

Principal Residence + Short-Term Rentals + Resale = Capital Gains Tax

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Vancouver empty nesters Steve and Barbara's beloved 3,500 square foot heritage home with spectacular ocean views is now leased four to six months a year while they assess life in a 700 sq. ft. luxury downtown condo.

In Toronto, Jody rents her Cabbagetown house to neighbours tackling extensive renovations as well as professionals working short-term contracts. The two- to six-month rentals cover her mortgage and operating costs, such as insurance, property tax and utilities and she enjoys summers at the cottage.

Like so many homeowners that rent through AirBnB and comparable websites, Steve, Barbara and Jody consider them their principal residences because they live there more than they live in any other location.

Most Canadians know they'll pay capital gains tax to the Canada Revenue Agency when they sell an asset, such as their home, or investment for more than they paid. They also know and appreciate the fact their principal residence is exempt.

However not every homeowner that rents part-time realizes their homes' principal residence status could change because it's being used differently and that 50% of the gain may be taxable as part of their regular income.

"My financially-savvy clients diligently report all rental income and related expenses to CRA and I'm surprised at how many don't realize those rentals could result in a significant capital gains hit when they sell," says Alex Leventis, a Toronto-based accountant. "Before you rent your principal residence talk to your accountant to find out if it will affect your principal residence and capital gains tax situation."

If you paid \$200,000 for your principal residence house in 1993 and sell it for \$1.4 million in 2019, you won't pay a penny in tax. However, if you rented it for six months in 2015 and 2016, 50% of the 2015 and 2016 gain may be taxable as part of your personal income in each calendar year.

"Understandably, my clients want to know what they might pay if they rent occasionally before they sell a principal residence, but I can't accurately predict how much a home will appreciate, whether their personal income will stay the same and most importantly, how CRA will determine the effect on their principal residence status," says Leventis.

Fortunately, accountants can tell homeowners that the CRA says a house, cottage, condominium, an apartment in an apartment building or duplex, a trailer, mobile home, or houseboat, must meet every one of these conditions to qualify as a principal residence:

1. You bought the space to live in it
2. You own the property alone or with another person
3. You, your current or former spouse or common-law partner or children live in it at some point during the year
4. You designate the property as your principal residence

Both Steve and Barbara, and Jody's homes would still be considered their principal residences based on the criteria above. Yet CRA notes the principal residence status may change if all or part of the home is used for rental or business purposes.

"When you're ready to sell your principal residence, the CRA's perspective on its status is the only one that matters and they assess each situation individually – it's incredibly complex and subject to interpretation," says Leventis.

Even if homeowners rent their principal residences, the status will not change **if** they comply with these three points:

1. Your rental or business use of the property is relatively small in relation to its use as your principal residence;
2. You do not make any structural changes to the property to make it more suitable for

rental or business purposes

3. You do not deduct any capital cost allowance on the part used for rental or business purposes

“You can ask the CRA what would be considered ‘relatively small’ or what type of structural change would be an issue, but good luck getting a straight answer – believe me I tried,” said one homeowner. “My accountant tells me there are many many shades of grey.”

Fortunately, homeowners who rent their principal residences because they had to relocate for work can maintain their homes’ status under certain conditions. For example, if the new workplace is at least 40 km farther from your temporary home than your principal residence, the principal residence status shouldn’t be affected.

“It’s never black or white, but homeowners that rent their principal residences need to get as much clarity as possible from their accountants because the long-term financial impact could be significant,” says Leventis.

Let’s just say that Steve, Barbara and Jody are meeting with their respective accounts next month.

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