Is The Principal Residence an Endangered Species?

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The government is desperate for money and is on the search for new sources of revenues to finance its deficits. In anticipation of a fall election, the spring 2021 Federal Budget followed the general trend that governments spend (or say they will) before an election by announcing $101.4 billion of discretionary spending and raising the federal deficit to $154.7 billion for the 2021-22 fiscal year.

Contrary to rumours, Budget 2021 did not include measures to eliminate or cut back on the principal residence exemption (PR). Tax increases do not precede elections but follow them. We can expect them next spring after the Liberals win a majority. The exemption is rich and in the government's sights.

The tax system is generous to Canadian residents who own homes. They are generally not taxable on any capital gains from the sale of their PR. Regardless of the value of the residence, the entire amount of the qualifying gain is exempt from tax. The law treats everyone equally: an individual who sells his PR for a gain of $35 million is treated the same as an individual who makes $30,000. Canadians cherish this tax benefit of home ownership as a source of their retirement income. What is even better, the residence can be outside Canada in a warmer climate.

The government has dipped its toes into the PR exemption. Since 2016, individuals must report all sales of their residences on their tax returns even if exempt so that the CRA can audit them. Also, there is no limitation period on unreported gains. The CRA can reassess at any time if you do not report the sale in your tax return. These steps target real estate "flippers", non-residents and money launderers who do not report their gains and play the audit lottery.

Who can claim the exemption?

A Canadian resident individual may claim the exemption if he, his spouse, common law partner, former spouse, former common law partner, or his child ordinarily inhabits the principal residence in the year and designates it as such for the year.

Hence, there are four essential aspects to the exemption: taxpayer's residence, habitation by the taxpayer or her family of a qualifying property and designation as a PR in prescribed form on the tax return.

What is a "Principal Residence"?

There are several technical requirements to qualify a property as a principal residence. However, first and foremost, the residence must be a "capital property". This is where tax law becomes obtuse. Individuals who sell houses as a business or an adventure in trade are *not* entitled to the PR exemption.

The critical test for determining an adventure or concern in trade is the taxpayer's intention, which must be evaluated objectively. If you walk like a duck and quack like a duck, you will be branded as a duck. This is particularly critical for individuals who "flip" multiple properties.

The intention test is objective and must be adduced from the facts in evidence. The factors to consider are:

- the nature of the property sold.
- the length of the period of ownership.
- the frequency or number of similar transactions.
- work expended on or in connection with the property.
- the circumstances that were responsible for the sale of the property; and
- motive for selling the property.

The taxpayer has the burden of proving his intentions in dealing with the property. Mere assertions are not enough. There must be credible evidence. This is where the individual does not want to quack like a duck.

The law is generous on the type of property that qualifies as a PR. It can be is a housing unit, a leasehold interest in a housing unit, or a share in a co-operative housing corporation.

The expression "housing unit" encompasses virtually any structure that an individual can inhabit. For example, a housing unit may be a mobile home, a trailer, a houseboat or, in some cases, even a tent.

However, the law draws the line: garden sheds that do not have water, heating, cooking facilities or electricity do not qualify.

The government is desperate for money. The Federal deficit is ballooning, and economists are in turmoil. However, in the short run till the fall, all political parties need your vote. After the election, however, the scene will change. The principal residence as we know it may become an endangered species by the spring of 2022.

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