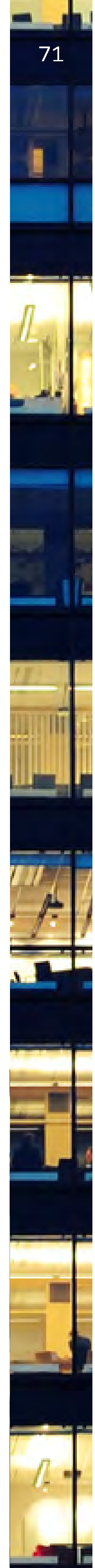
REAL PROPERTY

By Paul Galbraith



REAL PROPERTY

Land Registration Systems

Each Canadian province has its own systems for registering interests in real property, as property legislation is constitutionally a provincial responsibility in Canada. In Ontario, for example, there are two land registration systems: registry and land titles. The older of the two is the registry system, which merely provides for the public recording of instruments affecting land and does not guarantee the status of title.

Most Ontario properties, however, are in the land titles system, which is operated by the province pursuant to the *Land Titles Act.* Title to land within this system is guaranteed by the province. Where the land titles system applies, each document submitted for registration is certified by the province and, until this certification is complete, the registration is subject to amendment at the request of the registry officials.

In other provinces, registration systems vary. In the western provinces, for example, land falls exclusively within the provincial land titles systems. These systems are similar to the land titles system in Ontario, creating an "indefeasible title" that is good against the world, subject only to certain limited exceptions. In the Atlantic provinces, on the other hand, registry systems dominate land registration, except in New Brunswick, where its land titles system encompasses most of the land in the province. Québec has its own unique system for registering interests in land, which in its effect is more similar to a registry system than to a land titles system.

Canadian provinces have been working to modernize their land registration systems by automating the paper-based records and converting to electronic systems. In most of Canada, real property instruments can be registered and obtained electronically. In addition, in many provinces, including Ontario, registration occurs in real time. In other words, upon registering an instrument against specific land, the instrument will immediately thereafter appear on the title relating to such land.

Planning Legislation

All Canadian provinces regulate property development to some degree, and often this regulation occurs at the municipal level. Official plans, zoning bylaws, development permits, subdivision bylaws and servicing bylaws are the primary means by which municipalities control land use and development.

At the provincial level, the subdivision of land is restricted by statute in a number of Canadian provinces. In Ontario, the *Planning Act* is the main statute that controls subdivision. In British Columbia and many other provinces, the *Land Title Act* of that province is the main statute that controls subdivision. In addition, most provinces have legislation granting power to municipalities to regulate the subdivision and servicing of lands. In most cases, instruments such as transfers, subdivision plans or separation of title, which result in the issuance of separate titles, and instruments such as leases, mortgages or discharges, which deal with part of a parcel, require subdivision approval.

MOST PROVINCES HAVE LEGISLATION GRANTING POWER TO MUNICIPALITIES TO REGULATE THE SUBDIVISION AND SERVICING OF LANDS.

Subject to certain exceptions, the *Planning Act* in Ontario prohibits any transfer or mortgage of land or any other agreement granting rights in land for a period of 21 years or more (this includes leases and easements) unless the land is already described in accordance with a plan of subdivision, or the transaction has previously received the consent of the appropriate governmental body. If the proposed transaction does not fall within one of the exceptions outlined in the *Planning Act*, then it may be necessary to obtain a severance consent for the transaction to proceed. The process to obtain a consent typically takes at least 90 to 120 days to complete.

A number of changes passed by the Ontario government directly impact how development-approval applications are prepared, submitted, processed and appealed. The cumulative effect of these changes has been to put greater control of the development-approval process in the hands of municipalities and the province itself. However, there is an appeal process for most applications to the Local Planning Appeal Tribunal, which has broad jurisdiction, so prudence requires applicants to look farther down the road, past the municipal process, to eventual appeals, and to take careful steps to put their applications on an appeal-ready footing from the outset. For this reason, engaging experienced legal counsel as early as possible in the development process is advisable.

