

Income Tax

IMP. 164-1/R1 Tax Treatment of Certain Expenses (Interest and Property Taxes) in Relation to Land

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Reference(s): *Taxation Act* (R.S.Q., c. I-3), sections 83.1, 128, 164, 165, 165.2, 165.3, 165.4, 165.5 and 255 (paragraph k)

This bulletin cancels and replaces bulletin IMP. 164-1 of July 29, 1988, and applies from taxation year 1988.

This bulletin gives the interpretation of the Ministère du Revenu du Québec concerning the tax treatment of interest and property taxes in relation to land.

DEFINITIONS

1. For the purposes of this bulletin:

“base level deduction” means, in respect of a corporation, an amount determined in the manner described in articles 9 to 14 below;

“interest on debt relating to the acquisition of land” includes interest paid or payable in the year in respect of borrowed money that may reasonably be considered, having regard to all the circumstances

- i. to be borrowed money used in respect of the acquisition of land, even if it cannot be identified with particular land; or
- ii. to have been used to assist, directly or indirectly, any person or partnership related to the taxpayer to acquire land to be used or held by that person or partnership otherwise than as provided for in paragraph a or b of article 2 below, except where the assistance is in the form of a loan to that person or partnership and a reasonable rate of interest thereon is charged by the taxpayer;

“land”, except to the extent that it is used for the provision of parking facilities for a fee or charge, does not include:

- i. any building or other structure affixed to land;

- ii. the land subjacent to any property described in i above; or
- iii. the land immediately contiguous to the land contemplated in ii above that is a parking area, driveway, yard, garden or similar land necessary for the use of any property described in i above;

“property taxes” does not include an income or profits tax or a tax relating to the transfer of property;

“real estate corporation” means a corporation whose principal business is the leasing, rental or sale, or the development for lease, rental or sale, or any combination thereof, of immovable property owned by it, to or for a person with whom it is dealing at arm’s length;

“related person or partnership” in respect of a taxpayer means:

- i. any person with whom the taxpayer does not deal at arm’s length;
- ii. a corporation of which the taxpayer is a specified shareholder; or
- iii. a partnership of which the taxpayer’s share of any income or loss is 10% or more;

“specified shareholder” means a specified shareholder within the meaning of sections 21.17 and 21.18 of the *Taxation Act* (the “Act”). The reader is invited to consult the current version of bulletin IMP. 1-6.

Application of Section 164 of the Act

2. Section 164 of the Act provides that notwithstanding section 160 of the Act (provision calling for the deduction of interest), no amount shall be deducted by a taxpayer in computing his income for a particular taxation year in respect of an expense incurred by him in the year as, or in lieu of, full or partial payment of interest on debt relating to the acquisition of land or as, or in lieu of, full or partial payment of property taxes paid or payable by him in respect of land to a province or to a Canadian municipality, except to the extent of the amount determined in article 3 of this bulletin, unless, having regard to all the circumstances, including the cost to the taxpayer of the land in relation to his gross revenue therefrom for the particular year or any preceding taxation year, the land can reasonably be considered to have been, in the year,

- (a) used in the course of a business carried on in the particular year by the taxpayer, other than a business in the ordinary course of which land is held primarily for the purposes of resale or development, or
- (b) held primarily by the taxpayer for the purposes of gaining or producing income therefrom for the particular year.

3. The amount referred to in article 2 above is equal to the aggregate of

- (a) the amount by which the taxpayer’s gross revenue from the land for the particular year exceeds the aggregate of all other amounts deducted in computing his income from the land for the year; and

(b) where the taxpayer is a real estate corporation, the corporation's base level deduction for the particular year.

4. Where a taxpayer owns more than one parcel of land, he must carry out the calculation provided for in paragraph a of article 3 above separately for each parcel of land. Furthermore, if such a taxpayer is a real estate corporation, the base level deduction must be used for all its parcels of land. For the purpose of determining his base level deduction, he must therefore take into consideration the aggregate of his gross income from land over the aggregate of all other amounts deducted in computing his income from land (including those determined in paragraph a of article 3 above) for the year.

5. Where land can reasonably be considered to have been, in the year, used or held for one of the purposes described in paragraph a or b of article 2 above, the interest and property taxes are, in principle, deductible according to the general rules.

6. However, where land cannot reasonably be considered to have been, in the year, used or held for one of the purposes described in paragraph a or b of article 2 above, the interest and property taxes are only deductible in an amount equal to the portion of the gross income of the taxpayer from the land which exceeds the aggregate of all other amounts deducted in computing his income from the land for the year, to which is added the base level deduction of the corporation for the year where the taxpayer is a real estate corporation.

