

# FAQ - PERSONAL REAL ESTATE CORPORATIONS IN ONTARIO



## 1. HOW DOES THE PREC ALLOW INCOME SPLITTING?

The existence of a separate corporate entity (the PREC) that receives business income allows that corporation the ability to distribute its revenues and income in more ways than an individual can. The PREC regulations allow family members (defined broadly to include blended families), being children, parents and spouses, to own non-voting, non-equity shares of the PREC. The controlling Registrant (called the “controlling shareholder” in the PREC Regulation) can own voting, equity shares. The PREC can thus allocate its business income to employees (including the controlling Registrant, family members and others) as salary and issue dividends to any shareholder of the PREC. The cumulative effect of such income splitting on the taxes payable (in both the long and short term) by the controlling Registrant, the PREC and those shareholders depends on many factors and tax advice from an accountant or lawyer should be sought to ensure you get the tax consequence you wish. The tax rules are complicated and splitting income could result in more tax being levied.

## **2. CAN A PREC BE USED FOR PASSIVE INVESTMENT PURPOSES?**

Yes, a PREC is a regular *Ontario Business Corporation Act* business corporation and while there are limits on its ability to receive compensation for a trade in real estate, there are no requirements that it refrain from carrying on other activities, such as passive investing. There may be tax and other implications to doing so however and you should consult with a lawyer or accountant for tax advice.

## **3. WHAT ARE THE INSURANCE IMPLICATIONS OF USING A PREC?**

The PREC is an additional separate entity or person in the eyes of the law. It can be sued and since it will be providing the services of the controlling Registrant, your insurance broker(s) should be consulted with respect to appropriate insurance coverage for the PREC in addition to any existing insurance an individual REALTOR® may have.

RECO has provided guidance on this issue, which can be found here: <https://www.reco.on.ca/precs-ads/>

## **4. WHAT IS THE RELATIONSHIP BETWEEN A PREC AND A REGISTRANT'S OBLIGATIONS WITH RESPECT TO REGISTERING WITH RECO?**

The PREC may not receive any compensation from a trade in real estate or trade in real estate unless its controlling shareholder is a Registrant with RECO under the *Trust and Real Estate Services Act* ("TRESA"). The PREC itself need not be a Registrant. However the Registrant is required to provide appropriate notice to RECO if the Registrant utilizes an PREC. RECO has indicated in its



guidance how notice is to be provided here:  
<https://www.reco.on.ca/prec-ads/>

## **5. WHAT NAME CAN I USE FOR THE PREC?**

There are no limitations or specific requirements with respect to the name of a PREC other than those imposed on any business corporation incorporated or continued under the *Ontario Business Corporations Act*. The name must meet the normal rules for corporate names and should not suggest that the PREC itself is trading in real estate. An example of an appropriate name would be the individual Registrant's name followed by a "Professional Real Estate Corporation". For example: "*Jane Doe Professional Real Estate Corporation*".

## **6. DO THE RESTRICTIONS FROM RECO OR IN THE TRESA REGULATION HAVE TO BE INCLUDED IN A PREC'S ARTICLES OF INCORPORATION?**

The TRESA regulations do not require any of criteria for a corporation to be a PREC as defined in TRESA to be included in the Articles of Incorporation of that corporation. You should consult with your lawyer on whether doing so would provide more advantages than disadvantages in your circumstances. While doing so provides clarity and likely prevents inadvertent changes that would disqualify your PREC, there may be other reasons that this would be undesirable.

RECO's guidance on PRECs do not address this issue, but could be amended over time, and is found here: <https://www.reco.on.ca/prec-ads/>

## **7. IF I AM TRANSFERRING TO A DIFFERENT BROKERAGE, DO I NEED TO ALSO TRANSFER THE LICENSE OF MY PREC?**

A PREC does not need to be licensed. If you transfer to a different brokerage, your PREC will need to enter into a new agreement with the brokerage which meets the requirements found in TRESA and the regulations and give appropriate notice. The current notice instructions have provided by RECO at: <https://www.reco.on.ca/prec-ads/>

## **8. WHO CAN BE A NON-EQUITY SHAREHOLDER IN MY PREC?**

Members of your family, which includes your spouse, children, a trust for a minor child or children (under 18 years of age) and parents. The definitions of who a spouse, child and parent is are fairly broad. The definition of spouse is “a person to whom the shareholder is married or with whom the shareholder is living in a conjugal relationship outside marriage.” The definition of a child includes one you have “demonstrated a settled intention to treat as a child of his or her family, except under an arrangement where the child is placed for valuable consideration in a foster home by a person having lawful custody.” The definition of a parent includes a person who has “demonstrated a settled intention to treat [you] as a child of his or her family, except under an arrangement where the child is placed for valuable consideration in a foster home by a person having lawful custody.” In addition, a trust for minor (under 18) children can own non-equity shares of a PREC.

