

LAND TRANSFER TAX ACT – PART II

This issue of the Legal Business Report provides current information to the clients of Alpert Law Firm on tax planning strategies, exemptions and deferrals involving transactions, which are currently available under the Land Transfer Tax Act of Ontario (the “Act”). Alpert Law Firm is experienced in providing legal services to its clients in tax and estate planning matters, wealth preservation, tax dispute resolution, tax litigation, corporate-commercial transactions and estate administration.

A. NON-RESIDENT SPECULATION TAX (“NRST”)

1. GENERAL APPLICATION

The Government of Ontario has introduced the NRST, which is a 15% tax imposed in addition to the general land transfer tax on purchases or acquisitions of interests in residential properties in the Greater Golden Horseshoe by non-residents. The tax applies to both registered transfers and unregistered dispositions of beneficial interest in the affected properties. The Greater Golden Horseshoe includes the following geographic areas: Brant, Dufferin, Durham, Haldimand, Halton, Hamilton, Kawartha Lakes, Niagara, Northumberland, Peel, Peterborough, Simcoe, Toronto, Waterloo, Wellington and York. The NRST is effective as of April 21, 2017. Binding purchase and sale agreements signed before April 21, 2017 are not subject to the tax.

The NRST applies to foreign entities and taxable trustees. Foreign entities consist of foreign nationals and foreign corporations. For the purposes of the NRST, a foreign national is an individual who is not a Canadian citizen or permanent resident of Canada. A foreign corporation is a corporation that is either (i) not incorporated in Canada; or (ii) incorporated in Canada but is controlled in whole or in part, directly or indirectly in any manner whatever, by a foreign entity. A taxable trustee is a trustee that is (i) a foreign entity holding title in trust for beneficiaries; or (ii) a Canadian citizen, permanent resident of Canada, or a Canadian corporation holding title in trust for foreign entity beneficiaries. If a transfer of property is made to more than one transferee, the NRST will apply to the full value of the property if any one of the transferees is a foreign entity or taxable trustee. In these scenarios, each transferee is jointly and severally liable for any NRST payable, even if they are residents of Canada. The NRST does not apply when a person purchases or acquires property as a trustee of a mutual fund trust, real estate investment trust or specified investment flow-through trust.

The NRST is imposed on transfers of land containing at least one and not more than six single family residences. Examples of single family residences include detached and semi-detached houses, townhouses, and condominium units. The NRST will not

apply to other types of land such as multi-residential apartment buildings with more than six units, agricultural land or commercial land. If the land transferred includes both residential property and another type of property, the NRST applies only on the portion of the value of the consideration attributable to the residential property.

All transfers registered on or after April 21, 2017 must contain a statement expressly acknowledging that consideration has been given to the application of the NRST. Taxpayers reporting unregistered dispositions of land to the Ministry of Finance must also expressly acknowledge in a cover letter that consideration has been given to the application of the NRST and whether or not it is payable on the reported transaction.

2. **EXEMPTIONS**

Foreign nationals are exempt from the NRST if they are:

- (i) Confirmed under the Ontario Immigrant Nominee Program (“nominee”) at the time of the purchase or acquisition and the property is used as the foreign national’s principal residence;
- (ii) Conferred the status of “convention refugee” or “person in need of protection” (“refugee”) under the *Immigration and Refugee Protection Act* at the time of the purchase or acquisition; or
- (iii) A spouse of a Canadian citizen, permanent resident of Canada, “nominee”, or “refugee”, and the foreign national jointly purchased the residential property with that spouse. However, the exemption does not apply if the foreign national and his/her spouse purchased the property with a foreign third party.

3. **REBATES**

Foreign nationals may receive a rebate of the NRST with interest if:

- (i) They become a Canadian citizen or permanent resident of Canada within four years of the date of purchase or acquisition;
- (ii) They are enrolled as a full-time student for at least two years in an Ontario post-secondary institution from the date of purchase or acquisition; or
- (iii) They have legally worked full-time in Ontario for a continuous period of one year since the date of purchase or acquisition.

