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TaxNewsFlash Canada

Real Estate Industry — Prepare for 2016 Federal Budget Measures

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Entities in the real estate sector may want to start preparing for the effect of certain GST/HST tax changes proposed in the 2016 federal budget. Specifically, the budget proposes measures for:

- Reporting grandparented housing sales
- GST/HST *de minimis* financial institution rules — Interest from GICs or deposits
- The closely related test for GST/HST elections.

As well, the budget indicates that the government will not proceed with proposed measures affecting the donation of real estate or make changes to the rules on determining whether certain income from property should qualify as active business income.

Background

Finance Minister Bill Morneau delivered the government's 2016 federal budget on March 22, 2016. For full details of the budget, see *TaxNewsFlash-Canada* 2016-12, "2016 Federal Budget Highlights".

Reporting grandparented housing sales

The budget includes measures affecting the special reporting requirements for builders that sold newly constructed homes or substantially renovated homes (including condominiums) that were grandparented from HST rate increases or the introduction of HST in provinces since 2010.

The budget proposes to simplify the reporting requirements by limiting the reporting to those grandparented housing sales for which the consideration is equal to or greater than $450,000. The budget also proposes to allow builders to correct past misreporting and avoid potential

penalties by electing to report all past grandparented housing sales for which the consideration was equal to or greater than $450,000. This measure will apply for any reporting period of a person that ends after March 22, 2016. In addition, where builders make this election, the measure will also apply to any supply of grandparented housing for which the federal component of the HST became payable on or after July 1, 2010. Builders can generally make the election between May 1, 2016 and December 31, 2016.

KPMG observations

This budget measure affects reporting requirements and not HST remittance amounts. Because the penalties for not reporting or misreporting certain grandparented housing sales are significant, builders in provinces which either increased the HST rate or introduced the HST since 2010 should review the amounts reported in Schedules A – Builders Transitional Information to their electronically filed GST/HST returns to determine if there were any errors or omissions. Where there are errors or omissions, builders should consider electing to re-report before the end of 2016.

Under the transitional rules that applied when a province either joined the HST since 2010 or increased its HST rate, certain sales of newly constructed or substantially renovated homes were grandparented for HST purposes. This meant that the housing sale was not subject to the provincial component of the HST or the increased HST rate. A housing sale was generally grandparented if the agreement of purchase and sale was entered into in writing on or before the date the transitional rules were announced, and ownership and possession of the housing was transferred on or after the date on which the HST (or the increased HST rate) came into effect.

GST/HST *de minimis* financial institution rules — Interest from GICs or deposits

Based on the CRA's interpretation, interest from GICs and deposits are considered interest from the lending of money and therefore can cause an entity in the real estate sector making these types of deposits to be considered a *de minimis* financial institution under the GST/HST rules.

The determination of an entity's status under the *de minimis* financial institution rules is based on whether the entity has more than $1 million of interest income, separate fees or charges from financial services in the preceding taxation year.

The budget proposes to exclude interest for demand deposits, term deposits and guaranteed investment certificates (GICs) with an original due date to maturity not exceeding 364 days. The measures also provide rules for determining the 364 day limit where there is a right to withdraw, reinvest or extend the term of the deposit.

Under the coming into force provision, the new exclusion will generally apply to taxation years of an entity that begins on or after March 22, 2016. For 2017, some entities will no longer be financial institutions and will need to consider the potential benefits or drawbacks of a change in this status.

However, for purposes of determining only if the entity is required to file the GST/HST Annual Information Return (AIR), the new measure applies to the fiscal year that begins before March 22, 2016 and ends on or after March 22, 2016.

The closely related test for GST/HST elections

The budget proposes a new condition under the closely related test that may affect businesses in the real estate sector. This change will affect corporations with section 150 or 156 elections in place where there may be different voting rights for different categories of shares and a new measure in cases where another person (other than the owner of the share) may control the voting rights attached to shares.

This budget measure proposes an additional test for the closely related group election where the other corporation must hold "qualifying voting control". To meet this new test, the other corporation must generally own shares of the corporation to which are attached at least 90% of shareholder votes that may be cast in respect of each corporate matter (some exclusions apply).

The budget also proposes that, in some cases, a person will be deemed not to own a share where another person has a right under a contract, in equity or otherwise to control the voting rights attached to the share. Based on the new test and/or the new deeming provision, some entities may no longer be members of a closely related group.

For new section 150 or 156 elections, the new measure will apply to elections filed after March 22, 2016 and that are to be effective after that day. For previously filed elections, the new measure will generally apply the day that is one year after March 22, 2016 with some exceptions.

KPMG observations

As a result of this measure, corporations with section 150 or 156 elections should:

- Review previously filed closely related group elections to determine if all corporations meet the new "qualifying voting control" test
- Determine if the new deeming provision will apply and disqualify members from a previously filed election
- Determine the effect of an entity being required to charge GST/HST on certain supplies
- Where a section 150 election is no longer valid, determine the effect of no longer being a listed financial institution (e.g., review rules related to annual information returns, allocation between exempt and capital activities, self-assessment requirements, change-of-use rules).

Donation of real estate

The budget states that the government has withdrawn the proposed 2015 federal budget measure to provide that certain donations of cash proceeds from the disposition of real estate to a registered charity (or other qualified donee) would be exempt from capital gains tax. This measure also would have applied to private corporation shares.

KPMG observations

The proposed exemption from capital gains tax would have been available where certain conditions were satisfied, including that the cash proceeds from the disposition were donated to a registered charity or other qualified donee within 30 days after the disposition.

Active vs. investment business rules

The budget announced that the government is not proposing to modify the tax rules that determine whether income from business, the principal purpose of which is to earn income from property, should qualify as active business income.

KPMG observations

The small business deduction (SBD) is available on up to $500,000 of active business income of a Canadian-controlled private corporation. Active business income does not include income from a "specified investment business", which is generally a business the principal purpose of which is to derive income from property. A "specified investment business" does not include a business that has more than five full-time employees. As a result, income earned from a business with more than five full-time employees is eligible for the SBD even though its principal purpose is to derive income from property.

Certain real-estate related businesses, such as self-storage facilities and campgrounds that may operate with fewer than five full-time employees, have expressed concerns about the limitations of the "specified investment business" rules. The 2015 budget announced that the government would review the circumstances in which income from a business, the principal purpose of which is to earn income from property, should qualify as active business income and thus be eligible for the SBD.

Possible future changes

The budget did not include measures that were previously indicated as being under consideration, including:

- Changes resulting from the government's review of the joint venture rules for GST/HST purposes (although the budget did indicate that it will proceed with this measure)
- Measures to remove GST from capital expenditures by builders of affordable rental housing (e.g., through an expanded rebate).

We will continue to monitor future Finance communications for announcements about these and other GST/HST proposals impacting the real estate sector.

We can help

Your KPMG adviser can help you assess the effect of the tax changes in this year's federal budget on entities in the real estate sector. We can also keep you abreast of the progress of these proposals as they make their way into law.

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