Wealth Management

the Navigator

INVESTMENT, TAX AND LIFESTYLE PERSPECTIVES FROM RBC WEALTH MANAGEMENT SERVICES

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Investing in real estate

Many Canadians own real property in addition to their principal residence. These investment properties may include residential rental buildings, local retail plazas or small office buildings.

There are a number of ways you may hold your investment properties. Beyond tax considerations, you may need to think about factors such as financing options and restrictions, liability and creditor protection, flexibility in tax and estate planning, and privacy issues. To help you in navigating all of the potential options and considerations, this article discusses the Canadian tax implications of investing in real estate for the purposes of earning rental income and explores some of the different ownership structures available to you.

Please note that if you purchase an investment property for the purposes of earning income, it's generally considered a capital property. If you are in the business of buying and selling real property, the investment properties you purchase may be considered inventory. This article assumes that you're a Canadian resident and the investment property you own is capital property. Some of the information in this article may not apply to residents of Quebec.

Rental income from investment properties

Not all rental income is created equal. Rental income may be characterized as either "property income" (also referred to as passive income) or "business income" (also referred to as active income). This characterization is important because each is treated differently for Canadian income tax purposes in certain circumstances.

Property income is income earned in a passive manner. It requires little effort from the owner. For example, if you simply collect rent from the tenants, the rent is likely considered property income. Earning business income, on the other hand, requires significantly more involvement. The more and higher degree of services you provide, the more likely the income is business income. For example, you may provide linen,

maid and meal services to your tenants such that you are actually providing a service and not simply a space for use.

Expenses on your investment properties

Generally, you can deduct any reasonable expenses you incur to earn rental income.

Current or capital expenses

There are two basic types of expenses, "current expenses" and "capital expenses." This distinction determines the timing of the deduction.

Current expenses reoccur on a regular basis and generally provide only a short-term benefit. These expenses include maintenance and repairs to keep your rental property in the same condition as it was when you acquired it. For example, a current expense may be painting the hallways in your building. You can deduct current expenses from your rental income in the year you incur them.

Capital expenses provide a benefit that usually lasts for several years or improves a property beyond its original condition. For example, a capital expense may be replacing the roof of your building, as it provides a lasting benefit. Generally, you can't deduct the full amount of these expenses in the year you incur them. Instead, you add the expenses to the tax cost of the property, and you can deduct that cost over a period of several years as capital cost allowance (CCA).

Capital cost allowance (CCA)

If you rent out your property, you're generally able to deduct or write-off the purchase price of the property over a number of years against your rental income. The annual deductions or write-off is called capital cost allowance (CCA). It's based on a rate that applies to the CCA class the property belongs in. CCA can be claimed on the cost of the building, furniture and fixtures, etc. but not on the land. So, when purchasing an investment property, you will need to allocate the purchase price among the building, furniture and fixtures and the land.

You don't have to claim the maximum amount of CCA in any given year; in fact, you can claim any amount you like, from zero to the maximum allowed for the year. However, it's important to note that you generally can't use CCA to create or increase a rental loss (the CCA restriction). If you own more than one rental property, you have to calculate your overall net income or loss for the year from all of your rental properties before you can claim CCA.

The CCA restriction doesn't apply to a corporation where the principal business is the leasing, rental, development or sale of real property it owns. The CCA restriction also doesn't apply if your income is considered income from a business.

If you obtain a loan to fund the purchase of an investment property, the interest you pay may be deductible. Any payment you make towards the principal of the loan isn't deductible. It's important for you to be able to show that you're borrowing to acquire a property for the purposes of earning income.

The amount of CCA you claim on your building reduces the tax cost of your building. The tax cost remaining after the CCA deductions is referred to as the "undepreciated capital cost (UCC)." The opening balance of UCC is used to calculate the amount of CCA for the year. The UCC also comes into play when determining your taxes on the disposition of your property.

The CCA regime applies, regardless of the ownership structure you choose.

Interest expense

If you obtain a loan to fund the purchase of an investment property, the interest you pay may be deductible. Any payment you make towards the principal of the loan isn't deductible. It's important for you to be able to show that you're borrowing to acquire a property for the purposes of earning income. If you borrow to purchase a personal-use property, such as your home or a vacation property, the interest you pay on the loan is not deductible.

