
FineAnswers

Answers to questions on tax, finance and management

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Your Home And Taxes! Why Is It Important To You?

1) YOUR HOME AND TAXES! WHY IS IT IMPORTANT TO YOU?

Profit on the sale of real estate is generally subject to tax. However, a capital gain (profit) on the sale of your PRINCIPAL residence can be exempt from taxation in Canada.

2) WHAT TYPES OF PROPERTY ARE INCLUDED UNDER THE DEFINITION OF PRINCIPAL RESIDENCE?

- A house.
- An apartment or unit in a duplex, apartment building or condominium.
- A cottage.
- A mobile home.
- A trailer, or
- A houseboat.
- A leasehold interest in any of the above.
- A share of the capital stock of a co-operative housing corporation, if such share is acquired for the purpose of obtaining the right to inhabit a housing unit owned by that corporation.

Per Canada Revenue Agency – IT-120R6

3) UNDER WHAT CIRCUMSTANCES IS 100% OF THE CAPITAL GAIN ON THE SALE OF YOUR PRINCIPAL RESIDENCE EXEMPT?

- You or a personal trust (but not a corporation) owned the property solely or jointly.
- You were a resident of Canada throughout your ownership of the housing unit.
- The principal residence was ordinarily inhabited by you, your spouse, common law partner, (current or former) or your child. (adult or underage).
The exception is an election under Subsection 45(2) or 45(3) of the Income Tax Act, which allows you a four-year exemption from ordinarily residing in it. The exemption can be more than four years if your job requires you to stay elsewhere. **See 13 below.**
- You, your spouse or your children under the age of eighteen DO NOT own another property, which they designated as their principal residence.
- The primary purpose for acquiring and selling your principal residence was NOT to make a profit.

- The property's use was NOT totally or partially changed throughout your ownership. (Post 1971) Partial conversion gives partial exemption see below.
- The land on which the principal residence was built does NOT exceed half a hectare (5,000 square meters or 1.23 acres). This limitation could be increased depending on zoning by-laws and proof that a larger acreage was necessary for the full enjoyment of the property.
- You did not own the land on which you built your principal residence for more than two years before putting a building on it and ordinarily inhabiting it.

4) HOW IS THE CAPITAL GAINS EXEMPTION CALCULATED?

The exemption equals 100% of the gain if you could and did designate your home, as your principal residence for every year that you owned it. The exemption is reduced proportionally for every year that the property was owned but not designated as your principal residence. The formula is:

$$\text{Exemption} = \text{Gain} * (\text{Years Designated} + 1) / \text{Years Owned.}$$

The number of years is calculated from 1971 onwards.

TIP – The + 1 in the formula above means that you can designate your home for all the years you ordinarily inhabit it plus an extra year. If you have two homes that could qualify as a principal residence you should try and take the best advantage of this one extra year by using it to designate the home that gives you the largest capital gains exemption.

TIP – Keep all receipts of improvements to your principal residence so as to reduce any possible capital gain on its sale.

5) WHAT IS MEANT BY DESIGNATING A HOUSING UNIT AS YOUR PRINCIPAL RESIDENCE AND HOW IS THIS DONE?

When a housing unit fits the definition of your principal residence (see 3 above) you can – at the time you sell it or it is deemed to have been disposed of – designate it as your principal residence for each of the years, which you owned it. The designation should be made for each of the years the property was owned using form T2091. The form need not be filed with the tax return for that year unless a taxable capital gain remains after using the exemption or if a form T664, *Election to Report a Capital Gain on Property Owned at the End of February, 22 1994* was filed.

6) IF TWO OR MORE INDIVIDUALS OWN THE SAME PRINCIPAL RESIDENCE AND THE RESIDENCE IS SOLD, IS THE GAIN EXEMPT?

Yes if all the owners ordinarily inhabited the same principal residence, or elected under Subsections 45(2) or 45(3), throughout their ownership and did not designate another housing unit as their principal residence the capital gain enjoyed by each person is exempt subject to other conditions being met (see 3 above).

7) BY ORDINARILY INHABITING A RESIDENCE, IS IT MEANT THAT YOU HAVE TO LIVE THERE ALL YEAR ROUND?

No, in fact you may have several residences that you ordinarily inhabit and can designate **any one as your principal residence** for each of the years you own them, but just one principal residence per year.

8) IF YOU PERSONALLY DON'T ORDINARILY INHABIT YOUR HOME CAN YOU DESIGNATE IT AS YOUR PRINCIPAL RESIDENCE FOR THE PURPOSE OF CAPITAL GAINS EXEMPTION?

Yes, if your spouse, previous spouse, common law partner, or your child (adult or underage) ordinarily inhabit it.

