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Recent Developments in Ontario Real Estate

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Ontario Court of Appeal Rules on Assignment of Lease by Tenant

The Ontario Court of Appeal recently released its decision in *Hudson's Bay Company v. OMERS Realty Corporation*, a case that involved the assignment and sublease of the tenant's interest in anchor tenant leases at Yorkdale, Square One and Scarborough Town Centre. The assignment and sublease were proposed to be made in the context of a joint venture, split 90% and 10%, between Hudson's Bay Company and RioCan Real Estate Investment Trust, and structured as a limited partnership (First LP). The tenant's interest in the leases was to be held by a subsidiary limited partnership (Second LP), the general partner of which is HBC. The tenant's interest in the leases was to be assigned to HBC in its capacity as general partner of the Second LP and then subleased to HBC.

Under the terms of the applicable leases in question, an assignment and a sublease to an affiliate are permitted without landlord consent. HBC requested the landlord's consent without conceding that it was required by the leases. After the landlord denied the request for consent, HBC applied for a declaration that consent was not required or was being unreasonably withheld. The Ontario Superior Court of Justice and the Court of Appeal for Ontario decided in favour of HBC that no consent was required because the assignments and subleases were to an affiliate.

The reasoning of the application judge, which was adopted by the Court of Appeal, is based on the unique legal nature of the limited partnership structure and the role of the general partner. In summary, the lower court found the following: (1) any property in which a limited partnership has an interest can only be held by the general partner; (2) the general partner's interest in the property of a limited partnership is not limited to legal title to the property. The general partner has control over the property and is solely responsible for the operations of the limited partnership; and (3) vis-à-vis the other contracting party, the general partner is solely liable for the payment and performance of all obligations under the contract.

In such context, the court held that the assignee of the leases was the general partner of the Second LP, and the existence of other interests in the joint venture arrangement, including the interests of the limited partners of the First LP, were not relevant. The landlord unsuccessfully put forward the argument that the assignment of the leases to HBC in its capacity as general partner of the Second LP would result in the Second LP having beneficial and effective ownership of the leases and RioCan having decision-making power over certain major matters under the leases.

Narrowing of Ontario Land Transfer Tax Exemption for Partnership Interest Acquisitions

Since 1989, purchases of beneficial interests in Ontario real estate have been generally subject to Ontario land transfer tax (LTT). The Ontario Ministry of Finance (Ministry) treats partnerships as "look through" entities for these purposes, so that purchases of partnership interests are treated as indirect purchases (subject to LTT) of the partnership's Ontario real estate. A regulation has exempted transfers of partnership interests from this tax where the acquirer's partnership profit entitlement does not increase by more than 5% in a year.

A unit trust (such as a REIT) also has been considered a "look through" for LTT purposes. On this basis REITs have treated an acquisition of partnership interests by the REIT as an indirect acquisition by the unitholders, and concluded that each unitholder who each has less than 5% of the REIT's units has acquired a less-than-5% interest in the partnership and qualified for the 5% exemption. Thus, if there are no large unitholders, acquisitions of Ontario partnerships by REITs have been treated as exempt from LTT on the basis that the REIT itself

is not a purchaser because it is a "look through" entity, and the unitholders are exempt because they each are (indirectly) acquiring less than a 5% partnership interest.

A similar analysis has been applied to partnerships with partners individually holding small (*e.g.,* under 5%) interests in the partnership when they acquired partnerships holding Ontario real estate.

On February 18, 2016, Ontario released an amending regulation that provides that the 5% exemption does not apply when the acquirer of an interest in a partnership is a trust or another partnership. This amendment is stated to be "clarifying", which seems difficult to accept. On this basis, though, it is retroactive to July 19, 1989. The Ministry has indicated that it will respect rulings that it had previously issued for specific transactions (so that LTT would not be retroactively imposed on those transactions).

These amendments do not affect an LTT exemption for the transfer or issuance of units of a mutual fund trust having interests in Ontario real estate.

The purported retroactive effect of this amendment is controversial. Arguments doubtless will be made that:

- The purported imposition of retroactive LTT on already completed transactions is not something that is legislatively authorized to be done by a mere regulation, so that this retroactivity is invalid.
- The Ministry may be statute-barred from assessing or collecting LTT on transactions that occurred more than (approximately) four years ago.
- The Ministry has no right even after the amendment to impose retroactive LTT on REITs (or other trusts) themselves or on partnerships, and can instead only tax individual unitholders/partners (which in many instances would not be practical).

It is not clear whether the Ministry will attempt to use this purported retroactivity mostly as a lever in existing LTT disputes or in its audits of recent transactions, or whether it will try to open up transactions which have long since been completed.

We would be pleased to discuss the implications of these developments with you.

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