Purchasers Get Burned

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The article first appeared in GST, Commodity & Tax, Carswell Thomson, ©2008 Thomson Canada Limited, March 2008

Counsel and advisors to clients engaged in real estate transactions should be cautious when providing advice on the GST status of uninhabitable real property. The decision in *Yakabuski v. The Queen*,1 which was decided under the Tax Court of Canada's informal procedure, requires that the parties characterize a supply of residential property according to the immediate state of the property, without reference to how the property was characterized in the past. In the Tax Court's view, residential real property can change in character: what was previously exempt can revert back to a taxable status without a corresponding change in use or recovery of embedded GST.

Facts

The facts of the case are straight-forward. The Minister disallowed a rebate claim filed by the appellants to recover GST paid in error on the purchase of residential real property that had been severely damaged in a fire. Two buildings were on the property in question. One building had been used as the principal residence of an individual until it was damaged in a fire. The other building was a vacant cottage. At the time the appellants took possession of the property, the buildings had been partly demolished, and by the appellants own admission were uninhabitable. The demolition was completed post-closing.

Issues

The sole issues before the Court were whether (1) the fire-damaged dwelling house was a used residential complex and, (2) the supply was exempt under S. 2 of Part I of Schedule V to the *Excise Tax Act* (Canada) (the "ETA").

The Minister took the position that since the dwelling house was uninhabitable at the time of the sale, the supply was not a supply of a residential complex, used or otherwise, and was, therefore, taxable.

The Decision

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"residential complex" and "residential unit" in subsection 123(1) of the ETA. In particular, the appellants argued that the real property was a "residential unit" as that term is defined in part as follows:

(a) a detached house, semi-detached house . . .or

(c) any other similar premises, or that part that . . .

(f) is vacant, but was last occupied or supplied as a place of residence or lodging for individuals, or

(g) has never been used or occupied for any purpose, but is intended to be used as a place of residence or lodging for individuals.

The appellants focused on the following part of the definition of "residential complex":

(a) that part of a building in which one or more residential units are located, together with (i) that part of any common areas and other appurtenances to the building and the land immediately contiguous to the building that is reasonably necessary for the use and enjoyment of the building as a place of residence for individuals . . .

The appellants' arguments included the following points:

″ The term "residential complex" is intended to include that part of a building that includes a residential unit together with the land that was reasonably necessary for its use and enjoyment as a place of residence for individuals;

- ″ 'Residential unit" is intended to include a detached house *or that part thereof* that is vacant but was last occupied or supplied as a place of residence or lodging for individuals;
- ″ The definitions of "residential complex" and "residential unit" do not require that the property be "inhabitable";
- ″ The ETA permits the retention of the underlying characterization of tax exempt used residential property through a wide variety of circumstances including damage by fire; and
- ″ A seriously fire-damaged single family home, notwithstanding that it is uninhabitable until it is repaired or restored, is still a residential complex within the meaning of the ETA and subject to the GST rules affecting used residential housing.

However, despite the appellants' effort, the Court concluded:

> . . . what we are talking about at the point of transfer is "that which was transferred". We are not talking about whatever existed there before. All references in the terms "residential complex" and "residential unit" have to be related to that which was transferred to the Appellant when she completed the transaction as referred to in

> the Contract of Purchase and Sale.

Simply put, that which was transferred was not a "residential complex" or "residential unit". The Court considered "place of residence" to be "of paramountcy" in the definitions of the terms "residential complex" and "residential unit" and stated the following:

> When reviewing all of these terms with their clear and common use meaning, the Court is satisfied that that which was transferred according to the Contract of Purchase and Sale had to be capable of being used as a place of residence and that which was being transferred had to be a detached house or part thereof that was last occupied or supplied as a place of residence or lodging for individuals. These terms are almost synonymous with the term "inhabitable" as used by counsel for the Respondent. Consequently, it follows that that which was transferred had to be capable of being used as a place of residence or, as counsel for the Respondent put it, it had to be "inhabitable".

Principles of Statutory Interpretation

With respect, the Court should not have read in the requirement that the property be "inhabitable". What is missing in this decision (likely as the result of the informal nature of the procedure) is a serious discussion of the rules of statutory interpretation in the context of taxing statutes. The words of Vancise J.A. in *Royal Bank of Canada v. Saskatchewan Power Corp.*2 have been repeated many times:

> Historically, the courts took a literal approach to revenue statutes to determine legislative intent. . .. The literal interpretation, coupled with the restrictive interpretation, placed the onus on Parliament to express itself clearly, and if it did not, the benefit of doubt went to the taxpayer.

