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Real Estate

The Canadian condo vendor who wasn't

By **Ray Mikkola**

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(November 19, 2018, 9:43 AM EST) -- A recent Tax Court decision serves as a cautionary tale regarding the obligation to obtain a statutory declaration or affidavit concerning the residence of the vendor and the conveyance of real estate.

In *Kau v. Canada* 2018 TCC 156, Anibal Kau purchased a Toronto condominium unit for $368,000. Kau's lawyer noted that the vendor's address was in California, at the same address at which the vendor had purchased the unit two years earlier. Kau also knew that the vendor did not personally live in the unit but that the unit had been leased to a tenant of the vendor.

Kau's lawyer requisitioned "satisfactory evidence of compliance with section 116 [of the *Income Tax Act*]". In response, the vendor attended before a notary public in California and baldly declared before the notary that he is a resident of Canada and would be a resident of Canada on closing.

It turns out that the vendor was in fact a non-resident. Kau's lawyer had failed to withhold the required 25 per cent of the gross purchase price and accordingly under s. 116 of the *Income Tax Act,* Kau was assessed for $92,000 owing in taxes.

Kau appealed the decision of the minister. The court dismissed the appeal noting that the document provided to Kau regarding the residency of the vendor was not a statutory declaration as required by section 20 of the agreement of purchase and sale. The court also found that Kau's lawyer had ignored a number of "red flags" regarding the issue of the vendor's residency.

In his analysis, the judge noted that s. 116 (5) (a) requires a purchaser to make "reasonable inquiry" so that the purchaser has "no reason to believe" that the seller is not resident in Canada. The evidence of the vendor being in California, and having been in California for some time, required, according to the judge, Kau's lawyer to go beyond merely accepting a document setting out a bald assertion of the vendor's Canadian residency. Acknowledging that what is "reasonable" is very circumstance specific, the court nevertheless held that Kau's lawyer should have made further inquiry by, for example, asking to see a driver's licence with a Canadian residential address.

Of course, the challenge with determining residency is that it is not always cut and dry. For example, a taxpayer can become a deemed resident, by desire, accident or intention, by sojourning in Canada for at least half a year. However, there is no specific time-related test for determining when one becomes a non-resident. Even long absences from Canada may nevertheless not result in a person becoming a non-resident if, for example all or most of the assets, family, friends and relationships of the taxpayer continue to be in Canada (see Income Tax Folio S5-F1-C1, "Determining an Individual's Residence Status"). These connections with Canada may be sufficient to constitute the taxpayer as a resident Canadian.

In *Kau*, the purchaser's lawyer indicated that many of his clients executed closing documents outside Canada but were nevertheless residents of Canada.

The particular wording of s. 116 requires careful scrutiny. It requires reasonable inquiry to lead to the purchaser having "no reason" to believe the vendor is a non-resident. Taken literally, even a single

reason to believe that the vendor might be a non-resident would be enough to disentitle a purchaser from relying on the saving provision of that section. In that regard, it is important to note that s. 116 does not mandate a sworn document to be provided to demonstrate that the purchaser has discharged the onus of making reasonable inquiry.

A practice has developed whereby a purchaser may take comfort from the fact that a vendor makes a statement under oath, thereby exposing the vendor to prosecution if the statement is false. So, the mere provision of a statement would not necessarily satisfy the onus of a purchaser's reasonable inquiry. But in *Kau* the court held that even a sworn document would have had to address the red flags present in the circumstances of this transaction: "The statutory provision involved, ss. 116(5)(a), calls for and deserves more than a brief, baldly stated affidavit or solemn declaration when there are factual red-flags potentially suggestive of non-residency" [para 23].

Although the court held that the provision of even an unsworn document which was responsive to the red flags would "almost certainly" have constituted "reasonable inquiry" [para 22], the court clearly emphasized the fact that the document was unsworn. The judge went into some detail to note that a declaration made before a notary public is not to be treated as a "sworn" declaration, a statutory declaration or a sworn affidavit.

This is a reminder to all real estate lawyers that even in the age of electronic execution of documents and the replacement of previously sworn documents with certificates and pro forma statements, the form of a document may still be relevant in determining its effectiveness.

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