Tax Insights: The underused housing tax – A new compliance requirement for many owners of Canadian residential property

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April 5, 2023 update: *On March 27, 2023, the Canada Revenue Agency (CRA) announced that the application of penalties and interest under the federal* Underused Housing Tax Act *for the 2022 calendar year will be waived for any late-filed underused housing tax (UHT) returns and for any late-paid UHT, provided the return is filed or the UHT is paid by October 31, 2023. This transitional relief effectively extends the deadline for the UHT return and UHT payment by six months to October 31, 2023.*

In a further UHT development, the CRA's GST/HST Rulings Directorate issued a technical interpretation to the Canadian Home Builders Association, dated March 10, 2023, which clarifies that:

- *a property becomes "residential property" for UHT purposes when its construction is substantially completed (generally, 90% or more), so that it could be reasonably inhabited*
- *a builder/owner is not required to file a UHT return for a calendar year in respect of a property if its construction was not substantially completed on December 31 of the year*
- *a condominium complex does not have to be registered as such for its units to be regarded as "residential property" for UHT purposes, but an individual unit does have to be substantially completed by December 31 to require the builder/owner to file a UHT return in respect of the unit for that year*
- *a property's assessed value and most recent sale price do not have to be reported on a UHT return ("$0" can be entered on lines 280 and 285) if: (i) no tax is payable in respect of the property, due to an available exemption; and (ii) the UHT return is filed by December 31 of the following calendar year*

The remainder of this Tax Insights *was published on February 10, 2023. It has not been altered to reflect the March 27, 2023 CRA announcement or the March 10, 2023 technical interpretation.*

In brief

The federal *Underused Housing Tax Act* (UHTA) became effective January 1, 2022. As a result, a significant number of Canadian residential property owners will be required to file their first annual underused housing tax (UHT) information return in respect of their property by May 1, 2023, or face minimum penalties of $5,000 for individuals or $10,000 for corporations – even if no tax is payable.

The 2021 and 2022 federal budgets described the UHT as a 1% annual tax on the value of vacant or underused Canadian residential property held by certain non-Canadian owners. However, unless the owner is an "excluded owner," various Canadian owners will have a filing obligation, including corporations that are not publicly traded and certain trustees and partners – even in situations when the UHT is not payable. Accordingly, both Canadians and non-Canadians will be impacted.

This *Tax Insights* provides details of this new compliance requirement and the steps that owners of residential property need to consider.

In detail

Overview of the UHT framework

The UHT is payable each calendar year by the "owner" of a "residential property" in Canada as at December 31, if the owner is:

- not an "excluded owner" for the calendar year, and
- ineligible to claim an exemption in respect of their interest in the property for that calendar year

Individuals who are a Canadian citizen or permanent resident are generally an "excluded owner," as are (i) publicly traded corporations that are incorporated under the laws of Canada or a province (but not any unlisted subsidiaries); and (ii) trustees of a mutual fund trust, real estate investment trust (REIT) or specified investment flow-through (SIFT) trust, as defined in the *Income Tax Act*, who hold legal title to property on behalf of the trust. "Residential property" is generally defined to include (i) a detached house or similar building that does not contain more than three dwelling units; and (ii) the part of a building that is a semi-detached house, residential condominium unit or similar premises. Accordingly, most apartment buildings would not be considered a "residential property" unless the units in the apartment building are condominiums. For more information, see "Residential property" and "Excluded owner" below.

The UHT is 1% of the "taxable value" (or the fair market value, as described below) of the property multiplied by the owner's "ownership percentage." The UHT payable for a calendar year is due by April 30 of the following year (the UHT relating to a property for 2022 must be paid by May 1, 2023, because April 30 falls on a Sunday).

The "taxable value" of a property for a calendar year is the greater of:

- the assessed value of the property for local property taxation purposes for that year
- the property's most recent sale price on or before December 31 of that year

Alternatively, an owner can elect to use the fair market value of the property, based on a written appraisal by an arm's length accredited real estate appraiser as of any date between January 1 of the year to April 30 of the following year.

Annual mandatory filing requirement by certain residential property owners

A person must file a UHT return for a calendar year if, on December 31:

- the property is a "residential property," and
- the person is an "owner" of the residential property and is not an "excluded owner"

If the above criteria are met, the person (an "affected owner" as described by the Canada Revenue Agency (CRA)) will need to file the UHT return (**Form UHT-2900**)[1] by April 30 of the following year (a UHT return relating to a property for 2022 must be filed by May 1, 2023, as April 30 falls on a Sunday).

