LE 4 JUILLET 2019

KATHERINE BORSELLINO

RICHTER

PRESERVING THE CANADIAN DREAM: AMENDMENTS TO THE RULES GOVERNING THE PRINCIPAL RESIDENCE EXEMPTION, THE REPORTING OF REAL ESTATE TRANSACTIONS AND LAND TRANSFER TAX

Travail dirigé présenté au programme de maîtrise en droit, option fiscalité (LL.M. (fiscalité)), HEC – Décembre 2017

et

Le 8e Symposium en fiscalité – L’interaction des savoirs, Université de Laval – le 4 juillet 2019

TABLE OF CONTENTS

Introduction

Introduction

CANADIAN HOUSING MARKET

- Affordability, economic stability and tax fairness have been a growing concern within the Canadian housing market
- Influential factors
  - Low interest rates
  - Increased foreign investment
  - Speculative activity
  - According to most recent findings, money laundering
- Various measures have been adopted seeking to promote affordability, economic stability and tax fairness

Introduction

FINANCE – OCTOBER 2016

FEDERAL MEASURES

1. Amendments to the rules governing financing, mortgage eligibility and mortgage insurance

2. Amendments to the Income Tax Act (Canada) (the "ITA")

   - Capital gains tax exemption on the sale of a principal residence (the "principal residence exemption" or the "PRE")

   - Tax compliance and reporting measures related to residential and non-residential real estate transactions ("Real Estate Transactions")

Introduction

BANK OF CANADA – INTEREST RATES 2010 – PRESENT DAY

FEDERAL MEASURES

- Fluctuation in Bank of Canada's policy interest rate
  - Between 2010 – 2015, rate fluctuated between 0.5% - 1%
  - July 2017 increased 0.5% to 0.75%
  - September 2017 increased 0.75% to 1%
  - January 2018 increased 1% to 1.25%
  - July 2018 increased 1.25% to 1.5%
  - October 2018 increased 1.5% to 1.75%

Introduction

FINANCE – MARCH 19, 2019 FEDERAL BUDGET

FEDERAL MEASURES

1. Introduction of the Canada Mortgage Housing Corporation (“CMHC”) First Time Home Buyer Incentive
2. Modernization of the Home Buyers Plan (“HBP”)
3. Increased Canada Revenu Agency (“CRA”) funding to enhance tax compliance in the real estate sector

