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New Rules and Reporting Requirements Coming for the Real Estate Sector

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As 2022 comes to a close, we draw your attention to certain new and proposed legislation that the Canadian federal government has introduced and that will have important implications for Canadian residential real estate and the Canadian real estate sector more broadly. Specifically, we offer high-level comments on (i) the prohibition on the purchase of residential property by non-Canadians, (ii) the underused housing tax and (iii) new limitations on interest deductibility that are particularly relevant to the real estate sector.

Prohibition on the Purchase of Residential Property by Non-Canadians

On June 23, 2022, Parliament adopted the *Prohibition on the Purchase of Residential Property by Non-Canadians Act* (Prohibition Act).

The Prohibition Act prohibits non-Canadians from purchasing (directly or indirectly) residential property (as that term is defined in the Prohibition Act) in Canada for a period of two years starting on January 1, 2023. The prohibition applies to “non-Canadians,” which generally means (i) individuals who are not Canadian citizens, permanent residents of Canada, or registered as an Indian under the *Indian Act*, (ii) corporations that are not incorporated in Canada, and (iii) corporations that are incorporated in Canada but are “controlled” by non-Canadians.

By virtue of regulations released on December 21, 2022:

- a “purchase” includes the acquisition (with or without conditions) of a legal or equitable interest or a real right in a residential property and thus can apply to the acquisition of lesser rights in a property than the right of ownership, with limited exceptions;
- “control” of a corporation or entity is expansively defined to mean direct or indirect ownership of shares or interests representing 3% or more of the value of the equity or carrying 3% or more of the voting rights;
- “residential property” includes vacant land if it is located in an urban area and is zoned for residential or mixed use; and
- the prohibition does not apply to residential properties that are located in certain non-urban areas.

The prohibition does not apply if the non-Canadian becomes liable or assumes liability under an agreement of purchase and sale of the residential property before January 1, 2023.

Underused Housing Tax

The underused housing tax (UHT) is a new national 1% tax imposed annually on the value of non-Canadian-owned residential property that is considered by the legislation to be “underused.” These new rules are in force for the 2022 calendar year and may have implications for certain Canadian owners of Canadian residential real estate (as well as for non-Canadian owners), even if the residential property may not actually be “vacant” or “underused” as those terms are understood in ordinary parlance.

Filing obligation. Every person that is an owner of a residential property (as defined in the legislation) on December 31 of a calendar year is required to file a UHT return for the calendar year by April 30 of the following calendar year unless the owner is an “excluded owner.” One category of excluded owners consists of individuals who are Canadian citizens or Canadian permanent residents, provided that they own the residential property directly in their personal capacity. However, if the individual owns the property through a corporation, trust or

partnership, that entity is generally not an excluded owner and has a UHT filing obligation even if the property is not “underused” for purposes of the UHT.

Tax liability. An owner (other than an excluded owner) of a residential property on December 31 of a calendar year is subject to a 1% tax on the “taxable value” of the residential property unless exempted. In general terms, exemptions are available under certain conditions for Canadian ownership, new owners (i.e., where the residential property was acquired in the calendar year), residential properties that meet “qualifying occupancy” requirements, “seasonally inaccessible” residential properties, residential properties that are uninhabitable for certain periods due to disasters or renovation, and vacation properties in non-urban areas. There are also exemptions that apply depending on the moment in the calendar year that the construction of the residential property was substantially completed.

Persons that are owners on December 31, 2022 of properties that are “residential properties” for purposes of the UHT legislation should be mindful that they may be required to file a return and, unless exempted, pay the 1% tax by April 30, 2023.

New Interest Deductibility Rules

On November 3, 2022, the Department of Finance (Canada) released revised draft legislation on the proposed rules regarding excessive interest and financing expenses limitation (EIFEL). Briefly, the EIFEL rules limit the deduction, for income tax purposes, of “interest and financing expenses” of corporations and trusts (that are not “excluded entities”) to a fixed percentage, or “fixed ratio,” of earnings before interest, taxes, depreciation and amortization (EBITDA). Subject to the application of the group ratio rules, the ratio will be 40% for taxation years beginning on or after October 1, 2023, and 30% for taxation years that begin on or after January 1, 2024.

The revised EIFEL rules generally do not address their disproportionate impact on certain capital-intensive industries, such as real estate. The only potential relief is for qualifying consolidated groups that may elect under the group ratio rules. These rules are very complex and generally require audited consolidated financial statements. It remains to be seen whether Canada will adopt similar explicit exceptions for all real estate and infrastructure investment, such as is the case in the United States. Failure to do so may lead to investors increasing investment outside Canada and reducing investment in Canada.

Relief is generally provided for sale-and-leaseback transactions in respect of buildings, but uncertainty remains in respect of sale-and-leaseback transactions in respect of land or land and buildings.

For our full commentary on the revised proposals, see [Canada Releases Revised Draft Legislation on New Interest Deductibility Rules](#). The deadline for providing comments on the revised proposals is January 6, 2023.

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