9) CAN YOU, YOUR WIFE AND YOUR CHILDREN UNDER EIGHTEEN, EACH HAVE SEPARATE PRINCIPAL RESIDENCES AND ENJOY THE CAPITAL GAINS EXEMPTION?

No. Not since 1982. There is one principal residence per family unit.

10) CAN I BUY AND SELL MY RESIDENCE FREQUENTLY AND CLAIM THE PRINCIPAL RESIDENCE CAPITAL GAINS EXEMPTION?

You may be conducting a business, and in that case the gain will be considered income from business and not a capital gain. Income from business will be subject to tax .

11) CAN I DESIGNATE A PRINCIPAL RESIDENCE OUTSIDE CANADA?

Yes.

12) IF YOU OWN A COTTAGE AND A HOUSE WHICH YOU ORDINARILY INHABIT AND DECIDE TO SELL THE ONE WHICH HAS NO CAPITAL GAIN AND A FEW YEARS LATER SELL THE OTHER ONE WHICH HAS A GAIN, CAN YOU AVOID PAYING TAX ON THE CAPITAL GAIN?

Yes. You will designate the one that has the highest potential gain as your principal residence for all the years you owned it.

TIP – If you have two principal residences and sell one of them make sure that you designate the one that gives you the greatest capital gains. That does not have to be the one that you sold, but should be the one with the largest gain at the time of your sale.

TIP – If you have little or no taxable income and have more than one principal residence – say, a house and a cottage – and you sell the cottage at substantial profit, you may be able to eliminate your capital gain by designating it as your principal residence for all the years you own it. However, in order to take advantage of your personal non-refundable tax credits you should try and generate some capital gain on the sale of the cottage. Therefore, just designate as many years as you need to generate sufficient capital gain to utilize all your personal allowances and non-refundable tax credits.

13) WHAT IF YOU VACATE AND RENT YOUR PRINCIPAL RESIDENCE AND LATER RE-OCCUPY IT?

When there is a change of use of your principal residence to an income producing property, you are deemed by law to have sold it and reacquired it as a rental property. What this means is that any gain accruing while it is an income producing property is subject to tax as a capital gain. However, Subsection 45(2) and 54 {principal residence (d)} of the Income Tax Act allows you to make an election to designate your property as your principal residence for a further four years. So if you reoccupied your property in the fifth year you can still designate it for all these years and receive 100% capital gains exemption.

You can actually designate it for more than four years (section 54.1 of the Income Tax Act) if it is because of your or your spouse's employment that you had to vacate it and reside elsewhere. As long as your new housing unit is 40 kilometers closer to your new place of employment, the employer is not related to you and you reoccupy the house before or in the year after such employment is terminated.

NOTE, You have to be a resident of Canada or a deemed resident of Canada in order to apply for the Principal Residence exemption. In order to determine your residency check IT -221 *Determination of an individual's Residency Status*.

14) HOW CAN I MAKE THE ELECTION UNDER SECTION 45(2) OF THE INCOME TAX ACT SO AS TO DESIGNATE, MY PREVIOUS RESIDENCE FOR FOUR YEARS AS MY PRINCIPAL RESIDENCE?

You would have to attach a letter to your tax return when the change of use of your principal residence occurs and you have to make sure that you do not claim (CCA) Capital Cost Allowance (depreciation) against your rental income. The year you charge CCA your election is deemed to have been rescinded and this will affect the number of years you can designate this housing unit as your principal residence. Canada Revenue Agency accepts – as a matter of policy – late filing.

15) WHAT IF YOU MAKE A RENTAL PROPERTY YOUR PRINCIPAL RESIDENCE?

When there is a change of use of your rental property to your principal residence, you are deemed by law to have sold it and reacquired it as your principal residence. The sale may give rise to a capital gain or a capital loss. If it results in a capital gain you have to pay tax on it unless you elect (under Subsection 45(3) of the Income Tax Act) to defer the reporting of the gain until you subsequently sell this property or have it deemed disposed of. The election allows you to designate this housing unit a further four years –prior to the change of use- as your principal residence.

16) DOES THE FOUR ADDITIONAL YEARS ALLOWED UNDER SUBSECTION 45(3) IN THE CASE OF CONVERTING AN INCOME PRODUCING PROPERTY TO YOUR PRINCIPAL RESIDENCE, DEEM THE SALE OF YOUR RENTAL UNIT TO HAVE OCCURRED FOUR YEARS PRIOR TO ITS ACTUAL CHANGE OF USE.