Introduction

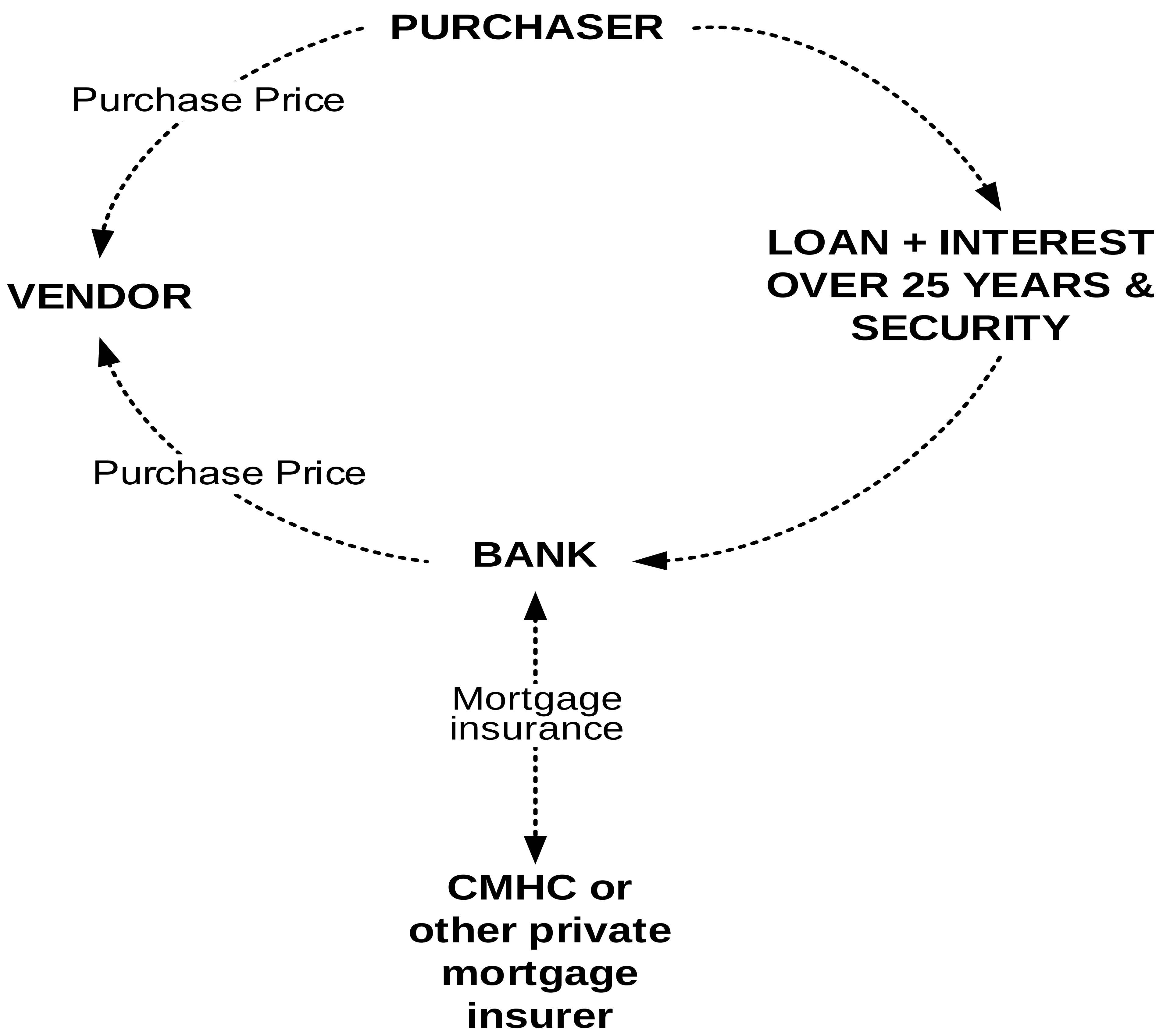
PROVINCIAL MEASURES

- Amendments to provincial legislation
  - Ontario and BC Additional land transfer tax ("LTT") payable by foreign purchasers
  - Additional measures and programs introduced by Ontario and British Colombia ("BC")
  - Additional housing incentives offered by some municipalities

Financing, mortgage eligibility and mortgage insurance

WHAT IS MORTGAGE INSURANCE

Financing, mortgage eligibility and mortgage insurance



- Obligatory where the minimum down payment is less than 20%
- Grants protection to the mortgage lender since the Government of Canada will guarantee most and, sometimes, the entire mortgage claim
- Purchaser pays an additional premium on their mortgage payments

Financing, mortgage eligibility and mortgage insurance

FINANCE – 2008 TO 2012

FEDERAL MEASURES

- Increased regulation on financing eligibility requirements
  - Increase in minimum down payment requirement to 5%
  - Decrease in the maximum amortization period (25 years)
  - Limit on the maximum insurable purchase price to below $1M
  - Application of maximum debt-service-to-income ratios
  - Mortgage rate “stress test” for certain insured mortgages

Financing, mortgage eligibility and mortgage insurance

FINANCE, CMHC, OSFI – DECEMBER 2015

FEDERAL MEASURES

- Finance – additional increase in minimum down payment requirements
  - 5% for the portion of the purchase price that is under $500,000
  - 10% for the portion of the purchase price that is above $500,000

- CMHC – increase to the guarantee fees charged to lenders

- Office of the Superintendent of Financial Institutions (“OSFI”) – updates to regulatory capital requirements for residential mortgages (applicable to banks, trust and loan companies and mortgage insurance companies)

