

Tax and Real Estate Investment: What Should Non-residents Investing in Canadian Real Estate Consider?

As recent articles suggest that the real estate market in Toronto may have bottomed out, and Ontario's new Premier has promised to drop foreign buyer's real estate tax, this is an opportune time to revisit some tax issues concerning non-residents investing in Canadian real estate.

There are a number of reasons why a non-resident might consider purchasing Canadian real estate including keeping it as a rental property investment and reselling or "flipping" the property for a profit.

In Canada, a real estate investment could give rise to income from a business OR income from property and distinguishing between these two types of income is vital as they are taxed differently.

Any statutory references contained in this article are to the Income Tax Act (Canada) ("the Act").

What are the factors used to determine the type of real estate income earned?

The general factors that the Canadian tax authorities would consider in making a determination of income versus capital for Canadian residents were discussed in Part I of this series, focusing on the taxation of profits arising from the purchase and sale of Canadian property.

Canadian tax authorities consider two important factors in making a determination of the type of income earned by non-residents who purchase a property with the intention of renting the property to and earning rental income from tenants:

- The degree of activity expended by the taxpayer in earning the income (i.e., time, attention and labour) and;
- The extent and nature of the services provided to the tenants.

Canadian tax authorities tend to assume that rental income is income from property unless the facts suggest otherwise (e.g. the non-resident has various properties and is heavily involved in the management of the properties).

Determining whether income earned is property income versus business income is important as they are taxed differently for non-residents.

How are non-residents taxed differently with respect to real estate income?

Non-residents that are considered to have earned business income in Canada are subject to Canadian Part I income tax. If the non-resident investing in Canada is a corporation, the corporation will also be subject to a branch tax. Branch tax is a tax applied to the after-tax profits earned by a branch of a non-resident corporation which has a permanent establishment in Canada. The Canada – US tax treaty exempts the first \$500,000 of profits earned by a branch and reduces the branch tax rate from 25 per cent to 5 per cent. Non-residents considered to have earned rental income in Canada that is not derived from a business are subject to a 25 per cent withholding tax under Part XIII of the Act on the **gross amount of rents received or credited to them**. It is generally the responsibility of the tenant to withhold and remit this tax to the government, however, a property manager usually carries out this responsibility. The withholding

tax payments are due on or before the 15th day of the month following the month in which the tenant paid its rent.

To avoid having to withhold and remit withholding tax on the gross amount of rent, a non-resident can file a NR6 form with the Canadian tax authorities and file a Canadian income tax return under subsection 216(4) of the Act to have the tax computed on the **net rental income at normal tax rates**. Subsection 216(4) tax return must be filed within six months from the yearend of the non-resident's taxation year.

Our next real estate series article will focus on the disposition of Canadian real estate by non-residents.

This article has been prepared for the general information of our clients. Specific professional advice should be obtained prior to the implementation of any suggestion contained in this article. Please note that this publication should not be considered a substitute for personalized tax advice related to your particular situation.

About Crowe Soberman LLP

Based in Toronto, Crowe Soberman is one of the leading public accounting firms in Canada. The firm has been in business over 60 years and has built a strong reputation in the community because of the excellent work our teams of dedicated professionals produce.

Our core services are in Audit, Tax, and Advisory. Along with these, we have professionals who specialize in Business Valuation, Claims Valuation, Corporate Recovery & Turnaround, Forensics, Estates & Trusts, Global Mobility Services, HR Consulting, Commodity Tax (HST), International Transactions & Consulting, International Tax, Litigation Support, M&A Transactions, Management Services, Personal Insolvency and Succession Planning. Members of our various specialty services groups are available when required as a technical resource to assist the client service team.

Crowe Soberman is an independent member of Crowe Global. As a top 10 global accounting network, Crowe Global has over 200 independent accounting and advisory firms in 145 countries. For almost 100 years, Crowe has made smart decisions for multinational clients working across borders. Our leaders work with governments, regulatory bodies and industry groups to shape the future of the profession worldwide. Their exceptional knowledge of business, local laws and customs provide lasting value to clients undertaking international projects. At Crowe Soberman LLP, our professionals share one commitment: to deliver excellence.