TOP 10 TAX PRINCIPLES

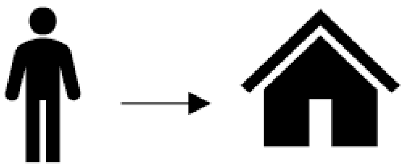
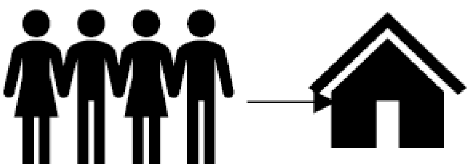
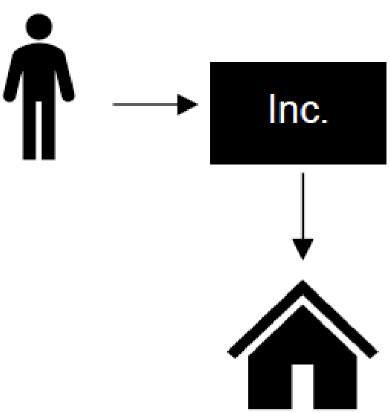
FOR THE ADVANCED CANADIAN REAL ESTATE INVESTOR IN 2024

TABLE OF CONTENTS

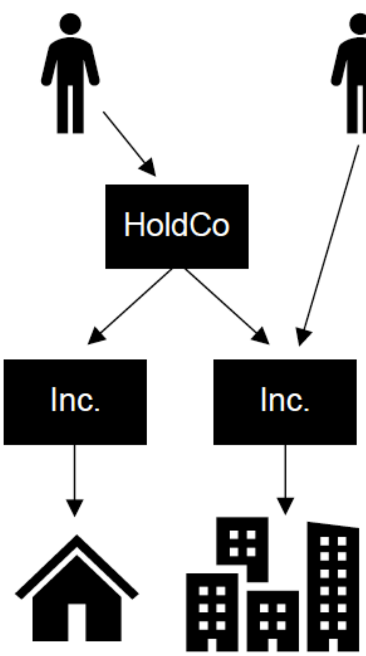
1. Choose The Right Ownership Structure

The right structure for your real estate holdings may depend on many factors, including the amount and types of income you are earning from real estate, the source of capital, the number of investors involved, how income and gains are to be shared, the anticipated holding period or duration of your project, tax planning, and more. There is no universally recommended structure, though some structures are more common for good reasons.

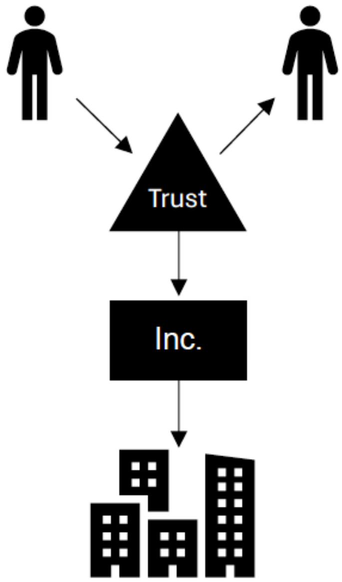
New Canadian investors and those investing in real estate alone or with a small group of persons, including family, will generally have one of the following structures:

	PROS	CONS
Direct Ownership 	• Simple • Cost effective	• Virtually no tax planning opportunities • Owner's personal assets are exposed to risks associated with owning real estate
Partnership or Co-Ownership 	• Simple • Cost effective • Income, gains, and losses may be shared relative to capital and labour committed	• Few tax planning opportunities • Owner's personal assets are exposed to risks associated with owning real estate
Corporation 	• Separation of personal and business finances • Limited liability protection for shareholders • May have one or multiple shareholders • Opens up many tax planning opportunities (some are discussed in the pages that follow) • Added privacy on who owns the property	• Small additional cost for setup and annual tax compliance

A corporation is a separate legal entity from you – it can own property, incur debts, employ employees, sue or be sued, and it files its own tax returns. It also provides another limited layer of protection as well as some more flexibility in tax planning, succession planning, and estate planning. As your holdings and businesses grow and your needs change, the right structure may involve one corporation to house one or multiple properties or businesses or it may involve housing each one in a separate corporation with a holding company (HoldCo) to own and manage all of your properties and business ventures.

	PROS	CONS
Multiple Corporations 	• Separates the risks associated with properties or businesses for additional creditor protection • Additional investors may participate in all properties (through HoldCo) or in specific corporations • Excess cash can be paid up to HoldCo as tax-free intercorporate dividends • If funds are required by any corporation, they can be loaned by the HoldCo and security may be registered for additional protection • May allow additional flexibility in tax planning	• Additional cost for set up and annual tax compliance for each corporation • Losses in a corporation cannot be used to offset profits in another (though strategies may be available to make use of losses in some cases) • More complicated structures may present challenges when obtaining financing (consider discussing proposed changes to your structure with lenders in advance)

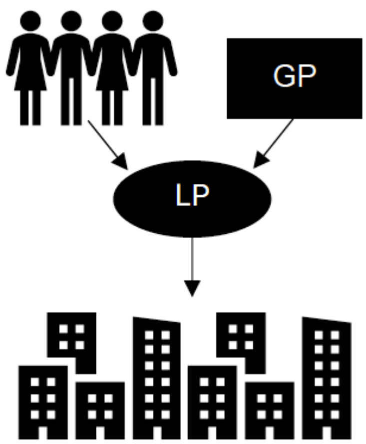
In some cases, the use of a family trust may be advisable. A trust, unlike a corporation, is not a separate legal entity but rather it is a relationship. A trust exists when one person (a trustee) has legal title to a property (including real property, or shares of a corporation), but they hold it for the benefit of someone else (a beneficiary). If you want to benefit your family members but do not want to make them owners or shareholders, or otherwise give them any control of your properties and businesses, or you wanted to keep the wealth you're accumulating protected and away from their potential creditors, a family trust may provide you with a flexible way to have some wealth accruing to them while you maintain control. However, there are many tax implications involved in setting up and maintaining a trust, so seek professional advice.