Failure to file the return on time can result in a penalty equal to the greater of:

- $5,000 for individuals and $10,000 for corporations
- 5% of the tax plus 3% per complete month that the return is late

If the UHT return for a year is filed after December 31 of the following year, certain exemptions based on the property (see below under "UHT exemptions") are not available for purposes of calculating penalties. If the UHT return is never filed, the CRA will be able to assess the owner of the residential property at any time in the future (i.e. the assessment of the UHT will not become statute-barred).

PwC observes

The penalties for failing to file the UHT return by the due date can be significant, even if no tax is payable. For example, condominium developers with completed, but unsold, units in inventory (or with units retained for rental) could face penalties of $10,000 per unit for late filing. The April 30 filing due date for the UHT return does not always coincide with the due date for other tax returns associated with a property, which can increase the risk of an affected owner (e.g. a trustee or partner) missing the deadline.

"Residential property"

A "residential property" is defined as property in Canada that is:

- a detached house or similar, containing not more than three "dwelling units," that is used as a place of residence for individuals
- a part of a building, including a semi-detached house, rowhouse unit, residential condominium unit or other similar premises, that is used as a place of residence for individuals
- a prescribed property (not yet defined)

A "dwelling unit" is defined as a "residential unit that contains private kitchen facilities, a private bath and a private living area."

PwC observes

A residential rental property with more than three dwelling units that is owned as a single parcel of real property (e.g. an apartment building or senior's housing residence) should not be a residential property subject to the UHT. However, multiple residential units within the same building, each held under separate title, would be considered separate residential properties. For example, two or more individual condominium units within a single building owned by the same owner could require a UHT return filing for each separate unit.

"Owner"

An "owner" is defined as a person that is:

- identified as an owner under a land registration system or similar system
- a life tenant under a life estate in the residential property
- a life lease holder of the residential property

- a lessee who has continuous possession of the land, on which the residential property is situated, under a long-term lease (having a term of 20 years or more, or containing a purchase option), or
- a prescribed person (not yet defined),

but does not include a person that gives continuous possession of the land on which the residential property is situated to either:

- a life lease holder of the residential property
- a lessee under a long-term lease

An owner's "ownership percentage" is 100% if the property has a single owner. Otherwise, it is the percentage equal to 100% divided by the number of owners (or, if different, the owner's percentage interest as specified under the relevant land registration or similar system where the property is located – for example, this could apply to tenancy-in-common).

PwC observes

As neither a trust nor a partnership (created under common law) can hold the legal title to a residential property in Canada, these entities cannot be considered to be the owner of a property and will therefore not have a UHT filing requirement.[2] Instead, a trustee or partner holding legal title to the property could have the filing requirement. Generally, an "owner" of a property for UHT purposes is typically a person holding legal title, and may not be the beneficial owner, who generally reports the property ownership for income tax purposes. For example, a residential property held by a family trust, with three trustees each listed on the legal title, will be considered to have three owners (the three trustees), and each will have a separate UHT filing obligation in respect of their one-third legal ownership percentage in that trust property. Similarly, for a residential property with title held by a bare trustee corporation on behalf of the beneficial owner, the corporate trustee will be considered the owner and will be required to file a UHT return.

"Excluded owner"

An "excluded owner" includes:

- an individual who is a Canadian citizen or a permanent resident of Canada, except for an individual who holds an interest in property:
  - as a partner of a partnership, or
  - as a trustee of a trust, but not including a personal representative of a deceased individual
- a corporation incorporated in Canada and the shares of which are listed on a Canadian stock exchange
- a person that is an owner of the residential property in their capacity as a trustee of a mutual fund trust, a REIT or a SIFT trust
- a registered charity or a cooperative housing corporation
- the Canadian, provincial or territorial governments, or their agents, a municipality, an Indigenous governing body and certain other public service bodies
- a prescribed person (not yet defined)

PwC observes

In most cases, a UHT filing obligation will arise when property is held for a trust or partnership, because the registered owner will be holding the property as a trustee and therefore, will not be an excluded owner. A corporation that is an owner of residential property will generally also have a filing obligation.

