

# TAX TALK

## CANADIAN TAX CONSIDERATIONS FOR NON-RESIDENTS OWNING CANADIAN REAL ESTATE

Many individuals living outside of Canada, including former Canadian residents and others who have never lived in Canada will purchase Canadian real estate including condominiums, houses and seasonal properties.

Former Canadian residents will often continue to own real estate in Canada after becoming non-residents, either as an investment or to have a home to move back to if they choose to return to Canada.

Non-residents should be aware of the Canadian tax implications when owning Canadian real estate.

### **Owning Canadian Real Estate and Canadian Residency for Tax Purposes**

The ownership of Canadian real estate could be seen as a significant residential tie to Canada, however, there are means to reduce this impact. A significant residential tie is important since it is one of the main factors in determining whether you are a resident of Canada for tax purposes.

If you are considered to be a resident of Canada for tax purposes you will be subject to Canadian tax on your worldwide income. This includes income earned in Canada as well as income earned outside of Canada.

One means to reduce this impact is to have the real estate rented to an arm's length party at fair market value, preferably under a long-term lease. Thus, the Canada Revenue Agency (CRA) will not see this property as a significant residential tie to Canada when making a residency determination. Whereas leaving the real estate vacant and available for regular and continuous use could be seen by CRA that an individual was a resident of Canada for tax purposes. Furthermore, renting the real estate to family members, or simply allowing family members to use the home rent-free could also be seen by CRA that an individual was a resident of Canada for tax purposes.

As a result, the individual would be treated as a resident of Canada for tax purposes and they would be taxed on their worldwide income.

### **Rental Income from Canadian Real Estate**

Unfortunately, many Canadian expatriates rent their homes but do not properly abide by the tax withholding and/or tax filing requirements because they are often unaware of these rules. The taxpayer should be aware that income from the rental of Canadian real estate is taxable in Canada, even if they are a non-resident of Canada, for tax purposes to ensure that the tax filing and remittance requirements are met.

Non tax residents of Canada are taxable in Canada on investment income including rent. This tax is commonly referred to as withholding tax. The general rate for this tax is 25% of the gross amount of the investments received from the Canadian source. The Canadian resident who pays the rent or other amounts to the non-resident is required to withhold the tax from the payment and remit it to the CRA. No deductions or credits are permitted and the non-resident is not required to file an income tax return. If there is an international tax treaty in place between Canada and the country of tax residence of the non-resident, then the rate of withholding tax may be reduced or eliminated on certain investment income.

Not surprisingly, there are withholding tax and annual non-resident rental filing requirements that individuals must comply with if they own real estate in Canada as a non-resident and earn rental income from it. If these requirements are not properly met, there could be significant interest and/or penalties imposed by CRA for non-compliance. Additional filing requirements and capital gains tax will result when the property is disposed of. A disposition will even include situations where the property's use is changed from income producing to personal use.

For rental income from real estate, non-residents of Canada can elect to be taxed on the net rent they receive instead of the gross amount of the rent they receive. Since there are usually costs associated with earning rental income, this can significantly reduce the amount of tax withheld from the non-resident. Non-residents who choose to make this election are required to file special tax returns annually by June 30th of the following year.

Non-residents are still not able to claim deductions (other than rental expenses) and credits against their net rents. They are also not able to use any loss carryovers if the rental property is losing money.

If the property is rented while an individual is abroad the rental income is often large enough to cover most of the expenses incurred on the real estate which can be a significant benefit. Some expenses involved in maintaining a property include property taxes, mortgage interest, utilities, property management fees, and repairs and maintenance. It will be necessary to track and keep proper documentation to support these and other expenses incurred to earn the rental income. As a result, the individual has the benefit of renting the home with little to no tax depending on the net income of the property.

### **Selling Canadian Real Estate**

When Canadian real estate is sold while the individual is a non-resident of Canada, there will also be tax owing on any gains as a result of the sale. Furthermore, the non-resident must meet certain filing and remittance requirements due to the sale.

The non-resident must file a special tax form and remit the required withholding tax to the CRA. The amount of withholding tax to be remitted is 25% of the purchase price less only the cost of the property. No selling expenses are allowed in determining the withholding tax. Once the non-resident has filed the form and remitted the withholding tax, CRA will provide the non-resident with a certificate.

