

News Analysis: Canadian Developer Markets Tax Work-Around

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A Vancouver real estate developer is offering a way around a foreign buyers' tax introduced in British Columbia last year that had a dramatic effect on foreign investment in the region. If the program succeeds, it could have implications for other major international housing markets, but it may prove as controversial as the tax itself.

Apex Western Homes Ltd., a property developer based in North Vancouver, initiated a rent-to-own program in January that the company says will help homebuyers who are struggling to come up with a down payment lock in a purchase price for a home and defer goods and services tax and property transfer tax. It could also help some foreign consumers avoid British Columbia's 15 percent transfer tax [introduced in August 2016](#) on residential property transfers to foreign entities in the greater Vancouver area. Several weeks after the tax went into effect, British Columbia's Ministry of Finance announced that it had [quickly caused a drop in real estate transactions](#) involving foreign nationals.

"When the tax was first implemented, it crashed the market; everything just stopped," said Ray Vesely, CEO of Apex and architect of the rent-to-own program. Property values dropped about 15 percent and homes didn't start selling again until January, he said. Prices have since recovered a bit, but the single detached housing market is pretty flat, he added.

For purposes of the foreign buyers' tax, foreign entities include foreign nationals, defined as transferees who aren't Canadian citizens or permanent residents. Permanent residents must live in Canada for at least two years in a five-year period. The tax applies to transfers registered with the provincial land title office on or after August 2, 2016, regardless of when the purchase and sale contract is entered into.

Under Apex's rent-to-own program, the parties sign a sale and purchase agreement, but buyers are given five years to close on the deal, according to the company's website. The buyer pays a 5 percent deposit in return for the option to buy the home in the future. Normally the required down payment in the area is closer to 20 percent for the first C \$1 million and can go up after that, Vesely said. The purchase price is agreed on at the time of the initial agreement.

The arrangement effectively gives homebuyers time to get their permanent resident status so they aren't foreign purchasers by the time the deal closes. "That's all it really is; it's pretty straightforward," Vesely said.

Will It Work?

According to Byron Burley, vice president of Chinese international real estate website Juwai.com, 27 percent of Chinese consumers looking at Canadian property and responding to Juwai's inquiries are buying for the sake of education and sending their children overseas for school. Eighty-three percent of wealthy Chinese intend to educate their children overseas, according to Juwai.

But people in Canada temporarily, like students or foreign workers, are not permanent residents, according to the national government.

Despite foreign buyers' taxes in both Vancouver and Toronto, Chinese consumers' interest in Canada in the first half of 2017 was up by 30 percent over the first half of 2016, Burley said during a September 19 interview with Canada's *Business News Network*. The second half of 2017 has been on par with 2016, and 2015-2017 have each been banner years for interest in overseas property, he said.

In 2015 and 2016, Canada was consistently the third-ranked country for Chinese consumers interested in investing money in overseas property, Burley said. Canada has now dropped to fourth place behind Thailand, but when investment value is aggregated, Canada is still third, he said.

The foreign buyers' tax has certainly had an effect on Chinese interest in resale property and could be a deal breaker for some, Burley said. But if consumers get in early enough during preconstruction sales processes for condominiums, buyers can still end up with a home or investment property at a decent price in a top market, he said. Asked whether interest from Chinese consumers is spreading to other cities in Canada, thanks to Canadian provinces' whack-a-mole approach to taxing foreign buyers one metro area at a time, Burley said Calgary and Ottawa "are starting to benefit."

Carrie Law, CEO of Juwai.com, told Tax Analysts that the company tells its buyers to look for two things when they are offered a program like Apex's: whether it's approved by the government and if it makes sense as an investment. "In this case, the program fails the first test," Law said. Canada's rising house prices are being blamed on foreign buyers, but it's more likely that they're being driven up by move-up buyers leveraging the equity in their existing homes, Law added.

British Columbia's Ministry of Finance told Tax Analysts that "rent-to-own models cannot be used to avoid the additional property transfer tax." The Property Transfer Tax Act includes a broad antiavoidance rule that prevents individuals from structuring a transaction to avoid paying the additional tax, according to the ministry's statement. "The government takes tax avoidance attempts extremely seriously," and will ensure that the appropriate tax is applied, it added.

When the finance ministry announced the tax, **it similarly warned that antiavoidance provisions would be enforced "to ensure all foreign entities report and pay the additional tax." Failure to comply, providing incorrect information, or other types of tax avoidance could lead to a fine of up to C \$100,000 for individuals and up to two years in prison, the finance ministry said.**

The common classic tenets of ownership are possession, use, and risk, according to Kim Moody of Moodys Gartner Tax Law LLP in Calgary, Alberta. A buyer taking advantage of the

rent-to-own strategy would of course argue that he or she doesn't have all possession, use, and risk of the property during the rental period, Moody said, adding that there might be some use, but ultimately the risk still accretes to the legal owner. The statements on the Apex website about avoiding the foreign buyers' tax are strong, however, making it a pretty safe bet that the government is aware of the strategy, he said.

The government could argue that the whole arrangement is an avoidance strategy because it believes that possession, use, and risk have passed to the buyer, but the counterargument is that legal form matters in Canada, Moody said. "It's not substance over form, it's legal form, and that could be a fairly strong argument," he said.

Vesely said his company has an interest in retaining ownership during the rental period as security for the financing of the property. The ownership title stays in Apex's name until equity has built up enough that the purchaser can qualify for a loan at a bank and close on the purchase, Vesely said. He added that he thinks the government will respect the characterization of transactions under the program as rentals until a sale closes.

The British Columbia government could take the position that a rent-to-own agreement is a "taxable transaction" if the option to purchase is registered in the Land Title Office, said Andrew Morrison of Shields Harney in Vancouver. If it isn't, that may limit a buyer's recourse if the developer wants to sell the property to someone else, he said.

The government could change the law if it wants to capture arrangements like this, Moody said. Minister of Finance Bill Morneau did something similar a year ago when he announced that going forward, individuals who weren't resident in Canada in the year they acquired a residence would not be able to claim a principal residence exemption for capital gains tax for that year on the sale of that residence.

But if the intent of the foreign buyers' tax is to avoid artificial increases in Vancouver property values so that homes remain affordable for the average Canadian, and to curb money laundering that could otherwise occur when foreign investors park money in real estate, it's not clear that the rent-to-own program would frustrate those purposes, Moody said. "If those are truly the policy objectives, maybe there's not a lot of mischief here," he said.

A rent-to-own program might not cause an immediate artificial increase in property values, Moody said. Potential buyers aren't actually buying the property, they're just putting 5 percent down, he said. Nor is money laundering likely in a 5 percent down scenario. On the other hand, this does look like an easy way around the tax; "if I was a policymaker, I'd certainly take a look at this," he said.

Vesely said he originally envisioned the program as something that would help people who couldn't afford a typical down payment in the region. It wasn't until an American buyer suggested that it could provide a way around the foreign buyers' tax that he used that possibility in marketing.

Vesely maintains that the program is on sound tax footing. He acknowledged that the government could use policy changes to attack the program, but said that wouldn't be in its best interest. The foreign buyers tax is targeting people that are living abroad and raising prices by flipping houses — people with no intent to live here — he said, adding that the rent-to-own

program doesn't work for those buyers. "If the government is going to go after immigrants that are trying to set up an honest life in Canada, that wouldn't be good press," Vesely said.