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BUYING PROPERTY FROM A NON-RESIDENT
PAYING NON-RESIDENTS — WATCH OUT FOR WITHHOLDING TAX!
GST/HST NEW HOUSING REBATE — TECHNICAL FIX
IN THE APRIL 19 FEDERAL BUDGET
DO YOU HAVE TO CHARGE GST/HST
IF YOU HAVE ONLY A LITTLE BUSINESS INCOME?
AROUND THE COURTS

BUYING PROPERTY FROM A NON-RESIDENT

If you are buying real estate — such as a house or condominium, or a commercial property — from a non-resident of Canada, you need to know about your **obligation to withhold tax** unless the vendor provides you with a "section 116 certificate" from the Canada Revenue Agency.

Non-residents generally are subject to Canadian income tax only on certain Canadian-source income. One such source is capital gains on "taxable Canadian property", which generally includes Canadian real property, shares of corporations whose value is primarily attributable to Canadian real property, and certain other items.

Of course, a non-resident who sells Canadian property might not have any other property in Canada, and so the CRA might not be able to enforce collection of the tax that is payable. To solve this problem, section 116 of the Income Tax Act makes the *purchaser* potentially liable for the vendor's capital gains tax.

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If you buy taxable Canadian property from a non-resident, then you are required to **withhold 25% of the purchase price** and remit it to the CRA. If you do not, you can be assessed for this amount. (The 25% reflects the typical maximum tax rate of about 50% on taxable capital gains, which are one-half of actual capital gains.)

To avoid having you withhold this 25%, the non-resident can apply to the CRA for a "section 116 certificate", which relieves the purchaser from the withholding obligation. The non-resident must calculate the amount of tax payable on the gain, and pay that amount to the CRA, in order to get the certificate.

Normally your real estate lawyer will be very aware of this issue and will ensure that if the vendor is non-resident, a section 116 certificate is provided before your purchase price is paid over to the vendor.

Note however that this rule can also apply to the **sale of a purchaser's right under an Agreement of Purchase and Sale**, which is a "right" to acquire real property and thus falls into the definition of taxable Canadian property.

For example, suppose you are looking to buy a condominium that is not yet finished but has been under construction for some time. A non-resident signed up to buy the condo from the builder three years ago when the cost was $200,000, and put down a $20,000 deposit. With increases in local real estate prices, the condo will be worth $300,000 on completion. The non-resident agrees to "sell" you her rights under the purchase agreement, with the builder's consent, for $120,000 (i.e., the increase in the condo's value, plus the $20,000 deposit that will stand to your credit on closing).

This sale is a sale of taxable Canadian property, and your lawyer should be advising you to withhold 25% of the $120,000, so that the CRA does not assess you for this amount. (There may be some cases where Canada's tax treaty with the non-resident's country of residence relieves you of this obligation, but even in such cases the relief may apply only if you notify the CRA of the purchase within 30 days after closing.) To prevent this withholding, the non-resident will need to get a section 116 certificate from the CRA.

Some lawyers are not aware of the requirement to obtain a section 116 certificate on the transfer of rights under a purchase agreement.

PAYING NON-RESIDENTS — WATCH OUT FOR WITHHOLDING TAX!

Under our Income Tax Act, non-residents of Canada are subject to Canadian withholding tax on various kinds of income paid to them by Canadian residents. If you are a Canadian resident making such payments to a non-resident, you **must withhold** the required amount and remit it to the Canada Revenue Agency within a prescribed period. These rules cover, for example:

- **Rent** for the use of property in Canada

  Example: you rent a house from a landlord who lives in Hong Kong and purchased the property as an investment, and who does not use a rental agent in Canada to collect the rents.

- **Royalties** (but not book royalties)

  Example: your business licenses a film from a company in Italy.

- **Dividends**

  Example: your corporation pays dividends to a US resident who invested in the business as a shareholder.

  (Taxable shareholder benefits are deemed to be dividends for this purpose.)

- **Estate or trust income**

  Example: you are executor of an estate, and income earned since the deceased's death is payable to a beneficiary in Mexico.

- **Pension income**

- **RRSP/RRIF withdrawals**

- **Commissions or fees** for services rendered in Canada. (While the rest of the non-resident withholding tax rules are in section 212 of the Income Tax Act, this one is buried in section 105 of the Income Tax Regulations and is often overlooked, even by many accountants.)

  Example: a motivational speaker who now lives in the Bahamas comes to Canada to lecture to your employees.

Interest payments were formerly subject to withholding tax in all cases. Since 2008, the tax no longer applies most of the time. However, it does apply to interest paid to a person with whom you don't deal at arm's length, such as a relative; or if the interest is "participating debt interest", meaning (in very general terms) that the interest rate is calculated by reference to revenue, profit, cash flow, commodity price or dividends.

Alimony, spousal support and child support were formerly subject to withholding tax. This was eliminated in 1997, and so you do not have to worry about withholding tax on any such payments that you make to a spouse or ex-spouse who now lives outside Canada.