When you borrow money to construct, renovate or alter the property to make it more suitable for renting, you may not deduct the interest expense in the current year. The interest expenses you incur during the renovation period and relating to the renovation are not current expenses; instead, they should be added to the cost of the building. Generally, repairs and maintenance are not considered construction, renovation or alteration to the property. Determining whether you can deduct interest in these circumstances can be complex, be sure to speak with a qualified tax advisor if you are in this situation.

Rental losses

If you have a rental loss, you may be able to deduct your rental loss against your other sources of income. Keep in mind, though, that if you rent your property to a family member for less than fair market value rent and your rental expenses are greater than your rental income, you can't claim a rental loss. If you incur a rental loss in other circumstances, speak with a qualified tax advisor to determine your ability to claim a rental loss.

Ownership structures

In general, the ownership structures for your investment property include holding it personally, in a corporation, in a partnership or in a trust. The following sections discuss the tax implications of holding your investment properties in these structures.

Holding the property in your own name

This is the simplest form of ownership. You purchase the property and your name is registered on the deed. You have direct control over the rental of your property and receive all of the rental income personally. You also have unlimited personal liability for the debts and obligations of your rental operations.

Taxation of rental income

You report your rental income/ loss on your income tax return and the income/loss is taxed at your marginal tax rate. A rental loss in the current year is generally deductible against your other sources of income. Remember, you cannot create or increase a rental loss by claiming a deduction for CCA. This rule does not apply where your income earned from your real property is considered income from a business as opposed to income from property.

Sale of property

If you sell your rental property, the proceeds you receive must first be allocated among the land, building and any fixtures to determine the taxation of the sale. The proceeds allocated to the land less the adjusted cost base (ACB) of the land is the capital gain or capital loss on the land. If the proceeds allocated to the building are greater than the original cost of the building, you'll have a capital gain. If the UCC of the building is less than its original cost, recapture of CCA will occur. In this case, recapture is equal to the original cost less the UCC. If the proceeds allocated to the building are less than the original cost of the building, but are greater than the UCC, you don't have a capital gain but there is recapture of CCA.

You have to include 100% of the recapture on your income tax return. If instead the proceeds allocated to the building are less than its UCC, a terminal loss will result. A terminal loss is 100% deductible against your rental income and other sources of income. You cannot have a capital loss related to the building. There are rules that apply to the allocation of proceeds between land and building on the sale of a property. The rules are complex and beyond the scope of this article. Be sure to speak with a qualified tax advisor if you are selling a rental property to ensure that the tax implications of the sale are properly determined.

Proceeds allocated to any fixtures as part of the sale are taxed in the same manner as the building.

In general, the ownership structures for your investment property include holding it personally, in a corporation, in a partnership or in a trust.

Tax implications on death

On death, you're deemed to have disposed of your capital property, including your investment property, immediately before your death. The proceeds of disposition are deemed to be the fair market value of the property at that time, unless the property is left to your spouse or transferred to a qualifying spousal trust, in which case the deemed proceeds of disposition is your tax cost.

Joint tenancy vs tenancy in common

Instead of sole ownership, you may choose to hold your investment property jointly with your spouse, children and/or other parties. This arrangement may be used as part of your estate planning strategy. There are two co-ownership options, "joint tenancy" and "tenants-in-common." One of the key differences between these two joint ownership structures is that true joint tenants enjoy the right of survivorship while tenants-in- common do not.

Please note that Quebec residents with real property located in Quebec can't hold property in joint tenancy since the automatic right of survivorship does not exist under Quebec law. Quebec residents holding real property should discuss this matter with a qualified legal advisor.

Under a tenants-in-common arrangement, each tenant holds a percentage interest in the property. On death, your interest in the property forms part of your estate and is distributed according to your Will, or, if you have no Will, the provincial or territorial intestacy legislation. Under a true joint tenancy arrangement, each tenant holds a common or undivided interest. On death, your interest in the property may pass to the other joint tenant(s) by right of survivorship. If the property passes by right of survivorship, then it should not form part of your estate and therefore shouldn't attract probate fees.

