

REALTY TAX CAPPING AND SHORTFALL RECOVERY: RENEWALS, NEW DEALS, EXPANSIONS, DOWNSIZING AND RELOCATION

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The transitional realty tax capping and shortfall recovery rules applicable to tenants of leased premises in Ontario have now been in place for approximately six years. They were introduced to ease the transition to the new province wide assessment standard which took effect January 1, 1998 and is based on current fair market property values.

Not all tenants are subject to the transitional rules. Essentially, they only apply to *a tenant of leased premises where the tenant's tenancy commenced on or before December 31, 1997 and has been continuous since then.*

An odd exception to this general rule is that the transitional shortfall contribution requirements (but not capping protection) also apply to a tenant who entered into its lease after 1997 and before June 11, 1998 in the City of Toronto and before December 18, 1998 outside the City of Toronto.

New tenants after the relevant dates do not enjoy capping protection nor are they subject to realty tax shortfall contributions. They pay according to the terms of their lease.

The *capped* realty tax contribution for a shopping centre may be significantly less than the *uncapped* realty tax contribution. This is more likely to occur in the City of Toronto where the phase in of the new assessment standard will take longer to fully implement than in other municipalities.

The continuation or loss of capping protection and shortfall contribution obligations must be considered when negotiating a renewal or any amendment to the original lease. Specifically, the transitional rules governing renewals, expansions, downsizing and relocations are as follows:

1. If the parties enter into a new lease for the same premises after 1997 capping protection and shortfall payment obligations will continue to apply.
2. If the leased premises are expanded after 1997, capping protection and shortfall payment obligations will not apply to the expanded portion but will continue to apply to the original premises.
3. If the tenant ceases to lease any portion of the leased premises (by surrender, termination, relocation or otherwise), then capping protection and shortfall payment obligations cease to apply for the entire leased premises not only the surrendered, terminated or relocated portion.

Failure to consider the above rules in the business negotiations may result in an unintended increase or reduction in the tenant's realty tax contribution.

Many landlords want to avoid the complexity and cost involved in administering the transitional rules. Often, it could be preferable to have all tenants pay on the basis of an uncapped realty tax contribution. Accordingly, on renewal a landlord might be willing to accept a reduction or lower increase in minimum rent for a tenant's agreement to pay an uncapped realty tax contribution.

The transitional rules include the statutory requirement that capping protection and shortfall payment obligations apply *despite any provision in the lease*. However, it may be possible to contract out of the transitional rules with a carefully drafted lease provision.

It is recommended that such provision provide: (i) for an early expiry of the tenant's tenancy several minutes before midnight on the natural or negotiated expiry date (thereby interrupting the continuous nature of the tenancy before the new term starts) and (ii) that the new business terms have been negotiated on the basis that the transitional rules do not apply and that both parties have received adequate consideration.