The non-resident withholding rules are very complex, and there are many exceptions and qualifications, both in the Income Tax Act and in Canada's tax treaties with other countries.

Amount to be withheld

The amount to be withheld is, according to what is written in the Income Tax Act, **25%** (15% for commissions or fees on services rendered in Canada). If the payee is resident in a country with which Canada has no tax treaty (e.g., Bahamas, Bolivia, Cayman Islands, Paraguay, Saudi Arabia), you must normally withhold the full 25%, and send those funds to the CRA.

However, for most countries you must find out whether the **tax treaty** between Canada and that country reduces the withholding tax. The rate that applies will depend on the type of payment as well as the country of residence of the payee. Canada has tax treaties with 94 countries or jurisdictions (including Hong Kong and Taiwan).

For example, here are some of the reduced rates of withholding tax provided by the **Canada-United States** tax treaty:

Dividends
15% (reduced to 5% if the shareholder is a corporation that owns at least 10% of the Canadian company's voting stock)

Estate or trust income
15% (for income arising in Canada)

Interest

15% on "participating debt" interest; 0% otherwise (i.e. on interest to a non-arm's length person which would otherwise be subject to Canadian withholding tax)

Pension payments

15% (for a "periodic pension payment", including a RRIF distribution up to certain limits each year)

Rent (real property)

25% (no reduction, as the treaty does not deal with such payments)

Royalties

10% (0% for most payments for use of a patent, computer software or technology)

You can find the text of all of Canada's tax treaties on the Department of Finance website, at www.tinyurl.com/can-treaties — scroll down to "Status of Tax Treaties", click on that and then on "I. In Force".

Can the non-resident get back the tax?

Generally, no. The non-resident withholding tax on passive income is normally the *actual* tax, not a prepayment on a tax to be calculated later (as is the case for employee payroll deductions that are withheld at source, or the withholding tax on RRSP and RRIF withdrawals by Canadian residents). The non-resident normally does not and cannot file a tax return in Canada to report the income.

There are some exceptions, however. The most significant is for **rent on real property**. The non-resident can elect to file a regular Canadian tax return to report the income, and to pay tax at normal graduated Canadian rates (that apply to Canadian residents) on the *net* income from the property, rather than having 25% withheld on the *gross rental income*. Where the expenses of the property are significant (e.g., mortgage interest, utilities, property taxes, property management fees and insurance), the non-resident will normally do this. In such cases, arrangements can be made in advance to reduce the amount that has to be withheld from each payment of rent.

For commissions or fees on services rendered in Canada, the non-resident does file a Canadian tax return, and pays regular Canadian tax, with a credit for the 15% tax withheld by the payer.

What happens if you don't withhold or don't remit?

If you fail to withhold the required percentage from each payment, you are liable for that percentage (or possibly more, if the amount you pay is considered to be a "net" amount after withholding tax). You are also liable for **interest and penalties**, which can be quite substantial. Interest compounds daily at a prescribed rate which changes quarterly (currently 5%). The penalty is normally a flat 10% of the amount you failed to withhold, but can be much higher for repeated violations or intentional failure to withhold. Criminal sanctions can also apply if you know about these rules and your failure to withhold is deliberate.

Similarly, if you withhold tax but fail to remit it to the CRA by the due date, you will be liable for the tax plus interest and penalties. The funds that you have withheld are considered to be held in trust for the federal government; you must not consider this as your own money.

If you are making any payments to non-residents, it is important to obtain accurate advice as to your possible obligation to withhold and remit withholding tax.

GST/HST NEW HOUSING REBATE — TECHNICAL FIX IN THE APRIL 19 FEDERAL BUDGET

Background

We last discussed the GST/HST New Housing Rebate in detail in our September 2018 issue. Generally, if you are purchasing a new home or condominium from a builder, you can normally claim a rebate if you meet the following conditions:

- The sale of the home is subject to Goods and Services Tax (GST) or Harmonized Sales Tax (HST).

- At the time you sign the agreement of purchase and sale, you are acquiring it with the **intention** of using it as your (or a close family member's) "**primary place of residence**". (If instead you are intending to rent out the property for at least a year, there is normally a parallel "landlord's rebate".)

- You pay all the GST/HST on the purchase.

- The construction is "substantially complete" by the time ownership is transferred to you.

- The home **has not yet been lived in** (if it has, the builder should have paid the GST/HST on it and there should be no GST/HST when you buy the home). However, occupancy of a condominium unit under an agreement of purchase and sale before closing is allowed — often this happens as a temporary rental before the condominium project is registered and thus ready to be legally transferred.

- You, or a close family member, are the **first person to live in the home** after substantial completion, OR you re-sell the home without GST/HST before anyone moves in.

A similar rebate is available if you build your own home.

The **federal** rebate (of part of the 5% GST) is only available if the **total cost of the home (including the land) is less than $450,000**. Up to $350,000, the rebate is 36% of the 5% GST. Above $350,000, it is phased down to zero as the cost approaches $450,000. As these dollar thresholds have not changed since they were introduced in 1991, this rebate is no longer useful for most new home purchases in some Canadian cities, as homes have become more expensive.

