American Friends of Canadian Conservation

Fact Sheet

Certificates of Compliance for Non-Resident Dispositions of Land (a.k.a "Clearance)

Introduction

American Friends of Canadian Conservation (AFCC) protects Canada's natural heritage by acquiring, primarily via donations, important properties owned by U.S. taxpayers. Through more than a decade of experience with these "cross-border conservation" transactions, AFCC has gained deep expertise in all aspects of this specialized topic.

Another way that AFCC achieves its cross-border mission is by sharing its expertise with its Canadian partners, landowners from the U.S. and their professional advisors. Education has proven to be an effective conservation tool, helping landowners protect land they love in a financially feasible manner and supporting Canadian entities in their efforts to work with U.S. taxpayers. This fact sheet is one in a series created by AFCC to explain key elements of cross-border conservation transactions and the bi-national tax incentives available.

Note: This document is **not** intended to provide tax, legal, estate planning or other advice. **It is essential that landowners and conservation organizations obtain independent advice from professional advisors who understand tax and legal issues in both the US and Canada.**

Background

Under Canadian tax law, gifts of land or interests in land (easements/ covenants/servitudes) are subject to capital gains taxes, even though no money has exchanged hands. Canada refers to gifts or other non-sale transfers (including bequests to anyone other than a spouse) as "deemed dispositions." To learn about deemed dispositions, Canadian capital gains taxes and their relationship to estate planning refer to Save Some Green: a handbook for U.S. taxpayers who own land in Canada. It is available for download at https://conservecanada.org.

This tax can be substantial, especially if the current owners have held the property for a long time or it is in one of the regions of Canada where values have increased substantially. Canada Revenue Agency (CRA) requires Non-residents to pay a withholding of 25% of the market value of the property rights being transferred in deemed dispositions to cover potential capital gains tax liability.

However, gifts of natural lands to Canadian conservation organizations and other qualified donees are effectively not subject to Canadian capital gains tax because donors can make a "special election" on their Canadian tax return for the year of the gift. For more information on the election, refer to Save Some Green.

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Landowners who donate land or a conservation easement to AFCC can avail themselves of the special election because the organization is "prescribed donee", under the Canadian Income Tax Act. [i]

Donors who obtain a "Certificate of Compliance[ii]" from Canada Revenue Agency (CRA), in advance of completing their land or easement gift, are not subject to the withholding requirement. The process of securing the Certificate, also referred to as "clearance," is described in this Fact Sheet.

The information provided is intended only to familiarize donors and conservation organizations with the requirements for clearance, and the importance of the process. It is imperative donors engage a Canadian accountant with non-resident experience to assist with the process. The calculations to correctly complete the Form T2062 requesting clearance require accounting expertise. Often the accountant will need to communicate with CRA regarding the application and help obtain the Certificate in a timely manner. This Fact Sheet will help donors gather the necessary information and participate in the process.

Steps in the Clearance process

1. The donor applies for a Certificate of Compliance for a Non-resident Disposition of Real Estate to the appropriate Canada Revenue Agency office. A Canadian Chartered Accountant, with expertise in non-resident taxation, will know which CRA office handles these applications. Elements of the application are:

    a. Form T2062 "Request by a Non-resident of Canada for a Certificate of Compliance Related to the Disposition of Taxable Canadian Property[iii]" The following must be included with the submission:

        i. Declaration of Proceeds of Disposition.