	PROS	CONS
Family Trust  	• Allows future growth to accrue to beneficiaries in a flexible manner • Allows you to maintain control of your properties and businesses • Provides an additional way to transfer assets to your heirs upon your death, like a will, but with more privacy • May allow additional flexibility in tax planning (attribution rules and the tax on split income must be considered) • May provide a way to transfer excess cash to another corporation that itself is a beneficiary of the trust, which may be particularly useful for creditor-protection and access to the lifetime capital gains exemption, if you are your business are eligible	• Small cost for set up and annual tax compliance • Taxation of trusts is a complex subject - this is not a situation where doing it yourself is recommended (see an experienced CPA) • Trustees must familiarize themselves with trustee law in their province and the fiduciary duty they owe to beneficiaries • May require the participation of multiple trustees who may be entitled to review the financial information of the business

You may have also heard of the term “trust” in the context of a bare trust. For example, rather than listing yourself as the registered owner of a property in the provincial land registry, a corporation (sometimes called a “nominee corporation”) would hold that legal title while you have the beneficial ownership of the property, receive rental income, and report income for tax purposes. This is normally done to maintain a certain level of anonymity and does not provide any tax benefits.

Developers and experienced, wealthy investors involved in larger real estate projects may be familiar with more advanced structures. For example, an investor, developer, builder, and brokerage may collaborate to promote, develop, and sell a large project, and often do so by forming a joint venture (“JV”). A JV, like a trust, is not a separate entity or taxpayer. It is also not the same as a partnership, which is the formation of a distinct business in common and which may create certain tax filing obligations. Rather, a JV is a relationship that has each participant carrying on their own business while dedicating their resources and expertise to see a large or complex project through. These arrangements must be carefully thought through to protect each participant's interests.

In cases where a much more significant amount of capital is required, a syndication may be formed. In Canada, a common structure for real estate syndication involves a limited partnership ("LP"). With an LP, a general partner ("GP") is responsible for planning and managing the project and is compensated accordingly, generally with a fee plus equity. The GP also takes on any business risk associated with the project. The limited partners are passive investors who are entitled to share in income, gains, and losses of the LP and who have limited liability protection in a similar way that shareholders of corporations have limited liability. Limited partners may be known or identified in advance, privately sought out, or may be attracted through a crowdfunding platform. These structures are generally best suited for raising large amounts of capital from hundreds or thousands of investors.

<table>
<tr><th></th><th>PROS</th><th>CONS</th></tr>
<tr>
<td>Limited Partnership ("LP")
</td>
<td>• Facilitates raising capital for larger, more complex projects with larger expected returns
• Income, gains, and losses flow through to the partners
• Flexibility - different classes of investors may participate in profits to a greater or lesser degree
• Limited partners are passive investors who do not deal with tenants
• Limited partners have limited liability in respect of the business risks, like that afforded by corporation
• Limited partners may hold their interest in a corporation for greater flexibility in tax planning
• Arrangements may be for an indefinite period or may be for a set period of time with an exit strategy and liquidity event for limited partners</td>
<td>• Not as liquid as owning your own property or investing in the market
• Requires multiple investors, generally requires raising much larger amounts of capital to justify the costs
• May require compliance with provincial securities laws (for accredited investors)
• LP requires registration under the applicable provincial laws
• More professional fees for set up, maintenance, and annual tax compliance, and therefore generally only worthwhile for larger developments
• Losses allocated to limited partners may be subject to restrictions for tax purposes</td>
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Investors looking to own an indirect interest in real property but who need high liquidity will generally look to other investment opportunities, such as private or publicly traded mutual funds, limited partnerships, and real estate investment trusts. A discussion on these investments would be beyond the scope of this brief.

The general information provided so far is applicable to Canadians investing in Canada. But what about Canadians investing in the U.S.? One of the most dangerous traps that a Canadian investor can fall into is reading up on U.S. tax advice online and assuming it applies to them. Although Canada and the U.S. do have a treaty to avoid double taxation, it does not always work to your advantage.

Consider an example where a Canadian individual invests in a rental property in Florida using a limited liability company ("LLC") formed under the laws of a U.S. state. LLCs are quite popular in the U.S. due to their tax advantages for U.S. residents and these advantages are touted in countless online resources. An LLC is generally treated as "fiscally transparent" in the U.S., meaning that its income is taxed directly in the hands of its owner or member. Another important fact about LLCs that are considered fiscally transparent is they do not qualify for benefits under the Canada-U.S. tax treaty, such as reduced rates of some taxes.

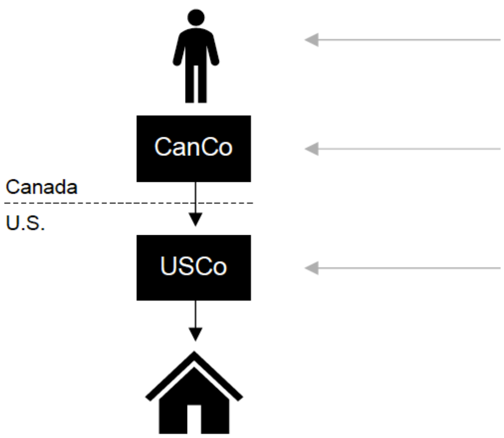
The individual in our example would be required to file a U.S. tax return and pay tax to the IRS on the LLC's net rental income personally, due to the LLC's fiscally transparent nature. However, Canada views an LLC as a corporation for income tax purposes and, in some cases, it may be considered a Canadian-resident corporation that needs to file a corporate tax return and pay tax to Canada on the same net rental income! This, combined with the fact that fiscally transparent LLCs do not qualify for treaty benefits, results in double taxation – the total taxes levied by Canada and the U.S. may exceed 90% up to the time the net rental income is ultimately paid out to the individual Canadian shareholder!

