

BULLETIN

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Purchases and Sales Involving Non-resident (Capital Gains Tax)

A mortgage broker forewarned with knowledge about the capital gains tax, as it applies to sales of real estate by non-residents, is better forearmed to assist in avoiding later delays and collapsing of transactions.

Overview Buying Canadian real estate from a non-resident of Canada can cost the buyer 25% (in some cases 50%)¹ more than if the same real estate was bought from a resident. Similarly, a sale of Canadian real estate by a non-resident of Canada can generate 25% (in some cases 50%), less sale proceeds than would be generated if the same real estate was sold by a resident.

The Tax The Income Tax Act (ITA) requires a seller to pay capital gains tax on profit made from the sale of real estate. This general rule is subject to very few exceptions (such as a Canadian resident selling his or her principal residence). If the seller is a non-resident and fails to pay the tax, the buyer could be required to pay 25% (in some cases 50%) of the purchase price to the Canada Revenue Agency (CRA).

Seller Pays the Tax The ITA allows the seller, in advance of the transaction completing, to:

- report the upcoming transaction to the Minister of National Revenue (Minister);
- pay 25% (or sometimes 50%) of the sale price on account of the tax payable by the seller, or post security to the satisfaction of the Minister; and
- obtain a certificate that sets out the amount of sale proceeds the non-resident seller is to receive.

Within 10 days of the sale completing, if the facts and amounts are different from those already provided, the seller is to provide updated information and any additional payment or security to cover any increase in the amount of tax due. If the non-resident seller does this, the Minister is to issue a certificate to the seller and send a copy of it to the buyer.

¹ Some examples to which the 50% may apply are commercial, investment, and depreciable properties. We will not be discussing details of these categories.



Perhaps because the Canada Revenue Agency (CRA) is unable to meet the timelines provided in the ITA, practice does differ from the ITA procedure indicated above. It can take months to obtain a certificate from the CRA and so the CRA provides a comfort letter instead to the seller's lawyer, it does not communicate with the buyer. The comfort letter generally includes the comment that although the ITA provides the following amount of time to remit, you have until (a much later date) to do so. The seller's lawyer copies the letter to the buyer's lawyer and the two arrange representations as to residency, undertakings concerning holdbacks, obtaining of a certificate, and (if in order to do so) remitting of the tax.

Buyer Pays the Tax As you might expect, a number of non-resident sellers do not follow the advance report procedure and fail to pay the tax. In such cases, ITA, section 116 makes the buyer responsible to pay the tax, unless:

- the buyer received a certificate from the Minister;
- a tax treaty applies to cover the non-resident; or
- after reasonable inquiry the buyer had no reason to believe that the non-resident person was not resident in Canada;

If the buyer does not satisfy at least one of the above three conditions, the buyer has 30 days (from the end of the month in which the property was purchased) to remit 25% (or sometimes 50%) of the purchase price to CRA. The practice is that, again, the time limit is often extended.

Prudent Steps It would be prudent:

- to address matters of capital gains tax as early as possible in the transaction. It creates greater certainty for the parties.
- to have the purchase agreement state that the seller is required to obtain a comfort letter and certificate from the Minister regarding the transaction.
- to have the court order specify whether the tax is to be paid from the sales proceeds and whether it is to be paid in priority to one or more other payments. Alternatively, the order could reflect that the buyer has the right to deduct the amount of the tax from the sales proceeds and to remit the amount to CRA.
- for the buyer in every purchase to make and document a reasonable inquiry as to whether the seller is a non-resident of Canada. (Unfortunately there is no answer definitive answer as to what amounts to a reasonable inquiry or if the current practices of conveyances having sellers sign a statutory declaration as to residency is sufficient.)
- to include in the purchase agreement that the seller is required to obtain a clearance certificate from the Minister regarding the transaction, and unless the buyer receives a copy of the clearance certificate the buyer will be deducting or withholding the amount of tax from the purchase price. This in effect is notice to the seller that the buyer will rely



upon the ITA section; it does not add to the buyer's rights but can add certainty to the process of closing the transaction.

The ITA states that "no action lies against any person for deducting or withholding any sum of money in compliance or intended compliance with (the ITA)".

The ITA gives the buyer the right to recover from the seller the amount remitted to CRA.

Takeaways

- A mortgage broker can help a buyer by suggesting, if all else fails, that the client explore with his lawyer completing the purchase from the non-resident by paying the tax amount directly to CRA. This can allow the arranged mortgage to fund as scheduled.
- A mortgage broker can help a lending client by suggesting that the lender:
 - obtain and maintain residency status of the borrower, and
 - allow for the fact that in the event foreclosure is necessary and the borrower is a non-resident, the sale proceeds available to payout the mortgage might be reduced by the amount of capital gains tax