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Does the Underused Housing Tax Apply to You? The Answer May Surprise You

By Ian Spiegel

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Bill C-8, which introduced the Underused Housing Tax (the "UHT") through the *Underused Housing Tax Act* (the "Act"), received Royal Assent on June 9, 2022. The UHT is effective as of January 1, 2022.

According to the Budget 2021, the UHT was implemented to ensure that foreign, non-resident owners, who simply use Canada as a place to passively store their wealth in housing, pay their fair share of tax.[1] The rationale for the UHT appears to be that such a tax will free up empty homes for residents of Canada and improve housing affordability.

However, as the Act is currently written, the UHT is a particularly broad tax, and filing obligations, as well as the tax itself, may apply to certain resident Canadians (not just foreigners). Many Canadians are no doubt unaware of how the UHT or the filing obligations under the Act may apply to Canadian individuals, corporations and trusts. Although there are exemptions from the UHT in certain circumstances, until the regulations to the Act are published, the requirement to file a return appears to apply to Canadian resident private corporations, partnerships, certain trusts (e.g. alter ego and joint partner trusts, and bare trusts) and estate trustees holding real property in Canada. Even if exempt from the payment of UHT, these persons may be required to file a return, with significant penalties for failure to do so.

This article will provide a general overview of the UHT, including the key substantive provisions, administration and enforcement.

Introduction to the UHT

Generally, the UHT applies for calendar years (beginning for the 2022 calendar year) to a person that is an "owner" of a "residential property" in Canada on December 31 of the relevant year, unless the owner is an "excluded owner" or is eligible to claim one of the available exemptions to the UHT in respect of the particular property.

The UHT is similar to the empty home taxes imposed in certain provinces, such as British Columbia and that being proposed for Ontario, as well as several municipalities across Canada, including

1 https://www.budget.gc.ca/2021/report-rapport/p4-en.html

Continued on page 2

that being proposed for Toronto. Unlike other empty home taxes which apply on a parcel-by-parcel basis, the federal UHT applies on a building or dwelling unit (see definition below) basis; accordingly an apartment complex with more than 3 dwelling units could have multiple residential properties, each of which could be subject to the UHT.

Key Definitions[2]

The "owner" of a residential property means the title holder under the relevant land registration system, and includes a life tenant, life lease holder, and an individual with continuous possession of land under a long-term lease.

A "residential property", for the purposes of the Act, means:

- A detached house or similar building, containing not more than 3 "dwelling units", or
- A part of a building that is a semi-detached house, rowhouse unit, residential condominium unit or other similar premises that is , or is intended to be, a separate parcel or other division of property,

  together with, in each case, that proportion of the surrounding appurtenances, land and (if applicable) common areas reasonably necessary for its use and enjoyment as a place of residence for individuals.

A "dwelling unit" means a residential unit that contains private kitchen facilities, a private bath and a private living area.

An "excluded owner" includes persons who, on December 31 of the relevant calendar year, are:

- Canadian citizens or permanent residents;

2 *Underused Housing Tax Act*, S.C. 2022, c. 5, s. 10 at s. 2 [UHTA].

- Corporations incorporated under the laws of Canada or a province whose shares are listed on a Canadian stock exchange;
- Trustees of mutual fund trusts, real estate investment trusts and SIFT trusts;
- Registered charities; and
- Prescribed persons (to date this term is not defined in the Act and there are no regulations yet provided which would explain who are "prescribed persons").[3]

Imposition and Rate of the Tax

The UHT is imposed on each *owner* of *residential property*, other than an *excluded owner* at a rate of 1% of the property's *taxable value*, which is a prescribed amount,[4] or the greater of:

a) The property's assessed value for property tax purposes, and
b) The property's most recent sale price on or before December 31 of the relevant year.[5]

Alternatively, the owner may elect to use the property's fair market value as determined at any time on or after January 1 of the relevant year and on or before April 30 of the following calendar year.[6]