Many provincial statutes (including Ontario's) provide that no interest in land is created or conveyed by an improper transaction carried out contrary to the governing legislation. Investors in real property in Canada need to consider the possible application of subdivision control regulations both at the provincial and municipal level when they are contemplating subdivision and development of land.

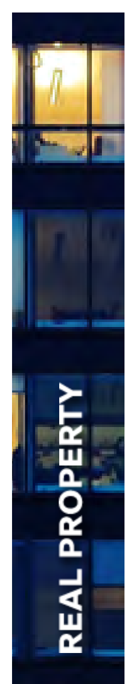
Title Opinions and Title Insurance

Rights in land are not required to be registered. That said, registration in the appropriate land registry office is essential to protect an owner's priority over subsequent registered interests and to protect an owner against loss from a bona fide third party. On an acquisition, in addition to registering a deed in the appropriate land registry office, a lawyer's opinion on title is typically issued to the purchaser of real property following closing.

However, the use of commercial title insurance as an alternative to the traditional lawyer's opinion on title continues to gain popularity, particularly for lenders (since the available protections are broader for lenders). Unlike a traditional lawyer's title opinion, title insurance provides protection against hidden risks, such as fraud, forgery and errors in information provided by third parties (e.g., a government ministry). Fraud, in particular, represents a significant loss when it does occur, and this is a risk generally better assumed by a title insurer. (Note, however, that for commercial properties, coverage is typically only provided for fraud that occurred prior to the date of placement of the policy.) Also, unlike a traditional lawyer's title opinion, title insurance is a strict liability contract — the policy holder is not required to prove that the title insurer has been negligent in order to receive compensation for a covered loss (up to the amount insured, which is typically the purchase price for an owner's policy and the mortgage amount for a lender's policy).

There are two types of commercial title insurance policies that may be issued: (i) an owner's policy that protects the purchaser against loss or damage arising from disputes regarding property ownership; and (ii) a loan policy that protects the lender against loss or damage arising from the invalidity or unenforceability of the lien of the insured mortgage.

While the benefits of an owner's policy remain in effect only as long as the insured owner possesses title to the property, the benefits of



a lender's policy automatically run to the insured lender's successors and/or assigns, thereby facilitating the sale of mortgages in the secondary market.

THE LIABILITY FOR IMPROPER ENVIRONMENTAL PRACTICES RUNS WITH THE LAND AND CAN BE INHERITED BY FUTURE OWNERS OF THE PROPERTY.

There is a wide variety of different title insurance packages and varying premiums for such coverage, and there is no regulation of title insurance rates in Canada. Policy premiums are negotiated, and when a premium is paid to the title insurer, such premium constitutes consideration for both the policy and any endorsements (the total price of which is typically lower than the combined price for premiums and endorsements in the U.S.).

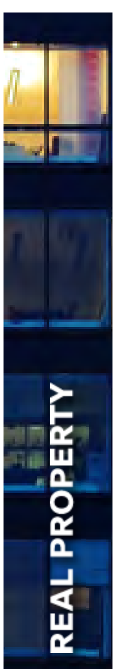
Environmental Assessments

In Canada, there is a legislative framework at both the provincial and federal level that governs the duties of land owners with respect to the storage, discharge and disposal of contaminants and other hazardous materials connected with real property. The liability for improper environmental practices runs with the land and can be inherited by future owners of the property. In certain circumstances, any "guardian" of a property, such as a tenant, may face liability for contamination. Additionally, it is incumbent upon a potential purchaser to inspect a property and assess environmental risks, as government officials in Canada cannot certify that properties are free of environmental risk. Commercial lenders in Canada will customarily require the completion of an environmental assessment of a property before the advance of funds.