One potential solution is to own the U.S. property personally or in partnership. While this eliminates the risk of double taxation, it provides no creditor protection. Furthermore, if your source of capital to purchase the U.S. property is currently inside a Canadian corporation, it may not be possible to make use of the funds personally without tax implications to you.

Another potential solution is to have your Canadian corporation invest directly in U.S. property. This may work out well from a tax-perspective for certain active businesses, like property development. However, the net rental income generated by a U.S. property inside a Canadian-controlled private corporation can likewise be subject to double taxation, at a combined rate exceeding 70%! These results are not intended by either country but are a result of the fact that the tax systems are not integrated in any way and the fact that the treaty does not address this issue specifically.

If your funds are in a Canadian corporation, yet another solution may be to own U.S. real property in a U.S. corporation that is in turn owned by the Canadian corporation, as shown in Exhibit 1.

Exhibit 1 – Simple Structure for Investment in U.S. Real Estate as a Canadian Resident



Individual pays tax on dividends received from CanCo.

CanCo pays an additional tax on USCo's underlying rental income as "foreign accrual property income" to ensure Canada tax rates are paid on passive forms of income.

USCo pays U.S income tax on profits and withholds an additional 5% U.S. tax on any dividend paid to CanCo if CanCo owns at least 10% of its voting shares.

Depending on your facts and circumstances, this structure may help eliminate the risk of double taxation to a great degree. The overall combined tax from the moment rental income is earned by USCo, paid to CanCo, and ultimately paid out to you, the individual shareholder of CanCo, may still exceed 55%, but that's certainly better than 70% or 90%!

The interplay between Canadian and U.S. tax laws is extremely complex, and the CRA's foreign reporting obligations and foreign accrual property income rules place an onerous burden on anyone looking to invest using this type of structure. One wrong move can cost you unnecessary tax and penalties on both sides of the border. Although the example provided above seems simple enough in concept, many accountants do not specialize in providing this advice and do not understand the complexity a cross-border structure may bring.

No matter the type of investment you make in real property as a Canadian, the use of a holding company may open tax saving opportunities for you. However, ***get legal and professional tax advice*** to ensure you comply with all laws and that your facts and circumstances allow you to minimize your tax bill.

2. Consider Ways To Access Lower Corporate Tax Rates

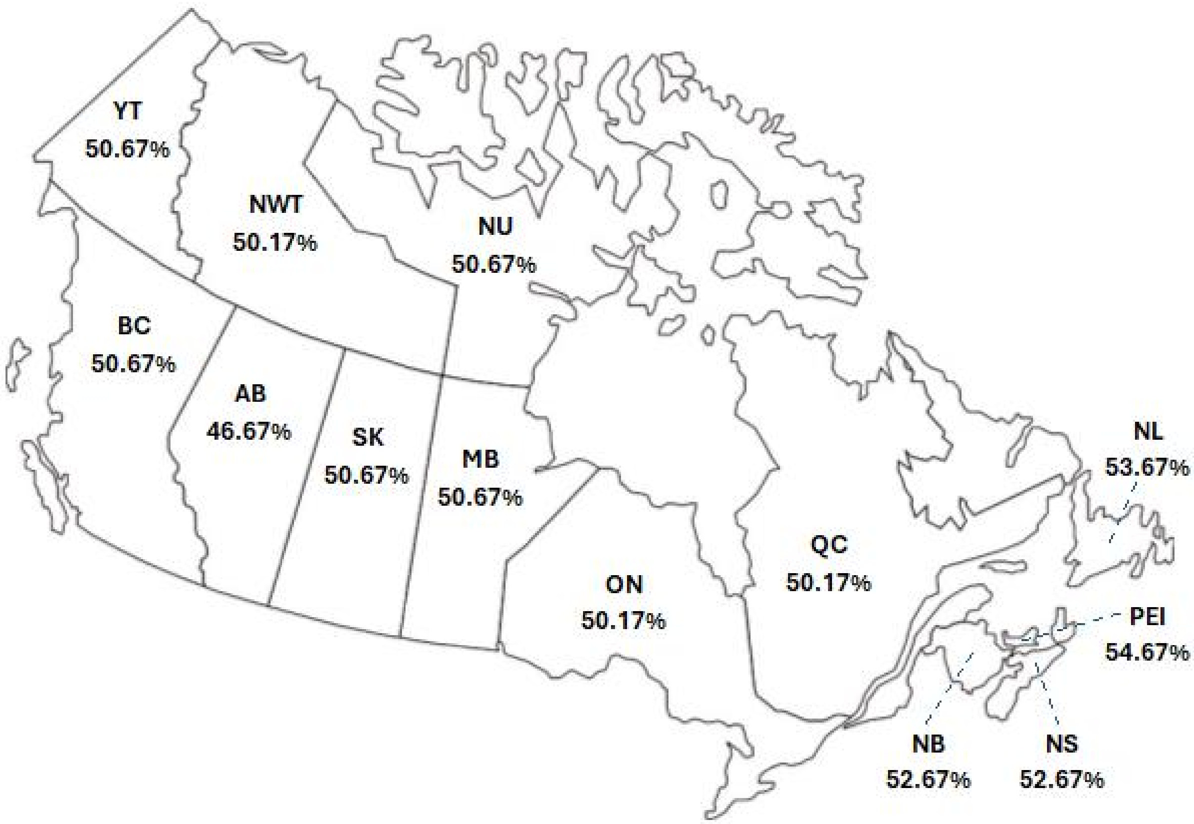
Canadian corporations have a reputation for being subject to lower income tax rates when compared to individuals. While its true that some corporations pay tax as low as 9% on their income, including corporations for developers and builders, this reputation generally does not extend to corporations earning rental and other forms of passive income, which can be taxed at a rate exceeding 50%. To understand why, read on.

