

Harmful tax rule changes affecting Canadian-owned foreign real estate businesses

September 08, 2023

On April 7, 2022, [Budget 2022: A Plan to Grow Our Economy and Make Life More Affordable](#) (Budget 2022) was released, announcing changes under the Income Tax Act (ITA)'s rules for Canadian-owned foreign companies that will pose significant challenges for certain Canadian-controlled private corporations (CCPCs) that carry on foreign real estate (and certain other types of) businesses through foreign affiliates. In short, CCPC-owned foreign real estate businesses will generally be subject to a tax rate in the 50 per cent range if they operate through a foreign corporate structure, unless they have at least six full time employees working outside of Canada.

As of the date of this article, the changes have not yet been enacted into law, but they are proposed to be effective retroactively for taxation years beginning after April 7, 2022 (that is, for the 2023 taxation year for taxpayers with a Dec. 31 year-end).

Background on FAPI

The foreign accrual property income (FAPI) rules are a set of anti-deferral rules designed to prevent the (potentially indefinite) deferral of Canadian taxes on passive income earned in a low-income jurisdiction by a controlled foreign affiliate (CFA). Without FAPI, a CFA could theoretically pay a low rate of tax in a foreign jurisdiction, and no Canadian tax would be paid until the CFA's profits are repatriated to Canada, thus allowing for the continued deferral of Canadian tax.

Under FAPI, a CFA's net passive income from sources such as dividends, rent, interest, royalties and certain capital gains are deemed to be income of the Canadian owner of the CFA (i.e., a CCPC) at the time the income is earned by the CFA rather than when cash is distributed to the Canadian, and thus subject to Canadian tax in the immediate taxation year unless otherwise excluded from these rules. Income from certain types of businesses that are included in the ITA's definition of "investment business" are also included in FAPI. Generally, income from rentals, leasing, and profits from a real estate development business are included in FAPI unless the CFA has at least six full-time employees engaged in the business outside of Canada. With the six employees, however, the same business is deemed to be "active," and its profits are not generally taxable in Canada at the corporate level.

The Canadian shareholder of a CFA is entitled to a tax deduction for the foreign tax paid **on the FAPI by the CFA multiplied by the “relevant tax factor” (RTF)**. Pursuant to Budget 2022 the RTF is reduced from 4 to 1.9 for CCPCs. The RTF remains at 4 for corporations that are not CCPCs, such as foreign-controlled or publicly controlled Canadian companies.

Under the current rules, when the RTF is 4, if a Canadian company’s CFA pays foreign tax of at least 25 per cent on its FAPI, the FAPI is fully eliminated by the foreign tax deduction ($4 \times 25 \text{ per cent} = 100 \text{ per cent}$). Budget 2022’s proposed reduction of the RTF results in an inclusion in a CCPC’s taxable income if its CFA pays foreign tax at a rate of less than 52.63 per cent on its FAPI. The net FAPI inclusion will be included in **“aggregate investment income” of the CCPC, and subject to a high rate of tax (currently 50.17 per cent in Ontario)**. With an RTF of 1.9, if its CFA earns \$100 of FAPI and pays \$25 of foreign tax, an Ontario-based CCPC will have Canadian tax payable of \$26.34, bringing the total foreign and Canadian net corporate tax to \$51.39. The tax on the aggregate investment income is partially refundable when the CCPC pays taxable dividends to its shareholders. If the same income was earned directly by the CCPC, the tax rate would be \$26.50 (being a corporate tax rate of 26.5 per cent in Ontario).

In short, CCPCs will be subject to an extremely high upfront corporate tax on FAPI earned through a CFA.

Real estate considerations

Aggregate investment income and FAPI generally overlap. For example, they both include portfolio dividends and interest income; however, FAPI applies to more types of income from business. Real estate development is one of the types of business income that can be FAPI when the business is carried on by a CFA but is not included in aggregate investment income when directly carried on by a Canadian company. In addition, income from a foreign real estate development business carried on by a CFA is FAPI unless the business qualifies for an exception requiring at least six full-time employees engaged in the business outside of Canada throughout the taxation year.

Accordingly, CFAs that are not large enough to meet the six-employee requirement therefore may have FAPI and therefore additional aggregate investment income, while income from an identical business with six or more foreign employees, or from a business carried on directly by the Canadian company, would not be FAPI or aggregate investment income. This can mean a distinct disadvantage for small businesses who do not meet the employee requirement.

