Different Ownership Structures for Real Estate Investment Property

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BMO Private Wealth

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Investing in real estate has always been a popular investment strategy for building wealth, particularly in active housing markets and big cities like Toronto, Vancouver and Montreal. No matter where you choose to invest, the decision to purchase real estate should be reviewed with your tax and legal advisors to understand the tax and legal issues applicable to your particular circumstances, and to determine whether it is a suitable option for your situation.

One important decision when purchasing a real estate investment property is to determine which ownership structure will be used. The ownership structure of any investment property is best decided prior to purchase and should complement any succession plan for its ownership, and should be informed by potential tax implications. Some considerations that will inform the ownership structure in which you purchase your property include[1]:

- Do you plan on holding title to the property throughout your lifetime, or do you intend to transfer ownership to your children or other individuals ("transferees") during your lifetime?
- How old are the intended transferees of the property(ies)?
- Do you or your transferees intend to reside in the property?
- How will any rental income and the future disposition(s) be taxed?

This article focuses on investment in Canadian real estate[2] and reviews common structures of ownership (including personal ownership, as well as ownership via a partnership, corporation, and trust), and select legal and tax-related implications of each structure. A chart at the end of the article summarizes some of the various advantages and disadvantages of each ownership structure.

Personal ownership

The simplest form of ownership is owning a property outright in your own name; however, this may not meet all of your other interests and goals for the property. Note that if you intend to share ownership with your children, or subsequently transfer ownership to them outright, minors will not be able to hold title to the property in their own name(s), so alternate structures should be considered.

Different methods of co-ownership

If you intend to either purchase a property with your children or business partners, or transfer the property to them during your lifetime while maintaining an interest in the property, it is important to understand the different methods of co-ownership.

Ownership as joint tenants with rights of survivorship[3] means that all owners have equal rights and obligations with respect to the property. On death of one joint tenant, their ownership interest will be shared by the surviving joint owners on title. The property will not pass through the probate process, which can result in significant probate tax savings for the estate of the first owner to die[4]. However, it also means that the entire value of the property may be available for any of the joint owners' creditor or marital property claims. Although not always recommended, married or common-law partners will often own property as joint tenants, particularly where it is intended that the property pass outright to the surviving spouse or common-law partner upon death.

Note that there are additional risks and legal complications to owning property jointly with adult children which commonly makes joint ownership with children not a recommended structure. You should review any decisions with your legal and tax advisors for further guidance. For more information, ask your BMO financial professional for a copy of our publication, *Pros and Cons of Owning Property as Joint Tenants with Rights of Survivorship*.

Ownership as tenants in common refers to a method of ownership whereby each owner has a defined interest or percentage in the property. Their rights and obligations with respect to the property may be unequal, and upon death that interest in the property forms part of their estate. If you own property as a tenant in common, your Will should speak to your intentions with respect to how your interest in the property should devolve, as your ownership interest in the property will be subject to probate.

Liability issues

Any property that you have a direct ownership interest in will be subject to any creditor or marital property claims you may be faced with during ownership. If this is a concern for you, please review alternate options with your legal advisor to determine the best structure to protect your investment. Keep in mind that if you intend to transfer the property to your children at some point, the property will then be subject to their own potential claims. Open discussions with your children about their financial and marital situations are key to timing the transfer of title effectively.

[1] There may be other considerations that will inform your decision, such as property tax and financing issues; these considerations are not discussed in any detail in this article but also form important aspects in structuring the purchase and sale of real property.

[2] There may be other legal and tax considerations when purchasing U.S. (or other foreign) real estate; for example, foreign tax filing obligations, withholding taxes, estate taxes, etc.

[3] Joint tenancy with right of survivorship is not recognized in Quebec. In Quebec, ownership of property by more than one person can only be achieved by way of co-tenancy, also known as tenancy in common.

[4] The rate of probate fees that will be applied to the value of your estate depends on the province in which the property is located.