Joint tenancy may appear to be a good estate planning idea for simplifying estate administration, reducing probate fees and passing the asset to your intended heir(s). However, there could be adverse consequences if you decide to own your property jointly with another person. For example, if you already own the property, you may realize a taxable disposition when you add someone, other than a spouse, on title to the property. If you add your spouse to the title of your investment property, attribution rules may apply to any income earned from

the property or capital gains realized on the sale of the property if your spouse has not paid fair market value consideration. Other considerations you may want to think about include the loss of control over your property and the exposure of the property to the other joint tenant's creditors. If you're considering transferring your property into joint tenancy, it's important that you get professional legal and tax advice to ensure that your estate planning objectives are met and your intentions are clearly documented.

When reporting the rental income from the joint property, generally you need to report your proportionate share according to your percentage of ownership of the property, subject to the attribution rules. Upon death, if your ownership interest in the property is not left to your spouse or transferred to a qualifying spousal trust, you are deemed to have disposed of your proportionate share of the rental property at the fair market value. Essentially you are treated to have sold your ownership interest in the property for fair market value. Please refer to the section on the sale of the property for information on the tax implications.

Canadian corporation

A corporation is a separate legal entity from its shareholders and generally provides its shareholders limited liability. Your personal liability is generally limited to the investment you made in the corporation and any personal guarantees you make on the debts of the corporation.

When you incorporate, you may capitalize your corporation with any amount. Your initial investment in the corporation can be withdrawn on a tax-free basis. You may choose to have family members as shareholders, either directly or indirectly through a family trust. This may allow more opportunities for income splitting and estate planning. If family members hold their shares directly, the corporation may consider issuing different classes of shares with different rights to each of the shareholders. This may provide flexibility in terms of paying dividends on some classes of shares and not on others, or different amounts according to the shareholders' needs.

If you want to implement income splitting strategies, keep in mind that there are attribution rules and "tax on split income" (TOSI) rules that limit splitting certain types of income with family members. These rules prevent you from shifting certain income from high-income earners to low- income earners. Before implementing any kind of income splitting strategy, consult with a qualified tax advisor. You may also ask an RBC advisor for articles on attribution and TOSI rules.

The corporation may buy the investment property outright if there is sufficient capital in the corporation. Otherwise, the corporation may borrow to make the purchase. Lenders may look to the shareholders for loan guarantees when there are no other assets in the corporation for collateral.

A corporation is a separate legal entity from its shareholders and generally provides its shareholders limited liability.

If you already hold the property personally, you may transfer it to a corporation on a tax-deferred basis by filing a joint tax election with the corporation. Any accrued capital gains and/or recapture is deferred until the property is sold or deemed to be disposed of in the future. If the property is currently generating a loss, you may want to consider transferring it at a later date when it is profitable. The rental loss is deductible against your other types of income if you hold the property personally. When the rental loss is generated within your corporation, the loss is trapped in your corporation and can only be used by your corporation.

If you're thinking about owning the property through a corporation, you should also consider the initial and ongoing costs of incorporation. Generally, you need to seek legal assistance for incorporation. You must file annual corporate tax returns, and this leads to higher annual administration, legal and accounting costs. When you're a single owner with one or two small investment properties, the added costs of maintaining a corporation may not be worthwhile. Corporate ownership may be more appropriate with a large investment property portfolio and/or multiple owners. However, if limiting your personal liability is an issue and it's too expensive to cover your potential liability through other avenues such as insurance, then incorporation may be worthwhile.

Taxation of rental income

A corporation is required to file an income tax return annually even if there are no taxes payable. The filing deadline is generally six months after the end of the corporation's fiscal period.

Income earned within a corporation is ultimately taxed at two levels, once at the corporate level and again at the personal level when the income is distributed to shareholders. However, this does not mean you are doubled taxed. One important principle of the Canadian tax system is a concept commonly referred to as "integration." Integration is the idea that an individual should pay the same amount of tax, whether the income is earned personally or through a corporation. The two levels of tax are integrated in a manner so that you are not double taxed.

As discussed earlier, rental income may be classified as either property income (passive) or business income (active). This applies even where you hold your rental property in a corporation. The same analysis is applicable to determine if your corporation is earning passive rental income or income from an active business. However, if your corporation's principal purpose is to derive income from property (including interest, dividends, rents and royalties) and it has more than five full-time employees, your rental income may qualify as active business income. You should consult with a qualified tax advisor if this determination isn't clear.