## **9. IF I AM A MEMBER OF A TEAM, CAN I USE MY TEAM NAME WHEN NAMING MY PREC?**

Yes. However the name of your PREC must meet the normal requirements for a corporation, which includes the requirement



that it be distinct and not be confusingly similar to another corporation's name. This means your other team members may not use the same name or a confusingly similar name. You will therefore need to distinguish your PREC's name from any name other team members choose for their PRECs.

## **10. IF I AM A MEMBER OF A TEAM THAT HAS FORMED A PREC, WILL I BE PAID BY THE PREC?**

No. This question is likely based upon a misunderstanding of what a PREC is. A group of REALTORS® cannot together form and use a single PREC. The Regulations contemplate an individual REALTOR® forming his or her own PREC. Each PREC must be controlled only by one (1) individual REALTOR® and (with the exception of a REALTOR® who is also a family member and then only with respect to non-equity shares) you cannot make another REALTOR® a shareholder of your PREC.

The PREC regime exempts the PREC from registration in exchange for the ability of RECO to identify and discipline one, and only one, controlling Registrant for that PREC in the event the PREC is accused of inappropriate behaviour.

Please note however that this does not preclude teams from working together. Individual REALTORS® can continue to work together even if one or all of them utilize PRECs, but their contractual arrangements with each other and their brokerage may need to be adjusted.

## **11. IF I AM A NON-EQUITY SHAREHOLDER IN A PREC, CAN I ENGAGE IN ACTIVITY'S RELATED TO REAL ESTATE, LIKE FLIPPING AND SELLING A HOME?**

It depends on whether you are a Registrant or not. A non-equity shareholder that is a Registrant is entitled to trade in real estate.

A non-voting shareholder in a PREC is not given any special status under TRESA. That individual does not become a Registrant. The PREC itself does not become a Registrant with RECO. The PREC is exempt from the prohibition against receiving compensation for trading in real estate, but only if it meets all of the rules in the Regulations, which effectively require it to provide only the controlling Registrant's services when trading in real estate.

A non-equity shareholder that is not a Registrant gains no additional abilities or rights as a result of owning shares in someone else's PREC. If the non-voting shareholder is a Registrant, a sales person or broker, she or he can trade in real estate.

A non-equity shareholder that is not a Registrant may, as he or she always could, engage in trades in real estate that are exempt under section 5 of the Act from the prohibitions against trading real estate. For example, if the non-voting shareholder meets all of the requirements set out in subsection 5(h) he or she may be able to trade "on the person's own account, in respect of the person's interest in real estate".

## **12. ARE THERE ANY FEES ASSOCIATED WITH REGISTERING MY PREC OR OTHER COSTS ASSOCIATED WITH INCORPORATION?**

The PREC does not need to register with RECO, but is a normal business corporation and will have all of the normal obligations of a corporation. Government fees include:



There is a fee (currently \$300) to file articles of incorporation under the OBCA. It is recommended that professional legal and accounting guidance be obtained in the setup and registration of same, which will incur additional professional fees.

Furthermore, all corporations, including PRECs, are required to file an annual corporate return, which notifies the government that the corporation is still active, and provides updates to any change of address or other details of the corporation. The filing fee is nominal, but if legal or accounting professionals are utilized to file same, there will be additional professional fees to consider.

Finally, all corporations, including PRECs, are also required to file annual corporate tax returns which would incur a filing fee and associated professional fees for accounting advice and support in relation to same.

### **13. CAN A PREC BE USED TO DEFER INCOME TAX PAYMENTS? FOR EXAMPLE, CAN THE PREC RETAIN MONEY FROM SALES IN A HIGH-INCOME YEAR TO BE PAID OUT IN A LOW-INCOME YEAR?**

A PREC is not obligated to pay out all of the revenue or income it generates in the same financial year. Whether that results in a material tax deferral is dependent on the factual circumstances of the PREC, its controlling shareholder (the Registrant) and the other shareholders. Advice from a lawyer and/or an accountant is strongly advised.