In order to be eligible for the rebates, the foreign national must exclusively hold the property, or hold the property exclusively with his/her spouse. The property also must

have been used as the foreign national's principal residence for the duration of relevant period.

B. STRATEGIES FOR MINIMIZING LAND TRANSFER TAX

1. SECTION 85(1) TRANSFERS

Section 85 of the *Income Tax Act* permits a deferral of income tax on the transfer of property from a shareholder to a taxable Canadian corporation. In order to claim this rollover, the vendor must receive at least one share in the capital stock of the purchasing corporation as consideration for the transfer. Also, the vendor and purchasing corporation must jointly execute and file with the Canada Revenue Agency ("CRA") a prescribed election form which states an elected amount for each asset transferred. This elected amount is then deemed to be the vendor's proceeds of disposition for the asset and the purchasing corporation's cost thereof. In the absence of the rollover, the vendor would be deemed to have sold its assets at fair market value and therefore to have realized whatever capital gain, recaptured depreciation or other unrealized income is inherent in the assets.

Where a section 85 rollover involves the transfer of land from a shareholder which is a corporation to an affiliate of the vendor corporation, a deferral of land transfer tax will be available upon application to the Ministry of Finance where the underlying control of the corporate group remains in the same hands and the interest in land remains within the corporate group for three years after the disposition. For further details on how to obtain this tax relief, please refer to Alpert Law Firm's Legal Business Report, "Land Transfer Tax Act – Part I". Likewise, where the shareholder is an individual transferring land pursuant to a section 85 rollover to a family business corporation as defined in the Regulations, an application for exemption from land transfer tax will also be considered by the Ministry of Finance. Please refer to Alpert Law Firm's Legal Business Report, "Land Transfer Tax Act – Part I" for further information on this exemption.

2. BUTTERFLY REORGANIZATIONS

A common commercial transaction, known as a double-wing butterfly reorganization is often used to divide corporate assets such as land, on a tax-free basis, between two or more shareholders who wish to go their separate ways. The Regulations to the Act exempt from land transfer tax dispositions of a beneficial interest in land through a double-wing butterfly reorganization. However, this relief is only available regarding dispositions from one corporation to another and requires an application to the Ministry of Finance for exemption from the tax to be filed within 30 days of the disposition of property by completing the return and the exemption application appearing at the end of the return. Penalties for late filing of returns are imposed which parallel the penalties specified in the Act for other late filings.

It should be noted that this exemption for a disposition of a beneficial interest in land through a double-wing butterfly reorganization does not eliminate the imposition of tax payable upon the registration of the change in legal ownership following a butterfly reorganization.

One possible solution is for the corporation that owns the real estate to convey legal title to a bare trustee corporation prior to the double-wing butterfly transaction. Since a conveyance to a bare trustee corporation is not subject to land transfer tax, there is a tax deferral on that transaction. The bare trustee corporation will then have the power to convey legal title to the lands at a future time on behalf of the beneficial owner to a person outside of the corporate group. Land transfer tax will be payable upon registration of the conveyance to the outside party. However, caution should be used and professional advisers should be consulted before undertaking this type of transaction, since the Ministry of Finance may deny an exemption if it is done solely in contemplation of avoiding the tax otherwise payable thereon.

An application to the Ministry of Finance for exemption from the tax is required to be filed within 30 days of the disposition of property by completing the prescribed return and exemption application appearing at the end of the return. In addition, the applicant must provide either a CRA ruling regarding the particular reorganization or written confirmation of a solicitor or accountant that: (i) the disposition occurred as part of a reorganization in the course of which a dividend was received by a corporation; (ii) the amount of the dividend would be deemed under subsection 55(2) of the *Income Tax Act*, but for the application of paragraph 55(3)(b) of that Act, not to be a dividend received by the corporation, but rather to be proceeds of disposition of a share or shares or to be a gain of the corporation from the disposition of a capital property; and (iii) the disposition constituted a transfer of property of a particular corporation to one or more corporations for the purposes of the application of paragraph 55(3)(b) of the *Income Tax Act* in respect of the dividend received as part of the reorganization.

