ADVISORS
POINT OF VIEW

NON-RESIDENT INVESTING IN CANADIAN REAL ESTATE – **KEEP THE TAXMAN IN MIND**

Canada has long been an attractive destination for foreign investors looking for a stable environment to invest in real estate. What many non-resident investors may not realize are the tax compliance requirements associated with owning Canadian real property.

EARNING RENTAL INCOME FROM CANADIAN REAL PROPERTY

Withholding tax is imposed on the gross amount of rent paid or credited to a non-resident landlord. The rate of withholding is generally 25%, unless specified in an income tax treaty. The tenant or the withholding agent for the non-resident landlord is responsible for remitting the tax to the Receiver General of Canada, who collects on behalf of the Canada Revenue Agency ("CRA").

If there are expenses related to the rental operations, the non-resident landlord may choose to file a Canadian income tax return within two years from the end of the taxation year in which the rents were received pursuant to section 216 of the *Income Tax Act* (the "Act") and deduct expenses related to earning the rental income, including capital cost allowances ("CCA") to arrive at the net rental income. Tax is calculated on the net rental income. This is an option that the non-resident landlord can decide on a year-by-year basis. For a non-resident landlord who is an individual, form T1159 is used but no "personal amounts" tax credits can be claimed.

An overpayment of withholding tax can be claimed as a refund. If CCA has been claimed and the property is subsequently disposed of, any recapture of CCA previously deducted must be included in income in the year of disposal.

It should be noted that filing a tax return under section 216 of the Act does not change the requirement to remit withholding tax on 25% of the gross rents. It merely enables the non-resident to obtain a refund if the tax so calculated on the net income is less than the tax withheld.

An option to reduce withholding tax can be made if an agent files form NR6 on behalf of the non-resident landlord, and makes an undertaking to file an income tax return within six months after the end of the taxation year. It permits the withholding of tax to be calculated based on 25% of the estimated net rental income (instead of 25% of the gross rents). This is beneficial if there are recurring rental expenses. Form NR6 must be filed and approved by the CRA before the first day of the following taxation year or before the first payment of withholding tax is due. For example if the monthly gross rent was $1,000 and monthly expenses were $800, filing form NR6 for the undertaking means that the agent would only need to remit $50 of tax based on $200 of net rent ($50 = 25% x [$1,000 - $800]). If no undertaking was filed, the amount required to be remitted would be $250 (25% x $1,000).

Another reporting requirement is to file form NR4 to report the gross rent received and the withholding tax remitted of the previous calendar year. This filing is due March 31st of the following calendar year.

DISPOSING OF CANADIAN REAL PROPERTY

By definition, Canadian real property is a taxable Canadian property ("TCP") for income tax purposes. A non-resident who disposes of TCP is subject to rules which constitute a prepayment on account of tax.

A person or entity who purchases Canadian real property from a non-resident vendor is required to withhold 25% of the purchase price and remit to the CRA on account of the non-resident vendor's tax account, unless the non-resident vendor has posted security for payment of the tax liability, or has agreed to request a tax clearance certificate (also known as a section 116 certificate) from the CRA in advance of the closing or at the latest, within 10 days after closing and pay the estimated tax liability. Generally the purchase and sale agreement will ask the vendor for status of Canadian tax residency.

CRA form T2062/T2062A is to be used by a non-resident vendor to request for a tax clearance certificate. The non-resident vendor is required to disclose the name and address of the purchaser, the date of the transaction, a description of the property, the sale price and the vendor's tax cost or adjusted cost base of the property. The filing also requires submission of documents to support the original purchase price, invoices that support additions to the property, the sale agreement, etc. The form implies that the non-resident vendor to make a prepayment of tax on account equal to 25% of the estimated capital gain. If the estimated tax calculated is not paid or if security is not provided, the purchaser will be obligated to withhold and remit the 25% from the gross purchase price to the CRA within 30 days after the end of the month in which the transaction has closed. Since 25% of the gain is generally less than 25% of the gross sales price, it is to the non-resident vendor's benefit to pay the former amount.

Once the processing of the request is complete, the CRA will issue the tax clearance certificate on form T2064. The certificate will set out an amount called a "certificate limit". In the event where there's an adjustment to the purchase price after the issuance of the certificate and the final sale price exceeds the certificate limit, the purchaser must withhold and remit to the CRA 25% of the amount by which the actual sale price exceeds the certificate limit.

Independent from the clearance certificate process, the non-resident vendor is required to file a Canadian income tax return after the end of the taxation year to report the transaction and pay the tax liability if there is a deficiency. Tax will be refunded if there is an overpayment.

A non-resident investing in Canadian real property should always seek professional advice to ensure all requirements are followed with the Canadian tax authorities, as there are penalties for non-compliance.

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