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Be careful buying nearly new home

Buyer exposed to risk of paying seller's taxes

Insist on clause offering credit for unpaid amounts

My client Rena was very excited about closing on her low-rise condominium townhouse in Toronto's Liberty Village development last month, but she wasn't prepared to get stuck with the seller's $2,500 property tax bill.

The seller, Narissa, had moved into the unit in May 2005, and closed with the builder in October. She lived there for a year, and then sold it to my client in June of this year. Closing took place July 19.

The transaction was proceeding normally until I received a closing statement known as a statement of adjustments from the seller's lawyer, Kenneth Tepper. On these statements it is customary to pro-rate payments for taxes and other items like common expenses as of the day of closing.

If there has been an overpayment, the buyer reimburses the seller. If there has been an underpayment, the buyer receives a credit.

On instructions from his client, Tepper prepared his statement of adjustments using a figure of only $250.30 for 2006 land taxes. Typically, Toronto condominiums worth more than $273,000 have tax bills well in excess of $2,000.

In this case, the $250 figure represents the vacant land component of the property tax without a building on it. No one knows what the 2005 and 2006 taxes are because it usually takes the Municipal Property Assessment Corporation (MPAC) a year or more to come up with an assessed value. In the meantime, nobody knows what the property taxes will be.

Once MPAC sets the assessed value, it is turned over to the City of Toronto, which will use it to issue a supplementary tax bill. That bill is based on the increase in assessed value after completion of the condominium unit.

If the property is sold and the original purchaser is long gone, or refuses to pay, the new owner could well get stuck with paying the supplementary bill for the period of time the first owner lived in the house or condominium.

In Toronto, there is no standard practice among real estate agents and lawyers on how to deal with the potential liability, and the printed forms used by agents do not address this issue.

Often, the parties and their lawyers adjust with each other based on an estimate of the supplementary bill, or one of the lawyers will hold back an amount sufficient to pay the supplementary bill when it comes out.

In our deal between Rena and Narissa, Tepper, the seller's lawyer, took the position on his client's instructions that the only tax to be adjusted between the parties was the $250. Since the supplementary bills for 2005 and 2006 hadn't been issued, his client said she was under no obligation to pay or adjust for them.

I couldn't fault Tepper for taking his client's instructions. I've always found him a competent lawyer and a pleasure to deal with. I just didn't agree with his client's position which placed my client in jeopardy.

Narissa offered to provide the standard seller undertaking that she would pay her share of the supplementary bill when it was issued, but she would not set aside any money for this purpose at the time of closing.

This exposed Rena to the risk of having to sue for the money if Narissa was unable, or unwilling, to honour the bill when it came due.

Since the real estate agents involved in preparing the offer failed to consider the issue of a holdback for supplementary taxes, my client was left exposed to the possibility that Narissa wouldn't pay her share of the bills when they came out.

I calculated that my client was exposed to about $2,500 in supplementary taxes for the period from late May, 2005 to mid-July, 2006. I based my calculation on the builder's original sale price of $242,000.

Toronto's 2006 taxes are based on the assessed value multiplied by a "mill rate" of slightly more than 0.83 per cent. In Rena's case, the annual taxes would be about $2,250 for both 2005 and 2006, but the calculations are only my "guesstimate".

In the end, Stewart Title provided coverage against the risk that Rena would get stuck with Narissa's taxes. Another title insurer I approached would not cover the risk since they had paid so many unpaid property tax claims in exactly the same circumstances and frankly, I don't blame them.

The lesson to be learned from Rena's experience is this: If you're buying a nearly new house or condominium and the seller or agent cannot produce a current tax bill, chances are the property has not been assessed.

In that case, the buyer should always insist on a clause in the offer stating that he or she will receive a credit on closing for the estimated unpaid taxes, or that one of the lawyers will hold sufficient funds in trust to pay the seller's share of the supplementary bills when they come due.

The amount of the supplementary taxes can be calculated fairly accurately by taking the builder's original selling price (without GST) and multiplying it by the municipal mill rate (Toronto's 2006 mill rate is 0.8308587 per cent). The result is then pro-rated backward to the original possession date.

Buyers of recently constructed homes and condominiums who fail to protect themselves in their purchase agreements risk getting stuck with the seller's tax bill or a title insurance claim.

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