The Act does impose penalties for the late filing of returns after 30 days following the disposition of a beneficial interest in land. Such penalties are calculated as an amount equal to 25% of the land transfer tax payable. Therefore, where a corporation disposes of a beneficial interest in land in the course of a double-wing butterfly reorganization and is therefore entitled to an exemption from land transfer tax, there is no penalty payable at this time for the late filing of a return. However, there is a general provision in the Act under subsection 7(1) making it an offence to knowingly contravene the Act and upon conviction; a fine in the amount of not more than \$10,000 (plus any outstanding land transfer tax liability) may be levied thereon.

3. CORPORATE SPIN-OFFS

A corporate spin-off transaction is not exempt from land transfer tax but is treated as the transfer of a beneficial interest in land from one corporation to another corporation each of which is an “affiliate” of the other immediately before or at the time of disposition. A company shall be deemed to be an “affiliate” of another company if one of them is a subsidiary of the other or if both are subsidiaries of the same company or if each of them is controlled by the same person or company. Control, in this context, is defined as *de jure* control, meaning that one corporation holds greater than 50% of the voting shares of the other corporation.

In order to obtain tax relief regarding a corporate spin-off transaction, the transferring corporation must submit an application to the Minister of Finance along with security for the tax in the form of a letter of credit, wherein the Applicant undertakes that the underlying control of the corporate group will continue in the same hands and the interest in land will remain within the corporate group for three years following the disposition. The security shall be returned to the corporation which furnished it when the said undertaking has been satisfied, or the conveyance evidencing the disposition of the beneficial interest in land is registered and tax owing upon registration is paid or when the beneficial interest in the land is transferred to a person who is not an affiliate of the corporation and tax is paid on the transfer.

4. TRANSFERS TO AND BY TRUSTEES

Where land is transferred to a trustee for the benefit of an individual, a corporation or a corporation to be incorporated, the conveyance is subject to land transfer tax when tendered for registration. However, on the subsequent registration of a conveyance of land to an individual or corporation, no tax is payable where it is established that, at the time of the earlier conveyance to the trustee, the purpose of the original conveyance was the holding of land in trust for the benefit of the individual, corporation or the corporation to be incorporated to which the land is now being conveyed. In order to claim the exemption, satisfactory affidavit evidence must be presented to the Ministry of Finance establishing the existence of the trust at the time of the original conveyance of lands to the trustee. In addition, the affidavit must contain the statement that the trustee has always held legal title to the property for the beneficial interest of the intended transferee. Thus, any change in the beneficial ownership of the lands will trigger the land transfer tax liability outlined in the Act.

5. CORPORATE WIND-UPS

Another commercial transaction which may involve the disposition of the beneficial title in land is the corporate wind up. The Act provides a procedure for applying for a deferral of land transfer tax where the underlying control of the corporate group and the

interest in the land will remain within the corporate group for three years following the disposition. For the purpose of determining whether this requirement has been met, a corporation which was an affiliate of another corporation immediately before winding up shall be deemed to continue to exist. Therefore, provided that the disposition of the beneficial interest in the land is made from a corporation prior to its winding up to an affiliate of that corporation, and the underlying control and interest in the land remains with that affiliated corporation for three years, then the amount of tax deferred will no longer be owing.