The recent statements of Estey J. writing for the Supreme Court of Canada in *Morguard Properties Ltd. v. City of Winnipeg*3 support the strict construction of taxing statutes:

> In more modern terminology the courts require that, in order to adversely affect a citizen's right, whether as a taxpayer or otherwise, the Legislature must do so expressly. Truncation of such rights may be legislatively unintended or even accidental, but the courts must look for express language in the statute before concluding that the rights have been reduced. This principle of modern construction becomes more important and more generally operative in modern times because the Legislature is guided and assisted by a well-staffed and ordinarily very articulate Executive. The resources at hand in the presentation and enactment of legislation are such that a court must be slow to presume oversight or inarticulate intentions

> when the rights of citizens are involved. The Legislature has complete control over the process of legislation, and when it has not for any reason clearly expressed itself, it has all the resources available to correct that inadequacy of expression. This is more true today than ever before in our history of parliamentary rule.

Based on the foregoing, the Court should not have concluded that the terms "residential complex" and "residential unit" required that the property be inhabitable; indirectly, in reaching this conclusion, the Court presumed that the Legislature had made an oversight by omitting to expressly include the requirement.

Some troubling implications

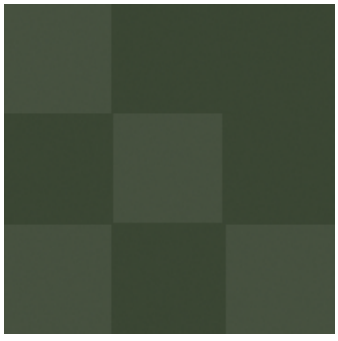
Yakabuski may have some troubling implications for other properties in transition.

1) Consider the proper characterization of a house after it has been rented to university students who are less interested in cleaning and maintenance and more interested in throwing some seriously wild parties, leaving holes in some of the walls and garbage—beer bottles, pizza crusts and cigarette butts—under loose floorboards. What if the landlord gave up on the rental and sold the house to purchasers who were willing to restore the house to live in it?

Based on the *Yakabuski* decision, it is unclear whether the transaction would be considered to involve used residential housing or taxable real property. The previous tenants had considered the property to be livable, but most others would not. What is or is not "inhabitable" could become subjective.

2) What is the proper characterization of a supply of a rundown apartment building that was previously occupied by many individuals as a place of residence that the municipality has condemned? What if all the renters have moved out of the building and the property is being sold so that it can be demolished and a new a building can be built? Does the answer depend on the presence of squatters?

If *Yakabuski* is followed, the buyer would be required to pay GST on the acquisition. However, it is not clear how the change in use rules would apply so that the seller or some other person would take advantage of the change in use rules and recover embedded GST.



3) What is the proper characterization of an apartment building or other multi-unit residential complex that is under construction, but not yet complete, when an individual moves into one of the residential units (triggering self assessment requirements)? As with many such buildings, some floors are not completed at the time the first person moves into the complex and, therefore, a significant portion of the complex is "uninhabitable". What if the builder defaults on its mortgage and the mortgagor has to sell the property to a new builder

who will complete the construction? Self-assessment has occurred, but much of the property has never been a place of residence for an individual and cannot be a place of residence until further work is completed by the new builder.

Based on the *Yakabuski* decision, part of the property arguably may not be a residential complex when it is sold.

As a result, there will be a second incidence of GST when the buyer pays GST to the supplier. The change of use rules may not apply to permit a supplier or mortgagee or other seller to recover the GST that had been self assessed.

There are many other examples that demonstrate that the "inhabitable" requirement may not be consistent with the scheme of the ETA. In the meanwhile, purchasers should exercise caution in transactions which involve properties which have suffered damage.

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1 (2008), [2008] G.S.T.C. 10, 2008 TCC 27, 2008 CarswellNat 69 (T.C.C.)

2 (1990), 1990 CarswellSask 211, 73 D.L.R. (4th) 257, [1991] 1 C.T.C. 532 (Sask. C.A.) at 264.

3 (1983), 1983 CarswellMan 162, 1983 CarswellMan 187, 3 D.L.R. (4th) 1, [1983] 2 S.C.R. 493 (S.C.C.) at 13.