Filing Returns and Remittance of UHT

Each owner, other than an excluded owner, of a residential property on December 31 of a particular year must file a return for that year in respect of each such residential property on or

3 The definition of "excluded owner" does not generally include private corporations, partnerships, certain trusts (e.g. alter ego and joint partner trusts, bare trusts) or estate trustees. UHT and annual filings may apply, even where all parties are Canadian residents or citizens.
The regulations have not yet provided a definition for "prescribed person", so it is unclear how much broader the category of "excluded owner" may get.
4 The regulations have not yet provided a prescribed amount.
5 UHTA, at ss. 6(3).
6 UHTA, at ss. 6(4).

before April 30 of the following year.[7] The first of such returns is required to be filed by April 30, 2023 in respect of the 2022 calendar year. Significantly, if an owner is not an excluded owner, a return must still be filed in respect of the year even if there is no UHT owing because the property is subject to an exemption (described below).

A person is not required to file a return for a residential property for a calendar year if the person is a "prescribed person" or if the residential property is a "prescribed property".[8] Thus, unless the expected regulations to the Act clarify the term "prescribed persons", it appears that every private corporation, partnership, trust[9] and estate that owns residential property in Canada must file a return.

Any UHT that is payable by a person must be paid for each year in respect of each such property on or before April 30 of the following year. UHT for the 2022 calendar year is required to be paid by April 30, 2023.

Exemptions
If the owner is not an excluded owner, the residential property is subject to UHT unless an exemption applies, including the following:

Primary Place of Residence
An exemption is available where a dwelling unit in a residential property is owned by an individual and is the primary place of residence of:

- the individual or the individual's spouse or common-law partner; or
- a child of the individual or the individual's spouse or common-law partner, and the child occupies the residential property for the purposes of authorized study at a designated learning institution (as defined in section 211.1 of the *Immigration and Refugee Protection Regulations*).[10]

If, on December 31 of a particular year, an individual who is neither a citizen nor a permanent resident is an owner in respect of two or more residential properties, the individual may elect to designate one of those residential properties for the particular year as a primary residence.[11] If an election is not made, the primary place of residence exemption cannot be claimed.[12] 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 jointly elect to designate one of those residential properties as a primary residence. Not more than one joint election may be made by the individual and the individual's spouse or common-law partner for any particular year.[13]

Qualifying Occupancy
A further exemption applies for a particular year where the property is occupied by qualifying occupants for at least 180 days throughout the year. Only days that are part of a qualifying occupancy period will be counted towards the 180 days.[14]

A qualifying occupancy period means a period of at least one month during which a qualifying occupant has continuous occupancy of a dwelling unit that is part of a residential property. Qualifying occupants include:

- an arm's length tenant who is given continuous occupancy of the dwelling unit under an agreement evidenced in writing;

7 UHTA, at ss. 7(1).
8 UHTA, at ss. 7(2). The terms "prescribed person" and "prescribed property" have not yet been defined by regulation.
9 Other than those trusts included in the definition of "excluded owner".

10 UHTA, at ss 6(8).
11 UHTA, at ss. 6(11).
12 UHTA, at para. 6(10)(a).
13 UHTA, at ss. 6(12).
14 UHTA, at ss. 6(9).

- a non-arm's length tenant who is given continuous occupancy of the dwelling unit under an agreement evidenced in writing and for consideration that is not below the fair rent for the residential property, prorated for the period;
- an individual who is the owner or the owner's spouse or common-law partner, who is in Canada for the purpose of pursuing authorized work under a Canadian work permit and who occupies the dwelling unit in relation to that purpose;
- 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.[15]

However, a qualifying occupancy period excludes months in which the only individuals who occupy the property are the owner, spouse or child, if each of those individuals resides at another place for an equal or greater number of days than they reside in the subject residential property.[16] Further, if the owner or the owner's spouse or common-law partner owns multiple properties and has filed a primary residence election as described above, the owner or the owner's spouse or common-law partner are excluded as qualifying occupants of the other properties for the purposes of the qualifying occupancy exemption.[17]

Fair rent for the purposes of the qualifying occupancy exemption means the amount determined in prescribed manner[18] or, in the absence of same, 5% of the taxable value in respect of the residential property.