The low tax rates commonly available to corporations apply to active business income. Depending on the province or territory, smaller businesses will generally pay anywhere from 9% to 12.2% in income tax on their active business income while larger businesses tend to pay from 23% to 30%. This is the government's way of leaving more money after taxes in the hands of business owners so that they can reinvest in and grow their business.

The government has made tax policy decisions over the years to discourage accessing these low corporate tax rates on various forms of investment income, indicating their preference that investment income is taxed at higher tax rates that apply to individuals. Therefore, active business income does not include income from property or income from what's known as a specified investment business, which is any business the principal purpose of which is to derive income from property. This includes most real estate rentals in a corporation.

When income from property is earned in a Canadian-controlled private corporation, a special tax of 30.67% applies. This special tax is in addition to the combined federal and provincial corporate income tax rates, bringing the total tax rate on this income as high as 54.67%! Refer to Exhibit 2 for the rates applicable across Canada.

Exhibit 2 – Combined Federal and Provincial Corporate Income Tax Rates on Income from Property, Including Refundable Taxes, in 2024



Thankfully, there may be strategies available to you to reduce this overall tax burden on income from property in your corporation.

a. **Pay dividends**
   The additional 30.67% tax is refundable to the corporation upon payment of adequate taxable dividends (other than eligible). The government refunds this tax to the corporation because personal income tax would end up being paid by shareholders instead, achieving the government's policy goal of taxing the rental income at personal tax rates. The tax is refundable to the corporation at a rate of $1 for every $2.61 of taxable dividends paid. This strategy works particularly well if your personal tax rate is lower than the top marginal tax rate in your province, but it needs to fit in with an optimized remuneration strategy for you (see the next section).

b. **Management services corporation**
If you do your own property management and maintenance and can justify the cost of having a separate corporation that carries on a business for that specific purpose, then this may be another way to reduce high rate of tax payable.
A management services corporation could charge a reasonable fee to your corporation that earns property income. The fee would be considered active business income that is eligible for lower corporate income tax rates, while the corporation earning income from property may deduct the fee, lowering its tax payable at the higher rate. However, take note: The CRA has indicated it is concerned about abuse of this type of planning, and so it should only be undertaken in cases where genuine management services are provided. Also, charging this fee may also require that the management services corporation charges GST/HST if it is required to register, and that tax would not be recoverable to the extent the services are provided in relation to long-term residential rents that are exempt from GST/HST.

c. **More than five full-time employees**
A special rule in our income tax laws deems rental income of a corporation to be active business income, thereby providing access to low tax rates, where more than five full-time employees are employed in the rental operation. Recent court decisions have clarified that this may mean either at least five full-time employees plus a part-time employee or six or more full-time employees. If your rental operation is substantial enough that it requires this level of labour, then you may benefit from the lower tax rates on active business income. If you currently outsource several management and maintenance services but would otherwise require more than five full-time employees to manage your properties, then it may be worthwhile considering how you can meet this threshold. This test may also be met if an associated corporation (generally, another corporation you also control) employs more than five full-time employees to provide services to your corporation with the rental operation.

d. **Rent to associated corporations that earn active business income**
Does your corporation own property that is rented to an associated corporation? If so, and if that associated corporation carries on an active business, then the rental income may be deemed to be active business income that is eligible for lower tax rates.

e. **Do nothing**
Sometimes, the best answer is to do nothing. While it may not seem like a great solution to pay a corporate tax rate in the 50% range, it may make sense if your current personal income pushes you into the highest marginal tax rate in your province. In some cases, the high corporate tax rate may be less than your personal tax rate, which means your corporation provides you with a small tax deferral. This deferral may translate into permanent tax savings if you retain your earnings in your corporation and only pay yourself dividends in future years when your income is lower, such as in retirement. Not only would the 30.67% additional corporate tax be refunded to the corporation at that later time, but the dividend income you take might be taxed at a very low effective rate. In effect, your corporation can be a personal pension plan!

Expert, proactive planning can help ensure that the combined tax paid by you and your corporation is minimized now and in the future by leveraging one or more of these strategies.

3. Optimize Your Remuneration Strategy

Salary or dividends? This age-old question seemingly has no right answer, but there definitely is a right answer for you. There may be differences involved in making this decision when earning active business income as opposed to income from property, as we will explain. First, a review of how our corporate tax system integrates with personal tax may be useful.

