Minden Gross LLP

Winter 2017

TOPICS:

Changes to the Principal Residence Exemption: Home Sweet Home?

On OCTOBER 3, 2016, the Department of Finance introduced significant changes to the principal residence exemption ("PRE") rules in order to "improve tax fairness by closing loopholes surrounding the capital gains exemption" as they relate to the sale of your home. The changes were aimed primarily at foreign investors of Canadian real estate, but they also catch many Canadian residents who, in the past, have been able to access the PRE and avoid paying capital gains tax on the sale of their principal residences. In this article, we will review what these changes mean for you. Before we get into the nitty gritty of the changes, let us first review the rules.

Key Rules and Requirements:

In order to take advantage of the PRE, certain requirements must be met:

- The home must be ordinarily occupied for personal use by you, your spouse or former spouse, or a child at some time during the year.
- The home must be "capital property". If the home was renovated and "flipped" a short time after it was acquired, there is a risk it might not be considered capital property but rather the inventory of a business.
- To claim the PRE on a large lot (over ½ hectare - about 1¼ acres), you must be able to establish that the excess land is necessary for the "use and enjoyment" of your home.
- Restrictions also apply if part or all of your home is rented out or is not used by a family member, or if you have not been a resident in Canada throughout the period of ownership (other than in the year of purchase).
- As a general rule, a family can claim the PRE on only one home at a time. Claiming a second home is more of a problem. To stop you from trying to claim a separate exemption for another home by putting it in the name of a child, the rules restrict children from claiming the exemption unless they have reached age 18 in the year or are married.
- Where specific conditions are met, non-Canadian properties may also qualify for the PRE.
- It is possible for a trust to claim the PRE, provided that a corporation is not a beneficiary and the trust designates a beneficiary (or their spouse, common-law partner, or child) of the trust who ordinarily inhabits the property (referred to as a "specified beneficiary").

How it works:

Most people think of the PRE as a black and white matter - either you qualify to sell tax free or you do not. Actually, this is not the case. When you sell your home, you must calculate the gain on your residence just like any other capital gain, then PRE itself reduces your gain.

Moreover, eligibility for the exemption is on a year-by-year basis, which might come as a surprise. The more years you qualify relative to your total period of ownership, the more your gain gets reduced. To be more precise, here is the basic formula that normally applies:

$$\frac{\text{1 + number of years after 1971 the house was used and designated as a principal residence (and you were resident in Canada)}}{\text{Number of years of ownership calculated after 1971}} \times \text{Capital gain otherwise calculated}$$

Despite only allowing one property to be claimed, the rules allow a full exemption on two residences in a particular tax year, i.e. where one residence is sold and another is purchased in the same year. That is why the above formula adds "1" to the number of years the property was a principal residence (the "plus one rule").

As you can see from the above formula, to get the tax reduction, you must designate the home as a principal residence on a year-by-year basis. If your gain is completely covered by the principal residence exemption, under the previous rules, the CRA did not require you to file the designation form with your tax return. This has changed.

New Rules

Ownership by a Trust:

Under the new rules, additional requirements were introduced where a trust owns a principal residence (for the years that begin after 2016). Essentially, only the following types of trusts are able to designate a principal residence (where the trust has a "specified beneficiary" who is a resident of Canada during the year(s) for which the PRE is being claimed):

- an alter ego trust, spousal or common-law partner trust, joint spousal or common-law partner trust, or a similar trust for the exclusive benefit of the settlor of the trust during his/her lifetime;
- a testamentary trust created under a Will that is a qualifying disability trust for which the beneficiary is a spouse, common law partner, former spouse, former common law partner, or child; or
- a trust for the benefit of a minor child of deceased parents.

