PRINCIPAL RESIDENCE EXEMPTION

- A family unit (spouses or common-law partners) can **elect only 1 home per year** between them as a principle residence for the purposes of principal residence exemption
- To qualify as a principal residence:
  - You, your current or former spouse or common-law partner, or any of your children lived in it at some time during the year
  - You own the property alone or jointly with another person (i.e. your spouse)
    - For example, a summer cottage qualifies as a principal residence
    - The home can be outside of Canada

How to calculate the principal residence exemption/Tax Planning

- When you own more than one residence that would qualify as a principal residence; you should designate the principal residence years first to the house with the highest capital gains per year
- You **must designate at least one year** to be able to get the principal residence exemption
- Consider also your goal:
  - if your goal is to reduce current taxes payable it may be beneficial to designate all your PR exemptions on the property you just sold, even though it's gain per year may not be the highest of all the properties you own; or
  - If your goal is to minimize taxes throughout your life; then designate PR exception years first to the property with the highest capital gains per year

Formula for principal residence exemption:

$$\frac{\mathbf{1 + \#\ \textit{years designated}}}{\textit{total years owned}} * \textit{Capital Gain} = \textit{capital gain reported}$$

Example

- Tom and his wife own two properties: a home and a cottage
- Home was purchased in 2000 and the Cottage Purchases in 2002
- Tom Sold his home in 2012 for $ 600,000; and decided to move into his Cottage

	Home	Cottage
Cost when purchased	$ 500,000	$ 300,000
FMV when home sold	$ 600,000	$ 600,000
Total Capital Gain	$ 100,000	$ 300,000
Years Owned	13 years	11 years
Gain per Year	$ 7,692	$27,273

- In this example because the accrued gains on the cottage is higher; it makes sense to designate as much years as possible to it first (to minimize taxes over your lifetime)
  - Using the formula above

- Designate 10 years to the cottage (1+10)/11 to make gains on cottage = $NIL
    - 2002 to 2011
- Designate 3 years (2000, 2001, and 2012) to the house
    - Principal Residence Exemption = [(1+3)/13]*100000*50% = $15,385

Change in the use of a property and impact on principal residence exemption:

- Anytime you change the use of a property you are considered to have sold the property at its fair market value and to have re-acquired it at the same fair market value
- Examples of change in use
    - You change all or part of your principal residence to a rental or business operation
    - You change your rental or business operation to a principal residence
- There will be capital gains or capital losses

When a tax payer rents out a property

- A taxpayer is eligible to designate the rental property up to 4 years as principal residence while the property is rented out
- However they **cannot claim CCA during this period**, otherwise they will not be eligible for the principal residence
- Therefore, if the Principle residence was rented out , the maximum years you can designate is 4 years on top of the years you actually lived in the house.

$$\frac{\mathbf{1 + \#\,years\ you\ lived\ in\ house\ (when\ not\ rented) + 4}}{\boldsymbol{Total\ years\ owned}} * \boldsymbol{Capital\ Gain}$$

- If taxpayer has to move for job purposes than there is **no 4 year limit**.
    - A taxpayer qualifies for this if he or she or his or her spouse needs to move 40 KM closer the work location; and
    - The property subsequently becomes ordinarily inhabited by the taxpayer during the employment term **or** before the end of the taxation year in which employment terminates; or
    - the taxpayer dies during the term of the employment.