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Owning Your Own Home: How to Make the Most of Making Money, and Pay No Income Tax!

There are not a lot of ways to make money and get away without paying income tax. But if a person makes a gain on the sale of his or her own home, no income tax would normally apply. What a deal! The concept of a “tax free” principal residence is fairly simple, but numerous complexities with “traps” could make a principal residence *not qualify*. In addition, some “tips” are available to make use of this “tax free” phenomenon. Following are some points for consideration.

What qualifies as a principal residence?

In general a “principal residence” might include a house, an apartment, a cottage, a mobile home, or even a houseboat! You need not live in the principal residence throughout the entire year, but at some time during the year. Most important, since 1982, only one housing unit can be designated per family as a principal residence. A family includes an individual, the spouse of an individual, and any unmarried children under 18 years of age.

How does one “designate” a principal residence?

If you own only one residence in any particular year, this residence will, by default, be designated as your principal residence for that year. Therefore, since many individuals only own and reside in one housing unit, the designation issue is really a non-issue; the administrative

position of CCRA [Canada Customs and Revenue Agency] is that it is not necessary to file a “designation” form (T2091) in the year of sale or “deemed” sale.

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If two or more properties are owned in a particular year (say a city house and a cottage, visited in summer), the issue of designation is more important. In this situation, an individual would consider the potential capital gain that might arise upon the sale of each of the properties, the number of years of ownership, and accordingly, designate the property with the bigger gain as the principal residence. This designation will not have to be filed until the year the first of the two properties is sold or “disposed” of. Please note that at the time of death, there is a “deemed” disposition of all properties.

What if a person rents out part of his or her home?

If part of a house is used as a principal residence and another part is rented out, it is still possible for the entire house to qualify as a principal residence. This would apply in the circumstances where

business or rental use of a principal residence is “ancillary” to the main use of the residence. To qualify, it is also important to note that no tax depreciation (capital cost allowance) be claimed on part of your residence.

If the business or rental portion is a significant portion of the house, then only the portion of the house (and related land) where the individual or family resides would qualify as a principal residence.

Does the surrounding land qualify as principal residence?

A housing unit and its immediately surrounding land would normally qualify as a principal residence, because the surrounding land is usually regarded as contributing to the use and enjoyment of the housing unit. If the total land, on which the housing unit sits and is surrounded, is greater than a half-hectare in size, however, it is possible that the excess land would not qualify. There *may* be an argument that will permit the excess to qualify; professional advice should be sought.

What if a person changes the use of a rental property to principal residence, and vice versa?

Any change in use of property may result in a deemed disposition of the property. There are certain circumstances where a special election can be filed that deem

the change of use not to have happened. It is important to note that the elections provide an opportunity to defer any potential income tax arising from a capital gain (assuming the property has appreciated in value).

In certain circumstances, the election will extend the principal exemption election on the property (without the owner having to reside in the unit) for an additional four years. If any clients are in the process of converting their property to a rental unit or a rental unit into a principal residence, they should consider seeking professional tax advice. If the specific elections are not filed on a timely basis, unexpected tax consequences may arise.

Tax Planning Considerations

Following are some tips you may wish to pass on to your clients.

- Keep track of all renovation and improvement costs that may be incurred on a housing unit. These costs may come in handy when determining the potential capital gain on a property, particularly if, at a later date, more than one property is owned. Remember, only one principal residence election is available per family
- If you marry or are deemed to be married, i.e., common law spouse or same sex couples, and each has a principal residence, the principal residence exemption will no longer apply to one of the properties (based on the one-per-family rule). If either member of the couple has children over age 18, the person may consider selling one of the properties to the children. Such transfers should occur, of course, at fair market values (whether they are gifted or actually sold for proceeds). Further professional tax advice is recommended before such a strategy is considered.
- Parents considering helping their children sometimes choose to buy a rental property, and have the children live in the house rent-free. At a later date, if the rental property were sold at an appreciated value, the gain would likely be taxable to the parents.

An alternative to this strategy might be to loan the funds to the children to acquire the house so that at a later date, when the house unit is sold, the gain would be eligible for the principal residence exemption to the children. To secure the loan principal, the parents may consider placing a mortgage on the housing unit. A reasonable interest rate should also be considered between parent and child.

Keeping in mind that few things in life are free, why not take advantage of this tax break? After all, there aren't many left! ▲

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