Income from property

If the income from your investment property is considered income from property, it is subject to the general corporate income tax and an additional refundable tax. The refundable portion of tax is recoverable by your corporation when it pays a taxable dividend to its shareholders. The purpose of the additional refundable tax is to eliminate any tax advantage of earning investment income in a corporation. For a more detailed discussion of how investment income is taxed in a corporation, please ask an RBC advisor for an article on this topic.

Generally, your corporation would be subject to the CCA restriction discussed earlier, which means it cannot use CCA to create or increase a rental loss. However, the CCA restriction doesn't apply to your corporation if its principal business is the leasing, rental, development or sale of the real property that it owns.

Income from property earned in a corporation may affect an associated company's ability to claim the small business deduction on its active business income. This can be a concern if your corporation runs an active business or you or your family members own another corporation that runs an active business. For more information, please ask an RBC advisor for our article on passive income inside a corporation.

Active business income

Corporations pay less tax on active business income than on passive income. The taxes payable on active business income may be further reduced if your corporation is eligible for the preferential small business corporation tax rate.

One of the most significant advantages of operating your business within a corporation is the ability to defer taxes. By incorporating and earning business income within your corporation, you can defer personal taxation on the business income until the time you withdraw it from your corporation. Generally, the longer you can leave the funds in your corporation, the greater the deferral advantage will be.

One of the most significant advantages of operating your business within a corporation is the ability to defer taxes. By incorporating and earning business income within your corporation, you can defer personal taxation on the business income until the time you withdraw it from your corporation.

For a more detailed discussion of the taxation of active business income in a corporation, withdrawing funds from a corporation and the applicable integrated rates for each province, please ask an RBC advisor for an article on this topic.

The CCA restriction discussed earlier should not apply to your investment property if the income earned on the property is considered income from an active business rather than income from property or rental income.

Sale of property

When your corporation sells an investment property, it may realize capital gains, recapture or terminal losses. The calculation of these items discussed earlier relating to individuals selling property also apply to corporations.

In addition, when your corporation realizes a capital gain, the non- taxable portion of the capital gain is added to your corporation's capital dividend account (CDA). The CDA is a notional account and it does not appear on your company's financial statements. It keeps track of the non-taxable portion of capital gains and the non-allowable portion of capital losses, as well as other amounts such as capital dividends received or paid by the corporation and certain life insurance proceeds received in excess of the policy's ACB. It is intended that the tax-free character of these amounts be transferable to shareholders. Your corporation can pay you a tax-free capital dividend if there's a positive balance in its CDA. The taxable portion of capital gains is taxed as investment income.

Tax implications on death of a shareholder

A corporation is a separate legal entity, it continues to exist even after the death of a shareholder. As such, the corporation could continue to operate and there is no disposition of the rental property.

On the death of a shareholder, the deceased shareholder is deemed to have disposed of their shares of the corporation immediately before death at the fair market value, unless the shares are left to a spouse or transferred to a qualifying spousal trust. This deemed disposition may

cause the shareholder to realize a capital gain/loss, which is reported on the shareholder's final tax return.

Without proper planning, there is the potential for double taxation when a shareholder dies holding private corporation shares. First, there's personal tax payable on the deemed disposition of the shares. Second, there's corporate tax payable on the disposition of the company's assets and tax payable by the estate on the wind-up and distribution of corporate assets to the estate or where there are successor shareholders, when the shareholders withdraw funds from the corporation. Post-mortem tax planning strategies may be considered to help mitigate the double tax burden. The details of these strategies are beyond the scope of this article. As part of your estate plan, consider obtaining advice from a qualified tax advisor about potential strategies that may apply in your circumstances.

Canadian partnership

A partnership is an association of two or more people carrying on a business together with a view of earning a profit. The joint ownership of property does not, by itself, create a partnership. In general, to have a partnership, you must show that two or more persons are carrying on business, in common, with a view to profit.

The legal liability of the partners depends on the type of partnership. In a general partnership, the partners have unlimited liability. All partners are liable for the debts of the partnership. Creditors may seize the personal assets of the partners. In a limited partnership, liability for limited partners extends only to the amount invested in the partnership but there must be at least one general partner who would have unlimited liability.