If you have a trust that owns a principal residence and does not meet the above conditions, you can take advantage of transitional rules that will allow the trust to crystallize the PRE in respect of any accrued capital gain relating to the property up to December 31, 2016. Essentially the trust will be deemed to have disposed of the property on December 31, 2016 (the trust can shelter the gain under the PRE up until that date) and to have reacquired the property at a cost equal to the fair market value on January 1, 2017. However, you may want to reconsider keeping the property in the trust for years after 2017 since it will no longer be sheltered (whereas it can be sheltered if owned directly by a beneficiary).

The new rules allow a trust that does not qualify for the PRE to make a tax-deferred distribution of the property to the beneficiary who had ordinarily occupied the property (assuming the beneficiary has a capital entitlement to the trust) and, for the purposes of accessing the PRE, the beneficiary will be able to designate the property as his or her principal residence for those years it was owned by the trust.

If the beneficiary who had ordinarily occupied the property does not have a capital entitlement to the trust such that the property cannot be distributed out to him or her, it may still be possible for the beneficiary to take advantage of the PRE after 2016 if there is another way for the beneficiary to become the beneficial owner of the property. For example, the property could be distributed to a capital beneficiary of the trust at fair market value (but this means that tax will be owing in the trust to the extent of any increase in value of the property from January 1, 2017, to the date of the distribution). The capital beneficiary in turn gifts the property to the first-mentioned beneficiary (who ordinarily occupies the property), who will then be able to designate the property as his or her principal residence for the tax years after the gift is made.

Trusts are often used to hold a principal residence as part of a succession and/or estate plan and as such, the planning described above might not be appropriate in a number of situations; for example, where the beneficiary is not equipped to control material wealth or where the property was originally intended to be transferred to other beneficiaries. If you kept the principal residence in a trust, any planning intended to sidestep or mitigate the impact of the new rules should be carefully reviewed by you and your advisors to ensure your original planning goals are still being achieved. Further, in considering such planning, you should be mindful of any applicable land transfer tax and structure the distribution from the trust to ensure such tax is avoided or mitigated.

Changes to the Plus One Rule:

Effective October 3, 2016, the plus one rule will not apply where an individual is not a resident in Canada during the year of acquisition. Under the previous rules, you could benefit from the PRE for the year that you purchased a residence in Canada, even though you were not a Canadian resident in the year of acquisition. This is no longer the case; however, a non-resident may be able to avoid this result by gifting funds to his or her resident spouse or child to acquire the property.

Requirement to Report a Sale & Extension of the Reassessment Period:

If your entire gain is covered by the PRE, we had noted that under the previous rules you were not required to file the designation form with your tax return to report the disposition of the principal residence. However, under the new rules, you are now required to report the sale of your principal residence and make the designation; this applies for all dispositions that occur on or after January 1, 2016. If you fail to do so, you will not be entitled to the PRE. In certain circumstances, the CRA will accept a late designation of your principal residence, but you could be subject to a penalty of up to $8,000.

Under the previous rules, the CRA could only reassess you within the normal reassessment period, which was generally three years after the date of the original notice of assessment (unless certain exceptions are applied). The new rules clarify that the CRA has the ability to reassess you for an unlimited period beyond the normal reassessment period (as it relates to your principal residence) if you failed to report the disposition of your principal residence, even if such failure to report was purely innocent.

Summary:

The two main take-aways from these new changes are:

1. There is no longer any flexibility through the use of a family trust for owning a principal residence (usually popular with the purchase of a cottage property); and
2. Do not assume that a sale of your home will no longer trigger any tax compliance on your part. If you sold your home on or after January 1, 2016, you must report the sale and make the proper designation or the PRE will not be allowed.

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Forfeited CORPORATE PROPERTY: The New Ontario Act and How It Affects Your Corporation

ON DECEMBER 10, 2016, THE *Forfeited Corporate Property Act, 2015* ("FCPA"), came into force.

This legislation addresses what happens to forfeited corporate property once a corporation is dissolved. The introduction of the FCPA amended several other Ontario legislations that may impact a corporation's day-to-day reporting requirements and could have long-term consequences for corporations that are dissolved and not revived within a strict timeline.