Financing, mortgage eligibility and mortgage insurance

FINANCE – OCTOBER 2016

FEDERAL MEASURES

- Standardized the financing eligibility requirements and the mortgage rate “stress test” for all insured mortgages

- Further changes to the eligibility requirements for certain insured mortgages

Financing, mortgage eligibility and mortgage insurance

2019 FEDERAL BUDGET

FEDERAL MEASURES

- Introduction of the CMHC First-Time Home Buyers Incentive
  - Available to eligible first-time home buyers (household income under $120,000)
  - First-time home buyer supports the minimum down payment for an insured mortgage (5%)
  - CMHC provides funding for 5% (existing home) or 10% (new construction) of the home purchase price (subject to certain restrictions)
  - Ultimately, reduces the insured mortgage and translates to a shared equity mortgage

Income Tax Measures

- Principal Residence Exemption
- Reporting of Real Estate Transactions

Income Tax Measures

PRINCIPAL RESIDENCE EXEMPTION

CONDITIONS OF APPLICATION

1. Principal residence (Section 54 ITA)
   - Capital property
   - Ownership – individual or joint ownership
   - Ordinarily inhabited by the taxpayer, by the current or former spouse or common-law partner or by the child of the taxpayer
   - Designation as the “principal residence” for each taxation year in which the principal residence exemption is claimed
   - Claimant must be a resident of Canada during the years the property is designated as the “principal residence”

2. Principal residence owned by a personal trust – outside the scope of this presentation

Income Tax Measures

PRINCIPAL RESIDENCE EXEMPTION

PRIOR TO 2017

Capital Gain (CG)

Less: PRE (40(2)(b))

$$\left(CG - CG \times \frac{1 + \text{total no. of years designated PR \& CAD resident}}{\text{total no. of years of ownership}} \right)$$

- CG on the disposition of a principal residence reduced by the amount computed under para. 40(2)(b) ITA (the PRE)
- Proportionate reduction equal to <u>one plus</u> the total number of years the property is designated as the principal residence and during which the taxpayer was a resident in Canada and the total number of years of ownership

Income Tax Measures

PRINCIPAL RESIDENCE EXEMPTION

PRIOR TO 2017

- One principal residence per family unit per year
  - Exception: “one plus rule” allows a taxpayer to designate more than one property as their principal residence during one year of ownership

- Essentially, a non-resident could benefit from a reduction for at least one year of the entire ownership period since there was no residency requirement embedded in the “one-plus rule”

Income Tax Measures

PRINCIPAL RESIDENCE EXEMPTION

AS OF 2017

Only if Canadian resident during the year of acquisition

Capital Gain (CG)

Less: PRE (40(2)(b))

$$\left[CG - CG \times \frac{1 + \text{total no. of years designated PR \& CAD resident}}{\text{total no. of years of ownership}} \right]$$

Income Tax Measures

PRINCIPAL RESIDENCE EXEMPTION

NEW LIMITATIONS

1. Non-resident owner of a principal residence in Canada
   - As of January 1, 2017, the “one-plus rule” is only available to a taxpayer who is resident of Canada during the year of acquisition
   - As a whole, the availability to the PRE is limited to the number of years during which the taxpayer was resident in Canada
2. Principal residence owned by a personal trust

Before 2017

- Canadian resident during all the years of ownership and designation as principal residence for each year of ownership
  - CG eliminated

- Canadian resident for some (but not all) the years of ownership and/or designation as principal residence for some (but not all) the years of ownership
  - CG partially eliminated

- Non-resident for all the years of ownership and no designation
  - 1 year exemption

As of 2017

- Canadian residents during all of the years of ownership and designation as principal residence for each year of ownership
  - CG eliminated (no impact)

- Canadian resident during some (but not all) the years of ownership and/or designation as principal residence for some (but not all) the years of ownership
  - CG partially eliminated (no impact)

- Non-resident during all the years of ownership (including the year of acquisition)
  - CG is fully taxable in Canada