Taxation of rental income earned on the property

Prior to understanding the income tax treatment of rental income[5], it is important to understand how rental income is determined for income tax purposes. In computing net rental income, no expenses[6] may be deducted unless they are reasonable and made or incurred for the purpose of generating the rental income. The purchase price or capital cost of the property is not deductible for income tax purposes; however, a specific allowable capital cost allowance ("CCA") can be claimed on the portion of a cost allocated to the building (not the land) at a prescribed rate applicable to that building class, and deducted against the rental income. The CCA claim is a discretionary, deductible expense and need not be claimed in any given year. It is important to note that restrictions[7] do apply, such that you generally cannot make a CCA claim to create or increase a rental loss already realized. Each CCA claim reduces the capital cost of the building for tax purposes, and an aggregate, undepreciated capital cost ("UCC") balance is maintained at the end of each year. Given the complexities associated in determining the rental income for tax purposes, it is important to engage a qualified tax professional to assist in computing all relevant income.

With respect to personally owned properties, net rental income is reported on the personal income tax return to the individual owner or owners in joint ownership structures. Any net rental income is added to the total income and taxed at each individual owner's personal marginal tax rate. A benefit of personal ownership is that the net rental income is considered "earned income" for purposes of calculating the individual owner's RRSP contribution room. To the extent that a rental loss is realized for the year, the loss may be deductible against the individual's other sources of income, providing an income tax savings based on their marginal tax rate[8].

Taxation on disposition of property

Upon the disposition of the rental property[9], there are typically two layers of taxation to consider. The net proceeds received are to be allocated between the land and building components of the property. A capital gain or loss would be realized in the amount of the net proceeds received less the adjusted cost base of the land. A capital gain would also be realized on the building component in the same manner, but any loss from the sale of the building is not considered a capital loss and; therefore, cannot be claimed as such. The second layer pertains to potential "recapture" of any CCA claims previously made on the building. That is, CCA claims previously deducted are recaptured and included in the individual's income up to the original cost (or proceeds received) of the building. In other words, the lesser of the original cost or proceeds received for the building in excess of any UCC balance is recaptured and is fully (100%) taxable. To the extent that the proceeds received are less than the UCC balance, a full deductible loss may be claimed for the difference, commonly referred to as a "terminal loss." There are additional nuances which could adjust the combination of the ultimate tax results. Therefore, it is important to work with a tax professional to assist in determining the tax consequences in your circumstances when disposing of property.

With respect to transfers of property between family members, whether you intend to transfer your interest in the rental property during your lifetime or on your death, there will be a deemed disposition of the property for tax purposes at the time of transfer.

- Transfers or bequests between spouses are deemed to occur at the tax cost (on a tax-deferred "rollover" basis), such that no capital gain or loss would be realized at that time. However, transfers during lifetime made from one sole owner spouse to another on a rollover basis will give rise to income attribution rules such that the net rental income (or loss) earned each year, and any future capital gain, recapture or terminal loss will attribute back to the original transferor spouse, thereby negating any potential income-splitting opportunity.
- Transfers or bequests made to children trigger a deemed disposition with proceeds equal to the fair market value of the property at that time. Any resulting capital gain and recapture is realized at that time and taxable in the year of transfer or death.

As a result, you should ensure you have sufficient liquidity to fund any tax liability either during your lifetime or on death. Given the sometimes illiquid nature of real estate property, a life insurance policy is typically a good investment option in order to plan for the necessary liquidity for the estate if the transfer will occur on death.

[5] For Canadian income tax purposes, rental income is typically either characterized as "passive" property income or "active" business income. Depending on the ownership structure, each type may be treated differently for tax purposes. Unless otherwise noted, this publication focuses on the tax treatments of rental income earned as passive property income.

