Newsletter

LRK TAX

January 2023

IN THIS EDITION...

- **The New Underused Housing Tax Return Applicable to all Corporations Owning Canadian Real-Estate**
- **A New Minimum Tax for Wealthy Canadians Expected in 2023**
- **More Real-Estate Investors Are Hitting the Sell Button but Need to Watch Out for the New Anti-Flipping Tax**

The New Underused Housing Tax Return Applicable to all Corporations Owning Canadian Real-Estate

Thanusan Raveendran and Martin Lee, CPA, CA

Are you a corporation that owns Canadian real estate? If so, you may need to file a new tax return by **May 1, 2023**.

What is it?

If you own residential property, you should be aware of the newly proposed **Underused Housing Tax** ("**UHT** ") that took effect on January 1, 2022. The UHT is a national, annual 1% tax on the value of non-resident, non-Canadian-owned residential real estate that is vacant or underused. We published a more detailed article explaining the UHT here.

What if I am Canadian, do I still have to file?

The UHT tax usually affects non-Canadians and corporations with foreign ownership, however it is important to note that even if a corporation is entirely owned by Canadians, it must still file the UHT Tax Return if it owns residential property in Canada, even if it is not subject to the tax.

The Canada Revenue Agency (CRA) has made it clear that even if a corporation's ownership of a residential property is exempt from the underused housing tax, it still has to file a return (Form UHT-2900) for the residential property and indicate the applicable exemption in the tax return.

Massive penalties for not filing

Failing to file Form UHT-2900 on time could result in **minimum penalties of $10,000 for corporations**. These penalties can increase the longer the return is late.

Deadline coming up in April 2023

The **deadline to file your Annual Declaration for 2022 is April 30, 2023**. So, if you owned real estate in a corporation in 2022, reach out to your accountant immediately to ensure compliance with this new requirement.

A New Minimum Tax for Wealthy Canadians Expected in 2023

Thanusan Raveendran, CPA, CA

The sentiment that a country ought to "tax the rich" has been circulating for several years. With record levels of government spending, impending recession, inflation, an increase in immigration, and funding the Ukrainian war, the government needs more money. It seems like 2023 will be an opportune time for the Canadian government to introduce another round of tax on the "rich."

According to the federal government, "wealthy Canadians" pay comparatively little personal income tax as a share of their income. Therefore, as part of the 2022 fall economic statement, the liberal government reiterated their commitment to introducing a new minimum tax regime to ensure that all wealthy Canadians pay their "fair share" of tax.

What will this minimum tax for wealthy Canadians look like?

It is unclear exactly how the new minimum tax for wealthy Canadians will function. However, in their 2021 election platform, the Liberal government announced their intention to create a minimum tax rule so that everyone in the top tax bracket pays at least 15 % each year, removing their ability to artificially pay no tax through "excessive" use of deductions and credits.

The top federal tax bracket in 2023 is $235,675. Therefore, this minimum tax would likely apply to people earning more than $235,675 (or whatever the highest bracket in the year will be) before factoring in certain deductions. The minimum tax ensures that these taxpayers pay at least 15% in taxes (assuming this is the rate that the government will announce in Budget 2023). If they already pay a 15% tax, this minimum tax will likely not apply. If they don't – because of additional deductions or tax planning – the minimum tax is intended to apply.

Is this the right policy?

It is also unclear whether this minimum tax would exempt one-time transactions. For instance, many Canadians who would not consider themselves "wealthy" may have one year of high income. For instance, after decades of hard work and risk, they may have sold their business in the year or received a lump-sum pension. We think it would be unfair to levy this minimum tax in such cases, which could significantly affect peoples' retirement.

Moreover, the tax rules provide certain deductions and tax benefits for good reasons, such as encouraging investments in small businesses, hiring people, and taking on risks. By levying a minimum tax, it could undo these objectives. Even worse, it may cause entrepreneurs to rethink whether Canada is the right place for them. We think that rather than a blanket minimum "tax on the rich, " the government should look at the tax benefits more carefully and restrict them if they are worried people are inappropriately accessing them. We hope the government finds a way to exclude some tax benefits from the minimum tax to encourage entrepreneurs to invest in Canada while preserving the tax base.