Before the reduction of the RTF under Budget 2022, CFAs engaged in foreign real estate development businesses were not overly concerned about FAPI, because (assuming the real estate was not located in a tax haven), any FAPI was usually offset by the 4x deduction for foreign taxes. The proposed changes will make it difficult for CCPC-owned CFAs to compete in foreign real estate development, as their Canadian tax will be roughly double that of their foreign competitors. In many cases, they will be forced to distribute their profits back to Canada to pay taxes rather than, for example, reducing debt or reinvesting in the business.

Feasibility of a branch or partnership

Affected Canadian taxpayers might consider hiring additional foreign employees in order to meet the six-employees test or reorganizing their foreign real estate operations into a branch structure or partnership. However, these options present their own set of challenges.

Winding up a CFA and transferring foreign real estate assets to a Canadian corporation will likely result in significant foreign tax obligations. For U.S. real property developers, the U.S. Foreign Investment in Real Property Tax Act (FIRPTA) regime may require a remittance of up-front withholding tax with respect to property transferred out of a U.S. corporate structure.¹ In the real estate context, additional hurdles include land-transfer taxes and mortgage complications.

Choosing to proceed with a branch or partnership structure has a number of other tax and operational disadvantages. Issues to be addressed will include foreign branch tax rules, commercial liability concerns, compliance with mortgage and lender requirements, and foreign withholding taxes on sales of the real estate.

Conclusion

Given the clear tax costs and practical issues created under the proposed changes to FAPI and RTF that will be problematic for Canadian-owned real estate developers and others, we hope that appropriate amendments will be made to the proposals by the Department of Finance before they are finally enacted.

BLG's lawyers are available to answer any questions you may have about these issues and how they may apply to your business. Reach out to any of the authors or the key contacts below for assistance.

** A similar version of this bulletin was first published by the Canadian Tax Foundation in (2023) 2:3 International Tax Highlights.

¹ FIRPTA provides additional hurdles as this complex reporting scheme generally requires a 15 per cent withholding on the gross sale price when transferring U.S. real property from a non-U.S. person.

By

Jennifer Hanna, Greg Rafter

Expertise

Tax, Commercial Real Estate

BLG | Canada's Law Firm

As the largest, truly full-service Canadian law firm, Borden Ladner Gervais LLP (BLG) delivers practical legal advice for domestic and international clients across more practices and industries than any Canadian firm. With over 725 lawyers, intellectual property agents and other professionals, BLG serves the legal needs of businesses and institutions across Canada and beyond – from M&A and capital markets, to disputes, financing, and trademark & patent registration.

blg.com

BLG Offices

Calgary

Centennial Place, East Tower
520 3rd Avenue S.W.
Calgary, AB, Canada
T2P 0R3

T 403.232.9500
F 403.266.1395

Ottawa

World Exchange Plaza
100 Queen Street
Ottawa, ON, Canada
K1P 1J9

T 613.237.5160
F 613.230.8842

Vancouver

1200 Waterfront Centre
200 Burrard Street
Vancouver, BC, Canada
V7X 1T2

T 604.687.5744
F 604.687.1415

Montréal

1000 De La Gauchetière Street West
Suite 900
Montréal, QC, Canada
H3B 5H4

T 514.954.2555
F 514.879.9015

Toronto

Bay Adelaide Centre, East Tower
22 Adelaide Street West
Toronto, ON, Canada
M5H 4E3

T 416.367.6000
F 416.367.6749

The information contained herein is of a general nature and is not intended to constitute legal advice, a complete statement of the law, or an opinion on any subject. No one should act upon it or refrain from acting without a thorough examination of the law after the facts of a specific situation are considered. You are urged to consult your legal adviser in cases of specific questions or concerns. BLG does not warrant or guarantee the accuracy, currency or completeness of this publication. No part of this publication may be reproduced without prior written permission of Borden Ladner Gervais LLP. If this publication was sent to you by BLG and you do not wish to receive further publications from BLG, you may ask to remove your contact information from our mailing lists by emailing unsubscribe@blg.com or manage your subscription preferences at blg.com/MyPreferences. If you feel you have received this message in error please contact communications@blg.com. BLG's privacy policy for publications may be found at blg.com/en/privacy.

© 2026 Borden Ladner Gervais LLP. Borden Ladner Gervais LLP is an Ontario Limited Liability Partnership.