[6] Expenses are typically divided into two categories: current or capital expenses. Current expenses are common, recurring amounts that generally pertain to the upkeep and maintenance of the property and are typically deductible in the current year in which they are paid. Capital expenses tend to be larger in nature and non-recurring, and which provide an enduring benefit to the property. Capital expenses are not deductible in the current year, and instead are capitalized to the cost of the property and may be subject to tax depreciation claims. Common real estate expenses include "soft costs" such as interest, legal, accounting, property taxes, etc. These costs are incurred while a building is being constructed or renovated and may be deducted in the current year as current expenses (up to the amount of rental income earned in the year), while any excess amounts would be treated as capital expenses.

[7] Note, CCA restrictions do not apply in certain ownership structures and where the income earned on the property is considered active business income rather than passive property income.

[8] Please note that caution should be taken in cases where a rental loss is derived from property that is rented to related parties, where rent is charged at less than fair market value. Such circumstances could render the loss not deductible.

[9] For purposes of this publication, the tax treatments described are under the assumption that the property disposed of is held as capital property and not as inventory, which would give rise to different tax results.

Ownership through a Canadian partnership

A partnership is an agreement by two or more persons to carry on business together with a view to profit. This form of ownership is typically used by professionals, such as lawyers and accountants, or for arm's length business associates/investors, but can also be used for any business arrangement. It is more complex than other forms of property co-ownership, as outlined above. Although a partnership is not a separate legal personality, setting up a partnership will require legal and accounting costs, both for the negotiating and drafting of a partnership agreement and for annual partnership information returns.

There should be a partnership agreement that governs the terms of the partnership, including the partners' respective percentage interest in the business, which would thereby inform their responsibility for expenses and tasks, as well as their share in the profits of their business. It should also deal with conflict resolution, steps to be taken when a partner leaves the partnership, and implications of death or incapacity of a partner.

Estate planning considerations

Partnership assets and liabilities are distinct from those of the partners. Instead, an individual partner holds a partnership interest (in the form of "units") rather than as a beneficial ownership of the partnership assets. The estate of a unit holder in the partnership will only retain the units in the partnership and not any specific rights with respect to the property or assets owned by the partnership.

In Ontario and British Columbia, interest in a partnership may bypass probate with the use of a secondary Will to deal with assets not requiring probate if the terms of the partnership agreement do not prohibit probate being dispensed with on the death of a unit holder.

Liability issues

The type of partnership will inform the potential liability of the partners for debts incurred by the partnership. As suggested by the name, a limited partnership limits the liability of the limited partners to the amount of their investment/capital in the partnership, while a general partnership results in the individual general partners being personally responsible (joint and severally) for debts of the partnership. Note that in a limited partnership arrangement, there must be at least one general partner who maintains general (unlimited) liability. A review of the advantages and disadvantages of each form of partnership should be reviewed with your external legal advisors.

Taxation of income earned by the partnership

A partnership itself is not a taxpayer, but rather acts as a "flow-through" entity where the partnership computes income for tax purposes – as if it were a separate taxpayer – at the end of its fiscal period, and the income is then allocated to the partners based on their income interests, as outlined in the partnership agreement. The income retains its character for tax purposes, and to the extent that the partners are individuals, the amount is included in the individual partner's tax filing in the same manner as described above in a personal ownership context. Similarly, any rental loss incurred in the partnership is allocated and deductible to the individual partners. However, losses allocated to limited partners are restricted to the amount of their liability or capital "at-risk" in the partnership, and any losses in excess of this amount cannot be claimed or deducted by that partner. The amount of losses that cannot be claimed in a given year can be carried forward indefinitely to be used in a future year to the extent the limited partner's investment "at-risk" in the partnership is increased. (This generally occurs when partnership income is earned in a future year or additional capital is contributed to the partnership by the partner.) These loss restrictions do not exist for losses allocated to general partners of a partnership.