Income Tax Measures

REPORTING OF REAL ESTATE TRANSACTIONS

ISSUES

- Increase in real estate speculation resulted in inaccurate and the complete lack of reporting
- Audit challenges - difficult to audit Real Estate Transactions, verify the nature of the income reported and verify the proper use of the PRE
  - Limited audit resources
  - Limitation to the normal re-assessment period
  - Permitted (administratively) non-reporting of principal residence dispositions

Income Tax Measures

REPORTING OF REAL ESTATE TRANSACTIONS

REPORTING REQUIREMENTS

The disposition of a principal residence must be reported and a designation in prescribed form must be filed irrespective of the ultimate tax consequences associated to the disposition

- For 2016 and subsequent years, if the disposition is not reported, must amend the tax return

- If the property is designated as the principal residence for the entire ownership period – complete Schedule 3, T1

- If the property is designated as the principal residence for some (but not all) years of ownership – complete Schedule 3, T1 as well as Form T2091 (IND) (or Form T1255)

- Dispositions in 2017 and subsequent years, Form T2091 (IND) is required in all circumstances

Income Tax Measures

REPORTING OF REAL ESTATE TRANSACTIONS

REPORTING REQUIREMENTS

Late-filed, amended or revoked designations

- Principal residence designation is now treated in the same manner as an election; therefore, the late-filing, amendment or revocation is formally possible

- Penalties may apply; however, CRA has confirmed they would waive penalties for late-filed principal residence dispositions for 2016 and 2017

Income Tax Measures

REPORTING OF REAL ESTATE TRANSACTIONS

NORMAL REASSESSMENT PERIOD

- General rule – tax authorities cannot assess beyond the “normal reassessment period”
- There are various exceptions which extend the normal reassessment period, granting the tax authorities an additional and, sometimes, unlimited, time frame to commence and complete an audit and reassessment

Income Tax Measures

REPORTING OF REAL ESTATE TRANSACTIONS

NORMAL REASSESSMENT PERIOD

New para. 152(4)(b.3) ITA expands the exceptions to include an unlimited assessment period where there is non-reporting of Real Estate Transactions

- Applicable to a taxpayer (other than a REIT) or partnership who disposes of real or immovable property and the disposition is not reported in their respective income tax or information return.

- Where the vendor is a corporation or partnership, only if the property qualifies as capital property

- If the disposition is included in an amended return, the time frame is limited to three (3) years following the day on which the amended return is filed

- Extension of the reassessment period cannot extend to other matters that do not relate to an unreported disposition

Income Tax Measures

2019
FEDERAL
BUDGET

- Modernization of the Home Buyers Plan ("HBP")
  - Increased RRSP withdrawal limit from $25,000 to $35,000 (applicable to withdrawals after March 19, 2019)
  - Extended access to HBP to marital and common-law breakdowns (applicable to withdrawals after 2019)

- Increased Canada Revenu Agency ("CRA") funding to enhance tax compliance in the real estate sector
  - $50M to create 4 residential and commercial real estate audit teams in Ontario and BC

Provincial Measures

Provincial Measures

BC AND ONTARIO

LAND TRANSFER TAX (LTT)

Additional tax aimed at discouraging foreign speculative investment

- Additional Property Transfer Tax (British Colombia)
  - 15% additional LTT based on the FMV of the non-resident purchaser's proportionate share in the residential real estate so acquired
  - Restricted to acquisitions in certain high-risk areas

- Non-Resident Speculation Tax (Ontario)
  - 15% additional LTT based on the FMV of the property (regardless of the non-resident purchaser's proportionate share)
  - Restricted to acquisitions in certain high-risk areas

- Certain exceptions in both cases

Provincial Measures

BC AND ONTARIO

OTHER MEASURES

- A variety of other measures and programs have also been introduced in BC and Ontario
  - Vacancy tax (1% of the assessed value if vacant/unoccupied for more than 180 days)
  - Rent control
  - First time home buyer relief
  - BC will introduce a public registry of beneficial owners of property and other recommendations have been put forth to address money laundering
    - Expert Panel on Money Laundering in B.C. Real Estate (March 2019)
    - In 2018, approximately $5.3B real estate transactions were the result of money laundering, representing 72% of all money that was laundered in BC
    - Important factor which has contributed to the increase in housing prices
    - Thus, the goal is to combat money laundering within the Canadian housing market