Ongoing Reporting Requirement

The introduction of the FCPA had the effect of amending the *Ontario Business Corporations Act,* the *Corporations Act,* and the *Ontario Not-for-Profit Corporations Act*

(together, the "Corporate Acts") by introducing a requirement to maintain an updated register of the corporation's ***ownership interest in land*** at its registered office.

This register must identify each such ownership interest and show the date of acquisition and disposal, if applicable. In addition, the corporation has to keep the following with the property register:

- A copy of any deeds
- Transfers or similar documents that contain the municipal address
- The registry or land titles division
- The property identifier number
- The legal description
- The assessment roll number, if any

Additionally, while there is no definition of "ownership interest in land" available, there is some suggestion that it can be interpreted broadly to encompass both beneficial and legal ownership interest.

While these legislative amendments came into force on December 10, 2016, there is a grace period of two years before the requirement to prepare and maintain this register is enforced. It applies to corporations that were incorporated prior to December 10, 2016. All corporations incorporated after this date do not have this grace period. It is advisable, however, especially for corporations that have ownership interests in many properties, that these registers be prepared and maintained sooner than the two-year deadline, as it may take significant time to gather all of the required information.

Dissolution and How It May Affect Your Corporation

The new FCPA brings about a new way for the Crown to deal with forfeited corporate properties and sets out new timelines within which owners can revive corporations and recover their assets.

The Corporate Acts provide that in the event that a corporation is dissolved and the corporation is the owner of real property, such property is forfeited to the Crown. Until the introduction of the FCPA, the corporate owners had 20 years from the date of dissolution to revive the corporation and recover their assets.

With the introduction of the FCPA, the timelines have changed. While the dissolved corporation can still be revived within 20 years from dissolution, it will not recover its assets if the revival takes place more than three years after the date of dissolution, subject to some exceptions.

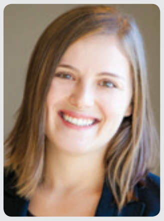
In addition to the forfeiture of real property, the FCPA also provides that any personal property left in, on, or under forfeited real property is also forfeited to the Crown, regardless of who owns the personal property.

After the three year deadline, the Crown can use the forfeited property for Crown purposes, dispose of it, and delete or amend any encumbrances registered against the property from title, in the case of real property, and under the *Personal Property Security Act,* in the case of personal property.

Conclusion

The enactment of the FCPA and the coming into force of the amendments to the Corporate Acts will place the onus on directors and officers of corporations to maintain updated property registers and will also make it more difficult to recover assets forfeited to the Crown in the event of dissolution. It is important and advisable that corporate owners come to terms with their new reporting requirements and take heed of the strict deadlines under the FCPA in the event the corporation is dissolved.

For further information please contact Ira Stuchberry at 416-369-4331 or at istuchberry@mindengross.com.



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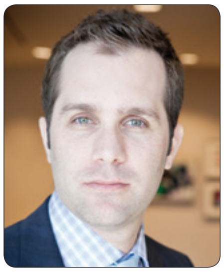
Firm News

Congratulations:

Minden Gross LLP is pleased to announce the admission to partnership of **Ryan Gelbart** and **Matthew Getzler.** **Ryan** has a broad corporate and commercial practice with a particular emphasis on commercial finance and private business transactions. **Matthew** focuses on domestic and international tax planning, primarily for owner-managers and other private corporations.


Ryan Gelbart


Matthew Getzler

Welcome:

Minden Gross LLP welcomes **Ethan Eisen** as an associate in our Commercial Real Estate Group and **Spencer Bailey** as an associate in our Business Law Group.


Ethan Eisen


Spencer Bailey

Professional Notes

Sasha Toten won the Women's Legal Mentorship Program Emerging Legal Leader Award in Ottawa on September 30, 2016.

