

Focus

REAL PROPERTY

New rules for foreign property reporting

Changes to tax form T1135 mean the Canada Revenue Agency wants a lot more information



Robert Kepes

Changes to the Canada Revenue Agency's foreign reporting tax form T1135 may affect many taxpayers in their wallets and in the personal information they must disclose. These changes are part of the federal government's efforts to combat offshore tax planning and evasion, and to target certain taxpayers for audit.

Canadian tax residents must report and pay tax on their worldwide income. In addition, individuals, corporations and partnerships must report if they own, at any time in the year, one or more "specified foreign properties" with total cost of more than \$100,000.

Usually, the cost is what you paid for the property, but issues can arise when vacant land is purchased in one year and a building is erected on the land later. The T1135 should be filed for the year when both the cost of the land and development exceed \$100,000. Also, the cost of property acquired by gift, inheritance or bequest is its fair market value at the time received. Appraisals or valuations may be necessary to establish the value. "Specified foreign property" includes:

- Funds or intangible property (cash, stocks, bonds) held, deposited or situated outside Canada, and tangible property (real estate, vehicles, boats) outside Canada;
- A life insurance policy issued by a foreign issuer;
- Shares of a non-resident corporation, unless a foreign affiliate (there is a different form for foreign affiliates);
- Interest in a non-resident trust, but only if you or a related person bought the interest for consideration;
- Indebtedness owed to you by a non-resident person; and
- Property that is convertible into, is exchangeable for, or confers a right to acquire property that is specified foreign property.

The following categories do not have to be reported:

- Property used exclusively in an active business such as a foreign branch, plant or office. The T1135 is meant for passive investment assets that would generate interest, dividends or rent. However, a property not generating any income does not exclude it from being reported.

■ Personal-use property that is owned by you and used primarily for your personal use or enjoyment, or that of a related person. So a foreign condominium, car, boat, or painting need not be reported if owned primarily for your personal use or enjoyment. That also applies if the property is owned by you, but used and enjoyed by a related person.

Rental properties can be a problem because they can lose their status as personal-use property when rented out more than 50 per cent of the time, or if more than 50 per cent of the space is rented out. This should be monitored on a regular basis.

The previous T1135 form required general information about the foreign property, such as type, cost, location, and total income. The new T1135 requires much more extensive information on a property-by-property basis, including:

- Name of institution holding the funds, country code, maximum funds during the year, funds held at year-end, and the income or loss.
- For other assets, such as shares or real estate, the form requires a description of each property, country code, maximum cost during the year, cost at end of year, income or loss, and gain or loss on disposition.

There are exceptions. No reporting is required for foreign property held inside a registered account (RRSP, RESP, TFSA). Also, if a taxpayer has received a T3 or T5 slip from a Canadian issuer for a foreign property, that property is excluded from the T1135 for

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Photo expert no help in adverse possession case



Mark McMackin

They say a photo is worth a thousand words, but it may not be enough to establish your right to your property, as Morgan and Leslie Reiner found out in the case of *Reiner v. Truxa* [2013] O.J. No. 4351.

On paper, the Reiners had title to a narrow strip of land along the southern border of their Toronto property, which they had owned since 2005. The strip, however, was occupied by the driveway of Leslie Truxa and Lydia Sani, who had lived there since 1985. The Reiners discovered their right to the strip when they had their land surveyed, and sought to assert that right. The Truxa-Sanis, in response, claimed possessory title by virtue of the doctrine of adverse possession. Despite the best efforts of the Reiners, Justice Eva Frank of the Ontario Superior Court of Justice found in favour of the Truxa-Sanis.

Following the Ontario Court of Appeal decisions in *Kefer v. Arillotta* [1976] 13 O.R. (2d) 680 and *Teis v. Ancaster* [1997] O.J. No. 3512, Justice Frank found that the Truxa-Sanis had gained possessory title by establishing actual possession of the property for at least 10 years prior to the implementation of the Land Titles registry, and had dispossessed the Reiners (and their predecessors) of ownership for the same amount of time.