#### **14. DOES THE HOLDING CORPORATION HAVE TO BE OWNED BY THE REGISTRANT THAT OWNS THE PREC?**

Yes, it must meet the same criteria at a minimum as the PREC itself. Please consult your lawyer for further advice on how to do that and on structuring the holding corporation.

#### **15. IF A REALTOR® INCORPORATES WITHIN THE TIME THAT THEY STILL ARE PENDING PAYMENT FROM A PREVIOUS DEAL, DOES THE BROKERAGE PAY THE INDIVIDUAL OR THE CORPORATION?**

TRESA and its regulations do not prohibit such an arrangement, provided the Brokerage is prepared to agree to do so and the agreement with the Brokerage appropriately deals with this possibility. OREA asked RECO to confirm this view and RECO's response can be found here: <https://www.reco.on.ca/prec-ads/>

It is just as important to consider how the REALTOR®'s own arrangements and those with his or her Brokerage are structured to ensure those accomplish the desired tax consequences. There are a number of possible scenarios to consider.

The payment of a commission from a deal that was closed before: (a) the incorporation of the PREC and (b) the entry into an independent contract for services between the PREC and the brokerage should generally be made to the REALTOR®. The payment of a commission in these circumstances would only be made to the PREC if the REALTOR® chooses to sell and assign their accounts receivable to their PREC and amends the contract with his or her brokerage for payment in accordance with this assignment of receivables. Since the PREC would have to pay the REALTOR® the fair market value of these receivables to avoid adverse tax consequences, we do not anticipate that a REALTOR® would enjoy any material tax benefit from a sale of their





receivables to their PREC.

The payment of a commission from a deal that closed after: (a) the incorporation of the PREC and (b) the entry into an independent contract for services between the PREC and the brokerage would generally be made to the PREC on the general principle that the commission is only fully earned at the time of the closing. At that time, the contract for services between the REALTOR® and the brokerage will have been replaced by an appropriate contract for services between the PREC and the brokerage. The precise terms of a REALTOR®'s pre-existing contract with the brokerage may impact this analysis.

This second scenario however raises the other important issue of whether the Canada Revenue Agency will accept that the full amount of the commission revenue is that of the PREC if the service to the client was partially provided before the PREC even existed. The answer to that will depend on the facts, the timing and the documentation of each transaction, including the specific provisions in the agreement between the PREC and the brokerage. If the Canada Revenue Agency is unwilling to accept the full amount of the payments as revenue of the PREC, a full tax deferral may not be achieved. Advice from your tax advisors on whether this approach is possible for you and what documentation is appropriate is highly recommended. Advice from a lawyer when entering into the agreement with your Brokerage, particularly if you have this particular concern, is also recommended.



## **16. WHAT CAN A REALTOR® DO TO MAXIMIZE THE TAX ALLOCATION OF COMMISSION REVENUE TO A PREC FOR EXISTING LISTINGS AND PENDING DEALS AT THE TIME THE PREC IS INCORPORATED?**

The services of a REALTOR® commence with the signing of a listing or representation agreement with the client. This applies whether the client is seller or buyer, landlord or tenant, or any other person seeking to trade in real estate. The work performed by the REALTOR® between the signing of that agency agreement and the time the commission becomes payable is the REALTOR®'s work-in-progress.

A REALTOR® may sell their work-in-progress to their PREC. If the PREC issues shares to the REALTOR® as payment of all or part of the purchase price of the work-in-progress, the REALTOR® and the PREC may jointly elect that the sale price of the work-in-progress is generally an amount between the cost amount of the work-in-progress and the fair market value of the work-in-progress. The lower limit of the cost amount of the work-in-progress will be increased if the portion of the sale price paid by the PREC in a form other than shares exceeds this cost amount.

The cost amount of the work-in-progress to the REALTOR® is generally simply the out-of-pocket costs you have incurred in relation to a particular client to that point in time. This may include photography costs, advertising costs, listing fees, and mileage. It most cases, it should not include any amount for the time spent by the REALTOR®. If it is possible to elect that the sale of work-in-progress to a PREC occur for tax purposes at the cost amount, that means that the commission revenue less the applicable cost amount for that transaction will be PREC revenue. The PREC would claim in those ideal circumstances, as an expense, the cost amount that will in turn be paid to the REALTOR® as a reimbursement of the tax-deductible expenses incurred by the REALTOR® prior to the incorporation of the PREC.



