Time Bomb Ticking on Canadian Home Construction Industry

Posted: February 3, 2020

By Robert G. Kreklewetz

They say that the “devil is in the details".

An individual buying a run-down house, fixing it up, and living in it a while, and then selling for a tidy income tax exempt profit (the house being the individual’s principal residence) sounds like a recipe for success. And there may be nothing wrong with that for either income tax or GST/HST purposes!

Repeat that 21 times in a row, and you may have a different kettle of fish.

“Carrying on a business?” the CRA may ask. “Or just an adventure of concern in the nature of a trade”. Don’t be tricked up! A “yes” to either question is likely to create all sorts of income tax and GST/HST issues for the individual.

More problems arise when the individual is connected to a commercial construction business (“Absolutely Best Ever Homes Inc.”), and the individual’s projects bleed over to the commercial business (e.g., the corporation perhaps paying for the renovations, or claiming as its own business deductions or GST ITCs, the expenses incurred by the individual personal).

Yes, the devil is in the details, and the CRA has caught up to what might be commonly understood to be Canada’s current real estate industry.

The CRA started its Real Estate Task Force in this area in May 2019, and this “project” (CRA code for work in the Underground Economy) is now going strong. While further information can be found here, many Canadians are now on the receiving end of CRA Inquiry Letters, some reaching back over 20 years of records.

You see, the CRA has figured out how to search past real estate transactions and is how sending out an Inquiry Letter and a detailed Real Estate Questionnaire to many commercial and individual builders, seeking detailed information on their past “real estate transactions”.

Lo and behold, the same inquiry letters contain a list of the individuals real estate purchases and sales over the last 20 years!

Questions about the individuals include: “Please list any corporations you own and/or partnerships/joint ventures you are a member of”.

Questions about the properties purchase include: “Did a relative reside in this property”; “Did you apply for a demolition permit?”; and “How many exterior walls remained intact”?

Some VERY loaded questions when you understand them from a tax implications perspective.

Initial responses to these Inquiry Letters and Questionnaires are met with even more detailed questions. One client was even then asked to provide 15 years of bank statements (… uh oh!). And then the CRA began to ask questions about his wife and sons, who had been listed on title to the various real properties (… stomach cramp!).

The CRA time bomb is ticking on the Canadian home construction industry, and it may not be a pretty sight when the bomb goes off. For those with exposure, there is no better time than the present to obtain legal advice.

The sad reality of this situation is that in the right case, the CRA can in fact compel virtually all of this information from the unexpecting taxpayer and can insist upon it even beyond the normal four year limitation period (yes, even back 15 years!)

Individuals and businesses on the receiving end of these sorts of CRA foray’s absolutely need legal advice, and likely tax lawyer advice. There is potentially both income tax and GST/HST exposure here – and it could be major exposure (think 13% of the value of that new house in Toronto, or Vancouver; for full income tax rates of selling profits, not just on the “capital gain”).

While the damage may not be able to be completely undone, mitigation strategies can be put in place. For individuals and businesses that have not yet been contacted, voluntary disclosure options may be available.

The CRA time bomb is ticking on the Canadian home construction industry, and it may not be a pretty sight when the bomb goes off. For those with exposure, there is no better time than the present to obtain legal advice.

Do you require assistance in this area? Please contact us by clicking here.