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TAX MATTERS

How you own your home matters for tax planning

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For many Canadians, owning a home represents financial security over the long term. It may be the biggest single asset you ever own.

But when it comes to choosing a home, don't forget the top three things to look for: Location, location and location.

My wife's cousin, Brent, forgot this when his family moved recently. They bought a home for a great price because it used to be infested – by cats. The woman who previously lived there owned 73 cats. Most of the neighbours failed to notice the horrific smell coming from the home, probably because of the fish hatchery down the road, and the neighbouring sewage treatment plant.

When it comes to a home – or cottage, for that matter – most people don't give as much thought to how they should own the property as they do to which property they should own. Yet, how you structure ownership matters.

The options

Own it personally. The default for home ownership is to own it in your personal name – unless an ownership structure mentioned below offers benefits you want.

One advantage of personal ownership is that it's simple, and may allow you to claim the principal residence exemption (PRE) for a tax-free sale later. Each "family unit" is entitled to designate one property as their principal residence.

A family unit consists of you, your spouse or common-law partner and any unmarried children under the age of 18.

You have to ordinarily inhabit a place to call it your principal residence and claim the PRE. If you own more than one property, speak to a tax pro about the exemption because the rules can be complex.

Own it in a spouse's name. If you're a business owner, or are otherwise concerned about potential lawsuits, placing the property in your spouse's name can protect the place from your creditors. Having said this, if you make the transfer to your spouse with the intent to hide your assets and defeat or delay existing creditors, there are laws designed to prevent this. What if your marriage fails? Putting the property in your spouse's name won't jeopardize your rights in the event of a marriage breakdown. Further, you won't trigger any tax when transferring the property to your spouse.

Own it in a trust. There are some non-tax reasons why you might place a home or cottage in a trust, including: protection from creditors; privacy (you can hide the beneficial owner of the property from the public); avoiding probate fees in certain provinces; allowing trustees to control the property while beneficiaries live in the place; providing a home for a disabled beneficiary if she's not able to manage her own affairs; and enabling a person to live in the home (such as a surviving spouse) until a future time (the spouse's death, for example) at which point the home, or proceeds from its sale, are distributed to others. In the past, a trust could claim the PRE to shelter the property from tax. These rules were changed on Oct. 3, 2016, to now limit the type of trusts that can claim the PRE for tax years after 2016.

Own it in a corporation. Holding a home or cottage in a corporation will disqualify you from claiming the PRE on a sale later. Now, if you don't care to claim this exemption, owning the property in a corporation can make sense if the funds to buy the place are already in the corporation, or if you plan to convert the property to a rental later and are looking to limit your personal liability in the event of law suits.
If you're going to place an existing property in a trust or corporation, be sure to talk to a tax pro first to plan to avoid a tax hit when making the transfer.

Clarification
Last week, I mentioned that the Canada Revenue Agency (CRA) has been looking at the use of life insurance owned by private corporations. I suggested that, based on comments by CRA, the taxman may, in the future, restrict the amount of insurance proceeds that can be paid out of the corporation tax-free by way of the capital dividend account (CDA). I've received clarification on this. The CRA is not looking to restrict the amount of insurance that will make its way to the CDA and would therefore be available for a tax-free dividend. Rather, the taxman simply plans to obtain more information from a corporation when it elects to pay a dividend from its CDA when life insurance proceeds have been received, to ensure that the CDA has been calculated correctly. Tax changes proposed on July 18 don't mention a change to the CDA rules when life insurance is owned.

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