ADVISORTOCLIENT

Corrected: How to claim the principal residence exemption

BY **Allan Tong and Advisor staff** June 29, 2017

July 10, 2017: This article has been corrected from an earlier version that misstated the formula for calculating the PRE.

Have you sold a home or cottage, or transferred ownership of your principal residence to a relative? You may be eligible to claim the principal residence exemption. Here's how to do it.

First, determine your eligibility

Your can claim only one property at a time as a principal residence, unless you're a Canadian resident selling one property and moving into another in the same tax year (this is permitted under the "plus one" rule). A family unit (you, the taxpayer, along with your spouse and any unmarried, minor children) is entitled to one principal residence exemption (PRE) per year.

Principal residence exemption criteria

1. Must be an eligible property type as per CRA.
2. The person claiming the exemption must own or co-own the property in the tax year.
3. The home must be ordinarily inhabited by the owner, her current or former spouse or common-law partner, or her child. (CRA does not define "ordinarily inhabited," saying it "must be resolved on the basis of the facts in each particular case.")
4. A property occupied for part of the year, like a cottage, may be considered a primary residence unless its main purpose is to "gain or produce income," says CRA. Fortunately, "a person receiving only incidental rental income from a housing unit is not considered to own the property mainly for the purpose of gaining or producing income."
   Note that a taxpayer can elect for a property to be considered a principal residence under subsection 45(2) or (3) of the Income Tax Act. **Warning:** Owners and immediate family members cannot claim different principal residences unless they're separated or living apart.

Next:

- Check if the property to be sold is eligible for designation as the principal residence (see "Principal residence exemption criteria").
- Determine in what years the property was your principal residence. Capital gains from years when the property wasn't your principal residence will be taxed. CRA's formula for determining tax for Canadian residents is*:

([1** + number of years designated]/number of years owned) x gain = exemption amount
**Foreign residents don't get the plus one.*

For example, if you own a home for 15 years, but it was your principal residence for only 13 of those years, and you had a $100 capital gain on the residence, this is the amount that could be sheltered by the PRE:

([1 + 13]/15) x $100 = (14/15) x $100 = $93.33

Warning: If you use your home to earn income, the income-earning portion isn't tax-exempt. Calculate the percentage of living space using square metres or the number of rooms, as long as the split is reasonable, says CRA. Multiply that percentage by the capital gain to determine the PRE.

Now, claim the PRE

- To designate the property as a principal residence for all years that you owned the property, select Box 1 on page 2 of Schedule 3 of the T1 Income Tax and Benefit Return.
- To designate the property as a principal residence for some, but not all, years that you owned the property, select Box 2 (or 3 for more than one property) on page 2 of Schedule 3.

Determine your capital gain

- If there's a capital gain to report (i.e., the home was not your principal residence for the whole time you owned it), you must submit the appropriate form in the year you sell, or you were deemed to have disposed of, all or part of your principal residence, or grant someone an option to buy all or part of your principal residence.
- If you previously reported a capital gain on the property as of February 22, 1994, fill out Form T2091(IND)-WS Principal Residence Worksheet, and then Form T2091(IND) Designation of a Property as a Principal Residence by an Individual (Other Than a Personal Trust), to calculate the PRE and the remaining capital gain.
- If you haven't previously reported a capital gain on the property, complete Form T2091(IND).

Now, finalize the tax forms

Where applicable:

- Enter the amount from Line 66 of the Form T2091(IND)-WS on Line 55 of Form T2091(IND). Attach a copy of the worksheet to the form.
- Enter the total from Line 56 of Form T2091(IND) on Line 158 of Schedule 3, Capital Gains (or Losses).
- Enter the result of Line 199 of Schedule 3 on Line 127 of your return. Attach a copy of Schedule 3 to the return.

Sources: Paul McVean, tax partner and president of Astute Strategies in Thornhill, Ont.; CRA

A previous version of this story misstated the formula for calculating the PRE. We sincerely regret the error. **Return to the corrected sentence.*