7. For the purposes of paragraph a of article 2 above, land is not considered to have been used or held by the taxpayer in the course of the carrying-on by a taxpayer of a business in the year, if it is used or held as an adventure or concern in the nature of trade.

Indeed, the term "business" is defined in section 1 of the Act and does not include, for the purposes of subparagraph a of the first paragraph of section 164 of the Act (paragraph (a) of article 2 above), an adventure or concern in the nature of trade.

Consequently, the interest and property taxes in relation to land used or held as an adventure or concern in the nature of trade are only deductible to the extent described in article 3 above.

8. Furthermore, land is not considered as being held for the purposes of paragraph b of article 2 above if it is not held primarily for the purpose of gaining or producing an income therefrom.

Thus, if a taxpayer occasionally leases part of his land to a dealer who installs advertising billboards thereon, the Ministère du Revenu might consider that the land is not held primarily for the purposes of gaining or producing income therefrom. That being the case, the interest and property taxes relating thereto will only be deductible as provided for in article 3 above.

Base Level Deduction of a Corporation

9. Sections 165.2 to 165.5 of the Act provide the rules for computing the base level deduction of a real estate corporation for the purposes of subparagraph b of the second paragraph of section 164 of the Act (paragraph b of article 3 above). Section 165.2 of the Act provides that a corporation's base level deduction for a taxation year is equal to the amount that would be the amount of interest for the year, computed at the prescribed rate, in respect of a loan of \$1 000 000 outstanding

throughout the year, unless the corporation is associated in the year with one or more other corporations in which case, subject to the rules described in articles 11 and 12 below, its base level deduction for the year is nil.

10. The prescribed rate for the purposes of this measure is that indicated in Schedule I to the current version of bulletin IMP. 487.1-1.

11. Section 165.3 of the Act provides that where all of the corporations that are associated with each other in a taxation year have filed with the Minister, in prescribed form, an agreement whereby they allocate an amount to one or more of them for the taxation year and the amount or the aggregate of the amounts so allocated, as the case may be, does not exceed \$1 000 000, the base level deduction for each of the corporations for the year is equal to the base level deduction that would be computed under section 165.2 of the Act (article 9 above) in respect of the corporation if the reference therein to an amount of \$1 000 000 were read as a reference to the amount so allocated to it. Furthermore, section 165.4 of the Act provides that where any of the corporations that are associated with each other in a taxation year has failed to file with the Minister an agreement as contemplated in section 165.3 of the Act within 30 days after notice in writing by the Minister has been forwarded to any of them that such an agreement is required for the purposes of any assessment of tax under Part I of the Act, the Minister shall allocate an amount to one or more of them for the taxation year, which amount or the aggregate of which amounts, as the case may be, shall be equal to \$1 000 000 and, in any such case, the amount so allocated to any such corporation is deemed to be an amount allocated to the corporation pursuant to section 165.3 of the Act.

12. Section 165.5 of the Act provides for certain rules applicable for the purposes of determining a corporation's base level deduction. Thus:

- (a) where a corporation, referred to as "the first corporation", has more than one taxation year ending in the same calendar year and is associated in two or more of those taxation years with another corporation that has a taxation year ending in that calendar year, the base level deduction of the first corporation for each taxation year in which it is associated with the other corporation ending in that calendar year is, subject to paragraph b below, an amount equal to its base level deduction for the first such taxation year determined without reference to paragraph b of this article; and
- (b) where a corporation has a taxation year that is less than 51 weeks, its base level deduction for the year is equal to that proportion of its base level deduction for the year, determined without reference to this paragraph, that the number of days in the year is of 365.

13. Where a corporation has more than one taxation year in a single calendar year and is associated in two or more of those taxation years with another corporation, the base level deduction of the first corporation is determined in two steps. The first is that whereby an amount constituting the base level deduction of that corporation for the year is attributed, without taking into account the fact that it has two taxation years in the same calendar year, pursuant to section 165.2 of the Act. This amount is deemed to be its base level deduction for each of its two taxation years.

Following this step, the second step consists in carrying out the proportional computation provided for in paragraph *b* of section 165.5 of the Act (paragraph *b* of article 12 above).

14. A partnership cannot claim a base level deduction, even if all its associates are real estate corporations and the business of the partnership is a business similar to that which is to be carried on by a real estate corporation. Moreover, a corporation that is a member of such a partnership could be considered as a real estate corporation and take advantage of the base level deduction if the provisions of section 164 of the Act apply to limit the deduction of interest on money borrowed to make a capital contribution to the partnership which allowed the latter to acquire land.