        The donor may make an election to eliminate (or reduce) Canadian capital gains tax owing on the gift under Section 118(1) of the Canadian Income Tax Act. Refer to Save Some Green for an explanation of Section 118 (1). The donor must decide, with the assistance of their Canadian accountant, what value to claim as the "disposition value" for the gift based on his/her tax circumstances. The disposition value can be any value between the adjusted cost base and fair market value. ***If the claimed disposition value is the same as the adjusted cost base there is no capital gain and the tax is eliminated.*** This declared amount is included on form T2062. Because AFCC is a "Prescribed Donee" under Canadian Income Tax Act Regulations 3504, donors may utilize the Section 118 (1) election.

        ii. Substantiation of value in the form of a full narrative appraisal report detailing the value of the property being donated.

    b. Letter of Undertaking from AFCC including the following:

i. Description of the ecological and public values of the property being protected

ii. Declaration that it is a registered U.S. charity, and a Canadian Prescribed Donee

iii. Intention to accept the gift of conservation real estate,

iv. Commitment to issue a tax receipt for the gift, once the certificate is issued and the gift received.

v. Statement that the property will be used for conservation purposes and held in the public interest.

c. Completed Form T1261 and required documentation if the donor does not have a Canadian Social Insurance Number.

d. Letter from donor indicating their intent to make a gift of land or interest in land, and to make the Section 118 election when they file the required Canadian Income Tax return for the year of the gift.

e. A copy of the draft conservation easement or deed – which will be signed after Certificate is issued.

f. Two notarized forms of identification from the owner, such as a passport or driver's license.

2. Certificate of Compliance (Form T2068) clearing the disposition.

The Certificate of Compliance issued by the CRA will indicate that the "proceeds of disposition" and the "certificate limit" are equal to the fair market value of the property. The donor must file a tax return for the year of the gift, using the election to designate the proceeds of disposition as equal to the adjusted cost base (or some value between adjusted cost base and fair market value) in order to eliminate (or reduce) capital gains taxes owed on the gift.

3. Completion of the planned land or easement donation to AFCC or other qualified donee.

4. AFCC/Donee issues a Canadian Tax Receipt.

The tax receipt/ letter includes the declared disposition value and information required under Section 3501 of the Canadian Income Tax Act[iv]:

a. Description of the property

b. Date of the donation and date of the receipt

c. Name and address of donor.

d. Fair market value of the property, name, and address of the appraiser.

e. For split-receipt donations (“bargain sales”), the letter will include the full value of the property, the “advantage,” (i.e. any money paid for the property) and the gift portion (i.e. the difference between fair market value and what was paid for the property).

f. Signature of an authorized representative of the donee

5. Donor Files Canadian Tax Return for the year of the gift, including the following:

a. Claiming an exemption or reduction in capital gains tax through the Income Tax Act election under Section 118(1)

b. Certificate T2068

c. Canadian tax receipt from AFCC/Donee

Conclusion

Under the U.S./Canada Tax Treaty, the country in which real property is located has the right to collect capital gains taxes. In Canada, almost any disposition is taxable, even when there are no cash proceeds. Nonresidents are normally required to deposit 25% of the market value of property being sold or donated. However, conservation land donors have an opportunity to avoid the Canadian capital gains tax by using a special election. It is possible to obtain “clearance” in advance of a transaction by declaring your intention to utilize the election. Talk to your Canadian tax advisor about the election and how to apply for clearance.

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[i] There are two options for eliminating Canadian capital gains tax on gifts of ecologically important property: The Ecological Gifts Program, and an election made under Section 118 of the Canadian Income Tax Act. Because AFCC is not a registered Canadian charity, it is not an eligible Ecological Gift Program recipient. Therefore, donors to AFCC use the Section 118 election and deem the disposition value of their property as equal to the adjusted cost base (thereby eliminating any gain.

[ii] All non-residents who dispose of Canadian property, or an interest in property, in any manner, are required to obtain this certificate. They are also required to submit part or all of the capital gains tax due, at the time of transfer. To avoid this requirement, AFCC, the donor and their Canadian accountant are providing documentation to satisfy the CRA that there will be no capital gains.

[iii] *See CRA Document 72*-17R4 Procedures Concerning the Disposition of Taxable Canadian Property by Non- Residents of Canada-Section 116 for guidance).

[iv] See CRA website for sample tax receipts and required contents www.cra-arc.gc.ca