Since a partnership involves two or more partners, this form of ownership structure can provide additional sources of investment capital and management expertise. With the addition of business partners, however, there can be potential for conflict and with that in mind, it's important to consider creating a written partnership agreement. The agreement should cover issues such as how profits/losses should be shared and what happens to the partnership if one party withdraws from or is asked to leave the partnership or upon the death of a partner.

Each partner may contribute capital to the partnership to purchase the investment property. If you already own the property, you may be able to transfer the property to the partnership on a tax-deferred basis.

Taxation of rental income

A partnership is not taxed as a separate entity for Canadian tax purposes. Instead, a partnership first computes its income for the year as if it were a separate person. The partnership then allocates its income or loss for the year to its partners as prescribed in the partnership agreement.

Since a partnership involves two or more partners, this form of ownership structure can provide additional sources of investment capital and management expertise. With the addition of business partners, however, there can be potential for conflict and with that in mind, it's important to consider creating a written partnership agreement.

Unlike a corporate structure where income is taxed first in the corporation and taxed again when paid to shareholders, partners are taxed only once personally on the partnership income that is allocated to them. The partnership income is "flowed through" to the partner, so the income retains its character. A partner may receive business income, capital gains, dividends, interest, foreign income, or other types of income, depending on what types of income the partnership earns. The allocation of any losses allows partners to claim the loss on their personal tax return. Please note that there are some restrictions on the amount of losses a partner can claim on their personal tax return. These rules are complex and it is important to speak with a qualified tax advisor for more information if you are in this situation.

Although a partnership is not taxed as a separate entity, tax filing obligations may still exist. Generally, all partnerships that carry on business in Canada or are Canadian partnerships must file a partnership information return, with some exceptions. Please speak with a qualified tax advisor to determine if a partnership information return needs to be filed.

The CCA restriction would normally apply to the partnership unless the partnership's income earned from real property is considered income from an active business as opposed to income from property.

Sale of property

The rules discussed earlier to determine the capital gain, recapture and terminal loss also apply to a partnership. Any resulting capital gain on the sale of the property is netted with any other capital gains or capital losses of the partnership and this amount is allocated to each partner. As mentioned before, capital gains and capital losses retain their character in the hands of the partner.

Any recapture is added to or any terminal loss is deducted from the partnership income or loss which is then allocated to each partner.

Tax implications on death

You do not typically own the underlying investment property of the partnership; rather, you own an interest in the partnership. Your interest in the partnership is your capital property and you may incur a capital gain or loss when disposing of your partnership interest. On death, your partnership interest is deemed to be disposed of for proceeds equal to the fair market value of your interest in the partnership immediately before death, unless left to a spouse or transferred to a qualifying spousal trust. Therefore, you may realize a capital gain or loss that is reported on your final return.

As with your other capital property, your partnership interest has an ACB. The calculation of the ACB of a partnership interest can be quite complex. In simplified terms, the ACB is calculated as your contribution of capital, plus your share of the annual partnership income, less any withdrawals you make from the partnership and less any partnership losses allocated to you during your period of ownership. Please keep in mind there may be other adjustments that need to be made to determine the ACB of your partnership interest and there may be other tax consequences to the partnership as a result of your death.

Canadian resident trust

A trust is created when you, the settlor, with the intention of creating a trust, transfer assets to one or more trustees who hold and manage the assets for the benefit of the beneficiaries. As the settlor of the trust, you select the trustees of the trust, designate the beneficiaries of the trust and provide instructions on how you want the trust assets to be managed through the trust agreement. Please note that a trust created under Quebec's Civil Code is very much different from the one created under common-law. Residents of Quebec should consult with their legal advisors to ensure a trust is valid for their purposes.

A trust created during your lifetime is an "inter vivos" trust. For a detailed discussion of the legal aspects of an inter vivos trust and its creation, please ask your RBC advisor for a copy of the article on living/family trusts. The following discussion only relates to personal inter vivos trusts that are not alter ego, a joint partner, a spousal or a self-benefit trust.

When you transfer your investment property to a family trust, generally you are deemed to have disposed of the property at its fair market value. If the property has appreciated in value since you first purchased it, you may trigger a capital gain and recapture, if any. The fair market value of the property at the time of the transfer becomes the property's ACB to the trust.

When you transfer your investment property to a family trust, generally you are deemed to have disposed of the property at its fair market value. If the property has appreciated in value since you first purchased it, you may trigger a capital gain and recapture, if any.