Transitional Rules

15. The rules described in section 164 of the Act, as described in this bulletin, apply from taxation year 1988. Transitional rules have been provided for, though. Hence, where these rules apply in respect of expenses incurred in respect of land that can reasonably be considered to have been held, but not used, in the course of a business carried on in the year by the taxpayer or land used in the course of a business in the ordinary course of which land is held primarily for the purposes of resale or development, a taxpayer may deduct the product obtained by multiplying the amount by which the aggregate of the expenses described in article 2 above (interest and property taxes) exceeds the aggregate of the amounts determined under article 3 above (income and base level deduction) by the percentage determined as follows:

- (a) that proportion of 100% that the number of days in the particular year that are before January 1, 1988 is of the number of days in the particular year;
- (b) that proportion of 80% that the number of days in the particular year that are after December 31, 1987 but before January 1, 1989 is of the number of days in the particular year;
- (c) that proportion of 60% that the number of days in the particular year that are after December 31, 1988 but before January 1, 1990 is of the number of days in the particular year;
- (d) that proportion of 40% that the number of days in the particular year that are after December 31, 1989 but before January 1, 1991 is of the number of days in the particular year;
- (e) that proportion of 20% that the number of days in the particular year that are after December 31, 1990 but before January 1, 1992 is of the number of days in the particular year.

Application of Paragraph *k* of Section 255 of the Act

16. Paragraph *k* of section 255 of the Act provides rules for adding the undeducted interest and property taxes to the adjusted cost base of land that is capital property where section 164 of the Act limits the amount allowable as a deduction in computing the taxpayer's income for a year. Where the provisions of section 128 of the Act (expenses not incurred to gain income) or 133 of the

Act (personal or living expenses) prohibit the deduction of an amount, that amount must not be added to the adjusted cost base of the property under paragraph *k* of section 255 of the Act.

Hence, a taxpayer, in computing the adjusted cost base of land at a particular time, must add every amount paid after December 31, 1971 and before the particular time, by the taxpayer or another taxpayer in respect of whom the taxpayer was a related person or partnership, pursuant to a legal obligation to pay

- interest on debt relating to the acquisition of land; or
- a tax relating to the transfer of property, paid by the taxpayer, with respect to such property, to a province or a Canadian municipality;

to the extent that that amount was neither deductible by reason of section 164 of the Act in computing his income from the land or from a business for any taxation year commencing before that time nor in computing the income of another taxpayer in respect of whom the taxpayer was a related person or partnership, and was not included in or added to the cost to that other taxpayer of any property otherwise than by reason of paragraph *e.1*¹ or subparagraph *xi* of paragraph *i*² of the said section 255.

Application of Section 83.1 of the Act

17. Under section 83.1 of the Act, a taxpayer may include in the cost to him of land that is described in the inventory of a business carried on by him, the amounts he cannot deduct pursuant to section 164 of the Act in respect of that land for which no deduction is permitted, pursuant to section 165 of the Act, to another person in respect of whom the taxpayer was a related person or partnership, where that amount was not included in or added to the cost to that other person of any property, otherwise than by reason of paragraph *e.1*¹ or subparagraph *xi* of paragraph *i*² of section 255 of the Act.

18. In general, the financial expenses related to such land must be deducted from the net income from that land and not from the net income of other land described in the inventory of the business

¹ Paragraph *e.1* of section 255 of the Act provides that a taxpayer must add, in computing the adjusted cost base of a share of the capital stock of a corporation of which the taxpayer was, at any time, a specified shareholder, any expense incurred by the taxpayer in respect of land of the corporation that was not deductible in computing the taxpayer's income for any taxation year commencing before that time by reason of section 164 of the Act. Considering the definition of the expression "interest on debt relating to the acquisition of land", the restrictions provided for in section 164 of the Act could apply to a taxpayer where, for example, he paid interest on money borrowed to acquire treasury shares from a corporation and that corporation used the proceeds of subscription to the shares to acquire land.

² Subparagraph *xi* of paragraph *i* of section 255 of the Act provides that a taxpayer must, in computing the adjusted cost base of an interest in a partnership, add, where the taxpayer's share of any income or loss of the partnership was, at any time, 10% or more, any expense incurred by the taxpayer in respect of land of the partnership that was not deductible in computing the taxpayer's income for any taxation year commencing before that time by reason of section 164 of the Act. Considering the definition of the expression "interest on debt relating to the acquisition of land", the restrictions provided for in section 164 of the Act could apply to a taxpayer where, for example, he paid interest on money borrowed to make a capital contribution to the partnership and that partnership used that contribution to acquire land.

of the taxpayer and, if the income from that land is insufficient, the excess amount must be added to the cost of the land described in the inventory. Where the taxpayer is a real estate corporation, though, that excess amount must be compensated for, where possible, by its base level deduction, before it is added to the cost of the land described in the inventory of the business it carries on.