UHT exemptions

Affected owners can be exempt from paying the UHT for a year, based on either their ownership or the use or nature of the property. The exemptions related to ownership depend on whether the owner can be considered sufficiently Canadian, or whether the circumstances under which they became an owner justify an exemption; whereas, the exemptions related to the property attempt to relieve situations where the property can be considered to not be vacant or underused. The CRA has provided guidance on their administrative approach to these exemptions, through a series of **Underused housing tax notices**.[3]

Exemptions based on ownership

An affected owner can be exempt from paying UHT in respect of a property for a year if they:

- on December 31:
  - hold the property solely in their capacity as a partner of a “specified Canadian partnership” (a partnership, every member of which is an excluded owner (with a modified test) or a specified Canadian corporation)
  - hold the property solely in their capacity as a trustee of a “specified Canadian trust” (a trust in which every person with a beneficial interest in the property under the trust is an excluded owner or a specified Canadian corporation)
  - are a “specified Canadian corporation,” a corporation incorporated or continued under the laws of Canada or a province, that is not:
    - a corporation in which one or more foreign entities (i.e. any individual, that is neither a Canadian citizen nor a permanent resident of Canada, or a corporation that is incorporated outside Canada) together has ownership or control, directly or indirectly, of shares of the corporation representing 10% or more of the corporation’s voting rights or the value of its equity, or
    - a corporation without share capital in which the chairperson or other presiding officer, or 10% or more of the directors or other similar officers, are individuals that are neither Canadian citizens nor permanent residents of Canada
  - are the personal representative of a deceased individual who was an owner of the residential property during the year or the previous year, and were not an owner of the residential property in either of those years, except as the personal representative of the deceased individual
- became an owner in the year, and they were never an owner in the previous nine years
- died in the year or the prior year
- owned the residential property with an individual who was also an owner of the residential property on the day the individual died in the year or the previous year, and the deceased individual's ownership percentage at the time of death was at least 25%

PwC observes

The threshold for a partnership or trust to be a specified Canadian entity is strict; if a non-Canadian has a direct interest (even less than 1%), the entity cannot be a specified entity. However, as the specified Canadian corporation definition allows up to a 9.99% voting or equity interest to be held by a non-Canadian, a non-Canadian can, within this limit, have an indirect interest in a specified Canadian partnership or trust through a specified Canadian corporation without tainting the partnership or trust. There are, however, no specific rules or guidance as to how indirect ownership of shares of a corporation will be determined, for purposes of the specified Canadian corporation definition (or, for that matter, whether "ownership" can include either legal or beneficial ownership). For example, it is not clear what portion (if any) of the shares of a Canadian private corporation held by a discretionary trust with Canadian individual trustees might be considered to be owned indirectly by non-Canadian beneficiaries of the trust.

Exemptions based on the property

An affected owner can be exempt from paying UHT in respect of a property for a year, if:

- the property is the primary place of residence of the owner, or certain members of the owner's family (with a more restrictive test)
- a dwelling unit that is part of the residential property was used for "qualifying occupancy periods," which in aggregate total at least 180 days in the year. A qualifying occupancy period includes a period of at least one month for which:
  - an individual who deals at arm's length was given continuous occupancy under an agreement evidenced in writing
  - an individual who does not deal at arm's length was given continuous occupancy under an agreement evidenced in writing, for consideration not below "fair rent" (defined to be 5% of the taxable value)
  - the owner, their spouse or common-law partner, has continuous occupancy for the purpose of pursuing authorized work under a Canadian work permit, or
  - the owner, their spouse, common-law partner, parent or child, who is a Canadian citizen or permanent resident of Canada, has continued occupancy
- construction of the residential property is not substantially completed before April of the year
- construction of the residential property is substantially completed in January, February or March of the year, the residential property was offered for sale to the public during the year and it had never been occupied by an individual as a place of residence or lodging during the year
- a dwelling unit that is part of the residential property was uninhabitable for at least 120 consecutive days in the year due to renovations, any work in relation to the renovations is carried on without unreasonable delay, and this exemption did not apply for any of the nine previous years
- the property is not suitable for year-round use as a place of residence
- the property is seasonally inaccessible, because public access is not maintained year-round
- the residential property is uninhabitable for a period of at least 60 consecutive days in the year as a result of a disaster or hazardous condition caused by circumstances beyond the reasonable control of an owner and this exemption did not apply in respect of the same disaster or hazardous condition for more than one prior year
- the residential property is located in an eligible area (**which may be determined through an online CRA tool**)[4] and the owner, or their spouse or common-law partner resides in the property for at least 28 days in the year (referred to as the vacation property exemption)

PwC observes

When a corporation is the owner of the residential property, the tests related to the owner's use do not appear available (such as the primary place of residence exemption or the vacation property exemption). The test for "qualifying occupancy" requires a minimum occupancy period of one month in a calendar year, such that a property used exclusively for short-term rentals, which are never more than four weeks at a time, cannot meet the qualifying occupancy period test.