Non-Resident Ownership

Non-residents may generally purchase, hold and dispose of real property in Canada as though they are residents of Canada, pursuant to the federal *Citizenship Act*, but subject to the restrictions set out in the *Prohibition on the Purchase of Residential Property by Non-Canadians Act*. In addition, each province has the right to restrict the acquisition of land by individuals who are not citizens or permanent

NON-RESIDENTS WHO DISPOSE OF REAL PROPERTY SITUATED IN CANADA ARE SUBJECT TO WITHHOLDING TAX REQUIREMENTS UNDER THE FEDERAL INCOME TAX ACT.



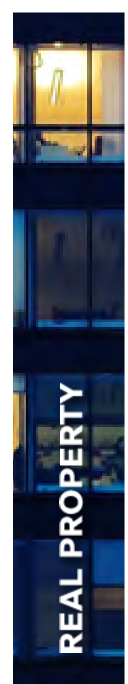
residents, in addition to corporations and associations controlled by such individuals. For example, in Québec, a non-resident (individual, corporation or any other legal entity) is not entitled, directly or indirectly, to acquire farm land except with the authorization of the *Commission de protection du territoire agricole du Québec*.

Each province has different legislation as regards to the particularities of foreign ownership of Canadian real property. In Ontario, for example, non-citizens have the same rights as Canadians to acquire, hold and dispose of real property, though corporations incorporated in jurisdictions other than Ontario must obtain a licence to acquire, hold or convey real property. Non-residents who dispose of real property situated in Canada are subject to withholding tax requirements under the federal *Income Tax Act* (ITA), as described below.

Overlaid on top of the above-noted rules are the requirements of the federal *Prohibition on the Purchase of Residential Property by Non-Canadians Act* and its associated regulations. As of January 1, 2023, and until January 1, 2025 (unless extended by further legislation), “Non-Canadians” (as distinct from non-residents) are prohibited from purchasing “residential property” within any census agglomeration area or census metropolitan area (e.g. most, if not all, medium to large municipalities).

“Non-Canadians” is broadly defined and includes: (i) any citizen of a country other than Canada; (ii) any corporation entity of which 10% of the equity interests or 10% of the voting rights are held by a citizen of a country other than Canada; (iii) a corporation or entity which is not formed under the laws of a Canadian province or the federal laws of Canada; and (iv) publicly traded corporations or entities which are controlled by another “Non-Canadian” entity and are not listed on a stock exchange designated under s. 262 of the ITA.

“Residential property” is defined to include: (i) detached houses or similar buildings containing not more than three dwelling units; and (ii) parts of buildings that are semi-detached houses, row-house units, or condominium units that are intended to be separately owned. We note that the original definition of “residential property” was extremely broad and contained a reference to “mixed use zoning,” which resulted in many commercial or industrial properties being considered



"residential property." The above-mentioned regulations were amended on March 27, 2023 to remove the inclusion of these types of properties, such that the *Prohibition on the Purchase of Residential Property by Non-Canadians Act* only applies to what would commonly be considered residential property.

Notwithstanding the above-noted restriction, the regulations to the *Prohibition on the Purchase of Residential Property by Non-Canadians Act* provide that the acquisition of "residential property" by a "non-Canadian" for the "purposes of development" does not contravene the Act. Although there is no case law, legislation, or regulation governing or defining the words "purposes of development," it has been understood that having a good faith intent to develop or redevelop, engaging with the local planning or zoning regulator and other professionals (e.g. architects, engineers, lawyers, planners) as part of the proposed development, and/or proposing a change of use to a property will constitute "development." Conversely, acquiring property for the purpose of leasing or renting out property to tenants or otherwise managing a rental portfolio will likely not constitute "development," nor will undertaking repairs, renovations or similar modifications to an existing residential property.

Although the *Prohibition on the Purchase of Residential Property by Non-Canadians Act* is generally not applicable to commercial properties, legal advice must be sought to ensure compliance, as contravention of the Act results in the contravening party (and any party that induces, aids, abets, counsels, or attempts to do the foregoing) being guilty of an offence under the *Criminal Code*.

