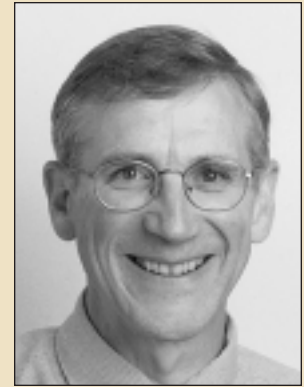


INTERNATIONAL INTERESTS

Peter McLaren



Non-Resident Dispositions: Did you report your rental income?

The article by Kathryn Edwards on Real Estate and Non-Residents explains the basic tax rules and tax exposure. The Certificate of Compliance (T2068) might be considered the equivalent of a Clearance Certificate (TX21) obtained by an executor before an estate is fully distributed. I want to relate a few real-life experiences regarding non-resident situations.

In the past year our office has filed tax forms for residents of Austria, Belgium, New Zealand, Singapore, and the United States. The most common non-resident situation is the ex-Canadian resident who has taken up residency in a new country and has now decided to sell his Canadian home.

In these situations, the first question to ask is: how long is it since he gave up his Canadian residency, and second, was the property rented at any time during his period of ownership? Last, are there any co-owners or joint owners?

While the principal residence exemption will usually offset any net capital gain for the period of Canadian residency, that option is lost when residency is terminated. If the sale takes place shortly after the change in residency, chances are no taxable capital gain will be realized. That, however, does not preclude the requirement to file the T2062 that Kathryn writes about.

Timing is Important

As with getting a clearance before distributing an estate, it takes time for

CCRA to process the T2062. If a rental period is involved, the T2062A must be included to identify possible recapture of depreciation. The legal professional acting for the purchaser needs to insure that sufficient sale proceeds are secured until CCRA confirms the withholding amount.

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Kathryn mentions that CCRA must be notified within 10 days of the sale's completion when a non-resident vendor is involved. Because CCRA requires time to process the T2062, we recommend that the form be completed as soon as the offer has been accepted, or as soon as all subjects have been removed.

The T2062 is used to report proposed dispositions in the same manner as a completed sale. The vendor should submit details of the proposed sale/distribution at least 30 days before the completion date. If there are no changes with the actual disposition, the vendor does not have to send any further notice.

The amount confirmed by CCRA is then withheld from the sale proceeds and remitted within 30 days by the legal

professional acting for the purchaser. Carolynne Maguire's article covers the nuts and bolts of the withholding in more detail.

It is, unfortunately, not uncommon in the case of non-residents for CCRA to question the calculation of the Adjusted Cost Base (ACB) of the property being disposed. A few of the items I have dealt with on recent T2062 applications include:

- providing proof of purchase price;
- evidence of the cost of additions or renovations; and
- confirmation of appraisal value at the date of change in residency status.

Because of this perceived higher level of scrutiny, the estimated tax (25 percent of the gain before deducting commissions and selling expenses) may occasionally be altered by CCRA. Also, although CCRA tries to process these matters promptly, there will be delays! Delays may be encountered because of the complexity of the transaction or CCRA may refer the file to Equity Valuations or Real Estate appraisals, the result being that without the timely release of net sale proceeds, a potential sale may collapse.

Even if it is calculated that no taxable capital gain will be realized on the disposition, the purchaser must be protected via an adequate holdback pending receipt of the T2068 Certificate of Compliance. It is especially important

to be holding funds if the house was rented for any period of time when the owner was not a Canadian resident.

Should CCRA determine that they are not getting all the information requested, they will promptly consider issuing a Purchaser Liability Assessment. Remember that the T2062 must include not only the name of the purchaser, but also details of the purchaser's representative. Name, address, telephone, and fax number for you—the representative—must be on the submitted form.

Purchaser Liability

The purchaser must take prudent measures to confirm the vendor's residency status. As Carolynne suggests in her article, the residency check-boxes on the standard form of contract of purchase and sale may not tell the whole story. The legal professional acting for the purchaser may want to consider asking the vendor's representative for a statement made under oath and perhaps asking where the funds are being distributed.

If it is determined that the vendor is a non-resident, then the Purchaser Remittance is not due only if:

- a Certificate of Compliance T2064 (proposed sale) or T2068 (completed sale) is issued;
- CCRA issues a letter absolving the purchaser of any Section 116 liability; or
- CCRA issues a comfort letter instructing the purchaser to hold the payment pending CCRA review.

Oops! Forgot to Mention it was Rented

My experience has shown that most non-resident-owned houses have been rented for more than just a few inconsequential weeks. If these rental activities have not been reported to CCRA, the vendor can expect to be assessed 25 percent of the gross rents plus interest compounding on this arrears balance.

