



# Rental Property Investment by Non-Residents of Canada

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Investing in Canadian real property, particularly vacation properties, is becoming increasingly popular with non-resident investors. Unfortunately, the Canadian tax consequences of investing in Canadian real property by a non-resident of Canada can be quite confusing. Since non-compliance with the Canadian income tax rules, particularly the withholding tax rules, and the Goods and Services Tax (“GST”) rules, can result in significant penalties, the potential investor should be aware of how these rules work prior to investing.

This letter is intended to provide a brief summary of the rules that the foreign investor should be aware of at the time of investing in Canadian real property. This letter is not intended to be a complete summary of the Canadian tax laws with respect to a particular situation. Rather, it is intended to provide a brief introduction of the rules to a potential investor. Each investor should consult directly with their own professional tax advisor to determine the exact consequences of their particular investment situation.

## Taxation of Non-Residents

If you are a non-resident of Canada you may be subject to Canadian income taxes if you:

- Receive rent from Canadian real estate; or
- Dispose of Canadian real estate.

Although you may be subject to Canadian income taxes as a result of receiving other income items, or carrying on other activities in Canada, these are beyond the scope of this letter.

## Canadian Tax Rates

If you are a non-resident of Canada and you have taxable income in Canada (i.e. income resulting from those activities listed previously) you will be required to pay Canadian income tax on this income. Based on income tax rates in effect on January 1, 2007, a non-resident of Canada will be required to pay a maximum tax in Canada of 23% on the first \$37,178 of taxable income for the year. This tax may be reduced by the income tax treaty between Canada and your country of residence.

## Rental Property Compliance Rules

In order to ensure that non-residents of Canada comply with the Canadian income tax laws, there is a complicated system of rules involving both the non-resident and the agent, if any exists, for the non-resident. For Canadian rental property, this compliance system includes rules with respect to withholding taxes, NR6 forms, NR4 forms and Section 216 returns.

### *Withholding taxes*

Rents paid to non-residents are subject to a 25% withholding tax on the “gross rents”, which is required to be withheld and remitted to Canada Revenue Agency (“CRA”) by the payer (i.e. the Canadian agent of the non-resident, or if there is no agent, the renter of the property) each time rental receipts are paid or credited to the account of the non-resident by the payer.

If the payer does not remit the required withholding taxes by the 15<sup>th</sup> day following the month of payment to the non-



resident, the payer will be subject to penalties and interest on the unpaid amounts.

### ***NR6 Forms***

The requirement to withhold tax on the gross rents can be waived or reduced if the non-resident selects a Canadian agent to act on their behalf and an NR6 Form is filed and approved by CRA annually and signed by both the non-resident and the agent. The NR6 Form is used to estimate the “net rental income” (see subsequent discussion) that is expected to be received during the current taxation year. If the net rental income is in a loss position and CRA approves the NR6 Form then there may be no withholding requirement for the current year. If the net rental is not in a loss position, then the 25% withholding tax may be calculated on the “**net rental income**” amount and remitted as rent is received.

An NR6 Form must be filed and approved for each taxation year before the first rent payment is received. In most cases, when income is being received throughout the year, the NR6 must be filed before January 1<sup>st</sup> of that year.

Any tax that is withheld can be claimed as a credit against taxes payable when filing your Section 216 personal tax return for the year (see below). If the amount withheld exceeds the income taxes otherwise payable, CRA will issue you a refund of the difference.

### ***NR4 Forms***

An NR4 Information Return must be filed by March 31<sup>st</sup> summarizing the amount of rents paid or credited to you by your Canadian agent, as well as the amount of withholding taxes, if any, paid to CRA on your behalf by your agent.

Although the Canadian agent is required to file this form, it is often prepared by the non-resident’s Canadian accountant, and then signed by the agent, to ensure that all of the Canadian tax rules are complied with on behalf of the non-resident.

### ***Section 216 Return***

A Canadian income tax return must be filed by June 30 in respect of the preceding calendar year. This income tax return is pursuant to Section 216 of the Canadian Income Tax Act and will only include the income and expenses relating to the rental property.

In determining the net rental income to be reported in the Section 216, the expenses relating to the rental property may include the following:

- Advertising
- Insurance
- Interest on mortgages obtained to finance the acquisition of the rental property
- Repairs and maintenance
- Management and administrative fees and commissions
- Annual accounting fees
- Property taxes
- Utilities

In addition, if the net result is income, you may claim depreciation on the rental building as well as furniture and equipment included in the rental property. Since claiming depreciation may result in a larger gain on the eventual sale of the property, you should consult your personal tax advisor on whether or not to claim depreciation on the property in determining your net rental income.

If you not only own the rental property for investment purposes but also use the rental property for personal vacation purposes, a reasonable estimate of the personal-use portion of the expenses related to the property should be determined. This personal portion of the property expenses should be deducted from the total expenses, with only the net amount being deducted from rental income in determining net rental income.

## **Foreign Bank Loans**

The interest payable on a bank loan obtained to finance the purchase of the rental property should be deductible in determining your net rental income in Canada, whether the loan is provided by a Canadian bank or a foreign bank. However, if the loan is provided by a foreign bank and secured by the Canadian rental property, Canadian withholding taxes will likely be payable with respect to the interest payable to the foreign bank. You should therefore consult with a Canadian tax advisor prior to arranging a foreign bank loan to purchase a Canadian rental property.

