

BC GOVERNMENT TARGETS FOREIGN BUYERS WITH MASSIVE TAX HIKE

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On July 25, 2016, the BC government announced Bill 28 – Miscellaneous Statutes (Housing Priority Initiatives) Amendment Act, 2016. These amendments come in the wake of Vancouver Mayor Gregor Robertson urging the provincial government to intervene in the Lower Mainland's housing market, where home prices have dramatically increased in recent years. This legislation is based on six guiding principles: increasing housing supply, expanding smart transit, supporting first-time homebuyers, protecting consumers, increasing rental supply, and protecting the dream of home ownership.

Bill 28 consists of four separate parts, all aimed at improving housing affordability. First, it proposes amendments to the *Property Transfer Tax Act*, imposing an additional property transfer tax of 15% on all residential property transferred to foreign buyers. The tax will be payable on all transfers that are registered with the Land Title Office on or after August 2, 2016. Second, the bill amends the *Vancouver Charter* to enable, but not require, the City of Vancouver to impose a municipal vacancy tax on vacant residential property. Third, the bill amends the *Real Estate Services Act*, ending self-regulation of the real estate industry and strengthening the regulatory regime to deter unlawful behaviour in the marketplace. Finally, the bill creates a new Housing Priority Initiatives special account to consolidate new tax revenues arising as a result of the amendments. The special account is intended to fund initiatives in respect of housing, rental, access, and support programs.

Bill 28 was announced and received a first reading on July 25, 2016 with no prior consultation with the industry or advance notice. It received a second reading on July 27, 2016, and received a third reading and royal assent on July 28, 2016. Should this bill be passed in its current form, the amendments to the *Property Transfer Tax Act* will be effective starting August 2, 2016, while the other legislative amendments will come into effect on the date of Royal Assent or by regulation of the Lieutenant Governor in Council.

Changes to the Vancouver Charter

While the amendments to the *Vancouver Charter* do not impose a vacancy tax, they will allow the Vancouver municipal government to pass vacancy tax bylaws. The amendments regulate how vacancy tax bylaws may be

enacted and set limits as to what these bylaws can do. Mayor Robertson has stated that this enabling legislation will be followed by a data-sharing deal, and that the City has yet to decide upon a method of enforcement or the rate of tax to levy upon vacant homes. However, he has also indicated that the City intends to target homes left vacant for 12 months a year.

Changes to the Property Transfer Tax Act

The surprising changes introduced in Bill 28 relate to the *Property Transfer Tax Act*, which regulates the taxes payable upon a transfer of legal title to real property in British Columbia. On the heels of recent amendments in February 2016, which were also introduced without consultation or notice and increased general property transfer taxes to 3% on the portion of the purchase price over \$2 million, Bill 28 aims to further increase the transfer tax paid by foreign buyers who purchase or acquire an ownership interest in residential property.

As presently drafted, Bill 28 mandates a 15% transfer tax on residential property located within the Greater Vancouver Regional District that is being transferred to a foreign buyer, in addition to the current transfer taxes that are payable. For a purchase of a \$3,000,000 property in Vancouver by a foreign buyer, these amendments would result in transfer taxes of \$518,000, \$450,000 of which relate to the foreign buyer property transfer tax. In situations where there are multiple purchasers, the additional 15% tax is only calculated on the foreign buyer's proportionate share of the property's fair market value; however all purchasers will be jointly liable for payment of the additional tax..

What property will be affected?

The proposed changes will affect all "residential property" within the "specified area". As currently drafted, "residential property" is defined as land or improvements described as class 1 property in the *Prescribed Classes of Property Regulation* and small tracts of farmland used for residential purposes. Class 1 property is generally defined as property used for residential purposes, such as single and multi-family dwellings, apartments, and condominiums, but does not include property used as a hotel or motel, other forms of temporary accommodation property, and property owned by the Crown when used for certain purposes, such as a correctional centre or mental health facility. The "specified area" is defined to include the Greater Vancouver Regional District and other prescribed areas, but excludes treaty lands of the Tsawwassen First Nation (unless other prescribed) or prescribed areas within the Greater Vancouver Regional District.

Who will be affected?

The proposed changes target sales to "foreign entities", which the bill defines very broadly. A "foreign entity" includes both a foreign national and a foreign corporation. A "foreign national" is a transferee that is neither a Canadian citizen nor a Canadian permanent resident. A "foreign corporation" is a corporation that is either: (a)

not incorporated in Canada; or (b) incorporated in Canada but is controlled by (i) a foreign national, (ii) a corporation not incorporated in Canada, or (iii) a corporation where the total shares owned by foreign entities would give the foreign entity control of the company, when taken together. For these purposes, control is defined in relation to the *Income Tax Act* (Canada) to include the concept of ownership of shares giving direct voting control, but also the more far-reaching concept of indirect control and influence that would result in factual control. However, Canadian companies listed on a Canadian stock exchange are excluded from the definition of a foreign corporation.