Our income tax system is based on the integration principle, meaning that you ought to pay the same total income tax whether you earn income personally, in partnership with others, or through a corporation. The integration principle applies whether you choose to pay yourself a salary or a dividend through your corporation. Take an example of a builder in British Columbia, where the combined 2024 federal and provincial small business tax rate is 11% and the highest marginal tax rate for individuals is 53.5%. This individual needs an additional $100,000 of remuneration from their corporation. If they take a salary, their corporation pays no tax on that $100,000 of earnings while they pay $53,500 of tax personally, leaving them with $46,500 after tax – the same as though they had earned the income as a proprietor. If they take a dividend, we expect the following result, in theory:

Corporate earnings	$	100,000	A
Corporate tax at 11%	$	11,000	B
Net amount available to pay a dividend	$	89,000	C = A - B
Dividend gross-up ***(theoretical)***	$	11,000	D
Amount to include in personal income	$	100,00	E = C + D = A
Personal tax at 53.5%	$	53,500	F = E x 53.5%
Dividend tax credit ***(theoretical)***	$	11,000	G = B
After-tax personal cash	**$**	**46,500**	H = C - F + G

As you can see, the integration principle is an attempt to ensure that:

- the individual is taxed on an amount (E) equal to the corporation's underlying earnings (A) because the cash dividend (C) is grossed up (D) before being included in income;
- the shareholder gets a credit (G) for the tax the corporation has already paid (B); and
- the overall result, being the after-tax cash in their pocket (H) is the same as though a wage had been paid.

While the math in our example works out perfectly, things aren't so perfect in practice. The integration principle is hindered due imperfect tax laws and a lack of coordination between the federal and provincial governments. Our B.C. builder would realize the following result with a dividend[1] in 2024:

Corporate earnings	$	100,000	A
Corporate tax at 11%	$	11,000	B
Net amount available to pay a dividend	$	89,000	C = A - B
Dividend gross-up ***(actual)***	$	13,350	D = C x 15%
Amount to include in personal income	**$**	**102,350**	E = C + D
Personal tax at 53.5%	$	54,757	F = E x 53.5%
Dividend tax credit ***(actual)***	$	11,247	G
After-tax personal cash	**$**	**45,490**	H = C - F + G

[1]This dividend would be a taxable dividend, but not an eligible dividend. Eligible dividends are so named because they are eligible for an enhanced dividend tax credit, resulting in a lower effective personal tax rate. This becomes possible if your business earns active business income in excess of the business limit which are then taxed at a higher corporate tax rate.

The result is the individual realizes $45,490 after paying tax, which is $1,010 less than they would have had they received a wage from their corporation! This is because the amount included in their income (E) is higher than the actual underlying earnings of the corporation (A), due to the 15% gross-up, causing extra personal tax to be paid. Even the fact that the dividend tax credit (G) ends up being higher than the actual corporate tax paid (B) doesn't help much here. This result is common across provinces and territories, with only Saskatchewan and the Northwest Territories having a net positive tax integration on these dividends. Understanding the math behind tax integration in your province is a crucial component of any good remuneration plan.

Despite this result, why would you consider paying a dividend instead of a wage? Here are a few of the more common reasons why:

- ***Dividends may be necessary to recover refundable taxes***, as previously explained.
- ***Dividends are generally easier to administer.*** Payroll requires accurately calculating source deductions and making remittances on a regular basis, as well as filing a T4 return and slip, while dividends only require that you make quarterly tax instalments and file a T5 return. Dividends may therefore be less time consuming and costly from a tax compliance perspective.
- ***Dividends are not subject to Canada Pension Plan contributions.*** While many business owners choose wages to contribute to the CPP and create RRSP contribution room, others prefer to keep the funds they would otherwise contribute to the CPP. This is a highly personal decision which will be influenced by your experience and perspective.

On the other hand, wages or a combination of wages and dividends may be necessary if you incur childcare expenses that you deduct on your tax return, or the Alternative Minimum Tax applies to you (which we will discuss in a bit). Ultimately, the choice for owners of active businesses, such as developers, builders, and rental operations with more than five full-time employees, will vary depending on their unique facts and goals and may change from year to year either due to legislative change or a change in facts and circumstances.

The logic above generally holds true to those earning rental income in a corporation. However, when your rental operation is very profitable, requires your full-time involvement, but does not meet the threshold of an active business, and if you're in a moderate to high marginal tax bracket, there may even be a clearer benefit to paying a wage.

Consider an example of an individual in Ontario. Their corporation earns over $150,000 of net rental income that is not considered active business income. The individual needs $150,000 of remuneration before tax from their corporation – assume this would be considered a market value rate for a property manager providing the same level of service to the corporation under the circumstances. If the corporation pays a taxable dividend, this is the result:

Corporate earnings	$	150,000	A
Corporate tax at 50.17%	$	75,250	B
Net income before the dividend refund	$	74,750	C = A - B
Dividend refund ***(the 30.67% refundable tax)***	$	46,000	D
Net amount available to pay a dividend	$	120,750	E = C + D
Dividend gross-up	$	18,113	F = E x 15%
Amount to include in personal income	$	138,863	G = E + F
Personal tax at graduated rates	$	38,292	H
Dividend tax credit	$	16,686	I
After-tax personal cash	$	99,144	J = E - H + I

How would that result differ if a $150,000 wage were to be paid instead? If the individual is active in the rental operation and the wage is reasonable with regard to all factors, then it could be deductible against the corporation's income that is subject to the high 50.17% rate of tax. This would be the result to the individual shareholder:

Corporate earnings available for a wage	$	150,000	A
Employer portion of CPP	$	4,056	B
Wages payable to the individual	$	145,944	C = A - B
Employee portion of CPP	$	4,056	D
Net wage received, before income tax	$	141,888	E = C - D
Income tax payable	$	41,894	F
After-tax personal cash	$	99,994	G = E - F

Although the benefit of a wage in these circumstances seems small at first glance, with an extra $850 in the individual's pocket when compared to a dividend, ***there are other big advantages:***

- Between the employer and employee portions, a total of $8,112 was contributed to the CPP which will entitle the individual to benefits in their retirement years. When compared to the option of paying a dividend, it's almost as though the CPP contributions are "free" in this example.
- The wage represents "earned income" which will create RRSP contribution room for the following year. Although corporations can be used as a form of personal pension plan as previously discussed, an RRSP may offer an additional tax deferral opportunity and may provide an additional layer of creditor protection in some cases.
- The amount included in the individual's income ($150,000) is higher than with a dividend ($138,863, after the gross up). This may make things easier for the individual when applying for personal loans and disability insurance.