Ultimately, a partnership structure can be a viable and flexible investment structure, particularly between business partners as it can provide the same income tax treatments as personally owned properties (provided there are no loss restrictions triggered),while also benefiting from a level of liability protection and potential probate tax savings.

Taxation on disposition of the property

The rules described above in determining any capital gain, recapture or terminal loss also apply to any disposition of the property by the partnership. Similarly, the resulting income amounts retain their character and are allocated and taxable to each of the individual partners in the same manner based on their interest outlined in the partnership agreement. To the extent that individuals already personally own real estate property and wish to form a partnership, the property can be transferred into the partnership on an income tax-deferred basis[10], such that any accrued capital gain tax or recapture can be deferred upon the disposition into the partnership. Specific income tax elections would be required to be filed with guidance from your external tax advisors.

As previously described, an individual partner owns an interest in the partnership as opposed to the underlying capital assets. As such, upon death, the individual partner is deemed to dispose of their capital partnership interest (units) with proceeds deemed to be received equal to the fair market value. Unless the partnership interest is bequeathed to a surviving spouse or qualifying spousal trust in the unit holder's Will, a capital gain or loss will be triggered in the amount of the deemed fair market value proceeds received, less the adjusted cost base of the partnership interest.

[10] Please note that upon transferring property between parties, other non-income tax-related considerations should be assessed, such as any potential land transfer taxes or GST/HST implications. These topics are beyond the scope of this publication and are items best addressed with external tax advisors prior to effecting a transfer of property.

Ownership through a Canadian-controlled private corporation ("CCPC")

Incorporation is a process undertaken in the creation of a legal entity, known as a corporation. It is a separate entity for legal and tax purposes and is distinct from its shareholders, the owners of the corporation. A corporation can hold the legal and beneficial ownership of real estate property. As such, the individual owners do not have a direct ownership in the property, but rather an indirect ownership via their shareholdings. A benefit of this corporate structure is that a level of flexibility can be implemented by having investors or family members participating in various share ownership interests with different classes of shares carrying different attributes. As such, certain shareholders may participate in a level of equity interest while others may hold a controlling interest tied to voting rights on separate shares. This flexibility can commonly assist with various tax and estate planning arrangements and potentially achieve a level of income splitting amongst shareholders, subject to corporate attribution considerations and the new tax on split income ("TOSI") rules which can prevent many income-splitting strategies. For more information, ask your BMO financial professional for a copy of our publication, *Tax Changes Affecting Private Corporations: Tax on Split Income ("TOSI")*.

Changes in the share ownership of the corporation do not result in a change of ownership in the underlying property, and through appropriately executed tax planning strategies, it may also be possible to effect the changes in shareholdings on an income tax deferred basis. For example, a corporation can be used to affect an estate freeze; a tax motivated transaction to facilitate a transfer of the future growth of the underlying real estate property to the next generation of family members on a tax-efficient basis. This sort of planning would not be available with personally owned property as any transfer of ownership to children would result in a disposition at fair market value for tax purposes, as previously detailed.

Even though there are benefits, owning assets in a corporation is complex and requires legal and accounting costs both for the negotiating and drafting of a shareholders' agreement and for accounting costs to prepare corporate income tax returns. The shareholders' agreement should set out all obligations and rights of the shareholders and define their respective holdings in the business. It should also deal with conflict resolution, sale of shares in the company, and implications of death or incapacity of shareholders.

Estate planning considerations

As the ownership interest of the actual property lies with the corporation and not with the individual shareholders, the estate of a shareholder will only own the shares in the corporation and not any specific rights with respect to the property owned by the corporation. As such, each shareholder's Will should only speak to the disposition of the shares and not the underlying assets owned by the company. The terms of the Will should also be broad enough to allow the executor to implement strategies to minimize double taxation on death, as described below. This will allow the executor to efficiently minimize taxes, preserve inheritance values and leave the beneficiaries with more of the estate.

