

2022 Issue No. 35
28 June 2022

Tax Alert – Canada

Canada's new *Underused Housing Tax Act* receives Royal Assent

EY Tax Alerts cover significant tax news, developments and changes in legislation that affect Canadian businesses. They act as technical summaries to keep you on top of the latest tax issues. For more information, please contact your EY advisor or EY Law advisor.

On 9 June 2022, Bill C-8, *Economic and Fiscal Update Implementation Act, 2021*, received Royal Assent. Bill C-8 implements certain measures announced in the federal economic and fiscal update tabled on 14 December 2021, as well as Canada's new underused housing tax.

More specifically, Part 2 of the bill enacts the *Underused Housing Tax Act* (UHT Act), which implements an annual 1% tax on the value of vacant or underused residential property directly or indirectly owned by nonresident non-Canadians, effective 1 January 2022. The UHT Act sets out rules for establishing a residential property owner's liability for the tax, reporting and filing requirements, as well as various administrative and enforcement measures. As outlined in Budget 2021, the stated purpose for introducing a national underused housing tax was to ensure that nonresident owners who were using Canada as a place to passively store their wealth in housing pay their fair share.

The new tax, which will be administered by the Minister of National Revenue, is modelled to some extent on the speculation and vacancy tax imposed by the province of British Columbia for 2018 and later calendar years. It should be noted that while the UHT Act is now in force, some details of the tax remain to be fleshed out by regulation, such as prescribed properties to be included or excluded from the tax and certain prescribed persons to be treated as owners for purposes of the rules.

Framework

In general, the underused housing tax applies on a calendar year basis (beginning with 2022) to a person who is the owner of residential property in Canada, on 31 December of the particular calendar year, if:

- ▶ The owner is not an excluded owner; and
- ▶ The owner is not eligible to claim an exemption in respect of their interest in the property.

Residential property generally includes:

- ▶ Detached homes and similar buildings with up to three dwelling units (such as a duplex or triplex); and
- ▶ Semi-detached homes, row-house units, residential condominium units and any other similar premises.

It also includes that proportion of any common areas (if applicable) and any other appurtenances to the building (such as a shed, cabin, pool house or studio) and the land subjacent or immediately contiguous to the building that is attributable to the house, unit or premises and that is reasonably necessary for its use and enjoyment as a place of residence for individuals.¹

An *owner* of a residential property is a person identified as such for the property under the applicable land registration system or other similar system where the property is located (i.e., the legal title holder). It also includes a person that:

- ▶ Is a life tenant under a life estate in respect of the residential property;
- ▶ Is a life lease holder in respect of the residential property;
- ▶ Has, under a long-term lease (20 years or more, or a lease that contains an option to purchase the land), continuous possession of the land on which the residential property is situated; or
- ▶ Is a prescribed person (to be defined by regulation).

¹ The UHT Act also indicates that certain prescribed property may be included in or excluded from the definition; however, no details have been released to date on the types of properties that may be prescribed.

The tax does not apply to excluded owners of residential properties. The UHT Act defines an *excluded owner* of a residential property for a calendar year as a person that is, on 31 December of the calendar year:

- ▶ An individual who is a Canadian citizen or permanent resident of Canada,² except to the extent the individual owns the property in their capacity as a trustee of a trust (other than a personal representative in respect of a deceased individual) or as a partner in a partnership;
- ▶ A publicly listed corporation incorporated under federal or provincial law;
- ▶ A person that owns residential property in their capacity as a trustee of a mutual fund trust, a real estate investment trust (REIT), or a specified investment flow-through trust, as those terms are defined under the *Income Tax Act* (Canada);
- ▶ A registered charity, as defined under the *Income Tax Act* (Canada);
- ▶ A cooperative housing corporation, as defined under the *Excise Tax Act* (Canada);
- ▶ A municipality or para-municipal organization, as those terms are defined under the *Excise Tax Act* (Canada);
- ▶ A hospital authority, public college, school authority or university, as those terms are defined under the *Excise Tax Act* (Canada);
- ▶ An Indigenous governing body or a corporation wholly owned by such a body; or
- ▶ A prescribed person (to be defined by regulation).

Note that the *excluded owner* definition does not include private taxable Canadian corporations, partnerships nor trusts, and may not include closely held subsidiaries of a public corporation; it is anticipated that the compliance obligations of a larger number of real estate investment entities (that are not currently structured as REITs) may need to be evaluated for requirements to comply with the UHT Act.

Application of the tax

The tax applies at the rate of 1% to the residential property's taxable value. Unless an amount is prescribed by regulation, a residential property's *taxable value* for a calendar year is the greater of:

- ▶ The property's assessed value for property tax purposes; and
- ▶ The property's most recent sale price on or before 31 December of the calendar year.

