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Your Principal Residence: *a Tax-Efficient Investment*

There are many reasons to consider owning your own home—you may wish to take advantage of anticipated upturns in the real estate market and resulting capital gains upon sale. Or, you may find that low rates of interest make mortgage payments no more burdensome than rent payments, yet allow you to increase the value of your equity by “paying rent to yourself.”

The most significant benefit to owning your own home, however, may arise from the special tax treatment that principal residences are accorded upon sale.

Did You Know?

There are few “tax breaks” left in our tax system, but owning your own home can give you access to one of them.

Generally, when you sell an investment—for example, stocks, equity fund units, real estate—any capital gain realized is subject to income tax. When you sell a home that has qualified as your principal residence, the capital gain you may realize on the sale is generally not subject to income tax! As such, your home can become your most tax efficient investment.

What is a Principal Residence?

A principal residence could be a house, a cottage, a condominium, an apartment unit, a townhouse or duplex unit, a trailer, mobile home, or a houseboat.

It may qualify as your principal residence, if it meets the following criteria:

- it is a housing unit described above, a leasehold interest in a housing unit, or a share of the capital stock of a cooperative housing corporation you have acquired only to get the right to inhabit a housing unit of the corporation;
- you own the property (alone or jointly);

- you, your children, your current or former spouse or common-law partner lived in it at some time during the year; or
- you designate the property as your principal residence.

Under tax law, for your home to be considered a *primary residence*, the land on which that home is situated may not exceed one-half hectare (1.24 acres).

- If your home is situated on a lot that is one-half hectare or smaller, the entire property qualifies as your principal residence; any gain arising on its sale is tax free.

Under tax law, for your home to be considered a primary residence, the land on which that home is situated may not exceed one-half hectare (1.24 acres).

- If your home is situated on a lot greater than one-half hectare, only the half-hectare portion of the property qualifies as your principal residence; the remaining portion is subject to capital gains tax.
- If you can show that more land (greater than one-half hectare) is necessary for the “use and enjoyment” of your home, you may upon sale be permitted to include more of the land as your “principal residence.” This might occur in circumstances where the size or character of a housing unit and its location on the lot require extra land to enable you to access the property from public roads or if there are in effect minimum lot sizes or subdivision restrictions.

Change in Use

The use of your home may change during your ownership. In fact, you may be considered to have sold your property, even though you did not actually sell it!

For example, if you were to move from your home and commence renting it out, you have triggered a “change in use” from principal residence to a rental operation. For tax purposes, this means you are considered to have sold your property at its fair market value and a capital gain could conceivably result. If the property did not qualify as your principal residence for all prior years, you may be surprised by your unexpected tax liability!

There are methods that may be used to defer the tax impact of such a change in use, so that no gain is reported until the property is ultimately sold in a real sale transaction. See the paragraph below for details on such special elections.

Special Elections

If you move from your home and commence renting the property, you may be able to avoid reporting the deemed disposition upon change in use by filing an election pursuant to section 45(2) of the *Income Tax Act*. This election may enable you to claim the home as your principal residence for up to an additional four years after you move out, as long as no capital cost allowance is claimed on the property

MISCONCEPTION

REALITY

Although I rented out my home for the last 12 years, if I move into it just before I sell it, the whole gain will be sheltered by the principal residence exemption!

Sorry, this is not the case. For your home to qualify in any particular year, you generally must have lived in it during that year.*

If I move out and commence renting my home, I'll no longer be able to claim the principal residence exemption.

Not so. Your home could still qualify as your principal residence for the years in which you lived in it and longer, if special elections are made.*

This is a great tax deal! I'll get my husband to buy a house, then we can each claim a property as our principal residence!

Unfortunately, not possible. Current tax law says that married or common-law couples/partners may only claim one property as their principal residence in any given year.

* See Special Elections, described on page 61.

and you report the rental income on your return.

Alternatively, if you move into a property that you previously rented out, you may be able to file a section 45(3) election to defer reporting a change in use and to deem that property to be your principal residence for up to an additional four preceding years.

If your property was your principal

residence during a portion of the period owned, but did not qualify during another period, then when the home is sold, you would need to complete form T2091 (IND) to determine what portion of the gain may be sheltered from tax.

Common Misconceptions

Rules relating to principal residences are complex; there are many common misconceptions. A few examples are detailed above.

The rules governing principal residences are very complex and have changed over the years. As such, it would be wise to consult your tax advisor upon the sale of your home if in *any* year it did not qualify as your principal residence. ▲

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