15 UHTA, at ss. 6(1). The term "prescribed individual" has not yet been defined by regulation.
16 UHTA, at ss. 6(2).
17 UHTA, at para. 6(10)(b).
18 The regulations have not yet set out a prescribed manner for determining fair rent.

Miscellaneous Exemptions
The following is a list of the various other circumstances in which UHT is <u>not payable</u> by a person in respect of a particular calendar year:[19]

- The person is an owner of the residential property solely in their capacity as
    - a partner of a partnership that is a specified Canadian partnership[20] in respect of the calendar year (however, it appears that if a partner is not an excluded owner or specified corporation, the partnership is not exempted); or
    - a trustee of a trust that is a specified Canadian trust[21] in respect of the calendar year and is trustee of the residential property (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). Subject to the expected regulations clarifying the definition of a prescribed person, this suggests that a trust whose beneficiaries include non-resident beneficiaries may be subject to the UHT.
- The person is in respect of the calendar year a specified Canadian corporation.[22]

19 UHTA, at ss. 6(7).
20 A specified Canadian partnership is a partnership for which each member is either an excluded owner (or would be without reference to "or as a partner of a partnership" in paragraph (b) of the definition of excluded owner) or a specified Canadian corporation on December 31 of the calendar year.
21 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 December 31 of the calendar year.
22 A specified Canadian corporation means a corporation that is incorporated or continued under the laws of Canada or a province, other than a corporation that is, on December 31 of the calendar year:
a) a corporation in respect of which ownership or control, directly

- The residential property is not suitable for year-round use as a place of residence or seasonally inaccessible because public access is not maintained year-round.
- The residential property is uninhabitable for a period of at least 60 consecutive days in the calendar year as a result of a disaster or hazardous condition caused by circumstances beyond the reasonable control of an owner. This exemption is only available for two calendar years in respect of the same disaster or hazardous condition.
- A residential property is uninhabitable for a period of at least 120 consecutive days in the calendar year as a result of a renovation, so long as any work in relation to the renovation is carried on without unreasonable delay and this exemption did not apply in respect of the residential property for any of the nine prior calendar years.
- The person becomes an owner of the residential property in the calendar year and was never an owner of the residential property in the prior nine calendar years.
- The person died during the calendar year or the prior calendar year. This exemption also applies to the person's personal representative, so long as the personal representative was not otherwise an owner of the residential property in either of those calendar years.
- If an owner of a residential property dies and that owner's ownership percentage in respect of the residential property at the time of death was at least 25%, any other owner's interest is exempt for that and the subsequent calendar year so long as they were an owner on the date of death.
- The construction of the residential property is not substantially completed before April of the calendar year.
- The construction of the residential property is substantially completed January, February or March of the calendar year, the residential property is offered for sale to the public during the calendar year and the residential property had never been occupied by an individual as a place of residence or lodging during the calendar year.[23]
- The residential property is located in a prescribed area and prescribed conditions, if any, are met.[24]
- The person is a prescribed person.

Penalties
Every person that fails to file a return as and when required is liable to a penalty equal to the **greater** of:

a) $5,000 if the person is an individual or $10,000 if the person is not an individual, and
b) the amount that is the total of:

or indirectly, of shares representing 10% or more of the equity or carrying 10% or more of the voting rights in the corporation is held by individuals who are neither citizens nor permanent residents or foreign corporations;
b) a corporation without share capital having a chairperson or other presiding officer or 10% or more of its directors being individuals who are neither citizens nor permanent residents of Canada; or
c) a prescribed corporation (not yet defined by regulation).