In Ontario and British Columbia, an interest in a corporation may bypass probate with the use of a secondary Will if the terms of the shareholders' agreement do not prohibit probate to be dispensed with upon death of a shareholder.

Liability issues

Owning property through a corporation creates separation between the shareholders and the assets of the corporation. It should therefore offer protection to the individual shareholders from creditors of the corporation. However, the shares owned by an individual shareholder may still be subject to claims against the shareholder personally, and may be subject to any marital property claims with which the shareholder might be faced.

Taxation of income earned via the corporation

Investing through a corporation introduces two levels of taxation to the property income earned. A corporation is required to file a tax return annually and report its net rental income. In general, there is no tax rate benefit of earning passive rental property income in a CCPC[11] as the income is subject to high corporate (and partially refundable) tax rates, which approximate the highest personal marginal tax rate. The corporate refundable taxes are refunded to the corporation when the corporation distributes taxable dividends to the individual shareholders, which triggers the second level of taxation. Ultimately, on an integrated basis, the combined corporate and personal taxes are approximately the same amount of total taxes paid as if the same amount of rental income was earned personally subject to the top marginal rate. Please note that a distribution of income out of the corporation does not retain its original character. Therefore, dividends paid out to individual shareholders are not considered earned income and would not create any RRSP room. Furthermore, to the extent that the corporation realizes a rental loss, the loss cannot be deducted against an individual shareholder's personal income. The loss is effectively suspended in the corporation but can be carried over to a limited number of previous or future years to be applied against income in those years.

[11] A CCPC is a private corporation which is controlled by Canadian residents. A corporation will not qualify as a CCPC if it is controlled directly or indirectly by a public corporation or non-residents, or a combination of the two.

Although not an area of focus in this publication, in circumstances where the rental income earned is considered "active" business income[12], the corporation will not be subject to high corporate refundable taxes and could gain access to the (lower) general or small business corporate income tax rates which can result in a personal income tax deferral advantage where the income is retained in the corporation. As well, in certain circumstances there may be relaxed restrictions on the CCA claims compared to personal ownership structure arrangements. Be sure to consult with a qualified tax professional to understand the nature of the corporate income earned and the applicable corporate tax rates.

When considering the earning of passive rental income in a corporation, be mindful of recent private company tax changes which can claw back the Federal small business deduction (or access to the small business tax rate) of any associated corporations earning qualifying active business income. This can be of concern where the shareholders of the real estate corporation own other active, operating corporate businesses. For more information, ask your BMO financial professional for a copy of our publication, *Understanding Personal Holding Companies.*

Taxation on disposition of property held by the corporation

The same tax results described under personal ownership also apply to the disposition or deemed disposition of the underlying property held inside the corporation. Similar to rental income earned, the same two layers of taxation apply, such that the corporation is subject to capital gains tax and recapture (where applicable) within the corporation with the after-tax corporate profits distributed to the individual shareholders and taxed personally. In order to maintain the necessary level of integration as previously described, the non-taxable portion of any capital gain realized on the disposition is credited to the corporation's notional capital dividend account. If this account is positive at the time of distribution, tax-free dividends can be paid out to Canadian resident shareholders.

To the that extent individuals already personally own real estate property and later wish to transfer the property to a corporation, the transfer can be effected on an income tax-deferred "rollover" basis[10], such that any accrued capital gain or recapture can be deferred upon the disposition into the corporation. Specific joint income tax elections would be required to be filed between the individuals and the corporation. Please note; however, this transaction cannot be reversed; in other words, a similar tax-deferred rollover cannot be achieved in transferring the property out of the corporation and into an individual shareholder's personal ownership.

A further word of caution is warranted where individuals seek to transfer personal use real estate property (for example, a principal residence or a personal cottage) into a corporation. It is generally not recommended to own or transfer these properties into corporate ownership as complexities exist where individual shareholders may be subject to a taxable shareholder benefit for the personal use of the corporate property. In addition, corporations do not have access to the principal residence exemption, such that any capital gain realized on the sale of the corporate principal residence could not be sheltered by the principal residence exemption.