If the non-resident is not able to provide a copy of the certificate to the purchaser proving that the non-resident has filed the form and remitted the withholding tax, the purchaser will be required to withhold and remit the 25% tax based on the total purchase price and not the purchase price less the cost of the property. In addition, CRA could also apply penalties to the non-resident for not filing the form and remitting the tax.

When CRA receives the tax form and the withholding tax from the non-resident they will issue a compliance certificate to the vendor. The vendor can then provide this certificate to the purchaser as proof. This certificate will permit the purchaser to not withhold the tax on the proceeds.

In addition, the non-resident is required to file a Canadian non-resident income tax return to report the Canadian real estate sale.

A tax refund will often arise since the overall Canadian tax rate may be less than the required withholding tax remittance. Moreover, since the selling costs were not allowed to be taken into account when the original withholding tax remittance was calculated, a refund will result.

### **Principal Residence Exemption**

For most Canadians departing Canada, the real estate they own in Canada, up to the time of their departure, can often be designated as their principal residence. If the home is sold prior to leaving Canada, the full principal residence exemption should be available, with some exceptions, resulting in no tax on the sale of the home. Complexities of selling a home that formerly qualified as a principal residence arise when the property is sold by a non-resident of Canada. The reason for this is that the home cannot be designated as an individual's principal residence for the years that they are not a Canadian resident for tax purposes for at least part of the year. The result of this is that the principal residence exemption will not fully offset the capital gain on the sale of the property and a taxable gain may arise in Canada.

### **Change in Use Rules**

When a property changes from being used for personal purposes to rental purposes there is a "change in use" of the property. This change in use results in a deemed disposition and reacquisition of the property for the fair market value at that time. The deemed disposition may result in a capital gain which will often be offset by the principal residence exemption.

However, there is an election that can be filed that allows an individual to defer the deemed disposition and to take advantage of the principal residence exemption to potentially reduce the tax on a future capital gain on the sale of the property. There are many complex issues involved in the decision of whether or not to file this election.

### **Purchasing Canadian Real Estate and the Non-Resident Speculation Tax (NRST)**

In 2017, the Province of Ontario announced a new 15% Non-Resident Speculation Tax (NRST) on the purchase of residential property located in the Greater Golden Horseshoe by individuals who are not citizens or permanent residents of Canada or by foreign corporations (foreign entities) and taxable trustees.

The NRST applies to purchases of land containing at least one and not more than six single family residences. If the property includes both residential property and another type of property, the NRST only applies on the purchase price of the residential property.

Purchases of Canadian real property may also be subject to Goods and Services Tax or Harmonized Sales Tax (GST/HST) when certain conditions apply. GST/HST is a sales tax that will apply to the sale price of new Canadian residential real property such as real property purchased from a residential home builder.

### **Tax on Unproductive Use of Canadian Housing by Foreign Non-resident Owners**

The Federal Budget 2021 proposes to introduce a new national 1% tax on the value of vacant or underused real estate owned by non-resident, non-Canadians. The tax will be levied annually beginning in 2022.

All owners of residential property in Canada, other than Canadian citizens or permanent residents of Canada, will be required to file an annual declaration for the prior calendar year in respect of each Canadian residential property they own, starting in 2023.

### **WE CAN HELP**

Your MG advisor can help you review your personal or business tax situation and help you decide which steps you should take next.

A memorandum of this nature cannot be all-encompassing and is not intended to replace professional advice. Its purpose is to highlight tax planning possibilities and identify areas of possible concern. Anyone wishing to discuss the contents or to make any comments or suggestions about this TaxTalk is invited to contact one of our offices.

Offices: First Canadian Place  
100 King Street West, Suite 5700  
Toronto, Ontario M5X 1C7  
Phone: 416-362-0515

1900 Minnesota Court, Suite 116  
Mississauga, Ontario L5N 3C9  
Phone: 905-451-4788  
Fax: 905-451-3299

TaxTalk is prepared by our Tax Group ([taxtalk@mgca.com](mailto:taxtalk@mgca.com)). Please visit our web site at [www.mgca.com](http://www.mgca.com).

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