

Update on Those Damn Flipping Rules

November 14, 2022

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The August 9, 2022 draft amendments to the *Income Tax Act* (Canada) include provisions to give effect to the residential property flipping rule first introduced in Budget 2022. If enacted as proposed, starting on January 1, 2023, subject to certain exceptions, profits arising from dispositions of residential property that was owned for less than 365 days will be deemed to be business income.

The 2022 Fall Economic Statement released earlier this month proposes to extend this new deeming rule to profits arising from the disposition of the rights to purchase a residential property via an assignment sale. Profits arising from an assignment sale would be deemed to be business income if the rights to purchase a property were assigned after having been owned for less than 365 days.

Background

Generally, when a taxpayer sells a residential property held on capital account (i.e., selling at a profit was not an operating motivation in the acquisition of the property), any profits are taxed as capital gains. If the property is a “principal residence” of the taxpayer, the taxpayer may also be able to apply the principal residence exemption to reduce or eliminate any such capital gains.

Where residential property is held for a relatively short period of time, the CRA will frequently reassess the taxpayer, taking the position that all profits are fully taxable business income on the assumption that the taxpayer acquired the property with the intention of reselling it for a profit. Furthermore, where the taxpayer built a new house or substantially renovated (effectively “gutted”) the house on the property, the CRA will also generally assess GST/HST on top of any income tax reassessments on the basis that the taxpayer is a “builder” under the *Excise Tax Act*.

We have assisted and continue to assist clients in disputing these reassessments (and/or ameliorating its effects through the claiming of input tax credits and/or business expenses). The onus is on the taxpayer to show that, despite the short period of ownership, selling at a profit was not an operating motivation in the acquisition of the property.

Proposed Changes

Under the proposed rules, it does not matter if the taxpayer can meet this onus. Any would-be capital gains on the sale of a residential property (or rights to such property) owned for less than a year will automatically be deemed to be fully taxable business income (subject to limited exceptions). Underscoring the unfairness of these proposed rules is that any capital loss on such a sale is not deemed by the rules to be a business loss (that could offset other income).

The new rules will not apply where the sale can reasonably be considered to occur due to, or in anticipation of, one or more of the following events:

- Death of the taxpayer or a related person

- Related person joining taxpayer's household (or vice versa)
- Marital separation commencing at least 90 days before the sale
- Threat to personal safety of the taxpayer or a related person
- Serious illness or disability of the taxpayer or a related person
- Relocation of the taxpayer or their spouse/partner
- Involuntary termination from employment of the taxpayer or their spouse/partner
- Insolvency of the taxpayer
- Destruction or expropriation of the subject property

Whether a sale occurs within 365 days of acquisition is a bright-line test, whether an exception applies is not. We anticipate battles around whether a sale can reasonably be considered to occur due to, or in anticipation of, an excepted event. Further, while some of the events are incontrovertible, we foresee future case law being required to inform others – e.g., how direct must the threat to personal safety be?

Even if an exception applies, the CRA can still reassess taxpayers on the basis that profits are business income under general principles. We anticipate that the CRA will take the position in certain circumstances (e.g., where there are multiple sales by the taxpayer within a relatively short period of time) that an excepted event merely hastened the sale of the property and that the sale in the context of the event does not mean that the taxpayer did not have an operating motivation of reselling at a profit when acquiring the property. The onus will remain on the taxpayer to demolish the CRA's assumptions.

The information and comments herein are for the general information of the reader and are not intended as advice or opinion to be relied upon in relation to any particular circumstances. For particular application of the law to specific situations, the reader should seek professional advice.

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