As a separate legal entity, the corporation could continue to operate and exist upon the death of an individual shareholder. Immediately before death, the deceased individual is deemed to have disposed of their shares of the corporation. Unless those shares are transferred to a surviving spouse/common-law partner or qualifying spousal trust, in the deceased shareholder's Will, the deceased is deemed to receive proceeds equal to the fair market value of their shares (derived from the underlying value of the property) and a taxable capital gain will be realized. Complexity exists in corporate ownership structures such that there is a potential for double (or even triple) taxation on death because, in addition to the deceased individual's capital gain realized on the shares, when the property is ultimately disposed of, or distributed to beneficiary shareholders, another layer of tax will be realized by the corporation and then, personally, by the individual beneficiary shareholders. For more information, ask your BMO financial professional for a copy of our publication, *Holding Investments Inside a Company – Taxes Upon Death.* Given these complexities, it is important that executors work with external tax advisors to understand available planning tools to reduce the various layers of taxation arising upon the death of a shareholder in the estate.

Ownership through a Canadian trust

A trust is a legally binding arrangement under which title to property and ownership and/or enjoyment of the property are separated. There are three different relationships that form the basis of every trust agreement:

- **Settlor** establishes the trust by transferring property to the trustee to hold for the benefit of the beneficiaries;
- **Trustee** is the individual or corporate entity appointed to make decisions regarding investments and distributions of trust income and capital; and
- **Beneficiaries** are individuals or entities entitled to receive income and/or capital of the trust.

[12] If the corporation's principal purpose is to derive income from property (such as interest, dividends, rents and royalties), and it has more than five full time employees, the rental income may qualify as active business income.

A trust may be established during the lifetime of, or on death of the settlor. A trust established during the lifetime of the settlor is referred to as an "inter vivos trust" and is settled by a trust deed that is executed by the settlor and trustees. It will likely entail legal costs to have the trust deed drafted as well as ongoing costs for record keeping and accounting. A trust that is meant to begin on the death of a settlor is referred to as a "testamentary trust" and is established in the Will of the settlor. There will be similar ongoing costs for record keeping and accounting needs for the trust once it has been commenced on the death of the testator.

In some jurisdictions, ownership of real property by a trust may be problematic from a land titles perspective. Review your intentions to purchase property by a trust or to have ownership of real property transferred into a trust with your legal and tax advisor.

Estate planning considerations

Typically, the death of a settlor does not impact the administration or existence of an inter vivos trust. This is because the settlor transfers ownership of the property to the trustees such that the property will no longer form part of the settlor's estate. This also means that the property held by the trust will not be subject to probate on the death of the settlor. In addition, depending on the nature of the trust and the class of beneficiary, there would not be a deemed disposition of the property held by the trust upon the death of any individual beneficiary of the trust[13].

Please note that if you lend money into the trust to purchase the real estate investment property, the loan may remain an asset of your estate when you die. In Ontario and British Columbia, the loan in the trust may bypass probate with the use of a secondary Will. For more information, ask your BMO financial professional for a copy of our publication, *Probate Planning* and speak to your estate planning lawyer and accountant before implementing any trust strategies.

Liability issues

A trust may offer potential protection from creditors of the settlor and/or beneficiaries if the settlor does not retain an interest in the trust assets, or if the beneficiaries do not maintain a vested interest or have veto power as trustee in making discretionary decisions of the trust. A full review of advantages of trusts for asset protection should be reviewed with your external legal advisors.

Taxation of income earned by the property in the trust

The computation of rental income earned within a trust is like that of properties held under personal ownership. Although not legal entities, inter vivos and testamentary trusts are taxed as though they are individuals, but subject to a flat rate equal to the top personal marginal tax rate[14]. For these reasons, there is typically no tax advantage realized in earning rental income that is retained and taxed within a trust. However, in computing the income of a trust, any income paid or made payable in the year to a beneficiary can be deducted from the trust's income and is taxable to that beneficiary in receipt of the income payments. As such, trusts can also act as a "flow-through" entity.

