I have previously written about how you can avoid paying capital gains tax on the sale of your principal residence, subject to ensuring that you are onside the various rules. However, on October 3, 2016, the Department of Finance introduced significant changes to those rules in order to “improve tax fairness by closing loopholes surrounding the capital gains exemption” as they relate to the sale of your home. But before I get into the nitty gritty of the changes, let’s first review the current rules as they stand:

In order to take advantage of the principal residence exemption (“PRE”), certain requirements must be met:

- The home must be ordinarily occupied for personal use by you, your spouse or former spouse, or a child at some time during the year.
- To claim the PRE on a large lot (over _ hectare - about 1 _ acres), you must be in a position to establish that the land over half a hectare is necessary for the “use and enjoyment” of your home.
- Restrictions will also apply if part or all of your home is rented out or not used by a family member, or if you have not been resident in Canada throughout the period of ownership (other than in the year of purchase).
- As a general rule, a family can claim the PRE on only one home at a time. So the second home is more of a problem: to stop you from trying to claim a separate exemption for another home by putting it in the name of a child, children are restricted from claiming the exemption unless they have reached eighteen in the particular year or are married.
- Where specific conditions are met, non-Canadian properties may also qualify for the PRE.
- It is also possible for a trust to claim the PRE provided that a corporation is not a beneficiary, and the trust designates a beneficiary (or their spouse, common-law partner or child) of the trust who ordinarily inhabits the property (referred to as a “specified beneficiary”).

How it works. Most people think of the PRE as a black and white matter - either you qualify to sell tax-free or you don’t. Actually, this is not the case. When you sell your home, you must calculate the gain on your residence just like any other capital gain. Then PRE itself reduces your gain.

Moreover, eligibility for the exemption is on a year-by-year basis, which might come as a surprise to you. The more years you qualify relative to your total period of ownership, the more your gain gets reduced. To be more precise, the following is the basic formula that normally applies:

Despite only allowing one property to be claimed, the rules allow you to have two residences in the same year: i.e. where one residence is sold and another is...
That is why the formula below adds “1” to the number of years the property was a principal residence (the “plus one rule”).

As you can see from this formula, to get the tax reduction, you must designate the home as principal residence on a year-by-year basis. If your gain is completely covered by the principal residence exemption, under the current rules, the CRA has not required you to file the designation form with your tax return.

Proposed Changes:
Ownership by a Trust:
Under the new proposed rules, additional requirements are being introduced where a trust owns a principal residence (for the years that begin after 2016). Essentially, only the following types of trusts are able to designate a principal residence (where the trust has Canadian-resident beneficiaries and a “specified beneficiary”):

- An alter ego trust, a spousal or common-law partner trust, a joint spousal or common-law partner trust (or a similar trust for the exclusive benefit of the settlor of the trust during his/her lifetime);
- A testamentary trust created under a Will that is a qualifying disability trust; or
- A trust for the benefit of a minor child of deceased parents.

If you have a trust that owns a principal residence and don’t meet the above conditions, you can take advantage of transitional rules that will allow the trust to crystallize the PRE in respect of any accrued capital gain relating to the property up to December 31, 2016. Essentially the trust will be deemed to have disposed of the property on December 31, 2016 (and the trust can shelter the gain under the PRE up until that date) and to have reacquired the property at a cost equal to the fair market value on January 1, 2017. However, you may want to reconsider keeping the property in the trust for years after 2017 since it will no longer be sheltered (whereas it can be sheltered if owned directly by a beneficiary).

Changes to the Plus One Rule:
Effective October 3, 2016, the plus one rule will not apply where an individual is not resident in Canada during that year. Under the current rules, you could benefit from the PRE for the year that you purchased a residence in Canada, even though you were not a Canadian resident in the year of acquisition. This is no longer the case.

Extension of the Reassessment Period & Requirement to Report a Sale:
If your entire gain is covered by the PRE, I had noted above that you are not required to file the designation form with your tax return to report the disposition of your principal residence.

Summary
The two main takeaways from these proposed changes are:

1. There is no longer any flexibility through the use of a family trust for owning a principal residence (usually popular with the purchase of a cottage property); and
2. Don’t assume that a sale of your home will no longer trigger any tax compliance on your part. 

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\text{Number of years of ownership. Calculated after 1971} \times \text{Capital gain otherwise calculated}
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