

# CRA Responses to Questions

Received from: Renzo Isabella/Isabella Law Professional Corporation concerning purchaser's liability under section 116 of the Income Tax Act<sup>1</sup>: 25% or 50%?

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## *S 116 provides for 2 types of holdbacks*

- *For non-depreciable capital property, at a rate of 25%*
- *For depreciable capital property, at a rate of 50%*

*CRA practice is to issue comfort letters, to permit real estate transactions to close with a holdback in place in the lawyer's trust account while a clearance certificate is processed. However, the comfort letters do not indicate the rate of holdback, and simply state that the appropriate amount is to be held back.*

Where a vendor has submitted a Notification in respect of section 116 and a certificate of compliance has not been issued by the time the purchaser remittance is due, the purchaser or vendor may request that the Canada Revenue Agency (CRA) provide a section 116 Comfort-Hold Remittance letter (comfort letter).

Examples of when a comfort letter will be considered:

- CRA delay in processing a T2062
- additional information has been requested by CRA
- a referral to another section in CRA has been made

The comfort letter advises the purchaser to hold in trust, for the Receiver General, the tax withheld for the vendor as required by subsection 116(5) and 116(5.3) until the CRA completes its review and requests the tax owing.

Comfort letters are usually issued at the beginning of the T2062 notification process, well before a CRA officer has reviewed the file and therefore the CRA has not considered nor confirmed the nature of the property. At this point, however, the purchaser and vendor are considerably more cognisant of the facts in relation to the nature of property involved.

## An overview of Section 116:

When buying property from a non-resident of Canada, a purchaser withholds an amount of the purchase price from the vendor because the purchaser can become liable to pay an amount under section 116. Where the CRA has not issued a certificate of compliance, the purchaser is liable to pay an amount to the CRA within 30 days of the end of the month in which the property was acquired.

The amount of payment that could be required depends upon the type of property involved.

- Subsection 116(5) requires a payment of 25% of the purchase price [for property other than property described in subsection 116(5.2)<sup>ii</sup>]
- Subsection 116(5.3) requires a payment equal to 50% of the purchase price for property referred to in subsection 116(5.2), such as a rental building.

**Examples:**

If the property is a personal-use property (for example a principal residence or a summer cottage), the 25% rate applies pursuant to subsection 116(5).

If the property is an income-producing property (for example, a rental property), the 50% withholding rate applies to the cost of the building pursuant subsection 116(5.3).

As mentioned, the CRA may issue a comfort letter to the purchaser to allow the purchaser to retain, without remitting, the amount until the CRA completes the review. This comfort letter confirms that a notification has been received and is under review. The letter authorizes the purchaser to not remit any amount at that time and advises that penalties and interest will not be charged as long as the purchaser remits any required tax when notified by the CRA to do so.

In order to comply with subsections 116(5) and (5.3), the purchaser, or the purchaser's solicitor, must make the determination of the amount required to be withheld from the purchase price until the such time as the CRA completes its review and requests the tax owing.

*Q1. In situations such as real estate where a single agreement covers a transfer of land and building, is the CRA interpreting the legislation as requiring a 25% holdback on land and a 50% holdback on building?*

Yes, **if** the property is an income producing property that includes both land and building, then the rates are:

- 25% - land
- 50% - building

Whenever a property disposition includes both land and buildings, and the building is depreciable property (e.g. rental property), the purchase price must be allocated between the land and the building. The 25% rate applies to the portion of the price that applies to the land [subsection 116(5)] and the 50% rate applies to the portion of the price that applies to the building [subsection 116(5.3)].

**Example:**

A rental property is purchased for \$500,000.00

The building is estimated to represent 90% of the value of the entire property

The amount the purchaser could become liable to pay, and therefore, the amount that should be withheld, is calculated as follows:

Building: \$500,000 x 90% = \$450,000 x 50% =	\$225,000
Land: \$500,000 x 10% = \$50,000 x 25% =	<u>\$ 12,500</u>
Total:	<u>\$237,500</u>

This amount is determined in consideration of any potential taxes for which the non-resident vendor may ultimately be liable in respect of the recapture of capital cost allowance on the building, and any capital gain on the disposition. Both a T2062 notification and a T2062A notification are required to be filed by the non-resident vendor when the property is land and building **and** the building is depreciable (e.g. a rental property).

