Planning using principal residence trusts for immigrants to Canada

Moodys
July 9, 2015

As many of our readers know, the Canadian Income Tax Act (the "Act") provides for an unlimited exemption from the imposition of Canadian income tax on the gains resulting from a disposition of a "principal residence". Access to the principal residence exemption can be valuable, especially in cities (e.g. Vancouver, Toronto, Calgary) where residential properties have enjoyed robust appreciation.

Non-residents of Canada are subject to Canadian taxation on the disposition of Canadian real estate, but a non-resident owner cannot claim a principal residence exemption. This is because the capital gain belongs to the owner but the principal residence exemption is only available to Canadian residents.

A trust, however, can own a residence. If a trust disposes of a principal residence, any gain belongs to the trust. Canadian resident trusts have their own principal residence exemption. As long as the trust is resident in Canada, access to the principal residence exemption does not require that the trust's settlor or beneficiaries be Canadian residents. Rather, the requirement is that the residence be "ordinarily inhabited" in each of the calendar years ending in the year for which the exemption is claimed by a "specified beneficiary" of the trust.[1] But it is the trust itself that claims the principal residence exemption.

Is it possible to ordinarily inhabit a Canadian residence without being a resident of Canada for Canadian tax purposes? Absent access to a tax treaty with residency tiebreaker rules, the answer would probably be no. Where there is a treaty with tiebreaker rules and a home is available to the individual in both countries, it will be necessary to try and determine the individual's "centre of vital interests". This would include personal interests and economic interests. If an individual's economic interests are in one country but the individual's personal interests are in another country and it is not possible to determine his or her centre of vital interests, this would then require moving on to the next tiebreaker rule in the applicable treaty. Assuming, for example, an individual has an "habitual abode" in both Hong Kong and Canada, the next tiebreaker rule in the Hong Kong – Canada Treaty would be the country where the individual has a right of abode or of which he is a national. As a further example, if an individual has an "habitual abode" in both Canada and China, the next tiebreaker rule in the Canada – China Treaty would be the country of which the individual is a national.

Regarding residential properties for immigrants, it is not uncommon for a Hong Kong or China resident father to buy a Vancouver home in which his spouse and/or children reside while father, except for periodic visits, remains in Asia where his economic interest lies. Father might take the position that he is not resident in Canada for income tax purposes. In this case, no principal residence exemption would be available on the disposition of the residence because the owner (father) is not a Canadian resident taxpayer.

Instead, father's spouse could purchase the residence and the principal residence exemption would be available for each year as long as the spouse remained a Canadian resident and the residence was ordinarily inhabited in the years in respect of which the exemption was being claimed by her or a child.

But the spouse might not remain a Canadian resident throughout the ownership period, in which case the principal residence exemption would not be available for those years. As earlier mentioned, it is not unusual with immigrant families to have one spouse, say, the father, to be an “astronaut” with the result that from time to time some family members are Canadian residents whereas others are not. As the children get older, attend university (perhaps outside Canada), commence working and become independent, the spouse might return to Asia to join father while one or more adult children continue to live in the residence.

Often at the time the residence is purchased, the family simply doesn’t know where the various family members are going to be living 5, 10 or 15 years in the future. An advantage of having a Canadian resident trust own the residence is that the owner will be the trust which will remain resident in Canada for purposes of the principal residence exemption regardless of where the beneficiaries reside from time to time. Another advantage may be the fact that there could be multiple beneficiaries that can potentially satisfy the “ordinarily inhabited” test in various years; i.e. some in some years and others in other years. “Ordinarily inhabited” is a question of fact, but it can be for only part of the year. This is also one of the reasons that Canadian resident parents often put cottages in family trusts.

One has to be careful to ensure that the residency of the trust is in Canada. Formerly, the *Thibodeau*[2] case suggested that a trust would be resident were the majority of the trustees resided. But the *Saint Michael Trust Corp.*[3] case held that a trust is resident where effective management and control lies. So while the trust would have Canadian resident trustees, it is now important to ensure that effective management and control lies with them. Amongst other things, there should be a Canadian bank account where the Canadian resident trustees have signing authority which should be used to pay property taxes, maintenance, gardeners, renovations etc. This is not dissimilar to the steps that one would take to establish where the mind and management of a company lies.

Of course, one should be mindful that planning with Canadian resident trusts to hold principal residences should not be attempted if the settlor, trustee(s) or beneficiaries are US citizens or residents. This could lead to significant US reporting and tax complications that could scuttle any benefits.

1. See paragraph (a.1) of the definition of principal residence in section 54 of the Act. A specified beneficiary is defined in paragraph (c.1) as someone who, in the calendar year ending in the year is beneficially interested in the trust and who ordinarily inhabited the housing unit or has a spouse or common-law partner, former spouse or common-law partner or child who ordinarily inhabited the housing unit. “”Beneficially interested” is defined very broadly in subsection 248(25) as including any person that has any right (whether immediate or future, whether absolute or contingent or whether conditional on our subject to the exercise of any discretion to receive any of the income or capital of the particular trust either directly from the particular trust or indirectly through one or more trusts or partnerships”. CRA has said that a life tenant who has the right to occupy a property but no right to income or capital would be as specified beneficiary (see IT9803755)

2. 78 D.T.C. 6376

3. 2012 SCC 14