Proceeds of Crime Legislation and Real Estate Developers

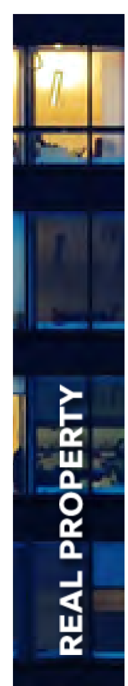
In January 2008, new amendments and regulations with respect to the federal *Proceeds of Crime (Money Laundering) and Terrorist Financing Act* were made. These came into force on February 20, 2009, and address transactions involving, among other groups, real estate developers (generally defined as those who sell new developments to the public, other than in the capacity of a real estate broker or sales representative). The amendments impose mandatory reporting and record-keeping requirements on real estate developers, who are obligated to report suspicious transactions, large cash transactions and any property in their possession that is owned or controlled by terrorists. They are also required to keep records of funds received, large cash transactions and client information, copies of official corporate records and suspicious transaction reports, and to ascertain the identity of any individual: (i) who conducts a large cash transaction (taking reasonable measures to determine whether that individual is acting on behalf of a third party); (ii) for whom they must keep a client information record or receipt of funds record; and (iii) for whom they must send a suspicious transaction report. They must also develop a compliance regime that includes, among other things, the appointment of a compliance officer, written compliance policies and ongoing compliance training programs. If real estate developers fail to comply with these requirements, criminal or administrative penalties may be imposed.

Some Taxes on the Transfer of Real Property in Canada

Withholding Obligations

The ITA contains provisions that protect Canada's ability to collect taxes when a non-resident disposes of "taxable Canadian property" (which includes, among other types of property, real property situated in Canada).

Unless (i) the purchaser has no reason to believe, after making reasonable inquiries, that the vendor is not a non-resident of Canada; (ii) the purchaser concludes after reasonable inquiry that the non-resident person is resident in a country with which Canada has a tax treaty, the property disposed of would be "treaty-protected property" if the non-resident were resident in such country, and the purchaser provides the Canada Revenue Agency with a required notice; or (iii) the purchaser is provided with an appropriate certificate in respect of the disposition issued by the Canada Revenue Agency, the purchaser will be liable to pay as tax on behalf of the non-resident up to 25% of the purchase price of land situate in Canada that is capital property and up to 50% of the purchase price of land inventory situated in Canada, buildings and other depreciable fixed-capital assets. If the non-resident vendor does not provide the purchaser with an appropriate certificate (or the purchaser is not satisfied that the conditions of either (i) or (ii) have been met), the purchaser will generally deduct from the purchase price the amount for which the purchaser would otherwise be liable. Québec tax legislation imposes similar requirements in respect of the disposition of immovable property situated in the Province of Québec. It should be noted that gains realized by a non-resident on the disposition of Canadian real estate are generally not, subject to certain



exceptions, exempt from tax under Canada's treaties, and therefore real estate in most cases will not qualify as "treaty-protected property" for purposes of the ITA. Accordingly, absent an appropriate certificate, most purchasers acquiring real estate from non-residents will withhold from the purchase price and remit the withheld amount to the applicable taxing authority.

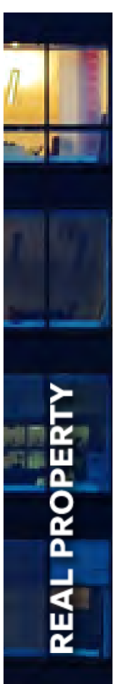
Land Transfer Tax

In all Canadian provinces, land transfer taxes (or in Alberta, "registration fees") are generally imposed on purchasers when they acquire an interest in land (typically including a lease in excess of 40 or 50 years, though the threshold is 30 years in British Columbia) by registered conveyance and, in some cases, by unregistered disposition.

