TAX MATTERS

Selling your home tax-free may be more complex than you think

TIM CESTNICK
SPECIAL TO THE GLOBE AND MAIL
PUBLISHED MAY 31, 2018 UPDATED MAY 31, 2018

Perhaps you’ve heard about the “Chicken Cannon.” As the story goes, it’s a gun designed by NASA to shoot dead chickens at the windshields of stationary aircraft to test the ability of the glass to withstand impact with flying birds. Apparently, the British were interested and wanted to test a windshield on a new passenger train being considered for purchase. After firing the ballistic chicken at the train, the windshield shattered and caused serious damage to the engine’s cab. The British were surprised and sent NASA the results of the experiment and asked for suggestions. NASA’s response was very brief: “Thaw the chicken.”

It appears that the chicken story is just folklore. But make no mistake, the rocket scientists at NASA are smart folks. Rocket science is second only to our tax law when it comes to complexity. If you doubt this, take a close look at the rules around principal residences.

CAPITAL PROPERTY

You’re likely aware that Canadian residents can often sell a principal residence free of tax, thanks to the principal residence exemption (PRE). To qualify as a principal residence, the sale of the property must give rise to a capital gain or loss – not business income. In other words, the property must be “capital property,” and not akin to business inventory.

If you happen to buy and sell properties on a regular basis after owning them for a short time, or you have expertise in real estate, your sale could be considered an “adventure in the nature of trade,” in which case any profit or losses could be considered business income or losses. In this case, you’d be unable to claim the PRE and you might owe tax on the sale.

TYPE OF PROPERTY

So, if your property is a capital property you've jumped the first hurdle to claiming the PRE. The next hurdle? The property must be of a certain type. It can be a housing unit (including a house, apartment or unit in a duplex, condominium, cottage, chalet, cabin, mobile home, trailer or houseboat), a leasehold interest in a housing unit, or a share of the capital stock of a co-operative housing corporation (if the only purpose of acquiring the share was to obtain the right to occupy a housing unit owned by the corporation). The property can be located inside or outside of Canada. Also, be aware that the property cannot be owned primarily for earning income (you can rent out part of your home if that rental activity is ancillary to the use of the place as your principal residence, but a place that is primarily a rental property won't qualify for the PRE).

Finally, your principal residence can generally include up to just half a hectare (about 1.25 acres) of land directly beneath and surrounding the home. You might be able to include more than this as part of your principal residence if you can show that the excess land was necessary for the use and enjoyment of the housing unit as a residence. I've seen this happen, for example, where you're not able to purchase the home with less land or sever the land because of government zoning or use restrictions.

INHABITING THE PROPERTY

The final hurdle to jump to ensure a property will qualify for the PRE is you've got to live in the place. The property must be "ordinarily inhabited" by you, your current spouse or common-law partner, or a child. There's no definition of "ordinarily inhabited" in our tax law, but the courts have said that 24 hours is not enough and the taxman has said that "a short period of time" (such as your vacation time) should be enough provided the property was not primarily owned to generate income.

So, living in a vacation property for one or two weeks each year should allow you to claim the PRE on the property if you're not primarily holding the place to earn rent.

Back to flipping properties: If you buy a property and live in the place for a month or two then hope to sell it tax-free, you'll generally be out of luck. How so? Although you may "ordinarily inhabit" the place, buying a property with the intention of flipping it for a profit will cause it to be an "adventure in the nature of trade" and the property won't be a capital property – so PRE will not be available. Follow me?

There's more to be said about how the PRE works, so I'll finish the topic next week and will talk about changes from 2016 that affect how you report the sale of a residence.

Tim Cestnick, FCPA, FCA, CPA(IL), CFP, TEP, is an author, and co-founder and CEO of Our Family Office Inc. He can be reached at tim@ourfamilyoffice.ca.