## GST and Rental Properties

The GST is a value-added tax, payable at the rate of 6% on certain sales and supplies in Canada. The following is a brief explanation of certain GST considerations with respect to rental properties owned by non-residents of Canada. It is not intended to be a complete explanation of the GST compliance rules, and specifically does not address periodic GST return filing, instalments, input tax credits claimable in reducing GST payable. If an individual decides to register for GST, these matters should be discussed with the non-resident's professional tax consultant.

Short-term residential rentals (i.e. rentals for personal accommodation for periods of less than 1 month at a time) are subject to GST. Generally, this means that rental of a skiing cabin or condominium for one week during the winter may be subject to GST, whereas the rental of the same property for three months during the summer will not be subject to GST.

However, if the owner of the property receives less than \$30,000 of GST taxable revenues during a year, they may choose not to register for GST. In this case, the renter would not be required to pay GST on the property and the non-resident will not be required to file GST returns, remit GST, etc.

### *GST on Purchase of Property*

GST may be payable on the purchase of a particular property. Whether or not GST will be payable on the property will be dependent on, among other things, whether or not the vendor of the property is a GST registrant and the use of the property prior to its purchase.

If GST is payable on the acquisition of the property, you may be able to avoid or reduce payment of the GST on the purchase, depending on your intended use of the property. If your intention is to acquire the property to be used primarily (i.e. more than 50%) for short-term rental, you may be eligible to register for GST. If you are registered for GST prior to the acquisition of the property, depending on the particular property, you may be able to avoid the cash-flow issues related to paying GST to the vendor on the purchase of the property and then claiming this GST back as an input tax credit on your next GST return.

Although you may be able to avoid paying the GST on the purchase of the property by registering for GST, if your short-term rental use does not exceed 90%, you will be required to self-assess a portion of the avoided GST and remit this directly to CRA. For instance, if you avoid GST on purchase of the property by registering for GST, but you expect your personal use of the property to be 20%, then you can avoid payment of the GST to the vendor, but will be required to pay 20% of the avoided GST directly to CRA. As well, if your personal use changes in the future, you may be required to self-assess and pay additional GST to CRA. The detailed rules related to the self-assessment of GST are complex and you should consult with your tax advisor.

If you register for GST to avoid the payment of GST on the purchase of the property, in addition to the potential self-assessment of GST explained above you will be required to:

- Collect GST on all short-term rental contracts;
- File an annual GST return (due March 31st) reporting the net GST payable for the prior calendar year;
- Remit the net GST amount to CRA (with the GST return for the first year, and possibly by quarterly instalments in future years); and
- Charge GST on the eventual sale of the property.

## Disposition of Real Property

A non-resident of Canada is subject to Canadian income tax on dispositions of Canadian real property.

### *Withholding Taxes*

In order to ensure that the non-resident complies with the Canadian tax rules on the sale of property, the purchaser of the property is required to withhold a portion of the vendor's proceeds and remit this to CRA on behalf of the non-resident vendor. As explained below, the requirement to withhold a portion of the proceeds can be avoided if certain clearance certificates are provided by CRA, either reducing or eliminating the withholding taxes to be remitted by the purchaser.

In general, the purchaser is required to withhold 25% of the gross proceeds related to the disposition of land and 50% of the gross proceeds related to the disposition of buildings.



In order to reduce, or eliminate, the required withholding taxes, the non-resident can file certain forms with CRA in order to request clearance certificates from CRA that provide for a lower withholding tax amount. If approved, the withholding taxes related to the land disposition can be reduced to 25% of the difference between the gross proceeds and the cost of the land. In addition, the withholding taxes related to the building disposition can be reduced to a percentage of the difference between the gross proceeds and the undepreciated capital cost of the building. The percentage related to the building may differ depending on the amount of the difference.

Once CRA issues the requested clearance certificates, the purchaser will only be required to remit the amount stated by CRA.

### ***Income Tax Return Reporting***

The non-resident will also be required to file a special Canadian personal income tax return by June 30<sup>th</sup> of the year following the disposition of the real property. In this return, the non-resident would report the actual gains or losses on the sale. In calculating the gain or loss on the property, the non-resident will be able to claim the real estate commissions and legal fees as a deduction in determining the net proceeds of the sale.

Generally, the actual income taxes payable with respect to the sale of the property will be less than the withholding taxes remitted on the sale of the property. As a result, the non-resident will generally receive a refund of a portion of the withholding taxes that were originally remitted to CRA.

## **Books and Records**

It is important to keep records of all transactions related to your real property. These records should include a summary of all transactions as well as original documents to support those transactions. It is especially important that documents substantiating the original cost of the real property, as well as the cost of all improvements and/or additions to the land, building, furniture and equipment should be retained to

substantiate these costs at the time of reporting the gain or loss on the sale of the property.

## **We Can Help**

For more information on the tax consequences of investing in real property in Canada, or to engage us to assist in any of the Canadian tax compliance matters outlined in this letter, contact a KPMG tax advisor.

In the Okanagan-South Thompson region the following individuals can be contacted for more information:

### **Kamloops:**

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