Canadian Real Estate Income Tax Guide

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Recent Cases

DESIGNATING THE PRINCIPAL RESIDENCE

— Ian V. MacInnis, Fogler, Rubinoff LLP (Lawyers)

The principal residence exemption is undoubtedly one of the most substantial tax "breaks" under the *Income Tax Act* (Canada) (the "Act"). Technically, in order for an individual to claim the principal residence exemption, the taxpayer must file a prescribed form to designate the property as a principal residence. Regulation 2301 to the Act specifies Form T2091 must be filed with the taxpayer's income tax return for the year in which the property is disposed of or the year in which the taxpayer grants an option to acquire the property, whichever comes first. If Form T2091 is not filed on a timely basis, the exemption is not available on a strict reading of the Act.

As an administrative policy, the Canada Revenue Agency (the "CRA") does not require the form to be filed unless the principal residence exemption does not completely eliminate the capital gain, or the 1994 election to use the $100,000 capital gains exemption was filed for the property. In addition, the instructions on Form T2091 state that the form is to be attached to the tax return "only if a capital gain has to be reported" (i.e., where the principal residence exemption does not completely eliminate the capital gain on the sale of the property).

It is important to note that this administrative concession is not binding on the CRA. Indeed, the CRA could reverse its position after the time for filing the form has expired. In at least three cases, the Minister of National Revenue raised the argument that the principal residence exemption was not available because timely elections were not filed. In at least three cases, the failure to file the required form was fatal to the taxpayer. This should serve as a warning to all taxpayers who rely on administrative concessions of the CRA. The CRA would have the authority under subsection 220(2.1) of the Act to waive the requirement to file Form T2091. Indeed, it could be argued that paragraph 2.15 of Income Tax Folio S1-F3-C2 constitutes such a waiver, but it would be prudent to file Form T2091 to remove any doubt. This would be particularly important in those situations where there is some sensitivity or doubt whether the principal residence exemption is available in whole or in part to the taxpayer (e.g., the sale of property in excess of one-half hectare or in situations where there might be doubt as to whether a taxpayer "ordinarily inhabited" the property in any given year in which the exemption is being claimed).

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RECENT CASES

Principal residence exemption did not apply as taxpayer did not prove he lived at property later sold to son

Tax Court of Canada, May 14, 2014

The issue was whether the taxpayer received a taxable capital gain of $176,000 from his transfer of real property. The taxpayer had purchased the property in 2004 for $648,000 and transferred it to his son in 2008 for $1,000,000, but did not report a gain in his 2008 tax returns. The taxpayer argued in his pleadings that at the time of transfer the property was his principal residence and that the principal residence exemption applied on the transfer. At the hearing, he also asserted that he had entered into a trust agreement whereby he retained the beneficial interest in the property while legal title alone was transferred to his son.

The taxpayer's appeal was dismissed with costs. There was no evidence that the taxpayer lived in the property from 2004 to 2008. Additionally, the taxpayer did not designate the property as his principal place of residence in his tax returns nor did he file a change of use election.

Eliyin v. The Queen, ¶90-310

Taxpayer entitled to deduct losses from rental of second home

Tax Court of Canada, May 9, 2014

The taxpayer and his spouse were accountants who purchased a home for their principal residence and partly for the taxpayer to use in his new accounting practice. A second home was purchased, which the taxpayer allegedly used as a rental property. The taxpayer rented the property temporarily to a friend for $2,000 a month for about four months while repairs and renovations were being made to the home. At issue was whether the taxpayer had operated a rental business from August 2009 to November 2010 and was entitled to claim rental losses of $13,071 and $24,014.81 in 2009 and 2010, respectively.

The taxpayer's appeal was allowed. Based on the evidence, a rental operation existed in 2009 and 2010, and the deductibility of the claimed costs was not precluded by any of the provisions in section 18 of the *Income Tax Act*.

Morris v. The Queen, ¶90-311

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