with th application. I find it is as much trouble to get a power attorney as it is to get the non-resident to sign it.

In particulars of the property, the vendor's interes must be shown. That is, there may be an undivided ha interest where joint tenants are selling. As well, the use which the property is being put must be indicated. providing this type of information to Revenue Canada, or should always recall that they are looking to establis whether or not all tax requirements have been met in th past with respect to the property or this vendor. Accordingl the information, in case you have any doubt, should alwa be directed towards satisfying Revenue Canada on thes particulars.

In the legal description to be furnished, of which at lea four copies are to be provided (and I suggest more), recital of the details as to how the vendor acquired h interest is required. Essentially, if you were doing a dra deed, and you have an up-to-date "being and intended be" clause, that is enough. That is, if at the end of th

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description you recite that it is being and intended to be the same property that the vendor acquired from the past vendor by deed dated such and such a date and recorded in such and such a book and page in whichever registry, that has always been satisfactory.

The adjusted cost base, which is very important in establishing what the tax payment will be, is the cost of acquisition of the property plus cost of improvements. The adjusted cost base could, of course, be a valuation day figure. Adjusted cost base can be established with a reasonable degree of accuracy by appraisal in case of large or expensive properties, or by assessment figures in many cases.

A few notes may be helpful for simpler situations. The starting point is the purchase price or valuation day price. To that can be added the cost of any improvement to the property. An example could be a new roof. Another addition to the adjusted cost base is interest and property taxes on unproductive land to the extent not allowed as a deduction from income. See s.53(1).

Where a part of the property has already been sold (or is not being sold) the adjusted cost base of that part has to be deducted.

Expenses incurred in disposing of capital property and in putting the property into saleable condition, which are deductible from the capital gain for Canadian income, are not recognized as deductible expenses for a non-resident, for clearance certificates purposes.

Divided Ownership

In the case of a divided ownership, only that owner's proportion of the total purchase price should be reported, although the total purchase price should show on a schedule together with the calculation of the various ownership interests.

Revenue Canada has indicated that they may in some circumstances require a non-resident vendor to file an income tax return. In advising any non-resident vendor, you probably should be directing his or her attention to the fact that an income tax return should be filed. The return is essential if the payment on account of tax exceeds the actual liability. For example, if there is a substantial real estate commission that would be deductible from the gain for a Canadian taxpayer, the non-resident could deduct this as well, but only on the income tax return, not in applying for the clearance certificate. Accordingly, to adequately protect the interests of your non-resident vendor client, you will now be recommending filing an income tax return for the taxation year in which the property was sold. In a great may circumstances, the non-resident vendor has no other income subject to Canadian tax (see subsection 115) and accordingly may have minimal tax payable.

Depreciable Property

Depreciable property must be reported on Form T2062A. Depreciable property would include rented properties. In this case, pay 25% of the gain and the estimated tax on recaptured depreciation is payable. Failure to get a clearance certificate in this situation can expose the purchaser (or his solicitor) to liability to pay Revenue Canada half the gross proceeds of disposition. A similar provision applies to resource property (oil, gas, minerals).

U.S. Residents

There remains a special provision for U.S. residents that requires the completion of a questionnaire. If the non-resident vendor owned a capital asset on September 26, 1980, and at all times since was resident in the U.S., the taxable portion of the gain is only the gain since December 31, 1984 (apportioned equally, month by month, unless other information is available). The provision does not apply if the property is part of a business property in Canada or qualifies for tax deferment in the U.S. See Paragraph 9, Article XIII of the 1980 Convention (in effect Dec. 31/84).

Principal Residence

Finally, in the case of a principal residence, all or part of the gain may be exempt and the Section 116 payment will be reduced accordingly. To apply send Form T2091 or a letter from the taxpayer setting out the expected capital gain and the calculations. Reductions will not be given if there are unresolved tax issues, for example, no final return when the taxpayer left Canada.

Consequences of not Filing

To summarize, under the present system an application for a non-resident tax certificate requires a payment of 25% of the amount of capital gain. In the event no certificate is received, the purchaser would be liable to pay 15% or more of the purchase price. The solicitor could be liable to the purchaser in such a situation. The vendor, of course, is also liable to prosecution for failing to apply for this certificate. The solictor for the non-resident vendor should almost always recommend to the vendor that an income tax return be filed, in order to recover the overpayment of actual tax that is required by the present system. Further, the provisions with respect to tax on non-resident transfers applies to gifts and to similar conveyances, such as those between husband and wife, and therefore must be considered in matters as simple as a joint-tenancy deed where a non-resident is involved. Finally, the tax consequences in the case of depreciable property are much more complex and serious.

— *John R. Cameron*

Note: To obtain further information or to inquire regarding specific transactions, solicitors should contact Revenue Canada Examination Officers Phil Doucet or Michael Moir at the Halifax office (426-2439)