23 This exemption would apply to land developers holding a residential property for sale.
24 This exemption relates to vacation properties held by foreigners. The Government of Canada recently put forward Bill C-32 for first reading, which includes the following definitions for "prescribed areas" and "prescribed condition" that are deemed to be effective for the 2022 and subsequent calendar years:
A prescribed area is an area that, as determined in the last census published by Statistics Canada before the calendar year, was neither in a *census metropolitan area* nor within a *specified census agglomeration* (that has a total population of at least 30,000); and an area within a census metropolitan area or specified census agglomeration but not within a *population centre* (italicized terms as defined within the meaning of the Statistics Canada document entitled *Standard Geographical Classification (SGC) 2021*).
A prescribed condition is that the residential property is used as a place of residence or lodging by the owner or the owner's spouse or common-law partner for at least 28 days during the calendar year. (https://www.parl.ca/DocumentViewer/en/44-1/bill/C-32/first-reading).

a. 5% of the UHT payable by the person in respect of the residential property for the calendar year, and
b. 3% of the UHT multiplied by the number of complete months from the date on which the return was required to be filed.[25]

If a person fails to file a return for a particular calendar year by December 31 of the following calendar year, the applicable tax is calculated on the basis that certain exemptions do not apply (e.g. primary place of residence and qualifying occupancy exemptions).[26] This means that, even where certain exemptions apply and there is no UHT payable, the minimum penalty of $5,000 for individuals, and $10,000 for all others will apply. This is particularly worrisome for those who may not realize that the corporation, trust or partnership owning Canadian real property and falling outside the excluded owner definition, is required to file.

Overall, the relevant administration rules, including assessment, objection, appeal, collections, penalties and a general anti-avoidance rule, are similar to those found in the *Income Tax Act* (Canada) and the *Excise Tax Act* (Canada).

However, the Act introduces the "parameter change rules" which operate to deny a tax benefit where transactions are undertaken to take advantage of a rate change or a definition change.[27]

Final Comments

Even though the Government of Canada has now put forward an update to the regulations providing for an exemption for certain vacation homes (see footnote 24), there still appear to be concerns with the wording of the exemption. On July 11, 2022, Brian Higgins, the Congressman representing the 26th District in New York, wrote to Deputy Prime Minister and Minister of Finance Chrystia Freeland, with concerns regarding the current exemptions under the Act:

"While the current law includes some exemptions to the Underused Housing Tax, it lacks guarantees that would exclude all American cottage owners from this tax. For example, cottage ownership structures are diverse, and often shared between families. Current exemptions do not take these shared responsibilities into account. Additionally, many of my constituents own cottages in Fort Erie, where the population is listed as 30,710 people. This makes Fort Erie too large to qualify for the exemption regarding vacation homes in communities with a population less than 30,000 people."[28]

This is quite a large oversight given the number of recreation and vacation properties owned by US residents in Canada.

As noted, a further concern, pending regulations defining "prescribed person", is that the definition of "excluded owner" does not currently include private corporations, partnerships, certain trusts (e.g. alter ego and joint partner trusts, bare trusts) or estate trustees. This is particularly worrisome to Canadian residents, as the UHT and/or annual filing requirements may apply to persons using trusts and corporate structures as an estate planning tool. In the case of an estate, it may not be clear who "owns" the residential property, and thus whether the executor has a filing obligation, particularly where there may be non-resident residual beneficiaries of the estate. Legal ownership, which is the basis of the UHT regime, may not change from the estate until after probate is granted.

25 UHTA, at ss. 47(1).
26 UHTA, at ss. 47(2).
27 UHTA, at s. 12.

28 https://higgins.house.gov/sites/higgins.house.gov/files/Higgins%20Letter%20-%20Freeland%20-%207.11.22.pdf.

Given that the majority of the regulations have not yet been published for the Act, these issues are something to keep an eye on as the first year's filings are coming due.

If you have any questions about the above information, please contact a member of Gardiner Roberts LLP's experienced Tax and Estates Planning Group.

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Contact us

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