FINANCIAL POST

Do you have to pay taxes on the sale of a cottage?

JAMIE GOLOMBEK | May 22, 2015 1:14 PM ET
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Illustration by Chloe Cushman/National Post One taxpayer wrote the CRA explaining that when he bought his cabin, it was “in very poor condition” and he had to invest money to make it livable. The question was, would any exemption apply to eliminate the potential capital gain that may arise when he sold it.

Victoria Day weekend marked the beginning of cottage season for many Canadians. One of the most common tax questions asked this time of year by vacation property owners is what happens if I were to sell the property – would I have to pay tax?

Around this time last year, the Canada Revenue Agency issued a technical interpretation letter in response to a taxpayer who asked whether a capital gain on the sale of his cabin could somehow be sheltered from tax.

The taxpayer, in his letter, explained that when he bought the cabin, it was "in very poor condition" and the taxpayer had to invest money to make the property livable. The taxpayer specifically wondered whether any exemption could apply to eliminate the potential capital gain that may arise when he sold it.

The CRA went through the tax rules governing the ownership, and subsequent sale, of personal-use property, which refers to items that you own primarily for your own (or your family's) personal use or enjoyment. It typically includes all personal and household items, like furniture, cars, boats and recreational real estate.

In order to properly calculate any tax owing on the sale of your cottage, you take the proceeds of disposition from the sale of your property, less any outlays and expenses incurred by you to sell the property (such as real estate commissions) and deduct from this your "adjusted cost base" (ACB), or tax cost, of the property.

While normally the ACB would be the amount you paid for the property, it can also include any capital expenditures you incurred, such as the cost of any additions and major improvements to the property. Normal repairs and maintenance expenses cannot not be added to the ACB.

Your capital gain or loss is then calculated by subtracting ACB from the proceeds less any outlays or expenses. You would then pay tax at your marginal tax rate on 50 per cent of the capital gain unless the property qualifies for the principal residence exemption.

Yes, that's right: Your cottage *may* qualify as your principal residence even if you don't principally live there.
Under the Tax Act, in order for a property to qualify as your principal residence for a particular tax year, four criteria must be satisfied: the property must be a housing unit, you must own the property (either alone or jointly with someone else), you or your spouse or kids must "ordinarily inhabit" the property, and you must "designate" the property as a principal residence.

The CRA wrote that a seasonal residence can be considered to be "ordinarily inhabited in the year" even if you only use it during vacation periods – "provided that the main reason for owning the property is not to gain or produce income."

Now the snag: Since 1982, you can only have one principal residence per family unit in a particular year. So if you own more than one residence that qualifies as “ordinarily inhabited,” you will need to do some analysis to determine which property should be designated for each tax year in which you own both properties.

Among other factors, you would consider the accrued gain to date (if any) on each property along with the anticipated holding period and future anticipated appreciation of each property before coming to a decision. Fortunately, you need only make the decision when you sell the first one.

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