Taxation of rental income

For tax purposes, a trust is treated as a separate taxpayer. Inter vivos trusts are taxed at the highest personal marginal tax rate. In determining the trust's taxable income, generally a deduction can be claimed for any income that it pays or makes payable to the beneficiaries in the year. The income paid or made payable to the beneficiaries generally retains its character and is taxable in the beneficiaries' hands. This makes a family trust an effective tool for income-splitting with family members in lower tax brackets, if structured and used properly. Inter vivos trusts have a December 31 year end and the income tax and information return is due 90 days after the year end.

If you plan to split income with family members, you need to consider the attribution and TOSI rules. If the attribution rules apply, the income earned in the trust may be taxed in your hands rather than in the hands of your beneficiaries. How the trust is funded; the amount of control exercised by the settlor over trust decisions after it is created; the relationship between the settlor, the trustees and the beneficiaries; and the age of the beneficiaries are all factors to be considered when determining whether attribution rules would apply. For more information, ask an RBC advisor for an article on the income splitting and the attribution rules.

The TOSI rules could apply to income from a partnership or a trust where the income was derived from the rental of property in certain cases. If your family members receive rental income allocated to them through a trust, the income may be taxed at the top marginal tax rate, eliminating any benefit of income-splitting. Be sure to speak with a qualified tax advisor if you are planning to income-split rental income through a trust with family members. You may ask an RBC advisor for an article on the income splitting and the attribution rules.

Trusts are generally subject to the CCA restrictions discussed earlier.

Unlike a partnership, it is not possible to allocate losses of the trust to the beneficiaries. In the case where the trust incurs a loss for the year, it can carry forward the loss to future years to reduce its taxable income and allocate less income to the beneficiaries in those years.

Generally, a trust is deemed to dispose of its capital property at fair market value every 21 years. This rule prohibits trusts from holding property indefinitely without recognizing accrued gains. If your investment property appreciates in value, the trust may realize a capital gain and recapture every 21-years. If this occurs, the capital gains and recapture triggered on the deemed disposition can't be allocated to the trust beneficiaries and must be taxed in the trust at the highest personal marginal tax rate.

There are strategies that may be used to mitigate the effects of the 21-year deemed disposition. One such strategy is to transfer the assets at cost to the capital beneficiaries, but this may not always be possible or practical. Speak to a qualified tax advisor well before the 21st anniversary of your trust so that proper tax planning can be done.

Sale of property

The rules discussed earlier to determine the capital gain, recapture and terminal loss on the sale of a rental property also apply to a trust. The trust first calculates its taxable income, which would include the taxable capital gain on the sale of the property and any recapture or the terminal loss. The trustee(s) of the trust may be able to then allocate the taxable income (taxable capital gain, rental income, etc.) to beneficiaries.

Any income retained in the trust is taxed at the top marginal tax rate.

The beneficiaries report the allocated income on their individual income tax returns. The various types of income retain their character and are taxed at the beneficiaries' marginal tax rates.

If the trust realizes a terminal loss, the loss can be used in the trust to offset any other type of income. However, if the terminal loss cannot be absorbed by other types of income and the trust has a loss for the year, the loss can't be allocated to the beneficiaries. It would remain inside the trust until the trust earns income in future years that can offset the loss. This type of loss can be carried forward 20 years.

Tax implications on death

On your death, there is no deemed disposition of property you gifted to a family trust since you do not own the property. There's also no deemed disposition within the trust. The trust does not have to be wound up unless the terms of the trust agreement say otherwise.

However, if you originally funded the trust with a loan, the trust may have to repay the loan unless you've forgiven the loan in your Will or have transferred the loan receivable to a beneficiary under your Will. If you choose to forgive the loan in your Will, the trust should not be subject to the debt forgiveness rules and there should be no tax implications to the trust or your estate.

Bare trust

A "bare trust," is commonly used to hold legal title to real estate. A bare trust is a legal relationship that arises where legal title of an asset is transferred by a person to a trustee and beneficial ownership of that asset is retained. A bare trustee (or nominee or agent) has no independent powers, discretions or responsibilities. Their only responsibility is to carry out the instructions of the beneficial owner. The beneficial owner is entitled to all of the income and gains on the property and retains all of the risks of ownership as well. To formalize the bare trust relationship, the bare trustee may sign a "Declaration of Trust" in favour of the beneficial owner and the beneficial owner's estate.