² Note the use of citizenship and the immigration concept of permanent resident, which is different from tax residency. For example, Canadian citizens who are nonresidents of Canada for income tax purposes are excluded from the applicability of the UHT Act tax.

However, a person may elect to use the property's fair market value as the tax base, as determined at any time on or after 1 January of the calendar year and on or before 30 April of the following calendar year (and in a manner that is satisfactory to the minister). The election must be filed with the minister on or before 30 April of the following calendar year, or any later day the minister may allow. It is unclear how the "satisfactory" conditions will play out in practice, given the minister's discretion.

The tax is pro-rated in accordance with the residential property owner's ownership percentage in respect of the property for the year.

Exemptions

An owner that is not an excluded owner (as described above) is required to pay the tax, unless the owner qualifies for one of the following exemptions in the calendar year.³

Primary place of residence – An owner who is an individual is exempt from the tax for a calendar year if a dwelling unit that is part of the residential property is the primary place of residence of:

- ▶ The owner or the owner's spouse or common-law partner; or
- ▶ An individual who is the child of the owner or the owner's spouse or common-law partner, but only if the child occupies the residence for the purpose of authorized study at a designated learning institution.

If an individual who is neither a citizen nor a permanent resident owns two or more residential properties, the individual may elect to designate one of the properties as their primary residence for the year. An individual who fails to file the election cannot claim this exemption. If an individual and their spouse or common-law partner both own one or more residential properties and neither individual is a citizen or permanent resident, they must file a joint election to designate one of the properties as a primary residence in order to claim the exemption. Only one single or joint primary residence election may be filed. The election to designate a primary residence must be filed on or before 30 April of the following calendar year, or any later day the minister may allow.

Qualifying occupancy – A qualifying occupancy exemption applies for a calendar year if the property is occupied by one or more qualifying occupants in relation to the owner for at least 180 days of the year. To satisfy this test, only days that fall into a qualifying occupancy period in the year are counted.

³ In addition to the exemptions noted below, certain prescribed persons (to be defined by regulation) may also be exempt for a calendar year.

A qualifying occupancy period means a period of at least one month in the calendar year during which a qualifying occupant has continuous occupancy of a dwelling unit that is part of the residential property.⁴

A qualifying occupant includes:

- ▶ An arm's length tenant (under an agreement evidenced in writing);
- ▶ A non-arm's length tenant who is given occupancy in exchange for consideration that is not below the *fair rent* for the property;
- ▶ An individual who is the owner or the owner's spouse or common-law partner and is in Canada to pursue authorized work under a Canadian work permit;
- ▶ An individual who is a spouse, common-law partner, parent or child of the owner and who is a citizen or permanent resident; or
- ▶ A prescribed individual (to be defined by regulation).

However, if the owner or the owner's spouse or common-law partner owns multiple properties and has filed the primary residence election (described above), the owner and their spouse or common-law partner will be excluded as qualifying occupants of the other properties for purposes of the qualifying occupancy exemption. In addition, any calendar months during which the only qualifying occupants of the residential property are the owner and/or the owner's spouse, common-law partner, parent or child, and each of those individuals resides at another property for an equal or greater number of days than they reside at the particular residential property, will be excluded from a qualifying occupancy period.

Specified Canadian corporation – An owner that is a specified Canadian corporation is not required to pay the tax. In general, this includes a corporation incorporated under federal or provincial law, but does not include a corporation that on 31 December of the calendar year is:

- ▶ A corporation for which ownership or control of shares representing 10% or more of the equity or voting rights in the corporation is held by individuals who are neither Canadian citizens nor permanent residents of Canada or foreign corporations; or
- ▶ A corporation without share capital, for which the chairperson or other presiding officer, or 10% or more of the directors or other similar officers, are individuals who are neither Canadian citizens nor permanent residents of Canada.⁵

⁴ A month for these purposes generally means a period beginning on a particular day in a calendar month and ending on the day immediately before the same day in the next calendar month. For example, if the owner moves into the residence on 5 March 2022, occupies the residence continuously until 31 March 2022, and leaves for a couple of months before returning to reoccupy the residence in the summer months, the days in March will not be counted towards the 180 days; however, if the owner occupies the residence continuously from 10 March 2022 to 9 April 2022, those days will be counted.

⁵ Certain prescribed corporations (to be defined by regulation) may also be excluded from the definition of a specified Canadian corporation.