This result occurs due to the relatively poor integration of corporate taxes and dividend income across all provinces. The dividend tax credit to the individual on a dividend is much lower than the actual amount of corporate income tax paid on this type of income.

As you can see, the choice between a dividend and a wage can get quite complex. The right ***professional tax advice*** can save you thousands of dollars per year, which can even offset your accounting fees in some cases.

4. Restructure Your Holdings To Allow Income Splitting

While opportunities to split income with your family are limited, there may be creative solutions available that might save you tens of thousands of dollars per year… if you know where to look.

Splitting income has become more complicated since the 2018 introduction of the **tax on split income (TOSI) rules.** The TOSI rules effectively tax any share of rental income from a partnership, dividend income from a private corporation, interest income on a loan, and other forms of income at the highest marginal tax rate unless an exception is met. The simplest exception is for an individual who is actively engaged on a regular, continuous, and substantial basis in the business of a partnership or corporation, which would generally protect an active owner-manager from the application of the TOSI rules, whether the business earns income from developing, building, renting, or something else. Where the TOSI rules do not apply, income splitting may instead be shut down by the **attribution rules**, which attribute income for tax purposes to a spouse or parent in some cases.

Despite these hurdles, just some opportunities to split income with family members may include:

- paying a fair wage to a spouse or children who work in the business in some capacity, whether directly in the business or in an administrative or other supporting role;
- paying interest to a family member who lends their own funds from arm's length sources to your business for an eligible income-earning purpose;
- lending funds to a spouse or a family trust a prescribed rate of interest for the purpose of generating investment income from the loaned funds;
- restructuring your corporate shareholdings so that family members own shares that entitle them to 10% or more of the voting rights and have a value equal to 10% or more of all outstanding shares (careful planning is required in this regard, and there may be several legal and other considerations to this); and
- updating your will to allow your family to take advantage of exclusions from the TOSI rules that may apply upon your death.

The TOSI and attribution rules are incredibly complex, and a **CPA who specializes in navigating the rules** can help identify the opportunities available to you.

5. Mind Your Interest Deductibility

With recent interest rate increases, ensuring that you can deduct your interest expense on your tax filings has become even more important than before. With very few exceptions, interest paid is deductible on an accrual basis, when there is a legal obligation to pay it, in the following circumstances:

- you incurred an amount payable for property, and that property was acquired for the purpose of gaining or producing income from the property (e.g., rent) or for the purpose of gaining or producing income from a business; or
- you borrowed money used for the purpose of earning income from a business or property.

The first example is easy to understand. This would include interest on debts, such as a mortgage, incurred to purchase a property that you will use in some income-producing capacity. The property might be either a rental property or premises used for your business operations, such as office space, storage, or a shop. Provided that the loaned funds are used exclusively to acquire this type of property, all interest would generally be deductible.

The second example is a bit vague, but it covers off many situations in which you would incur interest in the course of carrying on your business or rental activities. This might include interest on a line of credit used to pay for renovations or operating expenses and even interest that a supplier charges you an overdue invoice. The provision that allows this deduction for interest, and in particular the meaning of the word used, has been the subject of many interpretations by the CRA and various court decisions over the years. It is generally the direct use of the loan proceeds that matters when determining whether interest is deductible. If the direct use is not for an income-earning purpose, then your interest may not be deductible. The same rules apply whether you incur debt personally, in partnership, or in a corporation. In limited circumstances, there may be exceptions to the direct use requirement.

Though the rules seem flexible, there are many traps for the unwary where an interest deduction could be denied, partially or fully:

- interest incurred to purchase a property that is used for a mix of income-earning and personal reasons;
- interest incurred on debt that would normally be used for income-earning purposes but that was used to fund personal expenses;
- interest incurred by a corporation to make advances to shareholders;
- interest incurred by a corporation to pay dividends or redeem shares at amounts in excess of contributed capital and accumulated profits in the corporation;
- interest incurred to purchase a life insurance policy, even if the policy is used as collateral for another loan with a direct income-earning use;
- interest in excess of $350 per month on a loan for a passenger vehicle; and
- interest incurred on a loan payable to a non-arm's-length party that is in excess of a reasonable (e.g., market) rate.

There are many other rules in our tax laws that cause an interest deduction to be deferred or altered. For example:

- compound interest is only deductible when it is actually paid, not payable; and
- interest incurred on the acquisition of land or during the construction period may or may not be deductible based on many criteria and, if not, it may be added to the adjusted cost base of the property instead.

In addition, an interest deduction might be lost where the interest expense is so significant that it results in accumulating losses inside a corporation over time.

Knowing how and when your interest deduction might be limited or denied can allow you to be strategic about the use of your capital to maximize your deductions. A **CPA with tax expertise** can guide you during an annual review and discussion about your business needs.

6. Plan Ahead to Avoid Additional Tax On Capital Gains

The 2024 Federal Budget proposes to increase the inclusion rate for all capital gains realized by corporations and trusts, as well as certain capital gains in excess of $250,000 realized in a year by individuals, from 1/2 to 2/3 effective for dispositions occurring on or after June 25, 2024. Owners of private company shares and investors in real estate of all kinds may be impacted. In a province with a top marginal tax rate of 54%, this measure effectively results in an extra 9% tax on capital gains on the sale of shares, a residential complex, a single rental property, a cottage, and other assets. The increased tax might not only apply to an actual sale, but possibly to events that deem capital gains to arise, such as on a gift, upon death, or upon ceasing to be a resident of Canada for tax purposes. Some uncertainty remains as there is no legislation for this proposal as of the time of writing. Sources of business income, such as the business of a developer, a builder, construction, and others are unaffected by this measure.

