HST Issues of Interest: Taxation of Sales of “Vacant Land”

Carl Irvine
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Introduction

- HST Treatment of Sales of Real Property
- Overview of the Vacant Land Exemption
- Conditions for the availability of the Vacant Land Exemption
  - Individuals and “personal trusts”
  - Excluded sales
- Managing HST risk
HST Treatment of Sales of Real Property

- Generally, sales of real property are taxable under the *Excise Tax Act* (the “ETA”), unless there is an express exemption.

- Exemptions for sales of real property are, generally, found in Part I of Schedule V of the ETA, including two major ones:
  - Sections 2-5: various exemptions for supplies of “residential complexes”
  - **Subsection 9(2): vacant land, etc.** (the “Vacant Land Exemption”)

- Certain sales of real property by charities and “public service bodies” are also exempt under special provisions dealing with supplies by such entities.
Overview: The Vacant Land Exemption

• Subsection 9(2) of Part I of Schedule V of the ETA
• Applies to “a supply of real property made by way of sale”, provided that two conditions are satisfied:
  1. vendor must be an individual or a “personal trust” (as defined for purposes of the ETA)
  2. sale must not be a sale described in paragraphs 9(2)(a) to (f) of the Vacant Land Exemption
Overview: The Vacant Land Exemption (cont.)

- In theory, the Vacant Land Exemption is potentially available in respect of a sale of almost any type of real property, provided that both of the two conditions are satisfied
  - other than a “residential complex”

Examples of sales that may qualify:
- a residential property where “excess land” is not part of the “residential complex”
- a condominium locker that is sold separately from the condominium
- a hobby farm
- an abandoned or derelict building
Condition 1: Supplier must be an Individual or Personal Trust

- The Vacant Land Exemption is only available where the supplier is an individual or a “personal trust”
- For purposes of the ETA, a “personal trust” means
  - a testamentary trust, or
  - an *inter-vivos* trust that is a “personal trust” for purposes of the *Income Tax Act (Canada)* (the “*ITA*”) whose beneficiaries consist of:
    - non-contingent beneficiaries who are individuals, or
    - contingent beneficiaries, who are individuals, charities or “public institutions” (as defined in the ETA)
Condition 1: Supplier must be an Individual or Personal Trust (cont.)

• While this condition is seemingly straight-forward, it is a source of potential traps in, for example:
  • Real property is held by partnership with individual partners (see, for example, Ko v. R., or Dhir v. R)
  • Real property is held by an individual as bare trustee or agent for a corporation or partnership
  • Real property belonged to an individual/personal trust, but was seized by creditors (contrast this with the treatment of the land if sold by a receiver)
Condition 2: Sale is not an Excluded Sale

- Sales of real property by individuals or personal trusts are exempt unless the sale falls within one of 6 exclusions:
  1. Sale of capital property used primarily in a business (para. 9(2)(a))
  2. Sale in the course of a business or an adventure in the nature of trade (para. 9(2)(b))
  3. Sale of previously subdivided or severed land (para. 9(2)(c))
  4. Certain deemed supplies (para. 9(2)(d))
  5. Sale of a residential complex (para. 9(2)(e))
  6. Return of property to the original vendor (para. 9(2)(f))
1. Capital Property Used Primarily in a Business

• Exclusion applies to capital property that is used primarily (understood as more than 50%):
  • in a business (carried on with a reasonable expectation of profit, “REOP”) or,
  • if the supplier is a GST/HST registrant, in the course of making supplies by way of lease, license, etc.

• Determination of “primary” use is a question of fact
  • Non-use should not be taken into account in determining “primary use”
1. **Capital Property Used Primarily in a Business (cont.)**

- Sale of capital property used in a business is only excluded if business carried on with a REOP
- Extensive case law on what constitutes a REOP
- Sale of property used in a business not carried on with a REOP may still be exempt (i.e., a hobby farm)
- Definition of “business” for HST purposes is very broad
  - Includes leasing and licensing activities engaged in on a “regular and continuous basis”
- Capital property used for leasing (but not in a business) is only excluded from the Vacant Land Exemption if the vendor is an HST registrant
2. Sales made in the course of a business

- This exclusion applies to sales made:
  - in the course of a business carried on by the vendor; or,
  - if the vendor and the recipient jointly elect, to sales made in the course of an “adventure or concern in the nature of trade” of the vendor

- This exclusion is the counterpoint to the exclusion for capital property used in a business – catches sales of inventory
2. Sales made in the course of a business (cont.)