Advice from your tax advisors on whether this approach is possible for you and what documentation is appropriate is very important. There are very specific tax rules for the valuation of work-in-progress of a professional business for which you should seek the advice of a tax lawyer or accountant. For example there is a possibility that the fair market value of the work-in-progress could be lower than the cost amount. This may arise if the closing of the transaction was conditional on various factors, such as financing, due diligence, home inspections etc. If that is the case, you may be required to elect the lower of the two amounts. In addition, there may be Harmonized Sales Tax implications. Most importantly, the Canada Revenue Agency election form referred to above (currently Form T2057) must be filed on or before the earlier date upon which either the REALTOR® or the PREC is required to file an income tax return for the year in which the sale of work-in-progress occurs.

#### **17. WILL RECO BE PROVIDING GUIDANCE THE BROKERAGE'S OBLIGATIONS TO: "SATISFY ITSELF THAT THE PREC IS EXEMPT FROM REGISTRATION UNDER REBBA 2002?"**

OREA has passed along this question to RECO for its more definitive guidance and will update this FAQ with a link to RECO's guidance once that is published.

#### **18. HAS THE CANADA REVENUE AGENCY PROVIDED DIRECTION ON PRECS AND HOW MY INCOME WILL BE TAXED IF I USE A PREC?**

The Canada Revenue Agency rarely provides advice on the impact of changes to legislation and regulation that it did not initiate, particularly those of provincial legislatures. It will, however, respond to technical interpretation requests if all of the necessary individual facts are provided, including all of the individual

circumstances and details of the contractual relationships. You may wish to consult with a lawyer on whether you should seek such a technical interpretation.

## **19. IF MY PREC LETS ME CARRY OUT MY PROFESSION, IS IT A PROFESSIONAL CORPORATION WITHIN THE MEANING OF THE INCOME TAX ACT? WHY NOT?**

While your corporation carries out a profession, the term “professional corporation” is specifically defined in the *Income Tax Act* at subsection 248(1) as “a corporation that carries on the professional practice of an accountant, dentist, lawyer, medical doctor, veterinarian or chiropractor.” The term is defined solely to force members of those professions to have their corporations use a calendar year-end for tax purposes. So there is no advantage to being a professional corporation under the *Income Tax Act*.

## **20. HOW IS IT THAT ALL PRECS WILL NOT AUTOMATICALLY BE A PERSONAL SERVICES BUSINESS, WHICH DO NOT ENJOY SOME OF THE TAX ADVANTAGES PRECS OFFER? WHAT ARE SOME STEPS WHICH CAN BE TAKEN TO AVOID THIS?**

It is true that if a business is determined by the CRA to be a personal services business, amongst other adverse tax implications, its income would be disqualified from being eligible for the small business deduction. The definition is found in subsection 125 of the *Income Tax Act*:

“personal services business” carried on by a corporation in a taxation year means a business of providing services where

(a) an individual who performs services on behalf of the corporation (in this definition and paragraph 18(1)(p)



referred to as an “incorporated employee”), or

(b) any person related to the incorporated employee

is a specified shareholder of the corporation and the incorporated employee would reasonably be regarded as an officer or employee of the person or partnership to whom or to which the services were provided but for the existence of the corporation, unless

(c) the corporation employs in the business throughout the year more than five full-time employees, or

(d) the amount paid or payable to the corporation in the year for the services is received or receivable by it from a corporation with which it was associated in the year;

This somewhat complex and technical definition requires an clear understanding of who the “person or partnership to who or to which the services were provided but for the existence of the corporation” is. That person should be the brokerage.

Generally, that means it is important you not be in a relationship or act in such a way that causes you to “be regarded as an officer or employee” of the brokerage or their clients. We expect that the majority of REALTORS® intend to be independent contractors and not “employees” of their brokerages. If you are not clear whether you are or not, you should consult a lawyer.

There may be some of you who are officers or employees of your brokerage or client(s) for legitimate reasons and your lawyer and accountant should work through the consequences and potential changes to your status with you. You may need to weigh the advantages of being an officer or employee against any potentially advantageous tax advantages.

What can be confusing is the use of the word “employee’ in that subsection. This is because TRESA and the Regulation also use the word “employ” in describing the relationship between REALTORS® and their brokerages. The specific definition in TRESA of that word “employ” is very specific and does not necessarily require a REALTOR® to be an “employee” within the meaning of subsection. It encompasses REALTORS® being an independent contractor.

Whether you are an “employee” or independent contractor depends on how your various contracts are structured and many other aspects of your business activities. That should not be a new issue for most of you and you should continue to work with your tax advisors to ensure you qualify for the tax status desired.



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