VALUATION CASE STUDY
HST HORROR

The Challenge

There is many a slip 'twixt the cup and the lip; the property market is particularly error prone. Projects conceived in the warm glow of a strong market come to fruition years later … by which time demand may be much diminished. Fully one third of the condominium apartments in this 90 unit building failed to find a market. The developer was forced to rent them instead … and *that* triggered an HST self-supply liability. His appraisal, commissioned from a national real estate broker, failed to find favour with Canada Revenue Agency. The developer turned to Turner Drake for help.

Turner Drake's Approach

The Excise Tax Act requires the developer to "self assess" rented apartments for HST/GST on the basis of a deemed disposition at "Fair Market Value" on the "first occupied date". Part IX Para 123(1) defines "Fair Market Value" as *"the fair market value of the property or service without reference to any tax excluded by section 154 from the consideration for the supply"* … an explanation marginally more beneficial than not offering one at all. We interpreted it to mean Market Value (excluding HST).

There are potentially three ways to value property: the Cost, Income and Direct Sales Comparison approaches. The first was not practical; it would require estimating the cost of the entire building, deducting therefrom physical, functional and external obsolescence, then allocating the depreciated reproduction cost between each condominium unit. The second method consisted of calculating the income generated by each rented unit, deducting operating expenses, then capitalising the resultant net operating income at an appropriate discount rate. This was the approach rejected by Canada Revenue Agency; correctly in our opinion, since individual condominiums do not transact on this basis. Hobson's choice therefore dictated we employ the Direct Sales Comparison method. We valued each of the condominium units individually, utilising the sale prices (net of HST) of similar units as our benchmark. We heavily discounted the result to reflect waiver of condominium fee incentives currently offered in competing buildings to counter the soft market. Since the HST liability had been triggered by the renting of the apartments, a tax imposition that would not normally have occurred until they had been sold sometime in the future when the market had recovered, we "deferred" the anticipated sales income by two years at an appropriate discount rate. Essentially this reflected the fact that CRA had two mutually exclusive choices: wait until the properties sold sometime in the future; or levy the HST/GST now, in which latter event it should be a discounted amount.

Winning Results

Turner Drake furnished our client with a comprehensive Valuation Report, with a detailed logic path to the Fair Market Value conclusion anchored by market data, for deployment in their negotiations with Canada Revenue Agency.

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