



22 of the Best Tax Tips for Non-Residents Owning Rental Property in Canada

The following tips are for the benefit of non-resident individuals, corporations or trusts that own rental property in Canada. These tips would also be beneficial to those who serve as agents or professional advisors for non-resident owners. Because of the complexity of this subject, property owners and their agents should seek professional tax and accounting advice so as to minimize their tax liability under Canadian law.

Definitions

- 1 **Gross rents** - total revenue from a rental property, before operating expenses are deducted. This includes the recovery of expenses where property is rented on the triple net basis.
- 2 **Net rents** - gross rents minus all expenses, except depreciation. When a property is heavily financed, net rents are likely to be much lower than gross rents, and may also be zero.
- 3 **Net income** – net rents, less depreciation of the building.
- 4 **Depreciation of the building** - the amount deductible for tax purposes each year. You do not have to claim any depreciation; you can claim zero up to the maximum deduction for the year. You cannot carry forward depreciation not claimed in prior years. Depreciation is usually 4%. It cannot be used to create a net rental loss for the year. Depreciation may be subject to recapture (see below) when the property is sold.
- 5 **Undepreciated cost** - the original cost of the building less the accumulation of depreciation over the years.
- 6 **Recapture** - the opposite of depreciation; the amount that is added to income: it is a portion or all of the prior years' cumulative depreciation if the building is sold for more than the undepreciated cost.
- 7 **Depreciation and recapture tax ramifications** - depreciation is deductible every year, but the recapture is taxable in the year the property is sold.

Taxation

- 8 **Taxation options** - the Canadian Income Tax Act provides non-resident owners of Canadian rental property with two choices for monthly tax remittances: one is based on gross rents, the other is based on net rents; your choice will depend on how heavily financed the property is, on management fees and on other expenses.

- 9 **Taxation based on gross rents** - under this option, monthly tax remittances are based on 25% of gross rents collected during the previous month. Under some circumstances this amount could be lower than the final tax based on net rents.
- 10 **Taxation based on net rents** - under this option, monthly tax remittances are based on 25% of net rents. This option is possible only if the non-resident first files with Canada Revenue Agency (CRA) Form NR6 and later a Canadian Income Tax return. This option usually, but not always, results in a lower tax liability than taxes based on gross rents. There is one problem with this option: there are few property managers who will agree to sign this form and accept the responsibility as agent, because they are responsible for making sure the tax return is filed.
- 11 **Monthly remittances and rates** - taxes must be remitted to CRA on a monthly basis and are computed at 25% of the gross or net rents of the previous month. Taxes must be remitted by the 15th of each month.
Summary – if you are fortunate to find a property manager who will agree to be your agent and take responsibility for filing your tax return, you should file the NR6 and have taxes withheld and remitted based on 25% of net rents. You will probably not find a property manager who will agree to be your agent. That means you will have taxes withheld and remitted based on 25% of gross rents. You need a property manager who will prepare your accounts quickly after the end of the year and you need an accountant who will file your return quickly so that you can recover your overpayment of taxes as quickly as possible.
- 12 **Annual Canadian Tax Return (T1)** - if a non-resident files Form NR6 and remits taxes based on net rents, the non-resident is required to file a return by June 30th, reporting the rents from the preceding year. The final tax payment or refund is calculated by subtracting the total amount of taxes remitted on a monthly basis from the total taxes payable. If no election (NR6) is made and taxes are remitted at 25% of gross rents, a Canadian tax return is not required on rents. A Canadian tax return will be required only when the property is sold. There are few situations where the taxes will be more than 25% of gross rents.
- 13 **Tax rates on net income** - for non-residents filing a Canadian tax return, the approximate tax rates are: on the first \$35,000 of net income, approximately 22%, on the next \$35,000, approximately 32%, on the next \$45,000, approximately 38%, and on amounts above \$115,000, approximately 43%.

Tax Forms

- 14 **CRA Form NR6** - by filing an NR6 form, the non-resident undertakes to file a Canadian income tax return. A non-resident must file the NR6 form annually in early December before receiving rent from a Canadian property. It allows the non-resident (or an agent for the non-resident) **to remit tax monthly based on net rents.**
- 15 **CRA Form NR4** - the NR4 form is prepared by the agent annually confirming the total amount of taxes remitted on rents during the preceding year. The NR4 has to be filed even if no amount is paid to the non-resident.

- 16 **Consequences of not filing a NR6** - a non-resident who does not file an NR6 form before receiving rents is required to remit monthly 25% of gross rents to CRA. This is now the norm in Canada because the agent must be the property manager and most property managers will not accept the responsibility to file a Canadian tax return.

Taxation Decisions

- 17 **Filing NR6** - it is generally prudent and beneficial to submit an NR6 form (before rents are collected, and then again annually, covering the next year), followed by a Canadian tax return (also annually). This way monthly tax remittances will be based on net rents and not on gross rents. In all but exceptional cases, the total tax required to be paid will be lower by filing an NR6 and a Canadian tax return. If you wish to file a Canadian tax return, you do not have to file an NR6. But you should file your return within two years. We mentioned above that there are few property managers who will agree to be an agent because they are responsible for filing the Canadian tax return reporting income for all Canadian properties owned by the non-resident.
- 18 **When to consider not filing an NR6** - a non-resident with high rental revenue and low expenses (for example: no interest expense, as is the case if the property is not financed) may consider not filing an NR6 form. This would allow the non-resident to file a Canadian tax return only for the year the property is sold.
- 19 **Filing deadlines (Form T1)** - form T1, or individual income tax return (reporting only rental income from Canadian rental properties, **section 216** return) must be filed by June 30th of each year unless you disposed of a property and have recapture of capital cost allowance to report – then the tax return is due **April 30**. Failure to file the tax return on time will cause the monthly tax remittances to revert from net rents to gross rents. For example: assume that an NR6 was filed in 2004 applying to 2005 rents, but a T1 form was not filed by June 30 2006. In this case the withholdings will revert to 25% of gross rents; the difference between this amount and the amount already remitted is due immediately and payable by the agent. If the T1 form reports only the disposal of Canadian properties (**a section 116 return**), it must be filed by June 30th.
- 20 **Can you switch between options?** – yes, if the non-resident does not file an NR6, the agent is required to remit taxes based on gross rents.
- 21 **What if you sell your property?** - non-residents should file form T2062 (i.e.: a notice by a non-resident of Canada concerning the disposition or proposed disposition of taxable Canadian property = land) before the property is disposed of (and a T2062A reporting the proposed disposition of the building). If the form is not filed, the purchaser must withhold and remit taxes based on 25% of proceeds instead of on the estimated gain. The tax remitted with the T2062 (and T2062A) form typically exceeds the actual tax obligation. A tax return must be filed to recover the excess taxes remitted.

Partnerships that include non-residents and residents

- 22 **Withholdings required from Canadian residents also** – if a Canadian resident is part of a partnership that includes non-residents, monthly withholdings are required to be remitted for the Canadian partners. The withholdings can be based on 25% of net if permitted by CRA. For CRA to permit the Canadian partners to remit based on net, each partner is required to write a letter to CRA explaining the situation. CRA will usually provide approval to reduce the withholdings for the Canadian partner to 25% of net.

Bonus tip – how to own your rental property

- 23 **Own Canadian rental property personally (or through a partnership); do NOT Own Through a Corporation** – let's look at the additional taxes if you incorporate a company to hold your Canadian property and you earn \$120,000 or make a capital gain on sale of \$120,000 (the additional taxes are worse on lower earnings):