The 15% transfer tax will also apply to transactions involving transfers of property to a "taxable trustee". A "taxable trustee" is defined as either a trustee who is a foreign entity or a trustee where a *beneficiary* of the trust is a foreign entity. As a result, a conveyance of residential property to a Canadian trustee that holds title in trust for a foreign entity will also be subject to the additional transfer tax.

The concept of a taxable trustee creates some potential issues and uncertainties. First, the proposed definition appears to deem a Canadian corporation to be a "taxable trustee" if only one beneficiary is a foreign entity, making the whole transaction subject to the 15% additional transfer tax rather than just the portion of the foreign entity's beneficial interest. Second, it is also conceivable based on the proposed language that a limited partnership may fall under the definition of a "taxable trustee" if one of the limited partners is a foreign entity. This will depend in part on the nature of the relationship between the general partner and the limited partners under the relevant agreements. While we would argue that the language of this proposed act does not truly capture this situation, it will require further investigation.

These changes do not alter the current transfer tax structure which allows purchasers to avoid the payment of the property transfer tax when the purchaser acquires the beneficial interest in a property together with the shares of a trustee holding legal title, as property transfer tax is only payable when a transfer is registered with the land title office. However, a foreign entity acquiring the beneficial interest in a property by way of a share transaction, while avoiding the basic property taxes, would appear to be liable for the 15% foreign transfer taxes pursuant to new anti-avoidance rules. The anti-avoidance provisions in Bill 28 are broad, and deem any transaction that directly or indirectly results in an avoidance of the 15% tax to be an "avoidance transaction". There is a carve-out for transactions which are arranged for bona fide purposes, however this is not defined. It is unclear under the proposed legislation how avoidance transactions will be assessed and taxed.

These changes mark the first time the British Columbia government has introduced legislation looking through a trustee to the ultimate beneficial owner and creating an anti-avoidance rule in respect of property transfer taxes and could suggest the government may alter the current property transfer tax structure for domestic purchasers at some point in the future.

What are the implications?

If the proposed changes to the *Property Transfer Tax Act* are enacted without further amendment, registered property transfers will be subject to review and may be audited for up to six years after the date that the property transfer is registered at the Land Title Office. Share transactions, which do not require registration in the land title office, would be subject to the same audit rights; however there would be no time restriction imposed, allowing for audits in perpetuity to determine if the share transaction constituted an avoidance transaction. The amended *Property Transfer Tax Act* will also include strict anti-avoidance provisions, allowing for fines of up to \$200,000 for any corporation and up to \$100,000 and/or two years in prison for any individual that does not comply with the rules. Further, these penalties may apply to anyone who participates in a tax avoidance scheme, including Canadian sellers and professionals involved in the avoidance transaction. In a similar vein the changes to the *Real Estate Services Act* will substantially increase the penalties for professional misconduct.

However, even if enacted as currently drafted, the amended *Property Transfer Tax Act* will give the government a great amount of flexibility to modify various aspects of the legislation by regulation. This includes the power to modify the definition of "residential property", create prescribed areas where the additional tax will or will not apply, modify the tax rate (provided the rate is not less than 10% and not more than 20%), and create exemptions for certain persons or classes of persons or certain types of taxable transactions. Accordingly, we anticipate that the application of this new tax will evolve over time.

Whether the proposed changes will have the intended effect of curbing the flow of foreign investment in the residential housing market and improving affordability for Vancouver residents remains to be seen. However, we anticipate that if enacted these changes may affect the liquidity of land assemblies, development land and multi-unit residential real estate, at least in the short term, as the additional property transfer tax will decrease the attractiveness of such properties to foreign buyers. Also, the changes will have a significant effect on foreign buyers and sellers who have entered into agreements for purchase and sale prior to August 2, 2016, including condo pre-sale contracts, but which are scheduled to close on or after August 2, 2016. In such cases, the foreign buyer will be forced to pay the additional 15% property transfer tax, and some may opt to walk away from the purchase agreement rather than complete the transaction.

As a general comment, the way the BC government has chosen to enact these changes – without prior notice or consultation and with no exemption for deals in progress – risks harming BC's reputation as a reliable business jurisdiction and has caused significant market turmoil since announced. The notion of adding additional closing costs after the buyer and seller have entered into a firm and binding purchase contract, which may have been entered into years earlier (such as a condo presale agreement), amounts to a substantial alteration of what the parties originally intended when entering into the agreement. For foreign buyers who

attempt to complete (which could include everyone from the very wealthy to a first-time homebuyer in Vancouver on a work permit), they will have to find a significant amount of additional money to close the transaction. For sellers, this raises the real prospect that the transaction will not close and that their only recourse against non-resident foreigners will be the deposit under the purchase agreement. Although the February changes to the *Property Transfer Tax Act* were enacted in the same manner, the potential impact of this change is fundamentally unfair to buyers, burdened with significant and unanticipated additional closing costs, and sellers, who now face significant uncertainty about whether their deal will close.

We will provide a further update once the final version of the bill completes its final reading.

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A Cautionary Note

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