PERSONAL Newsletter

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Principal Residence Exemption in Brief

A special exemption is provided in the case of a capital gain realized upon the disposition of a property which constitutes your "principal residence". The general effect of this principal residence exemption is that you will not be taxed on a gain from the sale of your residence if it qualifies as your principal residence for each year you have owned it. However, you may be taxable if the residence does not qualify as a principal residence for each such year. It is very important to determine whether the property does in fact qualify as a principal residence for each year you have owned it, and the requirements for qualification are discussed below.

Note that the principal residence exemption is a complicated and diverse topic, so the information discussed here is far from complete.

"Principal Residence" Defined

To be considered a principal residence for a year, your property must meet the following conditions:

1. The property involved must be a housing unit, a leasehold interest therein, or a share of the capital stock of a cooperative housing corporation.
2. The housing unit, leasehold interest, or share of capital stock, must have been owned in the year by you, although this ownership may be joint ownership with some other person.
3. If a housing unit, it must have been ordinarily inhabited in the year by you, your spouse or common-law partner or former spouse or common-law partner, or your child.
4. If a share of a cooperative housing corporation, the share must have been acquired for the sole purpose of acquiring the right to inhabit a housing unit owned by the corporation that was ordinarily inhabited by you, your spouse or common-law partner or former spouse or common-law partner, or your child in the year.
5. If a housing unit, the property qualifying for the exemption is limited to the building itself, and land, including immediately surrounding land that may reasonably be regarded as contributing to your use and enjoyment of the housing unit as a residence. However, that land may not be included to the extent that it exceeds 1/2 hectare in size, unless you can establish that this excess land was necessary for use and enjoyment of the housing unit.
6. The housing unit or share must have been "designated" by you as your principal residence for the year. The designation is not required if the exemption fully exempts your gain from taxation.

7. No other housing unit or share can have been "designated" as a principal residence by you for the same year.
8. Only one housing unit or share per family may be "designated" as a principal residence in 1982 and subsequent years.

Certain trusts may also own a property that is considered a principal residence, but trusts are subject to additional criteria in order for the property to qualify.

If you met these criteria during every year that you owned your property, then the entire capital gain should be exempt from tax. However, if this is not the case, the exempt portion of your capital gain requires a computation. Moreover, the situation becomes more complex if a portion of your property has a different use (e.g., renting out a portion of your home) or you have more than one property for personal use (e.g., a cottage). Planning to claim your principal residence exemption is complicated business, especially when circumstances such as these apply. That is where having an experienced tax adviser on your side can guide you through the complexities of these rules.

Recent Changes to the Principal Residence Exemption

On October, 3, 2016, new proposed tax rules were introduced which affect taxpayers who dispose of their principal residence. Some of these changes apply more to taxpayers who are non-residents or who use a trust to own their residence. The other changes apply to just about anyone. It is important that Canadian taxpayers are aware of their reporting obligations when they sell their home, so these recent developments are discussed below.

Requirement to Report Disposition of Principal Residence

The tax rules have always required that individuals designate their property as their principal residence by filing a form in the year they dispose of the residence. However, it has long been the Canada Revenue Agency's (CRA) administrative position that where an individual taxpayer (other than a trust) disposes of his or her principal residence and no gain is taxable since the property was his or her principal residence during every year of ownership, the taxpayer is not required to report any information on his or her tax return. Otherwise, individuals are required to complete CRA Form T2091 (or T1255 in the case of deceased individuals).

However, effective for dispositions occurring on or after January 1, 2016, the CRA now requires that individual taxpayers report the sale of a principal residence on Schedule 3 for the tax year in which the property was sold if the property was designated as the taxpayer's principal residence for every year of ownership. This form requires that taxpayers provide the year of acquisition, the proceeds of disposition, and a description of the property. This new rule applies to actual and deemed dispositions.

Costs incurred for therapy or the design of a tIf you fail to report the disposition of a principal residence, you will have forfeited the principal residence exemption, so it is very important that you notify your tax adviser when you sell your home. If the disposition was not reported, you can request that the CRA amend your tax return for the year of disposition so that you can claim the exemption. Unfortunately, the CRA may enforce the penalty for late filed, amended, or revoked elections which is equal to the lesser of $8,000 and $100 for each complete month between the original due date and the date the request is made. The CRA has stated that they will only assess any late filing penalties in the most excessive cases.

CRA's Power to Reassess

Normally, the CRA can only reassess you within the normal reassessment period with respect to a tax year. For individuals and trusts, this period is three years after the earliest of the date that the original notice of assessment was sent and the date that a notification that no tax payable was sent.

However, the CRA may reassess taxpayers outside of this normal period in certain circumstances. The new rules proposed to expand the CRA's ability to assess you for any year outside of the normal reassessment

period if you did not report the disposition of real or immovable property on your tax return. However, if you were to subsequently amend your return to report the disposition, the CRA may only reassess you within the three years following the date that the amendment was filed.

Given the prospect of being denied the principal residence exemption or facing a significant penalty, it is paramount you include all pertinent information on Schedule 3 of your tax return for the year that you dispose of your property and wish to designate it as your principal residence for every year of ownership.

If the disposed property was not the your principal residence for every year of ownership (e.g., where a cottage will be designated for one or more of those years), you are required to report the disposition on Form T2091 and any gain computed on the form must be included on Schedule 3.

Other Changes

Further changes were made to claiming the principal residence exemption that apply to non-residents and trusts—if you fall under these categories, speak with your tax adviser.