Underused Housing Tax: New filing and tax considerations for many Canadian real estate owners

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The Government of Canada has proposed a new Underused Housing Tax (the UHT) applicable to residential real estate throughout the country. Bill C-8, currently before Parliament, proposes to enact the *Underused Housing Tax Act* (the Act) and can be traced back to the Government of Canada's Fall Economic Statement 2020.

Additional revisions may affect this new taxing regime. Real estate owners are advised to consider how the Act may apply to them and whether they will be able to claim an exemption.

What you need to know

- As currently drafted, many Canadian entities will have compliance obligations under the Act.
- Registered owners of residential real estate in Canada as of December 31, other than an "excluded owner", are required to file an annual return by April 30th of the following year.
- Only "excluded owners" fall outside the scope of the Act, which includes individual owners who are Canadian citizens or permanent residents, and certain publicly traded Canadian corporations, investment funds and public sector organizations.
- As drafted, some exemptions are inapplicable where the property is owned by an entity (*i.e.* by corporations or trusts instead of an individual).
- The availability of many tax exemptions can be lost if returns are not filed by specified deadlines.

Significant regulation making capabilities will enable the Government of Canada to make changes to such regime without a formal statutory amendment so there may be changes to the summary below by the time the Act receives royal assent.

Purpose

Effective January 1, 2022, this new taxing regime applies in addition to existing measures applicable in certain jurisdictions, such as the Vancouver Empty Homes Tax or B.C. Speculation and Vacancy Tax.

The UHT targets vacant or underused residential property owned, directly or indirectly, by foreign nationals who are neither Canadian citizens nor permanent residents. However, as currently drafted, **many wholly Canadian entities, such as private Canadian corporations, partnerships and trusts, will nonetheless have compliance obligations under the Act**. For this purpose, the "owner", as defined, is generally the person registered as such under the applicable land registration system, and includes life tenants, life leaseholders, and those with continuous possession under a "long-term lease" of at least 20 years. However, it is open to the Government of Canada to add to or subtract from this definition by way of regulation.

For purposes of the Act, "residential property" means a detached house or similar building containing not more than three dwelling units, as well as a part of a building that is a semi-detached house, row house unit, residential condominium unit (generally capturing premises that are, or are intended to be, a separate parcel of other division of real property), and includes the subjacent and immediately contiguous land. Thus, structures such as large multi-unit apartment buildings should fall outside the scope of the Act (unless they are stratified). Like with the definition of an "owner", it is open to the Government of Canada to further add to or subtract from this definition by way of regulation.

The only class of person, which falls outside the scope of the Act, is an "excluded owner". This term is defined to include, among other classes of persons, individual owners of real estate who possess Canadian citizenship or permanent residency status and certain public corporations, which are Canadian incorporated companies listed on a designated stock exchange in Canada. However, as currently drafted, the definition of "excluded owner" **does not, include private Canadian corporations, partnerships and trusts, nor wholly owned subsidiaries of public corporations who are "excluded owners".** While such owners may not be subject to the UHT, they will nonetheless be required to file an annual return under the Act even if they qualify for an exemption to the UHT.

Titleholder-focused tax

One notable difference between the Act and other Canadian tax legislation is its focus on the registered titleholder instead of the beneficial owner. Focusing on the titleholder may facilitate easier enforcement, but may create novel interpretation issues. For example, the Act is silent on concepts such as bare trusts or nominee relationships, where the titleholder is holding property as agent for a third party, but not as a true trustee. As another example, the exemptions for "specified" entities discussed below are unavailable for trusts with partnerships as beneficiaries, or for partnerships with trusts as partners. It remains to be seen whether these issues will be dealt with by regulation at a later time. Owners with complex legal structures should therefore closely consider and monitor their obligations under the Act, as the rules may be counterintuitive and subject to change.

Exemptions

The Act sets out a number of exemptions to the UHT, including the following (among others):

- The owner is a “specified Canadian corporation”, “specified Canadian partnership”, or “specified Canadian trust”. This generally includes private corporations, partnerships and trusts the interests in which are entirely or nearly entirely held by an excluded owner. While a foreign individual can hold less than 10 per cent of the votes or value in a private corporation and have the corporation still qualify as a “specified Canadian corporation”, any interest of a foreign individual in a partnership or trust would mean such partnership or trust does not meet the requirements for these definitions.
- The residential property is used as a primary place of residence by the owner or certain family members for the calendar year.
- The residential property is leased long term for at least 180 days in the calendar year.
- The residential property is not suitable for year round use as a place of residence or seasonally inaccessible.
- The residential property is uninhabitable for a specified number of days due to disasters or hazardous conditions beyond the reasonable control of an owner or due to renovations.
- The owner of the residential property acquired the property in the calendar year.
- The owner of the residential property died in the calendar year or in the previous calendar year.

In addition, the Government of Canada has stated its plan to bring forward an exemption for certain vacation or recreational properties where the following conditions are met.

- The residential property 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
- The residential property is personally used by the owner (or the owner’s spouse) for at least four weeks in the calendar year.

However, such exemption is not currently reflected in the Act (although the Act allows for this type of exemption to be added by regulation).

As drafted, it appears **some exemptions (such as the primary place of residence exemption) may not be applicable where the property is owned by a person other than an individual** (*i.e.* by corporations or trusts).

Those filing a return will need to give careful consideration to the specified requirements for qualifying for an exemption. Owners should also ensure that they keep all supporting documents for any applicable exemption in compliance with record keeping obligations under the Act in the event of an audit.

Tax Rate

Where the UHT does apply, the rate of UHT payable for a calendar year is equal to 1 per cent of the “taxable value” of the property. The taxable value is primarily determined

based on the assessed property tax value for the property, determined by the applicable province, or the most recent sale price (whichever is greater). Owners will also be able to elect to use fair market value, determined under prescribed rules. The tax is paid based on an owner's proportionate share in the residential property.

Annual Filing Requirement

Registered owners of residential real estate in Canada as of December 31st of the relevant calendar year, other than an "excluded owner", **will be required to file an annual return for such calendar year by April 30** of the following year. Failing to file a return as required results in a minimum penalty of $5,000, if the person is an individual or $10,000 if the person is not an individual. For non-individuals, this penalty is actually greater than the 1 per cent tax payable on the average-priced detached home in Canada as of February, 2022 of $750,000 (and is payable even if the owner qualifies for an exemption to the UHT). Penalties can rise even higher because the calculation is based in part on the amount of UHT payable *without regard* to the application of certain exemptions to the UHT and on the number of months by which the return is overdue.

Enforcement of the Act is supported by robust anti-avoidance rules, as well as administration, audit, penalty, enforcement, and collection provisions.

How BLG can help

If you own residential real estate in Canada and would like to learn more about how the Underused Housing Tax may affect you, please reach out to any of the authors or key contacts listed below.

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