In some circumstances, trusts can be used as an income-splitting tool, such that income can be paid out to beneficiaries subject to lower tax brackets. Commonly, trusts are funded by family members by a loan with interest equal to the Canada Revenue Agency's prescribed rate at that time, and these funds are then used in purchasing the trust's property. These loan structures are employed as an income-splitting strategy, but a clear review of any income attribution or TOSI rules should be assessed as circumstances may exist to prevent intended income-splitting results. In assessing various attribution rules, care must be taken when structuring a trust to understand all relevant parties, their roles, relationships to each other and, ultimately, how the trust is funded. Unlike a partnership flow-through structure, losses cannot be allocated to beneficiaries. A rental loss can be carried forward to a limited number of future tax years to offset rental income in that year which will; therefore, reduce the amount of any income paid to beneficiaries in that year.

Taxation on transfer of property into a trust

Unlike transfers of property into a partnership or corporation, transfers of real estate property into a trust either during lifetime or upon death are deemed to occur at fair market value[10,15], and any capital gain and recapture will be realized at that time.

Taxation on disposition of property or wind-up of trust

In order to prevent the indefinite deferral of capital gains on property retained by a trust, for income tax purposes the trust is deemed to have sold all of its property at fair market value (and to re-acquire it at the same amount) on each 21st anniversary of the creation of the trust[16]. Capital gains (and potential recapture) that are

[13] A deemed disposition of the trust property may be realized upon the death of a life interest beneficiary in life interest trusts (such as a spousal or joint partner trust). This concept is beyond the scope of this paper and should be reviewed in further detail with your external legal and tax advisors.

[14] There may be an exception for Graduated Rate Estates ("GRE") and Qualified Disability Trusts ("QDT"); however, these considerations are beyond the scope of this article.

[15] There may be an exception for inter vivos, alter ego or joint partner trusts or for qualifying testamentary spousal trusts such that the transfer may occur at the property's tax cost amounts. However, these considerations are beyond the scope of this article.

[16] There may be an exception for alter ego, spousal or joint partner trusts. However, these considerations are beyond the scope of this article.

unrealized will; therefore, become taxable to the trust. However, it may be possible to allocate these deemed gains to beneficiaries depending on the terms of the trust. Because of this rule, many trusts will contemplate a termination date prior to the first 21st anniversary, but there is no requirement for a trust to be terminated within this period[17]. Often the terms of the trust are drafted to provide flexibility so that the potential capital gains tax can be deferred. For example, the trustees could be given discretion to distribute all, or some, of the capital property to beneficiaries before 21 years have elapsed since the trust's creation. In most cases, this distribution of capital property (to a Canadian beneficiary) can occur at the trust's tax cost, thereby avoiding any immediate tax consequences to the trust or the beneficiary. The beneficiary will then own the property outright (which is not always desirable depending on the scenario), generally at the tax cost base of the property to the trust, such that the beneficiary will be subject to tax on the accrued gains when they ultimately dispose of the property (or at death). For these reasons, trusts can be an effective tool in structuring a tax-efficient succession plan for the transition of real estate property to the next generation.

Seek advice

The determination of the appropriate ownership structure for real estate will depend on many factors, such as the main purpose of the real estate investment (for example, immediate rental or development, and extent of any personal use), the nature, timing and amount of income (or loss) expected, liability concerns and the availability of financing (and potential interest deductibility). Deciding which ownership structure suits your needs is a complex decision that requires professional guidance to help you balance the advantages and disadvantages of each method of ownership. Speak to your BMO professional on how your future investment in real property will impact your overall wealth planning, and engage your professional legal and tax advisors to understand all considerations in your personal circumstances.

