



How to avoid tax traps: A guide for condo flippers

In many parts of Canada, notably Vancouver and Toronto, the real estate market is red hot. Demand exceeds supply, as international investment money is looking for a safe harbour inside Canada. Buying condos from plans before they are built and then selling them at a profit once they are completed has been a profitable business for many Canadians and foreign investors in many Canadian real estate markets.

BY DAVID J. ROTFLEISCH



What does Canada Revenue Agency say about reporting revenue from condos? Here's an easy guide for condo flippers to prevent problems with the Canadian Tax Man:

1. Condo flipping is taxable business income

Condo flipping, even once, is almost certainly considered to be an "Adventure in the Nature of Trade" (a one-off transaction that is a trading venture rather than a capital transaction) and is taxable as business income (100-per-cent taxable), not a capital gain (50-per-cent taxable).

Even worse, many condo flippers sell the property without ever taking title to the unit and never report any gain. Since they just sell the purchase agreement and don't appear on title, they assume that CRA won't find them. They are very mistaken.

CRA has an ongoing audit project specifically for condos. They look at purchasers of new condos from builders by going to the builders' sales records and sending out detailed questionnaires to each

and every purchaser to ensure that gains have been reported. The Tax Man assesses taxes, penalties and interest if profits on the sale are not reported and will also charge the condo flipper with tax evasion.

2. Tax evasion, tax fraud and penalties: CRA

A failure to report income from flipping a condo is tax evasion. Trying to report it as a capital gain instead of regular income may be tax fraud as well.

Penalties for tax evasion are a fine of between 50 per cent and 200 per cent of the tax evaded and a jail term of up to two years. Even if a condo flipper is not charged with tax evasion, the profits will almost certainly be subject to gross negligence penalties plus interest on the tax and penalties.

CRA recently told *The Globe and Mail* that 41 people have been audited regarding speculative real estate; another 128 people are being investigated.

The underground economy — for condo construction in particular — is the target of extra CRA enforcement. The above scenario is a form of tax evasion, says CRA.

3. Principal residence exemption not applicable

Many condo flippers think that living in the condo allows them to claim the principal residence exemption and thereby avoid all taxes on their profits. They move into the condo, live there for a while, sell it, and claim the exemption. They then repeat the whole process over and over again. They are wrong. Merely living in the condo does not automatically mean it was a capital property and eligible for the principal residence exemption.

The motivation for the purchase is relevant, says CRA.

If the condo was bought to sell and living in it was just done to try to claim the principal residence exemption, it may well be an adventure in the nature of trade as specifically discussed in the income tax folio

that analyzes how the CRA has interpreted the rules pertaining to a principal residence, and as the courts have held.

Not only does the condo purchaser need to be able to prove he or she really lived there, but may have to show that selling for a quick gain was not the purpose of the purchase.

4. Voluntary disclosure avoids penalties and prosecution

So what should a condo flipper who has not reported gains do? Revenue Canada has a policy called Voluntary Disclosure to encourage taxpayers to come forward to report any previously unreported income or GST or to file returns that were not previously filed.

This means they will not undertake criminal prosecutions or apply civil penalties, including late filing penalties on any voluntary disclosures. This policy applies even to someone who has committed deliberate tax evasion, including failure to declare income such as through condo flipping.

To meet Revenue Canada's criteria, the taxpayer must initiate the voluntary disclosure. If CRA has begun audit or enforcement action, or has sent a condo questionnaire, the disclosure is not considered to be voluntary and full penalties will be applied. □

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