Provincial rates vary widely. In Ontario, for example, land transfer tax is calculated on the "value of the consideration" paid for the interest transferred, whereas in Alberta the fees assessed against a purchaser are based on the value of the land being acquired by the purchaser, and in British Columbia, the tax is calculated on the "fair market value" of the interest transferred. In Québec, the calculation is made on the basis of imposition that equals the greatest of: (i) the consideration furnished for the transfer; (ii) the consideration stipulated for the transfer; and (iii) the market value of the immovable property at the time of its transfer. Of note, the City of Toronto has recently mandated an additional land transfer tax for conveyances within the city that is roughly equivalent to the Ontario land transfer tax (resulting in what is essentially a doubling of the total land transfer tax payable when real property is conveyed in Toronto). In addition, the City of Montréal has, via bylaw, set a higher rate than what is provided for under the provincial legislation for the calculation of duties for any part of the basis of imposition that exceeds C$500,000.

Federal Goods and Services Tax, Provincial Sales Tax, and Harmonized Sales Tax

In Canada, the Goods and Services Tax (GST), currently at a rate of 5%, is generally payable upon a supply of real property (this includes a sale). See **Sales and Other Taxes — Federal Goods and Services Tax**. The vendor is responsible for collecting GST from the purchaser in respect of a sale of real property unless the purchaser is registered for GST purposes and required to self-assess the applicable GST. The conveyance of previously owned residential property is not subject to GST (except where such



residential property has been “substantially renovated”).

In provinces that have “harmonized” their provincial sales tax with the GST, the rate of the harmonized sales tax (HST) is generally payable on the sale of any non-residential real property and any new or substantially renovated residential property, on the same basis as the GST.

The same self-assessment rules that apply for GST purposes apply for HST purposes.

QST

The province of Québec harmonized the Québec sales tax (QST), and the same rules apply to real property (immovable) in Québec as for GST/HST purposes.

Financing

Real estate financing for commercial, industrial, retail, multi-family residential and mixed-use real property as well as condominiums, hotels, casinos and other types of real estate can be structured in a variety of ways, including:

— conventional mortgage lending;

— public and private capital market financing;

— portfolio loans;

— acquisition financing;

— permanent financing;

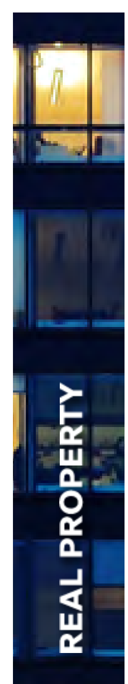
— public and private bond financings;

— syndications;

— restructurings; and

— securitization.

Banks, pension funds, credit unions, trust companies and other entities all arrange such financing on credit terms that vary on the basis of the transaction itself and the risks involved. Various rate and term combinations are offered. See **Bank Loans and Other Loan Capital**. There are various instruments used to take primary security over real property in Canada, such as a mortgage or charge, a debenture containing



a fixed charge on real property and trust deeds securing mortgage bonds (where more than one lender is involved). Additional security usually includes assignments of rents, leases and other contracts, guarantees and general security agreements.

Common Forms of Ownership/Interest

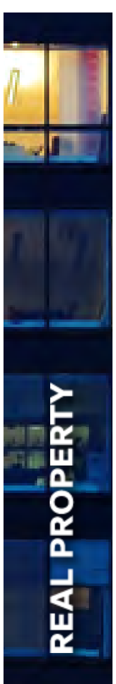
Generally, both asset acquisitions and share acquisitions are common in Canada. Canadian real estate transactions typically involve the following common forms of ownership/interest in real property: freehold, condominium, mortgage/charge, easements and leasing. In Québec, where the real property regime is based on civil law concepts, these forms of ownership/interest in real property all have their equivalents, but other types of interests, based mainly on surface or building rights, also exist.

Developments on Aboriginal lands are subject to a unique set of legal regimes governing ownership interests and security arrangements. See **Aboriginal Law**.