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At first glance, *Reiner v. Truxa* seems like a run of the mill adverse possession case; the particular fact scenario has been well-litigated, and the law on adverse possession is settled. However, the case does have one interesting twist worthy of comment. In order to establish their claim, the Reiners had hired an expert in photogrammetry and photo interpretation, and asked him to analyze aerial photos of the driveway's position before and after it had been resurfaced by the Truxa-Sanis in 2001. Their argument was that the driveway had been extended northward in the course of resurfacing, a fact that, if established, would have defeated the Truxa-Sanis' possessory interest. After reviewing before and after photos, the expert had concluded that the driveway had moved northwards by anywhere from four to 24 inches.

Justice Frank didn't buy it. In her reasons, she identified several concerns that led to the rejection of the expert's evidence. First, she took issue with the manner in which the Reiners had instructed the expert; they had informed him that the northern edge of the driveway had been extended and asked him to determine the extent of the change. Justice Frank felt that this instruction compromised the independence of the expert. Second, the expert's opinion relied on a premise that was in conflict with the otherwise uncontradicted evidence of the Truxa-Sanis, as well as the previous owners of both properties. Given the subjective element involved in photo interpretation, Justice Frank determined that the testimony of the other witnesses ought to prevail. Finally, Justice Frank determined that the margin of

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error was significant enough that the expert's opinion, even if accepted uncritically, did little to rebut the Truxa-Sanis' claim to the strip of land.

What lesson can practitioners take from this case? On a general level, it emphasizes the bias against “hired guns.” The court wants to satisfy itself that the expert is not manipulating the subject material of the analysis to serve a particular conclusion, and is instead providing independent advice to the court. A practitioner must be careful in selecting the information he or she provides to the expert to avoid compromising the expert's independence.

In property dispute cases in particular, *Reiner v. Truxa* also suggests that expert evidence is persuasive only to the extent that it buttresses the evidence of the parties' perceptions and behaviour toward the contested land; where it is in clear conflict with

that evidence, the court will favour the testimony of the parties over the expert. Finally, before spending money on having expensive experts testify, a party must consider the real value of that evidence. In the worst-case scenario, is the expert's evidence still dispositive of the issue in question? The Reiners' expert evidence fails that test because the margin of error was too great. At the low end of the range, it was insufficient to fully rebut the Truxa-Sanis' entitlement to the property. Had they thought about that before having the expert testify, they might have saved themselves some money.

Unfortunately for the Reiners in this case, pictures don't always tell the entire story.

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Offshore: The filing deadline has been extended to July 31

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that year. If you receive a T5 for dividends from IBM, but no T5 for dividends from Apple, then the Apple shares must be reported. The cost of both the IBM and Apple shares go into the calculation of the \$100,000 threshold.

Even if you received T3 or T5 slips for all your foreign income, the T1135 form must still be filed to claim the exclusion. The T3/T5 exclusion does not benefit taxpayers who hold foreign investment real property.

With this added burden on tax preparers, the government announced some administrative relief. The filing deadline for the

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2013 T1135 form has been extended to July 31, instead of when the tax return is due.

Relief for 2013 is also provided

by allowing reporting of the combined value of foreign properties, instead of cost, for each property, when they are held with a Can-

adian-registered securities dealer. This does not benefit taxpayers who hold foreign investment real property.

Penalties for failing to file the T1135 range from \$100 to \$2,500 per year. The penalty increases to \$12,000 if the failure was made knowingly or in circumstances amounting to gross negligence.

What if you inadvertently exclude one or more foreign properties? The penalty is \$100 per omission. Taxpayers can apply to the CRA's voluntary disclosure program to file or amend the T1135, and if you qualify, all penalties can be waived.

Also, a deficient or late-filed T1135 form can result in the nor-

mal three-year reassessment period being extended by another three years should you also fail to report income from a foreign property. The extended reassessment period applies to all aspects of the return, not only foreign property.

For sure, complying with the government's effort to identify offshore accounts will be costly and time-consuming.

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