- For GST/HST purposes, a “business” does not include an “adventure or concern in the nature of trade”
  - Differs from ITA definition of a business
- In some cases it can be tricky to determine whether supply is made in the course of a business
- Where the sale is made in the course of an adventure or concern in the nature of trade, the parties can elect to treat the sale as taxable by filing form GST 22
  - Election form must be filed prior to the completion of the sale
3. Subdivided Properties

• A sale of real property will be excluded from the Vacant Land Exemption where the individual, the trust or the settlor of the trust previously subdivided or severed the land unless:
  • The land was not severed into more than 2 parts, or
  • The severed land is supplied to an individual who is related to, or a former spouse or common-law partner of, the individual or settlor of the trust for their personal use and enjoyment
3. Subdivided Properties (cont.)

- For the purposes of this exclusion, a severance will be deemed not to have occurred where the sale following a severance or subdivision is to an entity that has a right to expropriate the property (such as a municipality or public utility)
  - Property need not actually be expropriated or acquired under a threat of expropriation; it is sufficient that the recipient has a right under the relevant legislation to expropriate the property
- This exclusion may have effect even where the severance or subdivision predates the introduction of the GST
  - The CRA takes the position that a historical severance taints the Vacant Land Exemption
4. Deemed Supplies under sections 206 and 207 of the ETA

- These are change-of-use provisions which apply where individuals or personal trusts start or cease to use property in a “commercial activity”
- This exclusion is intended to ensure that the change of use rules are not avoided in reliance on the Vacant Land Exemption
- Unlikely to be a live issue in the context of a transaction.
5. Sale of a Residential Complex

- Supplies of a “residential complex” will generally be exempt under Part I of Schedule V, so Vacant Land Exemption is not required.
- But, the Vacant Land Exemption can still be relevant to sales of residential properties.
- Land that does not form part of the “residential complex” may be exempt on the basis of the Vacant Land Exemption.
  - CRA generally considers land in excess of 0.5 hectares to be excluded from the “residential complex” and, therefore, a separate supply of real property.
5. **Sale of a Residential Complex (cont.)**

- A sale of partially constructed home (or, alternatively, partially demolished home) may also be exempt on the basis of the Vacant Land Exemption
- Property is not a “residential complex” if it is uninhabitable
- Consideration would have to be given to whether that sale occurs in context of carrying on a business or adventure or concern in the nature of trade
6. Re-supply to the original vendor

- Parties can elect to treat a sale of real property as a taxable sale where:
  - The recipient is registered for GST/HST;
  - The recipient previously made a supply of the property (the “prior supply”) to the vendor (or, in the case of the trust, the settlor of the trust);
  - The agreement for the prior supply gave the recipient a right or obligation to repurchase the property;
  - The sale occurs within one year of the earliest of the day on which the vendor (or settlor) acquired possession or ownership of the property
6. Re-supply to original vendor (cont.)

- Somewhat odd provision, but allows a vendor to return property to the original vendor and recoup HST paid (either by claiming an ITC or claiming a rebate under section 257 of the ETA)
- Election is made by filing form GST 22
  - Should be filed with recipient’s HST return for the relevant reporting period
Managing HST Risk

- Availability of Vacant Land Exemption is highly dependent on various questions of fact and mixed law and fact:
  - What is the “primary” use of the property?
  - Is it capital property? Inventory?
  - Is the vendor carrying on a business or an adventure or concern in the nature of trade?
  - Has the property ever been subdivided or severed?
- In many cases, the answers will be obvious, but not always
  - In some cases, the vendor may not be able to come to a conclusive answer on these questions (or may come to a different answer than the recipient)
Managing HST Risk (cont.)

• This is unlikely to be an issue where the recipient:
  • is an HST registrant and can claim ITCs to recover HST payable, or
  • is otherwise entitled to claim a rebate for some of the HST payable (such as a “public sector body”)
• To the extent that making a taxable supply allows vendor to claim a rebate for HST that it previously paid, it will prefer to characterize a sale as a taxable supply
  • Obviously, this will be a commercial issue for the recipient
Managing HST Risk (cont.)

Where HST status is unclear, consider different strategies for allocating HST risk between the parties:

- Purchase price is HST-inclusive
- Vendor gives a representation or certifies in writing that sale is HST exempt
- Recipient agrees to pay HST, if applicable
- Recipient agrees to pay HST, as well as interest or penalties assessed against vendor, if applicable
- Recipient pays HST, but vendor agrees to assist recipient in seeking rebate for HST paid in error
Questions?
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Carl Irvine, Principal
carl.irvine@mcmillan.ca
d 416.865.7266 | f 416.865.7048

McMillan LLP
181 Bay Street, Suite 4400
Toronto, ON M5J 2T3
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The statements and material presented herein do not represent legal or tax advice.

No transactions should be executed on the basis of the foregoing statements and commentary.

Formal legal, tax, and accounting advice should be obtained prior to making any investment or executing any transaction.