Specified Canadian partnership – A person that is an owner of a residential property solely in their capacity as a partner of a specified Canadian partnership is not required to pay the tax. A specified Canadian partnership is a partnership for which each member is either an excluded owner or a specified Canadian corporation on 31 December of the calendar year.⁶

Specified Canadian trust – A person that is an owner of a residential property solely in their capacity as a trustee of specified Canadian trust is not required to pay the tax. A specified Canadian trust is a trust under which each beneficiary (having a beneficial interest in the residential property) is either an excluded owner or a specified Canadian corporation on 31 December of the calendar year.⁷

Seasonal residence – The tax does not apply in respect of a residential property if it is not suitable for year-round use as a place of residence, or if the property is seasonably inaccessible because public access is not maintained year-round.

Disaster or hazardous condition – The tax does not apply in respect of a residential property that is uninhabitable for at least 60 consecutive days in the calendar year as a result of a disaster or hazardous condition caused by circumstances beyond the owner's reasonable control. This exemption can only be used in respect of the same disaster or hazardous condition for up to two calendar years. A disaster includes an earthquake, fire, flood, landslide or any other natural disaster or dangerous event. Hazardous conditions generally include any condition that is hazardous to the health or safety of the property's occupants, such as a structural defect or contamination by a dangerous substance.

Renovations – The tax does not apply in respect of a residential property that is uninhabitable for at least 120 consecutive days in the calendar year due to renovations, as long as:

- ▶ Any work relating to renovation is carried out without unreasonable delay; and
- ▶ This exemption did not apply in respect of the property for any of the nine prior calendar years.

Year of acquiring an interest in property – An exemption applies for the calendar year in which a person first becomes an owner of a residential property, as long as the person never owned the property in the prior nine calendar years.

Death of owner – An exemption applies in respect of a residential property for a calendar year if the owner died during the calendar year or the previous calendar year. This exemption extends to the personal representative of the deceased individual (e.g., the executor of the individual's will or the administrator of the individual's estate), provided they did not previously own the property in the calendar year or the prior calendar year.

⁶ Certain prescribed partnerships (to be defined by regulation) may also be included in the definition of a specified Canadian partnership.

⁷ Certain prescribed trusts (to be defined by regulation) may also be included in the definition of a specified Canadian trust.

Death of other owner – If an owner of a residential property dies and that individual's ownership percentage on the date of death was at least 25%, any other owner's interest in the property is exempt for the calendar year in which the death occurred and the subsequent calendar year, as long as they were an owner of the property on the day the individual died.

New buildings – An exemption applies in respect of a residential property for a calendar year if construction of the property is not substantially completed (i.e., generally 90% or more) before April of the calendar year. As well, the UHT Act provides an exemption for new property held by a developer as inventory for sale. Specifically, the tax does not apply to a residential property for a calendar year if:

- ▶ Construction of the property is substantially completed after March of the calendar year;
- ▶ The property is offered for sale to the public during the calendar year; and
- ▶ The property is not occupied by an individual as a place of residence or lodging during the calendar year.

Vacation/recreational properties – The tax does not apply to a residential property if it is located in a prescribed area and any prescribed conditions are met.

As part of the federal economic and fiscal update tabled on 14 December 2021, the government indicated it would provide an exemption for vacation and recreational properties. This exemption would apply to a property that is:

- ▶ Located in an area of Canada that is not an urban area within either a census metropolitan area or a census agglomeration having 30,000 or more residents; and
- ▶ Used personally by the owner (or the owner's spouse or common-law partner) for at least four weeks in the calendar year.

However, the details of this exemption have not yet been confirmed by regulation.

Anti-avoidance

The UHT Act contains a general anti-avoidance rule that is similar to that found in other federal tax legislation such as the General Anti-Avoidance Rule in the *Income Tax Act* (Canada). As well, the UHT Act contains a more specific anti-avoidance provision that applies to deny a tax benefit arising from a transaction or series of transactions that are undertaken to take advantage of a *parameter change* (i.e., a change to the tax rate or a defined term in the UHT Act).

Returns and remittances

An owner (other than an excluded owner) of one or more residential properties on 31 December of a calendar year is required to file a return for each residential property, unless the owner is a prescribed person or the property is a prescribed property. A return for a calendar year is due on or before 30 April of the following calendar year. As a result, a return for the 2022 calendar year must be filed on or before 30 April 2023. The return must be made in prescribed form containing prescribed information and must indicate the amount of tax (if any) that is payable.

Tax for a calendar year is also due on or before 30 April of the following calendar year. Therefore, tax for the 2022 calendar year must be paid to the Receiver General on or before 30 April 2023. Payments of \$50,000 or more under the UHT Act must be made at a financial institution such as a bank (which includes an authorized foreign bank), a credit union or a trust corporation. Late payments are subject to interest, compounded daily.

