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By

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April 11, 2003

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Real Estate Group - Lawson Lundell - Barristers and Solicitors

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Bare trusts are increasingly being used when investors acquire investment properties as they provide a number of significant advantages. Anyone considering purchasing an apartment building should fully examine the potential use of a bare trust arrangement.

What is a bare trust? A bare trust is a legal structure that facilitates the division of the beneficial and legal ownership. Typically a bare trust is the use of a company to hold the legal or registered title to property as nominee, in trust for the “real” or beneficial owner of the property.

The beneficial owner as the “real owner” of the property is entitled to receive all revenue from the property and is the decision maker with respect to all aspects of the property. The beneficial owner determines the rents charged, the terms of any leases or tenancy agreements, who to hire as property manager, who to finance the property with and when to sell the property. The bare trustee typically has no significant powers or responsibilities as the beneficial owner continues to have complete control over the property. The bare trustee can only act, and must act, at the direction of the beneficial owner.

The legal relationship between the bare trustee and the beneficial owner is set out in a bare trust agreement. The bare trust agreement is invariably not registered in the Land Title Office. The beneficial owner typically owns all of the shares in the bare trustee company.

To maintain ultimate flexibility, the bare trustee company must be a single purpose company created to hold the legal title for the specific property and has no other history, assets or liabilities. The bare trustee company should not own more than one property with a different company used for each property. When first purchasing a property, it is advisable to use a bare trustee structure even if the buyer does not need the bare trust arrangement because it allows for flexibility in the future.

INCOME TAX AND GST CONSEQUENCES

The bare trustee is ignored for income tax purposes. As the bare trustee earns no income (the rents are paid to the beneficial owner), it has no taxable income. The beneficial owner will declare the rents as income, which are offset against the cost of financing and maintaining the building. On the sale of the property, it is the beneficial owner, and not the bare trustee that reports the gain or loss.

The beneficial owner, not the bare trustee, is the registrant for the purposes of goods and services tax under the *Excise Tax Act*.

PROPERTY TRANSFER TAX

One of the principle advantages of the establishment of a bare trust is that it allows for the sale of the property without property transfer tax being payable by the purchaser, provided that the bare trust agreement is not registered in the Land Title Office. Under current legislation, property transfer tax is payable only when a transfer is registered in the Land Title Office. As the transfer of the beneficial ownership is not filed in the Land Title Office, it does not result in the payment of property transfer tax. However, if the bare trust agreement is for some reason registered in the Land Title Office, the transfer of the beneficial interest from the former beneficial owner to the new beneficial owner will attract the payment of the property transfer tax.

If the property is held by a bare trustee company when offering the property for sale, the vendor can hold out as an advantage the fact that the purchaser will not have to pay property transfer tax on the transaction. The savings to the purchaser can often result in an increased purchase price.

On the sale of the property, the purchaser will buy the beneficial interest in the building at the agreed value and will buy the shares in the bare trustee for \$1.00. Since there is no transfer registered in the Land Title Office, no property transfer tax is payable. As the bare trustee company has no assets other than legal title, it should not have any liabilities, and the purchaser should have no concerns about buying the shares in the bare trustee company.

FLEXIBILITY ON TITLE REGISTRATION

The use of a bare trust allows multiple co-owners to hold a beneficial interest in the real property with only the bare trustee registered on title. This allows changes in the co-owners without triggering the payment of property transfer tax. It also allows simplicity in dealing with third party contracts (i.e. leases, property management agreements, contracts with service providers, etc.).

NON-RESIDENT VENDORS

Bare trusts also provide flexibility in managing the withholding and remitting requirements under section 116 of the *Income Tax Act* on the sale of a property owned by a non-resident. Where a non-resident owner sells Canadian property, they must obtain a clearance certificate from Canada Customs and Revenue Agency. Until the clearance certificate is obtained, a purchaser must holdback a portion of the purchase price (25 to 33 percent of the purchase price).

Where the owner of the beneficial interest is a non-resident owner, they can transfer the beneficial interest to the bare trustee prior to the sale to a third party purchaser. The bare trustee (a Canadian company) thus becomes the true owner of the property owning both the legal and beneficial titles. The bare trustee as the “true owner” can then sell the property and, because it is a Canadian corporation, no clearance certificate is required.

A clearance certificate would however be required with respect to the transfer from the non-resident owner to the bare trustee company. While a clearance certificate must be obtained for this transfer, it does not require the involvement of the end purchaser.

DISADVANTAGE OF BARE TRUST

The main disadvantage of a bare trust is that you must establish and maintain the trustee company. It costs approximately \$1,200 to incorporate a trustee company and prepare the bare trust agreement. Thereafter, you have the annual cost of maintaining the trustee company of approximately \$250 per year.

When financing the property, lenders will typically require both a registered mortgage of the legal interest executed by the bare trustee (at the direction of the beneficial owner) and an unregistered mortgage of the beneficial interest executed by the beneficial owner. This means there will be slightly higher legal fees charged as two documents must be prepared.

Vancouver

1600 Cathedral Place
925 West Georgia Street
Vancouver, British Columbia
Canada V6C 3L2
Telephone 604.685.3456
Facsimile 604.669.1620

Calgary

3700, 205-5th Avenue SW
Bow Valley Square 2
Calgary, Alberta
Canada T2P 2V7
Telephone 403.269.6900
Facsimile 403.269.9494

Yellowknife

P.O. Box 818
200, 4915 – 48 Street
YK Centre East
Yellowknife, Northwest Territories
Canada X1A 2N6
Telephone 867.669.5500
Toll Free 1.888.465.7608
Facsimile 867.920.2206

genmail@lawsonlundell.com
www.lawsonlundell.com