A bare trust may be used to hold real estate for a number of reasons, including the potential minimization of land transfer tax, probate fees and privacy. You may wish to speak to a qualified tax/legal advisor about whether using a bare trust would make sense in your circumstances.

Note that bare trusts are not recognized in Quebec. However, a prête-nom agreement may be used for similar purposes. You may wish to speak to your qualified legal advisor for more information on prete-nom agreements.

For income tax purposes, a bare trust is ignored, and the beneficial owner is treated as the owner of the property. The beneficial owner will report the rental income or losses earned from the property on their personal income tax returns as though the bare trust does not exist. Also,

> A "bare trust," is commonly used to hold legal title to real estate. A bare trust is a legal relationship that arises where legal title of an asset is transferred by a person to a trustee and beneficial ownership of that asset is retained.

transferring title of the property from the beneficiary to the bare trust or from the bare trust to the beneficiary doesn't result in a disposition for income tax purposes. For example, if you own property and transfer legal title to a bare trust, the transfer is not considered a disposition for income tax purposes because there's no change in beneficial ownership. On your death, you are deemed to dispose of the assets held by the bare trust at their fair market value, unless they're left to a spouse or transferred to a qualifying spousal trust.

Other tax considerations

Land or property transfer tax

You should be aware of other costs associated with transferring land or real property between parties. Canadian provinces and territories, and some municipalities and cities, charge a transfer tax or a "fee" based on the value of the property being transferred. There may be limited exemptions, depending on the province and territory, from land or real property transfer tax, such as certain transfers from an individual to their family business corporation. A qualified real estate lawyer should be able to assist in this regard.

Goods and Services Tax (GST)/ Harmonized Sales Tax (HST)

The application of the GST/HST is very complex and specialized. These rules may apply to certain purchases and sales and rental of real property. You're strongly encouraged to seek professional advice from a qualified GST/HST specialist to ensure you are in compliance with the law.

If you're planning to purchase real property for investment purposes, one of the major decisions you have to make is how to structure the ownership of the property.

Planning for your investment

If you're planning to purchase real property for investment purposes, one of the major decisions you have to make is how to structure the ownership of the property. Tax-efficient investing should not be the only factor in your decision. Other considerations in making your decision may include financing options, insurance needs, regulatory requirements and legal liability.

Planning ahead may save you time and money. By deciding how you want to own your property before the purchase, you may reduce future complications and restructuring costs. As always, you should seek relevant legal and tax advice from qualified advisors to assist you in choosing an ownership structure for your rental properties.

This article may contain several strategies, not all of which will apply to your particular financial circumstances. The information in this article is not intended to provide legal, tax or insurance advice. To ensure that your own circumstances have been properly considered and that action is taken based on the latest information available, you should obtain professional advice from a qualified tax, legal and/or insurance advisor before acting on any of the information in this article.

The following table provides a quick reference guide on some of the aspects of each ownership structure:

	Advantages	Disadvantages
Individual ownership	• Rental loss can offset other sources of income • Simple and fewer costs associated with the structure	• Unlimited liability of property owner • Rental income taxed at the individual's marginal tax rate with no opportunities for tax deferral on income earned
Corporation	• Limited liability • Income splitting opportunities with family members (subject to attribution and TOSI rules) • Potential creditor protection • Possible opportunities for tax deferral	• Incorporation costs and higher administrative costs • Losses trapped in the corporation • Two levels of taxes, may be able to defer personal tax • Potential double tax on death without post-mortem tax planning
Partnership	• Income earned in partnership retains its character so partners can use rental losses on their personal tax return • Increased sources of management expertise and financing from other partners	• Information filing requirements • Increased complexity in managing the operations by having more parties involved • Costs involved in creating partnership agreement • Annual partnership income taxable on partner's income tax returns resulting in no tax deferral
Trust	• Income splitting opportunities (subject to attribution and TOSI rules) • Minimization of probate fees • Potential creditor protection	• Deemed disposition every 21-years • Losses cannot be allocated to beneficiaries • Transferring assets to a trust may be a taxable event

Wealth Management

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