In **Ontario**, there is an additional rebate of 75% of the Ontario 8% portion of the HST, up to a purchase price of $400,000. The maximum rebate is thus $24,000. **This rebate is not phased out for more expensive homes**, as the federal rebate is. Thus, in practice, in a city like Toronto where virtually every new home or condominium now costs over $400,000, the rebate is a flat $24,000.

The rebate is normally credited to the purchaser by the builder on closing, and is factored into most builders' quoted sale prices.

The "family friend" problem

As noted above, one of the conditions for the rebate is that you acquire the home with the intention of using it as your, or a close family member's, "**primary place of residence**".

Until now, this condition has applied to **every co-purchaser**, if multiple people are listed as purchasers on the Agreement of Purchase and Sale.

This has posed a problem in cases where the "real" purchaser does not qualify for mortgage financing, and the bank or mortgage company insists that they find a relative or friend with good credit to co-sign the mortgage. If the person who helps out in this way is a close relative such as a parent or sibling, the "intended as primary place of residence" condition is still met, since a close family member qualifies. However, if the person is merely a friend, or a more distant relative such as an uncle or cousin, the condition is not met for any purchaser. The "real" purchaser loses the rebate!

This has led to **many purchasers unexpectedly losing the rebate** — the CRA assesses them months or even years after the purchase, to recover thousands of dollars.

The problem is being fixed

Finally, the government has addressed the unfairness of these cases. The April 19, 2021 federal Budget states:

> Budget 2021 proposes to remove the condition that where two or more individuals buy a new home together, each of them must be acquiring the home for use as their primary place of residence or the primary place of residence of a relation. Instead, the GST New Housing Rebate would be available as long as the new home is acquired for use as the primary place of residence of ***any one of* the purchasers** or a relation of any one of the purchasers.

This change is included in Bill C-30, the Budget bill which received First Reading in Parliament on April 30, 2021 and at time of writing was expected to be enacted by mid-June. However, it will apply only where the **purchase agreement is signed after April 19, 2021.**

DO YOU HAVE TO CHARGE GST/HST IF YOU HAVE ONLY A LITTLE BUSINESS INCOME?

Most people know that, under the GST/HST, a business with sales under $30,000 per year does not need to charge GST/HST on their sales. (Such a person is called a "small supplier".)

However, the rule is not that simple.

First, **if you are GST/HST registered**, you must charge and collect GST/HST on your sales, and remit it to the CRA (Revenu Québec, in Quebec). You might be registered because in a past year you crossed the $30,000 threshold, and you have not cancelled your registration. Or you might have chosen to register even as a small supplier, so that you can claim input tax credits on your purchases (and because your customers are businesses that do not mind if you charge them GST/HST). Either way, once you're registered you are "in the system" and the $30,000 threshold is not relevant, until your registration is cancelled (your one registration applies to you personally and thus to all businesses you carry on). You must charge GST/HST on all your sales (unless they are exempt or "zero-rated").

Second, when counting the $30,000 threshold, you must total up not only your own sales, but also those of other persons with whom you are **"associated"**. This includes **any corporation you control**; as well as any partnership from which you (and associated persons) are entitled to more than half the profits; and certain trusts.

Your spouse is not normally "associated" with you, but you are likely "associated" with a corporation that you and your spouse control together.

Example: You are not GST/HST-registered. You have a small consulting business in which you bill only $5,000 per year. However, you also own 60% of the shares of a company that operates a carpentry business, with $100,000 in sales a year.

Because you and the corporation are "associated", with combined sales exceeding $30,000, you must register for GST/HST and charge GST or HST on your consulting fees.

If you neglect to do this, so that you don't file GST/HST returns, **there is no time limit** for the CRA to assess you, even if you have correctly reported the income for income tax purposes. If the CRA discovers this situation 10 years from now, you could end up with a large assessment for all the uncollected tax, plus interest, plus penalties for not filing.

So beware this situation!

AROUND THE COURTS

Business loss claims: some win, some don't

Taxpayers who claim substantial business losses that offset their income from other sources are usually audited by the CRA, and their losses are often challenged. In the CRA's view, the so-called "business" is often just a hobby, or a personal activity, or has not yet become serious enough to be a real business. As a result, the CRA reassesses the taxpayer to deny the loss claim. Many of these taxpayers file a Notice of Objection to the CRA reassessment, and if the CRA Appeals Officer upholds the auditor's decision, some continue with an appeal to the (independent) Tax Court of Canada.

The results in these cases are mixed. The taxpayer will have more chance of success if the "business" is not something one would do as a hobby or personal activity.

In other cases, the activity simply did not have the "hallmarks" of business, as there was no business-like operation.

In some cases, the business was considered to not yet have begun.

On the other hand, some taxpayers succeed in convincing the Tax Court that they were operating a "real" business in the tax year in question.

Of course, every case depends on its facts, and on how well the case is presented in Court. But sometime, when the CRA denies a loss, that decision can successfully be appealed.

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