HOUSING INITIATIVES

Provincial Measures

QUEBEC AND CERTAIN MUNICIPALITIES

To list a few …

- Increased information requirements on the transfer of immovables (announced February 2019)
  - Disclosure of residency
  - Disclosure of the consideration paid
  - Disclosure of intention to occupy a dwelling in the immovable as a principal residence
- Montreal's Home Ownership Program (January 2018) and Montreal's Home Purchase Assistance Program (June 2018)
  - Financial assistance offered to first-time home buyers or families as a lump-sum payment or refund of the LTT
- Montreal's Regulation 20-20-20
  - Seeks to impose 20% social housing, 20% affordable housing and 20% 3-bedroom unit on large new residential developments

Conclusion

Housing Market Statistics

THE CANADIAN REAL ESTATE ASSOCIATION

COMPARATIVES

*Approximate averages

AREA	JUNE 2017	JUNE 2018	JUNE 2019
National	$500,000	$500,000	$510,000
Greater Vancouver Area	$1,000,000	$1,100,000	$1,000,000
Province of BC	$725,000	$739,000	$707,000
Greater Toronto Area	$800,000	$770,000	$794,000
Province of Ontario	$550,000	$574,000	$615,000
Greater Montréal Area	$370,000	$342,000	$363,000
Province of Québec	$300,000	$312,000	$323,000

https://www.crea.ca/housing-market-stats/national-price-map/

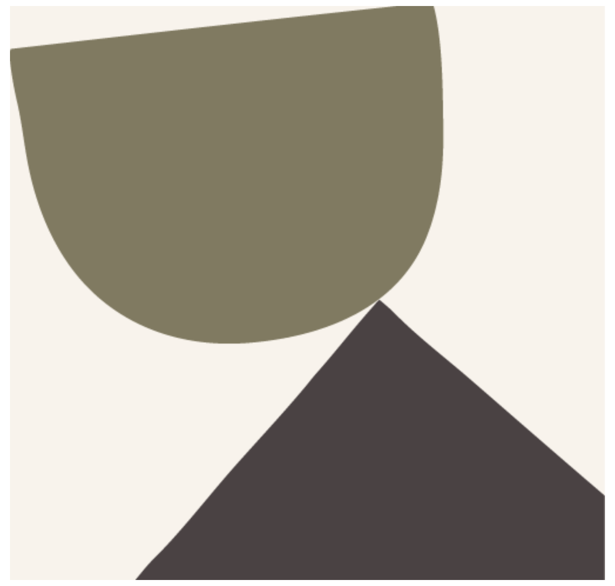
Conclusion

WHERE ARE WE NOW?

- Financing, mortgage eligibility, and mortgage insurance
  - Long-term, reduction of housing costs and household debt
  - Short-term, limits borrowing eligibility and limits buying power
- Income Tax Measures
  - Most straight forward in addressing unintended tax consequences (one-plus rule), addressing non-compliance and undesired behavior while generating additional tax revenues
- Provincial Measures
  - Changes to LTT and other measures unclear whether this will have a lasting impact on sales or desired impact on affordability but has generated additional tax revenues
- On-going efforts that are continuously being implemented
  - 2019 Budget
  - Additional provincial and municipal measures

Conclusion

- Each of the measures seem distinct in their nature and application
- However, there is a common policy focus which drives the various levels of government
  - Financial and economic stability in the Canadian housing market
  - Accessibility to Canadian home-ownership
  - Tax fairness
- This is not easy to accomplish and requires collective and on-going action and review



KATHERINE BORSELLINO

LL.B., J.D., LL. M. FISC
SENIOR MANAGER
TAX