What should I do now?

A minimum tax could significantly shut down the benefits of many tax strategies you have in place. Assuming this minimum tax is not grandfathered to start from 2023 onwards, it may be prudent to accelerate some tax planning involving deductions (i.e., the lifetime capital gains exemption, etc.). It would be best if you began conversations with your tax advisor in early 2023 to review your overall tax plan and see the potential impact of the minimum tax. For

instance, if you were planning on taking advantage of the lifetime capital gains exemption on selling your business or farm, a minimum tax could result in a significant amount of tax.

We expect details to emerge in the 2023 Federal Budget (around March to April 2023).

More Real-Estate Investors Are Hitting the Sell Button but Need to Watch Out for the New Anti-Flipping Tax

Thanusan Raveendran, Martin Lee, Mohammed Al-Khooly

With rising interest and energy costs, more real-estate investors are expected to sell in 2023. These investors need to watch out for the **Anti-Flipping Tax** that comes into effect on January 1, 2023.

The **Anti-Flipping Tax** is deeming rule that taxes profits from flipping residential real estate owned for less than 12 months as business income rather than capital gains. In Canada, capital gains are taxed favourably. Only 50% of the capital gains get included in taxable income and taxed.

With historically low mortgage interest rates in early 2022 and the red-hot real-estate market, many investors invested in residential rental properties, especially condos. If these investors are looking to sell their investments, they need to be careful of the Anti-Flipping Tax because they may not have held onto the property for over 12 months.

What is the new anti-flipping tax?

The anti-flipping rule applies to a housing unit in Canada owned by the taxpayer for less than 365 consecutive days before the sale (referred to as the "**Flipped Property**").

In such cases, the gain on the sale of the flipped property is treated as business income, not capital gain.

Application to assignment sales

The 2022 Fall Economic Statement proposed to extend this deeming rule to gains from the sale of the rights to purchase a residential property via an assignment sale. Profits arising from an assignment sale would be deemed to be business income if the rights to purchase a property were assigned after having been owned for less than 12 months.

The 12-month holding period will reset once the taxpayer owns the property subject to the purchase and sale agreement. This will ensure that taxpayers cannot bypass the anti-flipping tax when selling a constructed property simply because a taxpayer held the rights to purchase the property before it was constructed. In other words, the 12-month holding period would reset once a taxpayer secures ownership of the property.

Investors who signed onto pre-construction projects in 2023 may look to assign the agreement to purchase to someone else. The anti-flipping rule also applies to these arrangements.

There are exemptions

The anti-flipping rule does not apply where a taxpayer was required to sell due to, or in anticipation, of one or more of the following events:

- Death of the taxpayer or a person related to the taxpayer
- Related person(s) became a member of the taxpayer's household, or the taxpayer became a member of a relayed person
- Breakdown of marriage or common-law partnership if the taxpayer has been living separate and apart for at least 90 days before the sale
- Threats to personal safety
- Serious illness or disability
- Relocation to be 40 KM closer to work (employment or business) or to study at a post-secondary institution.

- Involuntary termination of employment of the taxpayer or spouse/common-law partner
- Insolvency
- Destruction or expropriation

Cannot claim losses on a Flipped Property

With the real estate market declining, some investors may suffer a loss. However, the Anti-Flipping Tax does not allow you to claim a business loss on a Flipped Property. The loss would be treated as a capital loss instead, meaning you only get to deduct 50% of the loss and only against other sources of capital gains.

What does this mean for investors?

With the Anti-Flipping Tax coming into effect in 2023, Investors looking to sell could end up with an unexpected tax bill. Holding onto the property for at least 365 days before selling may be prudent. However, we advise you to consult with your tax advisor as, in some cases, your gain may still be treated as business income, even if you held onto it for 365 days.

Strategies

Our next newsletter will cover strategies where the Anti-Flipping Tax may work in your favour.