Prudent planning may include one or more of the following, depending on your circumstances::

- crystallizing accrued capital gains prior to June 25, 2024, while weighing this decision against the cost of doing so, which is the acceleration of tax you might otherwise defer for many years;
- proactively managing your personal capital gains by regularly realizing them and remaining under the $250,000 annual threshold, with a view to avoiding a situation where a much larger gain is brought into income all in one year;
- holding certain assets personally as opposed to in a corporation in order to benefit from the $250,000 threshold, while being mindful that leaving equity in a corporation to defer personal taxation will still provide a greater benefit in most cases;
- making use of capital gains reserves on a sale that involves a vendor-take-back mortgage, depending on whether the eventual legislation on this proposal allows this as a way to remain under the $250,000 threshold;
- maintaining qualified small business corporation share status for a corporation that carries on an active business, as the inclusion rate on a capital gain on these shares may be lower than 2/3 rate under the proposals;
- harvesting tax losses in a strategic way to offset capital gains, while being cautious not to run afoul of the superficial and suspended loss rules; and
- revising your succession and estate plans and considering providing gradual living inheritances to your family.

In addition, proposed changes to the Alternative Minimum Tax (AMT) may apply to levy an additional layer of tax on your capital gains. A full-service CPA firm with tax experts can become a valuable tax planning resource for you to manage your tax liability now and throughout the entire lifecycle of your business.

7. Beware Of Big Traps When Non-Residents Are Involved

When a non-resident is involved in your ownership structure or in a Canadian real estate transaction, or if you are a non-resident of Canada investing in Canadian real estate either directly or indirectly (through a partnership, corporation, or other entity), there are many potential tax traps to be aware of. In addition to potential restrictions on ownership, special land transfer taxes or speculation taxes, and underused housing taxes, there can be onerous income tax obligations to deal with.

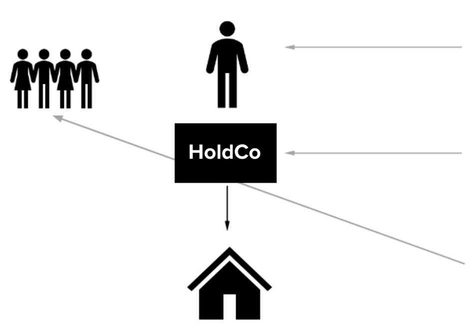
Any rental income paid to or for the benefit of a non-resident owner is subject to a flat 25% non-resident tax on gross rental income – not net, but gross! This tax must be withheld by either the tenant or a withholding agent and remitted to the CRA monthly by the 15th of the following month. Significant penalties may be levied by the CRA for failure to follow this process. A special election process may allow tax to be paid on a net income basis and allow the non-resident owner to pay tax at graduated tax rates, but there are strict requirements and deadlines to benefit from this special treatment. Planning is crucial. This tax cannot be avoided by holding Canadian real estate through a partnership, and the tax may likewise be payable on dividends on shares of a corporation owned by a non-resident.

When an interest in a property is sold, including most indirect interests in Canadian real estate such as interests in a partnership or shares of a corporation, special tax obligations likewise apply. A non-resident vendor of Canadian real property will have 25%-50%[2] of their gross sale proceeds withheld by the purchaser's lawyer and remitted to the CRA[3]. A special process known as a section 116 certificate of compliance may allow the non-resident to pay tax based on their capital gain instead of their gross sale proceeds, but filings are due within 10 days of any sale, otherwise penalties apply. This tax likewise cannot generally be avoided by selling an indirect interest in Canadian real property or by transferring the property in another way, such as by way of barter, gift, or bequest. The process may also be complicated depending on the country of residence, since a treaty with Canada may affect whether any capital gain is taxable in Canada, the other country, or both. Failure to comply might result in the CRA assessing the purchaser of the property for the non-resident owner's tax bill!

If you are a non-resident of Canada investing in Canada or are investing alongside or purchasing from a non-resident of Canada, the most prudent thing to do is **to obtain professional tax advice well before any transaction is carried out** so that all parties are certain their tax obligations are being met.

8. Prepare An Estate Plan To Prevent Triple Taxation On Death

Ownership of real estate through a corporation may offer many tax planning opportunities. However, things can become quite complex upon the death of a shareholder, and there is the potential for not one, not two, but three layers of taxation without proper planning!



1. Individual pays tax on a capital gain due to a deemed disposition of their corporation's shares upon death (as though these were sold at market value).

2. HoldCo pays tax on any recapture and capital gains when the real estate is sold. Although this creates some favourable corporate tax attributes, they are not always able to be used.

3. HoldCo is liquidated, and the after-tax corporate funds are paid out to the individual's heirs. This is usually treated as a dividend to the heirs.

[2] The 2024 Federal Budget proposed an increase to the inclusion rate for capital gains. At this time, it is unclear whether the rate of withholding tax applicable under section 116 may also increase as a result.

[3] Additional withholding taxes may apply to properties located in the province of Québec.

Thankfully, strategies exist to minimize the risk of this awful result, but they are time sensitive. The tax due to the deemed disposition on death (#1) may be avoided with proper planning that must be carried out within the first taxation year of the estate, something that may be impossible to do if the estate is complex, records are disorganized, or family members are fighting over money and control. Having an estate plan in place and discussing it with family members goes a long way toward avoiding multiple layers of taxation on your real estate empire.