It will then be in everyone's best interest to file Section 216 Returns as quickly as possible for all missing years.

If tax had been remitted on the gross rent, the owner may file a 216(1) T1 Return no later than two years from the end of the tax year in which he received the income. These returns will usually result in a significant refund, depending on the extent of the expenses paid by the owner.

Where an NR6 has been filed to have tax withheld from the net rent, the taxpayer only has until June 30 of the following year to file a return under Subsection 216(4).

Where no tax was remitted and the rental income has not been reported to CCRA, then on the sale of the property it is recommended that the taxpayer take advantage of a new CCRA policy.

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Under a new policy, a non-resident has one opportunity to late-file returns under Subsection 216(1) for any previous year. There are, however, exceptions—if CCRA has previously advised the taxpayer of his responsibility to remit 25 percent of the gross rent or if other enforcement action has already been initiated.

Let the Tenant/Buyer Beware

Kathryn's article mentions that the tenant is required to withhold and remit a percentage of the gross rent. If the tenant fails to deduct or withhold as required, the tenant is liable to pay, as tax, the amount that should have been deducted or withheld. The *Income tax Act* then empowers the tenant to deduct or recover, from the owner, any amount paid as tax by the tenant.

In a different situation, we have a borrower rather than a tenant. In a 1996 Federal Court decision, the borrower failed to withhold tax on interest paid to

a non-resident. After being assessed by CCRA and paying the withholding tax from his own pocket, the borrower was unsuccessful in obtaining a reimbursement from the non-resident. The borrower then deducted, as a bad debt, the receivable from the non-resident person. When challenged by CCRA, he took his case to the federal court. He lost!

As much as it may seem punitive, which it is, holding back the purchaser's potential remittance liability—as advocated by Carolynne Maguire—may be the only way to ensure your purchaser client is protected.

The Evicted Spouse

Last year we were involved in a situation where, three days after the purchase of a house in White Rock, the wife evicted her newlywed husband. He promptly returned to his home in Europe. A year later, the house was sold at a loss, subject to the Certificate of Compliance being received by a certain date. The purchaser's financing had been approved, but the terms were only guaranteed for 60 days. If clearance was not received, the deal would collapse.

CCRA could not process the T2062 in time to meet that deadline. Due to the circumstances, CCRA issued a "comfort letter" that confirmed no tax be remitted to the Receiver General, but that \$30,000 be held back from the sale proceeds pending issuance of the Certificate of Compliance.

The sale completed as scheduled in May. In late July, I was contacted by CCRA suggesting that because the ex-wife had allegedly rented the property for up to eight months prior to the sale, the non-resident husband should be liable for 25 percent of the unreported gross rent. This position was not pursued further when it was explained that the man could not be held responsible for the actions of his ex-wife who was resident and had possession of the family property.

A few days later, the T2062 Certificate of Compliance was issued with no withholding tax.

Here are other conditions regarding non-resident real property dispositions.

- Although a property may have always been a man's principal residence, that exemption terminates when he gives up his Canadian residency.
- I have dealt with a few files this year where properties were being sold a few years after a marital separation. One party remained in the house and the other became a non-resident. With the recent recovery of the real estate market, current dispositions may trigger a tax-free gain to the resident party, while the non-resident is taxed on that portion allocated to the period after his/her departure from Canada. The gain is usually prorated by the number of years resident in the house over the total years of ownership.
- Be vigilant for transactions that transfer property between corporations that may not be dealing at arm's length on a non-resident

transaction. CCRA will usually request independent appraisals to support the transfer price.

- Filing a T1 Return after obtaining a Certificate of Compliance is required of the non-resident. With the additional deduction of Realtor commissions and other selling expenses, the resulting refund will usually be worth the cost of filing.
- If the vendors had filed an election under section 45(2) regarding the change in use from personal residence to rental property, CCRA will not issue a T2068 relating to the T2062A. They recognize that although the property was rented, for these purposes it is still considered a capital property.
- Each person with an interest in the property being sold must file a T2062. Therefore both husband and wife (non-residents) must file if they held the property as joint tenants or tenants in common.

- The residency of an estate is determined by the resident address of the executor(s).

When acting for the purchaser in a transaction involving a non-resident vendor, the legal professional should always be sure to hold sufficient funds to cover any CCRA claims.

The best thing you can do when acting for a non-resident vendor is to contact a qualified accountant as early as possible, before completion, to work out the actual withholding requirements. It is in your client's best interest to know what the maximum tax exposure will be, before any sale completes. ▲

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