

# The Principal Residence Exemption

Beginning in 2016 you must report the sale of your Principal Residence



In late 2016, administrative changes were announced affecting the Principal Residence Exemption. This Exemption assists with reducing and/or eliminating capital gains tax when you sell a property that has appreciated in value by choosing to designate it as your Principal Residence for each year the property qualifies.

As of the 2016 tax year, individuals who sell their Principal Residence will have to report the sale on Schedule 3, *Capital Gains* of their T1 tax return. This will be required for all sales that occur on or after January 1, 2016. Previously, the Canada Revenue Agency (CRA) did not require you to report the sale if the property met all the conditions to be a Principal Residence, and it was your Principal Residence for every year you owned it.

The administrative changes will have an immediate effect on all taxpayers who sell a principal residence. While the CRA highlights improved compliance and administration as the motivation behind the new rules, the changes also aim to crack down on individuals who may have inappropriately benefited from the Principal Residence Exemption when buying and occupying properties briefly, and then flipping them.

## Eligibility for the Exemption

One of the conditions of obtaining the Exemption is that the property must be the taxpayer's "capital property" which typically includes any property that, if sold, would result in a capital gain or capital loss. A property may be designated as a Principal Residence for a given year as long as no other property has been designated by the taxpayer or any member of the taxpayer's family unit.

The following formula is used to calculate the exemption:

$$\frac{(1 + \text{number of years the property is designated as your Principal Residence}) \times \text{capital gain}}{\text{Number of years the property was owned}}$$

The formula also allows taxpayers who own and occupy two properties in a given tax year to claim the Principal Residence Exemption.

For example, the O'Brien's bought a condo in 2006, and then sold it in 2012. In the same year, 2012, they bought a house. They later sold the house in 2016. Even though their ownership of the condo and home overlapped, if they designate their properties according to the formula, then they can use the "+1 rule" to allow them to claim the Exemption for both properties on their 2012 and 2016 tax returns, respectively.

**Let's look at the O'Brien's *timeline* for owning the two properties and claiming the exemption on both properties:**

- **2006:** The O'Brien's buy a condo.
- **2012:** They sell their condo in April and buy a house in May.
- **2012:** The O'Brien's designate the condo as their Principal Residence for 2006-2011.
- Due to the "+1 rule", they are able to claim the Principal Residence Exemption for the 7 years they owned the condo (2006-2012) on their 2012 tax return.
- **2016:** The O'Brien's designate the house as their Principal Residence for 2012-2015.
- Due to the "+1 rule", they can get the full capital gain exemption for the 5 years they owned the home (2012-2016) on their 2016 tax return.

It should be noted that under the new rules, the "+1 rule" is no longer available to home-owners who are non-resident throughout the year in which they buy a Canadian property.

Those individuals will not be able to claim the exemption for that +1 year.

### **Impact on residences held by trusts**

There are also proposed new rules which will restrict the use of the Principal Residence exemption by certain trusts after 2016. Examples of trusts that would still be eligible to claim the exemption under the proposed rules include: alter ego trusts, spousal or common-law partner trusts, joint spousal/partner trusts, trusts for minor children of a deceased parent and qualified disability trusts (QDTs). For trusts owning a Principal Residence property before 2017, the new rules do not apply in determining eligibility for tax years before 2017.

### **Failure to report sale**

Under the new rules, if you fail to report the sale and designation of your Principal Residence on your income tax return it's possible to do it by amending your income tax return for that year with a late-filing form. However, you may face a late-filing penalty. The penalty for failing to report the transaction is typically the lesser of:

- \$8,000 or \$100 for each complete month from the original due date to the date your request was made in a form satisfactory to the CRA.

Finally, the new rules also allow the CRA to reassess beyond the normal three-year assessment period when a sale has not been reported.

For more information please see:

[cra-arc.gc.ca/gncy/bdgt/2016/qa11-eng.html](http://cra-arc.gc.ca/gncy/bdgt/2016/qa11-eng.html)

### **Now you're ready to:**

- **Ensure that your Principal Residence has been properly designated and its sale has been reported on your tax return.**
- **Contact your TD Advisor and your tax professional if you have questions.**



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