The situation addressed in the Act contemplates that legal title remains in the name of the wound-up corporation. This creates a problem since both the *Corporations Act* and the *Business Corporations Act* of Ontario provide that upon dissolution, undisposed real property of a corporation is forfeited to the Crown. One possible solution is for the corporation to convey, prior to winding up, legal title to a trustee corporation prior to transferring beneficial title to the affiliate. Since a conveyance to a trustee corporation is not subject to land transfer tax, there is a tax deferral on that transaction. The trustee corporation will then have the power to convey legal title to the lands at a future time on behalf of the parent corporation that is the beneficial owner to a person outside of the corporate group. Land transfer tax will be payable upon registration of the conveyance to the outside party. However, caution should be used and professional advisers should be consulted before undertaking this type of transaction since the Ministry of Finance may deny an exemption if it is done solely in contemplation of avoiding the tax otherwise payable thereon.

C. REAL ESTATE SPECULATORS

The current assessing practice of the Ministry of Finance allows a real estate speculator to profit from rising house prices and avoid paying land transfer tax. This situation occurs when a speculator enters into an agreement of purchase and sale, but before the closing date, assigns the agreement to a third party at a profit in accordance with paragraph 3(1)(g) of the Act. On closing, the vendor conveys the land directly to the third party for the price specified in the agreement and the third party pays the speculator the amount agreed for the assignment.

In May 2006, the Ministry of Finance issued a guide titled “Land Transfer Tax and the Treatment of Unregistered Dispositions of a Beneficial Interest in Land”. Pursuant to the Ministry’s guide, the speculator’s transaction is never “complete”. As a result, a speculator is not required to pay any land transfer tax on the transaction. “Completion” of a transaction under paragraph 3(1)(g) of the Act occurs when the value of consideration in the agreement is satisfied. In most cases, this is when the purchaser obtains possession of the land, thereby crystallizing the liability for the value of consideration. The tax liability falls upon the third party at the time the conveyance is registered.

The Government of Ontario has announced its intention to crack down on assignment clauses and possibly tax the assignee for the total consideration paid to the seller and the speculator. The 2017 Ontario Budget states that additional disclosure requirements on the assignments of property transfer agreements will be introduced in order to ensure that the correct amount of tax is paid on these types of transactions. At the time the transfer is registered, purchasers must declare whether they entered the agreement by way of assignment or another similar arrangement. Any consideration for the assignment would then need to be included as part of the value of the consideration for the land used to calculate the land transfer tax amount. Details about these changes have not been unveiled and the stricter information requirements are not yet in effect. However, this is subject to change at any time and no actions should be taken without first consulting with your professional advisers.

D. PENALTIES

Subsection 7.1(3) of the Act imposes a penalty of 5% of tax payable by every person failing to deliver a return as required. The requirement for filing of returns by both the person acquiring a beneficial interest and the trustee is not satisfied by only one or the other of the parties filing. Under this section, a trustee who fails to file as required may be assessed a penalty equal to 5% of the tax payable by the beneficial owner of land, whether or not the beneficial owner has paid the tax or filed a return.

In addition to the above-noted penalty, section 6.1 of the Act provides that every person who fails to deliver a return as required or who fails to remit the tax payable, is guilty of an offence, and on conviction, is liable to a fine of not less than 25% of the tax payable and not more than double the amount of the tax payable.

In addition, under subsection 7.1(1) of the Act, if the Minister of Finance is satisfied that a person's failure to pay tax is attributable to fraud or willful default, the Minister of Finance may assess a penalty against that person in an amount equal to the greater of \$500 and 25% of the tax that the person failed to pay.

Under section 12 of the Act, the Minister of Finance may assess or reassess tax payable at any time where the person has failed to deliver any return required by the Act. The four-year limitation on assessments does not apply in these circumstances.

E. VOLUNTARY DISCLOSURE

When returns have not been filed as required, the assessment of penalties can be avoided by complying with the provisions of the Ontario Ministry of Finance policy on voluntary disclosure, outlined in the Tax Information Bulletin "Voluntary Disclosure" dated January 2004.