**Note:** An allocation of the cost between land and building is not required when the property is Personal- Use Property (e.g. a personal residence or a summer cottage that is not rented).

*Q2. Where the allocation between land and building is required, on what basis should the parties allocate the purchase price between land and building?*

The allocation must be “reasonable” based on the fair market values of similar properties in the area and on the circumstance of the specific case (for example, is the building in disrepair; is the property valuable only because of the land?).

Sometimes, the breakdown of the value between land and building is stated in the purchase and sale agreement (which again needs to be based on market conditions). The CRA will generally accept this breakdown when it appears to be reasonable and the parties (the buyer and the seller) are dealing at arm’s length. The provincial registry may be helpful. In some provinces, the registry provides a breakdown of the assessed value between land and building.

Generally speaking, CRA will accept a reasonable breakdown for purposes of determining the amount of the holdback. In the rare case where there is a major disagreement in the values used, then a formal appraisal may be required.

**Note:** If, as the purchaser, it is uncertain whether subsection 116(5) or (5.3) applies, then it is best to withhold 50% of the full purchase price [i.e. apply subsection 116(5.3)] until a certificate of compliance or other confirmation is received from the CRA.

*If it is to be conducted based on vendor's filings, what should parties do in situations where:*

- *a vendor claims they have not taken any depreciation or claims they have not made any filings, or*

A property is a depreciable property regardless of whether or not the vendor has claimed capital cost allowance [depreciation]. Therefore, when acquiring a building that is depreciable [i.e. an income producing property], the amount the purchaser could become liable to pay is 50% of the cost of the building plus 25% of the cost of the land, regardless of whether the vendor has claimed capital cost allowance in respect of the building.

- *where, the property is a personal use property and no depreciation has been taken*

An allocation between land and building is not required when the property is a personal use property. The amount the purchaser could become liable to pay is 25% of the cost of the personal use property [land and building].

*Q3. What evidence supporting the answers to Q2 should a purchaser obtain to protect themselves from a CRA assertion that a higher amount should have been allocated as depreciable capital property?*

As mentioned above, the CRA will normally accept a reasonable breakdown. The breakdown reported on a T2062/T2062A notification provided by a vendor would normally be accepted, provided it is reasonable in the circumstances.

However, if the situation arises where the CRA requests the remittance of the holdback from the purchaser, and the purchaser does not agree with the amount requested, then the purchaser should provide CRA with the calculation of the amount withheld by the purchaser. Purchasers can provide the CRA with information to show how they calculated the allocation, including any documentation they may have used to support their calculation, such as:

- provincial tax assessment values ,
- comparable information relating to other properties in the area,
- details on the condition of the building,
- a copy of any appraisal or letter of opinion obtained from a realtor familiar with properties in the area.

Usually, the allocation of the cost between the building and the land is not an issue. If there is a major disagreement where the CRA and the purchaser are far apart in terms of the allocation, a professional appraisal would be required to resolve the issue.

As noted above, if as the purchaser, the amount required to be withheld is uncertain, then it is best to withhold 50% of the purchase price until a certificate of compliance, or other confirmation, is received from the CRA.

## References:

Income Tax Act subsections 116(5.2) and 116(5.3)

[IC72-17R6 Procedures Concerning the Disposition of Taxable Canadian Property by Non-Residents of Canada - Section 116](#)

[Disposing of or acquiring certain Canadian property](#)

[T2062 Request by a Non-Resident of Canada for a Certificate of Compliance Related to the Disposition of Taxable Canadian Property](#)

[T2062A Request by a Non-resident of Canada for a Certificate of Compliance Related to the Disposition of Canadian Resource or Timber Resource Property, Canadian Real Property \(Other Than Capital Property\), or Depreciable Taxable Canadian Property](#)

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<sup>i</sup> Unless otherwise note, all legislative references are to the Income Tax Act (Revised Statutes of Canada, 1985, c. 1 (5th Supp.))

<sup>ii</sup> For the subject matter of this paper, references to subsection 116(5.2) are in respect of a disposition of depreciable property that is a taxable Canadian property, such as a rental building.