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Can new home GST also apply to renos?

Tax charged if 90 per cent of interior redone

Calculation is based on the entire house

It is common knowledge that GST applies to the sale of a new home. There is a partial rebate available if the home is owner-occupied, or rented out, but for new homes there is always some GST payable.

What is not as well known are the rules that apply when a home has been substantially renovated. Is GST applicable when the house has been gutted and looks brand new?

I recently acted for a young couple purchasing an older house in central Toronto. Just prior to closing, the seller's lawyer sent me a copy of the computer-generated forms his client proposed to sign and deliver to me on closing.

The standard form wording of the GST declaration used by most lawyers certifies to the buyers that the seller did not carry on any construction or renovation to the property in the course of his business.

The title search, however, told a different story. In the spring of last year, the owner of the property had bought it for \$235,000. This year, he was selling it to my clients for \$395,000 after an extensive renovation.

What concerned me was the section of the Excise Tax Act that made the purchasers - my clients - responsible for almost \$26,000 in GST if they were buying a "taxable supply" and if the seller did not pay the tax to the government.

I had a sleepless night worrying about whether a house that had increased in value by 68 per cent in only 10 months was subject to GST. I pulled out my copy of the skinny softcover I like to call "GST for Dummies," and learned that if the house was substantially renovated it was subject to the full seven percent GST hit.

The book defines substantial renovation as one in which all or substantially all of the building has been removed or replaced, except for the roof, interior and exterior walls, foundation and staircases.

It seemed to me from the massive price increase that the house must have been totally redone, so I asked the seller's lawyer to deduct \$26,000 from the price and send it to the feds.

While he and his client were deciding the most polite way to say no, I did some checking. I unlocked the office vault, and carefully took out the precious telephone number of my Secret Source in the GST branch of the Canada Revenue Agency (CRA). Like someone in a spy movie, I only call this number in cases of dire emergency, and I figured that the \$26,000 problem warranted a call.

My source was exceptionally helpful, and in less than 20 minutes, I thought I knew everything there was to know about substantial renovations and GST. Maybe.

It turns out that G.S.T. Memorandum 19.3.7, buried on the CRA website, actually defines substantial renovation in a way that is almost understandable. The government says that for tax purposes, "all or substantially all" means that 90 per cent or more of the interior has been removed or replaced.

The calculation is based on the entire house.

If only two rooms, such as a kitchen and bathroom, are extensively renovated, but little or no work is done to the rest of the house, the building would not normally be considered substantially renovated, regardless of the cost of the renovations.

In the same vein, if work is done to the roof and external walls with little or nothing done to the interior, the renovation would not be a substantial one, no matter how much money was spent on the outside.

The calculation can be based on the total floor space of the house or the number of rooms in it, as long as the method is fair and reasonable. If areas or rooms were not substantially renovated but other work, such as plumbing or electrical, was done to those areas, that work should also be figured in to assess if the extent of the work is 90 per cent or more.

Once the work hits the 90 per cent target, it meets the "all or substantially all test," and seven percent GST is payable on the entire purchase price including the land.

Separate and even more complex rules apply to mixed-use buildings, or if the house is extended outward or an additional storey is added, or if an unfinished basement is converted to habitable space. It's all there on the CRA website (www.cra.gc.ca) for everyone to decipher.

After a bit of detective work, I was able to verify to my satisfaction that the work done to the house was nowhere close to a 90 per cent renovation. As a backup, my title insurer (TitlePLUS) agreed to stand behind this assessment and protect the purchasers if they ever got dinged for the GST. The deal closed smoothly and the renovator walked away with a tidy profit which I calculate approached six figures.

Despite the price, my purchaser clients are quite happy with the house and the price they paid for it. It was just another challenge in the daily life of a real estate lawyer.

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