The Ministry of Finance requires that five conditions be satisfied for the voluntary disclosure to qualify as valid: (i) the disclosure must be voluntary; (ii) the disclosure must be full and accurate; (iii) all books of account, records and documents must be made available and questions from Ministry staff answered so that the information disclosed can be verified; (iv) the disclosure must not relate to information for the current tax return; and (v) the disclosure must involve an offence with a civil penalty, fine or jail term.

F. FIRST TIME HOME PURCHASERS

The Act provides that under certain conditions, first time purchasers of both newly constructed homes and re-sale homes may be eligible for a refund of all or part of the tax payable on their acquisitions. Commencing January 1, 2017 no land transfer tax would be payable by qualifying first-time purchasers on the first \$368,000 of the value of the consideration for eligible homes. First-time purchasers of homes greater than \$368,000 would receive a maximum refund of \$4000.

Only an individual who is at least 18 years of age, has not owned an interest in a home anywhere in the world and whose spouse has not owned an interest in a home anywhere in the world while he or she was a spouse of the individual, qualify as first-time purchasers. The meaning of “spouse” is defined in section 29 of the *Family Law Act*. The home must be the purchaser’s principal residence and must be occupied within 9 months of the date of the conveyance. In addition, the purchaser cannot have previously received an Ontario Home Ownership Savings Plan (OHOSP)-based refund of land transfer tax. Beginning January 1, 2017 eligibility for the first-time homebuyers refund program is restricted to Canadian citizens and permanent residents of Canada. As a transitional measure, purchasers who entered into agreements of purchase and sale on or before November 14, 2016, would remain eligible for the refund regardless of citizenship or residency status. Purchasers who would otherwise be eligible for a refund, but who are not Canadian citizens or permanent residents of Canada when the transaction closes, have 18 months following registration to become eligible. Upon obtaining Canadian citizenship or permanent resident status, these purchasers may apply for the refund within the 18-month period following registration of the conveyance or the date the unregistered disposition occurs.

The first-time purchaser is required to purchase a newly constructed home or an interest in a newly constructed home. A newly constructed home is a home in which the purchaser is entitled to receive a warranty under section 13 of the *Ontario New Home Warranties Plan Act* and which is sold to the purchaser by a vendor pursuant to that Act. The newly constructed home is also required to be used as the principal residence of the first-time purchaser.

G. MUNICIPAL LAND TRANSFER TAX ACT (“MLTT”)

The City of Toronto imposes the MLTT over and above the provincial land transfer tax. The MLTT, as amended effective February 15, 2017, follows an identical rate scheme as the Act. For all properties purchased in the City of Toronto the following rates apply: the rate is 0.5% for the amount of the purchase price up to \$55,000, plus 1% of the amount between \$55,000 and \$250,000, plus 1.5% of the amount of the purchase price between \$250,000 and \$400,000, plus 2% of the amount of the purchase price over \$400,000. For residential properties including at least one, but not more than two single family residences an additional tax bracket was added increasing the rate to 2.5% on the amount of the purchase price over \$2,000,000.

The MLTT provides an exemption for first-time home buyers in addition to the provincial rebate. Those who are eligible for the provincial rebate are also eligible for the MLTT rebate. First-time buyers in Toronto for new and re-sale properties will receive a rebate of up to \$4,475, which means all homes purchased for up to \$400,000 will be exempt from the MLTT. The value of the rebate is exempt at the time of registration. First-time buyers who purchase homes for over \$400,000 in Toronto must pay the balance of the MLTT above the \$4,475 exemption. As of March 17, 2017, the eligibility requirements for the first time purchaser rebate are harmonized with those under the Ontario Land Transfer Tax Act.

This issue of the Legal Business Report is designed to provide information of a general nature only and is not intended to provide professional legal advice. The information contained in this Legal Business Report should not be acted upon without further consultation with professional advisers.

Please contact Howard Alpert directly at (416) 923-0809 if you require assistance with tax and estate planning matters, tax dispute resolution, tax litigation, corporate-commercial transactions or estate administration.

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