For more information, speak with your BMO financial professional.

[17] Certain jurisdictions require trusts to be terminated within a period of time known as the "perpetuities period;" however, this rule is unrelated to the 21st anniversary rule for income tax purposes. A full discussion of the complexities of the rule against perpetuities is beyond the scope of this article.

Appendix: Benefits and drawbacks to different structures of ownership

Ownership structure	Benefits	Drawbacks
Outright ownership – Transfer at death	• Simple to implement with little administrative costs. • Your intended future owner will not have legal ownership to the property during your lifetime, thereby not subjecting the property to their creditor/marital claims. • Any rental income will generate RRSP contribution room, while rental losses may be used to offset other sources of personal income.	• Property open to your creditor or marital claims. • No opportunity for income splitting with children. • Rental income taxed at your personal rates which may be higher than other family members. • Your intended future owner must wait until death for ownership to the property and any income. • Entire value of property will be subject to probate tax and likely large taxable capital gain tax in your estate.
Outright ownership – Transfer during lifetime	• Simple to implement with little administrative costs. • If transferred to future owner as tenants in common, allows for each owner to determine their own succession planning. • If transferred to future owner as joint owners, allows avoidance of probate on death of joint owners.	• If property purchased while intended future owner is a minor, parent must purchase in own name and transfer to child at later date, with likely capital gains tax consequences on transfer to child. • Even when transferred at later age, children will have outright ownership. • If transferred to future owner as tenants in common, their ownership interest may be subject to their own creditor/marital claims. • If transferred to future owner as joint owners, entire value of property may be subject to their creditor/marital claims, and intention at time of transfer must be documented, preferably with lawyer. • Transfers into joint ownership with a spouse (or common-law partner) may give rise to income attribution, while transfers into joint ownership with adult children will trigger a deemed disposition, likely triggering capital gains tax.
Ownership via partnership	• Probate savings on death of unitholder if secondary Will is executed and available. • Income retains character and is taxable to individual partners. Partners can use losses to offset other sources of personal income, subject to review of loss restrictions for limited partners. • Limited partners can achieve a level of creditor protection based on capital at-risk.	• Legal costs to set up partnership agreement. • Annual accounting costs for partnership information returns. • Complex to operate. • Limited opportunity for income splitting (reasonable allocations required to partners based on contributions of partners).

Ownership via corporation	• Potential protection from creditors and other liabilities of shareholders. • Probate savings on death of shareholder if secondary Will is executed and available. • Potential for reorganization of corporation at later date to facilitate tax-efficient succession planning and potential income-splitting opportunities (subject to attribution and TOSI rules).	• Legal costs to set up corporation. • Annual accounting costs for corporate income tax returns. • Limited opportunities for income splitting. • Complex post-mortem tax planning after death of shareholder. • Shareholders' personal use of corporate real estate property may result in a personal taxable benefit and the loss of principal residence exemption upon future disposition of property.
Ownership via trust	• Potential protection from creditors and other liabilities. • Can maintain control over property as trustee. • Administration of trust would not be impacted by settlor's death. • If prescribed rate loan used to fund trust for purchase, potential for income splitting with children (subject to review of attribution and TOSI rules). • If loan used, there may be probate savings on death of lender if secondary Will is executed and available. • Probate not applicable on property value held in trust • Ability to transfer property in future to children/ beneficiaries at the property's tax cost, thereby deferring capital gains tax until such time as children/beneficiaries dispose of the property.	• Legal costs to set up trust. • Annual accounting costs for trust income tax returns. • Complex accounting to accurately calculate income earned by trust. • If property first purchased personally and transferred into trust, may be capital gains tax at time of transfer. • Cannot allocate losses to beneficiaries. • Trust deemed to dispose of property every 21 years (consider planning opportunities). • Most trusts generally do not have access to principal residence exemption (consider planning steps required to gain access to the exemption).

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