Common Investment Vehicles for Real Property in Canada

There are various avenues for investment in real property in Canada, including corporations, partnerships, limited partnerships, trusts, co-ownerships and condominiums. See **Business Organizations**.

Each of these vehicles has its own nuances and with careful planning and legal advice, investors in the Canadian real property market can structure their investments so as to take maximal advantage, for tax purposes or otherwise, of the available alternatives. A real estate investment trust (REIT) is a special type of trust whereby a trustee agrees to hold real property assets for the benefit of unitholders as the beneficiaries of the trust. The trustee (or more commonly, a corporate nominee) will hold legal title to the trust property. One disadvantage of this vehicle is that under common law, beneficiaries of a trust are potentially subject to unlimited liability. Commercial documentation, however, is generally crafted so as to limit such liability that may arise in relation to the assets or business dealings of the trust. Like shares of corporations, units of REITs can be publicly or privately held. The units of public REITs may be listed on public stock exchanges, like shares of common stock, and REITs can be classified as equity, mortgage or hybrid.



The REIT structure was designed to provide a structure for investment in real estate that is similar to the one mutual funds provide for investment in stocks. Currently, a significant advantage to a REIT is that if its income is distributed to the unitholders, it will be taxed in their hands at their marginal rates rather than at the REIT level. REITs have been generally excluded from the income trust tax legislation changes the federal government enacted in 2007; these require income trusts to be taxed in the same manner as corporations beginning in the 2011 tax year. Legal advice is often necessary to determine whether a particular REIT falls within the exclusion provisions and to ensure the REIT continues to qualify for exclusion.

Co-Ownership Arrangement

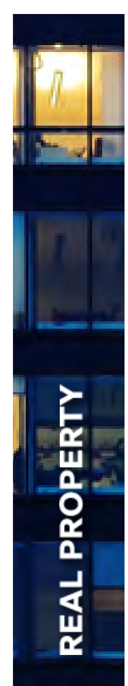
A co-ownership arrangement is typically used where joint and several liability is not desirable. The advantages to using a co-ownership arrangement include the following: (i) each co-owner receives its own share of the revenues and pays its own share of expenses; (ii) each co-owner decides its own capital cost allowances, subject to the rules in the ITA; and (iii) each co-owner can sell, mortgage or otherwise separately deal with its interest.

Condominiums

Condominium ownership is a form of real estate ownership where the owner receives title to a particular unit and has a proportionate interest in certain common areas. Legal advice is needed to ensure that condominium projects satisfy all local policies and legislative requirements, including:

- structuring the project, e.g. common and shared facilities, exclusive use areas, commercial versus residential facilities, phasing and community associations;
- pre-selling units — preparing real estate disclosure statements or prospectuses, complying with securities and pre-marketing regulations;
- registering condominium/strata plans, declarations, descriptions and bylaws and developing policies; and
- closing and conveying the individual units.

Issues can include, for example, obtaining exemptions from the securities commissioner of a given province to permit the sale of rental pool units without a securities prospectus.



Nominees

Limited partnerships, REITs, trusts and even some corporations will often structure their business affairs so that a separate entity, usually a single purpose corporation, holds registered title to real property as "bare trustee," "agent" or "nominee" for the beneficial owner. For both tax and accounting purposes, the property belongs to the beneficial owner and appears on its balance sheet; it is not the property of the nominee. Although nominee arrangements may be used for several reasons, they are frequently established to facilitate dealing with property in the land registration system where there is a complex, underlying ownership structure — either to permit the beneficial ownership of the property to be kept confidential or to facilitate corporate reorganizations or third-party transfers on a land transfer tax-deferred basis.

Pension Funds

Canadian pension funds have been steadily increasing their presence in the Canadian real property market over the last few years through acquisitions of various portfolios, including Class A office buildings and shopping centres. Pension fund capital has, in fact, recently overtaken public real estate capital as the primary impetus of large real estate transactions in Canada. Pension funds that invest in real estate need to comply with strict national and provincial rules to retain their tax-exempt status.

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