Penalties

A person who fails to file a return on time is liable to a penalty equal to the greater of the following amounts:

- ▶ \$5,000, if the owner is an individual, or \$10,000, if the owner is not an individual; and
- ▶ The total of:
 - ▶ 5% of the applicable tax for the property for the calendar year; and
 - ▶ 3% of the applicable tax for each complete calendar month the return is late.

For the purpose of determining the penalty, if a person fails to file a return for a calendar year by 31 December of the following calendar year, the applicable tax is calculated on the basis that certain exemptions are not available (e.g., the primary place of residence and qualifying occupancy exemptions).

As the UHT Act is a comprehensive and self-contained piece of legislation, it also contains various administrative provisions dealing with record retention, objections and appeals, audit enforcement action, computations of arrears interest, and other similar administration comparable to those in the *Income Tax Act* (Canada) and the *Excise Tax Act* (Canada).

Implications

Under Canada's new underused housing tax, foreign owners of residential property situated in Canada (whether owned directly, or indirectly through a partnership or trust) will be required to meet an annual return filing requirement for each Canadian residential property they own, thus creating an additional compliance burden. It is important to recognize that the ownership of real estate through a closely held entity, Canadian or foreign, will not provide an exclusion from the compliance obligations.

Unless the owner is an *excluded owner*, the annual filing requirement applies even if no tax is payable for the year; for greater certainty, this extends the annual filing obligation to the various persons and entities that are not excluded owners but that may satisfy one or more of the tax exemption criteria. It will also be necessary for foreign owners to assess on an annual calendar year basis if they satisfy any of the available exemptions from the tax (such as the primary residence exemption). Failure to file a return by the due date may result in penalties including the loss of certain exemptions from the tax if the return is not filed by the end of the following calendar year.

Nonresident owners should also be alert to similar taxes imposed at the provincial or municipal level. For example, the city of Vancouver imposes an "empty homes" or vacancy tax, which is in addition to the speculation and vacancy tax levied by the province of British Columbia. As well, the province of Ontario announced in its 2022 Budget that it would engage with Ontario municipalities that are considering the implementation of vacant homes taxes. The stated purpose of this collaboration is to help maximize the impact of such taxes on provincial housing supply and ensure a consistent approach throughout the province.

Learn more

For more information, please contact your EY or EY Law advisor or one of the following professionals:

Toronto

Jeremy Shnaider

+1 416 943 2657 | jeremy.shnaider@ca.ey.com

Gabriel Baron

+1 416 932 6011 | gabriel.baron@ca.ey.com

Ottawa

Chris Jerome

+1 613 598 4865 | chris.jerome@ca.ey.com

Calgary

Dean Radomsky

+1 403 206 5180 | dean.w.radomsky@ca.ey.com

Sanjaya Ranasinghe

+1 780 441 4692 | sanjaya.ranasinghe@ca.ey.com

Vancouver

Perry Yuen

+1 604 643 5451 | perry.yuen@ca.ey.com

EY | Building a better working world

EY exists to build a better working world, helping to create long-term value for clients, people and society and build trust in the capital markets.

Enabled by data and technology, diverse EY teams in over 150 countries provide trust through assurance and help clients grow, transform and operate.

Working across assurance, consulting, law, strategy, tax and transactions, EY teams ask better questions to find new answers for the complex issues facing our world today.

EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. Information about how EY collects and uses personal data and a description of the rights individuals have under data protection legislation is available via ey.com/privacy. For more information about our organization, please visit ey.com.

About EY's Tax Services

EY's tax professionals across Canada provide you with deep technical knowledge, both global and local, combined with practical, commercial and industry experience. We offer a range of tax-saving services backed by in-depth industry knowledge. Our talented people, consistent methodologies and unwavering commitment to quality service help you build the strong compliance and reporting foundations and sustainable tax strategies that help your business achieve its potential. It's how we make a difference.

For more information, visit ey.com/ca/tax.

About EY Law LLP

EY Law LLP is a national law firm affiliated with EY in Canada, specializing in tax law services, business immigration services and business law services.

For more information, visit eylaw.ca.

About EY Law's Tax Law Services

EY Law has one of the largest practices dedicated to tax planning and tax controversy in the country. EY Law has experience in all areas of tax, including corporate tax, human capital, international tax, transaction tax, sales tax, customs and excise.

For more information, visit <http://www.eylaw.ca/taxlaw>

© 2022 Ernst & Young LLP. All Rights Reserved.

A member firm of Ernst & Young Global Limited.

This publication contains information in summary form, current as of the date of publication, and is intended for general guidance only. It should not be regarded as comprehensive or a substitute for professional advice. Before taking any particular course of action, contact EY or another professional advisor to discuss these matters in the context of your particular circumstances. We accept no responsibility for any loss or damage occasioned by your reliance on information contained in this publication.

ey.com/ca