In addition to all these taxes, many provinces have an estate administration tax or probate fee that is based on a percentage of the estate. The percentage may be small, but with the rising value of your real estate the amount payable by your family upon your death may be four, five, six, or more figures! If you reside in a province that levies such a tax, planning may be available to avoid it, including dual wills or the use of an alter ego trust.

Always ***get professional advice that is tailored to your unique circumstances.*** You are never too young to know what your ultimate tax liability may be or to plan for it to ensure your family's inheritance is maximized.

9. Stayed Informed

Canada's tax laws change at a mind-numbing pace. The tax system is complex to begin with, and new tax laws and updates to existing laws are announced in the federal and provincial budgets (late winter or early spring), the fall economic statement, and sometimes other times throughout the year. From 2022 to 2024 alone, we have seen the following proposed and exacted tax measures:

- an increase to the capital gains inclusion rate from 1/2 to 2/3;
- changes to the Alternative Minimum Tax which may also cause increased taxation of capital gains in some circumstances;
- acclerated capital costs allowance for purpose-built rental housing;
- enhanced GST/HST rebates available on certain purpose-built residential rental properties with at least four private apartments which effectively eliminate the sales tax on these new builds;
- underused housing tax and bare trust filing requirements, which have thankfully been curtailed to a certain extent;
- new property flipping rules that may deem someone to have business income on the sale of a residential property or right to acquire a property;
- a new rule that denies the deduction of virtually all expenses on short-term residential properties that do not comply with local registration or licensing requirements; and
- various credits and rebates for green initiatives, such as air source heat pumps.

One of the best strategies to reduce your tax burden is the simplest: never assume the advice you received in the past is still applicable today. Stay up to date by reading frequently and attending seminars, or consult your trusted tax advisor annually, at a minimum, to learn about any new opportunities available to you and changes in tax laws that may alter your plan.

10. Keep great records

Sometimes, the simplest tax tip to implement is to just keep great records, for reasons we will get into below. A great record keeping system is:

- **Timely –** Timely record keeping is crucial for the proactive management of your real estate holdings. Financial information is most valuable when it's current, allowing for fast action and responsive decision-making. Timely financial reporting can help identify issues such as late payments or cash flow problems early, preventing them from escalating into significant obstacles. Meeting statutory obligations like tax filings is another key benefit of timely record keeping. It helps to avoid potential penalties and maintain good standing with your lenders and other stakeholders, fostering an environment of compliance and financial transparency within your organization.

- **Accurate –** Records should be maintained by an experienced bookkeeper, and ideally someone with experience in bookkeeping for real estate holdings and who keeps up to date on technological trends and leverages the latest software and tools. Accurate bookkeeping is crucial for tax compliance. It ensures all transactions are correctly recorded and categorized, reducing the risk of errors in tax filings, which could lead to penalties or audits. Additionally, should the business seek external financing, investors and lenders will require precise financial records to assess the company's viability and creditworthiness.

- **Insightful –** Records should be organized in a manner that permits quick retrieval of key information on demand. Informed decisions, rooted in deep insights derived from accurate and timely bookkeeping, are the bedrock upon which you can build your future. Whether you're contemplating selling a property, assessing the profitability of a new property, or navigating the intricacies of financial compliance, the ability to access meaningful insights is the key to steering your real estate empire in the right direction.

- **Complete –** Records should include standard financial records, including a balance sheet, income statement, statement of changes in financial position, a trial balance, and ledgers, and include source documentation from a variety of sources, including bank records, supplier records, receipts, and tenant data. Records should be stored locally and in the cloud to help ensure your data is safe and can be available at all times. Additionally, records should be retained for a minimum period of six years from the end of the last tax year to which they relate to satisfy CRA requirements, or perhaps longer for some potentially valuable insight.

With non-residential properties, a great record keeping system is crucial for tracking your entitlement to GST/HST input tax credits which expire after four years, especially with how complicated this can become if you incur expenses that both are and are not subject to the GST/HST, own properties that are mixed-use, or own properties in other provinces where the tax rates differ. Access to timely and accurate information can provide valuable insight into your spending and allow you to strategically time some large expenditures near a year end to manage your tax liability. Timely records will also allow your accountant to quickly estimate your tax owing after each period end so that you can pay the CRA on time and avoid costly late-filing and instalment interest and penalties. Even though corporate tax returns are due within six months of a year end, your taxes must be estimated and paid within two months, or sometimes three if your corporation has active business income subject to a small business deduction. As of January 1, 2024, the prescribed rate of interest on overdue taxes is 10% annually, which accrues and compounds daily and is not deductible! Don't let a poor record keeping system be the cause of an increase in tax, interest, and penalties paid to the CRA.

In response to the growing demand for enhanced bookkeeping efficiencies and sophisticated tax strategies, we developed our one-of-a-kind cloud accounting solution, Profit Simple Bookkeeping, designed from over 15 years of servicing the financial needs of thousands of small to medium sized businesses. As an Intuit QuickBooks Solution Partner, Gauvreau is at the forefront of integrating your financial data seamlessly into QuickBooks Online, optimizing your investment performance through innovative tax strategies and diligent bookkeeping.

Leveraging our in-house expertise in the Real Estate Investment industry, we offer a tailored solutions for Real Estate Investors just like you. This not only simplifies financial management of your portfolio, but also minimizes the risk of errors, enhancing compliance with tax regulations and maximizing your investment returns. Our team stands ready to empower you in managing your real estate portfolio ensuring your financial records are impeccably organized to capitalize on tax advantages. Start optimizing your real estate investments today by **scheduling a Free Discovery Call with our team.**

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Our team stands ready to empower you in managing your real estate portfolio ensuring your financial records are impeccably organized to capitalize on tax advantages.

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