Joan Jung was elected to the 2017 Board of Governors of the Canadian Tax Foundation at the 2016 Annual General Meeting and was appointed to the Executive Committee of the Board of Governors. Joan was a moderator for several presentations at the Ontario Tax Conference on October 24, 2016. Her article, "Mutual Will Challenge Upheld" was published in *STEP Inside*, October 2016.

The *2017 Lexpert/ALM Guide to the Leading 500 Lawyers in Canada* continues to recognize **Stephen Posen** and **Stephen Messinger** as the country's top practitioners in Property Leasing. In this edition, they co-authored "Property Leasing: Recent Developments of Importance", with the help of Student-at-Law, **Ladi Onayemi**.

Matt Maurer published six articles on *Slaw.ca*, including "Why Short-Sightedness May Cost Marijuana Dispensaries a Fortune" on January 3, 2017, with the help of Student-at-Law, **Whitney Abrams**. He published "No merit? No problem! Eviction order stayed during bogus appeal" on *REM Online* on October 25, 2016. *Homes of Muskoka* republished his article "Court of Appeal Clears Way for Mortgagees to Set Aside Sham Tenancies" on November 14, 2016, and on October 31, 2016, he was quoted in *Law Times* on negligent representation.

Samantha Prasad published three articles on *The Fund Library* including "Year-end tax tips for small business" on December 20, 2016. She received a Top Communicator Award from *Mondaq* on October 11, 2016. She also published two articles in *The TaxLetter* including November's "Trim Your Tax Bill - almost year end planning".

Arnie Herschorn was quoted in the "*Caveat emptor* reigns in real estate law" on October 31, 2016, in *Law Times*. *Law Times* also quoted him on a recent case relating to informing clients of environmental hazards on October 31, 2016.

Eric Hoffstein presented "Executor/Trustee *de son tort*: Recognizing and Avoiding the Traps of Unintended Fiduciary Obligations" at the Estates and Trusts Summit on November 4, 2016, with an accompanying article in *STEP Connection*. He led a workshop on Will Challenges at the CBA National Will, Estate & Trust Fundamentals for Estate Practitioners program on October 29, 2016.

Michael Goldberg hosted the second session of Tax Talk: Year 4 on November 16, 2016.

Hartley Nathan co-authored, with the assistance of **Ira Stuchberry**, the 11th edition of *Nathan's Company Meetings for Share Capital and Non-Share Capital Corporations*. They both presented at the ACC Seminar on the topic of "Corporate Governance Essentials for Corporate Counsel" on December 14, 2016.

Benjamin Bloom was quoted in "Hands on: Plex Cloud" in the October 11, 2016, edition of *Digital Trends*.

Irvin Schein published "Who Says You Can't Fight City Hall?" on irvinshein.com on October 7, 2016.

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Yosef Adler presented "Should I Say 'I do'? - The Corporate Marriage & Avoiding Shareholder Disputes" at the Schulich School of Business on November 3, 2016.

Minden Gross LLP acted for the underwriters in connection with a bought deal private placement that closed at $4,607,820 involving AcuityAds Holdings Inc. (TSXV: AT), a technology leader that provides targeted digital media advertising solutions, with a team that included **Andrew Elbaz** and **Sasha Toten**.

Steven Pearlstein spoke on "Special Considerations for Lenders" at the OBA Easements for Real Estate and Municipal Lawyers: Level II program on October 6, 2016.

The **Commercial Leasing Group** spoke at Dealing with the Lease: A State of The Art Update on November 16, 2016, led by **Stephen Messinger** with presentations by: **Stephen Posen, Michael Horowitz, Adam Perzow, Boris Zayachkowski, Cheryl Berger, Angela Mockford,** and **Benjamin Radcliffe**. The group also participated in ICSC Whistler held January 29-31, 2017.

Howard Black was part of a panel titled "Case Law and Potpourri of Trust Issues" at the STEP seminar on January 18, 2017.