No. The four years only allows you to claim that you ordinarily inhabited that housing unit and therefore allows you to designate it as your principal residence, if all the conditions are present.(See 3 above)

TIP – If you buy a housing unit, which you initially have to rent out, try occupying it in its first five years of ownership. This would allow you to designate the house as your principal residence for four of the five years by electing under Subsection 45(3) and use the extra year given in the formula for calculating the exemption.

17) HOW CAN I ELECT UNDER SUBSECTION 45(3) TO DEFER THE CAPITAL GAIN RESULTING FROM THE CHANGE OF USE OF MY RENTAL HOUSING UNIT TO MY PRINCIPAL RESIDENCE?

An election under Subsection 45(3) can only be made if you have not charged CCA (depreciation) since 1985. Also, the election need not be made until you finally dispose of your principal residence.

TIP – Do not charge CCA (depreciation) on a rental building if you expect the building to appreciate in value and you may, some time in the future, occupy it as your principal residence. This may, however, depend on the amount of the capital gain. If the gain is not significant you might be better off charging CCA and paying tax on both the capital gain and the recapture of CCA.

18) IF CCA WAS CHARGED BEFORE 1985 WOULD THE CHANGE OF USE GIVE RISE TO A RECAPTURE OF CCA? (increasing the taxable income by the total of all depreciation charged on the building)

Yes, and it cannot be deferred by making a Subsection 45(3) election.

19) WHAT IF YOU OWNED THE LAND ON WHICH YOU LATER BUILT YOUR RESIDENCE?

Land regardless of whether it is income producing or not cannot be designated as principal residence and therefore if you build your principal residence on the land which you have owned for two years or more then you will lose some of your principal residence capital gains exemption. However, if you have a housing unit on the land and rent it out you may be able to take advantage of the election under Subsection 45(3). See 17 above.

20) WHAT IF PARTIAL CHANGE OF USE OF YOUR PRINCIPAL RESIDENCE IS MADE?

Partial change of use of your principal residence to income producing results in a deemed disposition of the changed section of the property and when the property is sold the changed part may give rise to a taxable capital gain. However, if there has been no structural change a deemed disposition will not take place and the property can be designated as your principal residence in full. See below.

21) WHEN A PARTIAL CHANGE OF YOUR PRINCIPAL RESIDENCE TO INCOME PRODUCING DOES NOT GIVE RISE TO A DEEMED DISPOSITION?

Canada Revenue Agency states in its bulletin IT - 120R6 that:

“it is our practice not to apply the deemed disposition rule, but rather to consider that the entire property retains its nature as a principal residence, where all of the following conditions are met:

- a) the income-producing use is ancillary to the main use of the property as residence,*
- b) there is no structural change to the property, and*
- c) no CCA is claimed on the property.”*

This means you can use part of your home for business or rent it out without losing your ability to claim all of it as your principal residence.

22) WHEN PART OF AN INCOME PRODUCING HOUSING UNIT IS PERMENANTLY CHANGED AND OCCUPIED AS A PRINCIPAL RESIDENCE AND THEREFORE A DEEMED DISPOSITION OCCURS CAN YOU ELECT UNDER SUBSECTION 45(3) TO DEFER THE RESULTING CAPTAL GAIN?

When there is a deemed disposition as a result of a partial change no Subsection 45(3) election is available.

23) WHAT IF YOUR PRINCIPAL RESIDENCE IS OWNED BY A PERSONAL TRUST AND YOU ARE A BENFICIARY UNDER THE TRUST?

The personal trust can claim the principal residence exemption if it owns a housing unit and designates it as such for any of its specified beneficiaries who are in compliance with the normal rules allowing an individual to designate a property as his or her principal residence.

24) WHO IS A SPECIFIED BENEFICIARY?

A specified beneficiary of a personal trust as defined for the purpose of determining the principal residence exemption is stated in IT-120RS as:

“... one who either ordinarily inhabited the property or had a spouse or common law partner, former spouse or common law partner, or child who ordinarily inhabited the housing unit.”

25) WHAT IF A SPECIFIED BENEFICIARY DESIGNATES HIS OR HER OWN HOUSING UNIT AS A PRINCIPAL RESIDENCE?

The trust cannot designate its housing unit as a principal residence for the same years that a specified beneficiary designates her or his home as principal residence.

26) WHAT IS THE PROCEDURE FOR A PERSONAL TRUST TO DESIGNATE A HOUSING UNIT IT OWNS AS A PRINCIPAL RESIDENCE?

The trustee should complete and file Form T1079, *Designation of Property as a Principal Residence by a Personal Trust*. The form must be filed when the property is disposed.

27) CAN A PERSONAL TRUST USE THE ELECTIONS UNDER SUBSECTIONS 45(2) AND 45(3) OF THE INCOME TAX ACT, SIMILAR TO THAT AS A REAL PERSON?

Yes.