Filing the UHT return

If a UHT return is required in respect of a residential property by an owner (because the owner is not an excluded owner for the year), the following information must be provided, irrespective of whether an exemption applies:

- owner's legal name and type of owner
- owner's social insurance number (SIN), individual tax number (ITN) or business number (BN-RU)
- property address
- property identification used in the land registration system
- property tax or assessment roll number (if applicable)
- residential property type
- year the person became an owner of the property
- owner's percentage interest in the property and, if it is less than 100%, the form of ownership and names of other owners with a 10% or greater ownership percentage
- assessed value of the property
- most recent sale price of the property on or before December 31

If an exemption from the tax applies, that exemption must be identified on the return.

PwC observes

Non-resident individuals and corporations without an ITN or BN-RU should request the applicable identification number from the CRA as soon as possible, to avoid processing delays when the UHT return is filed. Note that corporations that already have a CRA business number will still need to request a BN-RU from the CRA, because this is specific to the UHT. The UHT return requires information to be provided to the CRA (even if the property is exempt from UHT) that could be time-consuming to compile, so owners should consider initiating the information-gathering process now.

Other noteworthy items

Certificates of compliance

An application by a non-resident of Canada for a certificate of compliance under section 116 of the *Income Tax Act* relating to the disposition of Canadian residential property will automatically trigger a UHT compliance review by the CRA. The CRA will not issue a certificate of compliance to an applicant until it is satisfied that the applicant has complied with its obligations under the UHT.

PwC observes

It is unclear how the section 116 requirements might apply in respect of a disposition of a beneficial interest in a property in a transaction where the legal ownership of the property does not change, such as where title is held by a bare trustee corporation and the corporation is sold to the purchaser as part of the same transaction. In that case, the non-resident property vendor (the beneficial owner) that is required to obtain the certificate of compliance under section 116 will not have had any UHT obligations in respect of the property.

Similar vacancy-related taxes

The UHT is a federal tax, but it is not the only vacancy tax of its kind in Canada; British Columbia has a speculation and vacancy tax, and the municipalities of Vancouver, Toronto and Ottawa have their own empty home or vacancy taxes. While the federal UHT targets non-Canadians, the municipal taxes currently enacted apply to all owners and provide no exclusion or exemption specific to Canadians. Other municipalities that are considering the introduction of similar taxes include Hamilton (proposed to be effective January 1, 2023, with the first filing due in 2024), Peel, Halton, York, Windsor and Durham.

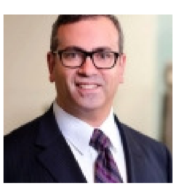
The takeaway

The federal government introduced the UHT with the stated aim of helping to address the housing crisis in Canada and make home ownership more affordable for Canadian citizens and permanent residents. However, the UHTA results in many residential property owners in Canada, including many corporations, trustees and certain partners, being subject to mandatory annual reporting requirements, even if they are exempt from paying the UHT. Owners of residential properties, and especially those that will have reporting requirements, should be aware of the UHT framework and how it may impact them.

1. CRA, **UHT-2900** “Underused Housing Tax Return and Election Form” at **www.canada.ca/en/revenue-agency/services/forms-publications/forms.html**.
2. The UHT filing and payment obligations in respect of a residential property of a partnership in Québec, where title of the property is registered in the name of the partnership (as allowed under the *Civil Code of Québec*) are currently unclear as neither the UHTA nor CRA have directly addressed this situation.
3. CRA, **Underused housing tax notices** (February 7, 2023) at **www.canada.ca/en/services/taxes/excise-taxes-duties-and-levies/underused-housing-tax.html**.
4. CRA, **Underused housing tax vacation property designation tool** at **www.canada.ca/en/services/taxes/excise-taxes-duties-and-levies/underused-housing-tax.html**.

Contact us

Ken Griffin
Partner, PwC Canada
Tel: +1 416 815 5211
Email



Fred Cassano
Partner, National Real Estate Tax Leader, PwC Canada
Tel: +1 905 418 3469
Email

Brent Murray
Partner, PwC Law LLP
Tel: +1 416 947 8960
Email

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