Income Tax Folio S1-F3-C2, Principal Residence

Series 1: Individuals

Folio 3: Family Unit Issues

Chapter 2: Principal Residence

Summary

This Chapter discusses the principal residence exemption, which can eliminate or reduce (for income tax purposes) a capital gain on the disposition of a taxpayer's principal residence.

In order for a property to qualify for designation as the taxpayer's principal residence, he or she must own the property. Joint ownership with another person qualifies for this purpose.

The housing unit representing the taxpayer's principal residence generally must be inhabited by the taxpayer or by his or her spouse or common-law partner, former spouse or common-law partner, or child. A taxpayer can designate only one property as his or her principal residence for a particular tax year. Furthermore, for a tax year that is after the 1981 year, only one property per family unit can be designated as a principal residence.

Important notice

On March 19, 2019, the government issued Budget 2019 which contained a proposed amendment to the Income Tax Act that would allow a taxpayer to elect that a deemed disposition that normally arises on a partial change in use of a property not apply. The proposed amendment would apply to changes in use that occur after March 18, 2019. The Chapter will be updated to reflect this change. More information is available on the Budget 2019 webpage.

The Canada Revenue Agency (CRA) issues income tax folios to provide a summary of technical interpretations and positions regarding certain provisions contained in income tax law. Due to their technical nature, folios are used primarily by tax specialists and other individuals who have an interest in tax matters. While each paragraph in a chapter of a folio may relate to provisions of the law in force at the time it was written (see the Application section), the information provided is not a substitute for the law. The reader should, therefore, consider the chapter's information in light of the relevant provisions of the law in force for the particular tax year being considered.

The CRA may have published additional guidance and detailed filing instructions on matters discussed in this Chapter. See the CRA forms and publications webpage for this information and other topics that may be of interest.

Table of contents

- Discussion and interpretation
  - Introduction
  - When the sale of a property results in business income
  - Types of property that can qualify as a principal residence
  - Ownership is required
  - The ordinarily inhabited rule
  - Designation of a property as a principal residence
  - Calculating the gain on the disposition of a principal residence – the principal residence exemption
  - Ownership of a property by both spouses or common-law partners
  - More than one residence in a tax year
  - Construction of a housing unit on vacant land
  - Property owned on December 31, 1981
  - Loss on the disposition of a residence
  - Land contributing to the use and enjoyment of the housing unit as a residence
  - Land in excess of one-half hectare
  - Disposition of part of a principal residence
  - Disposition of a property where only part of it qualifies as a principal residence
  - Principal residence on land used in a farming business
  - Complete change in use of a property from principal residence to income-producing
  - Complete change in use of a property from income-producing to principal residence
  - Partial changes in use
  - Change in use rules regarding CCA, deemed capital cost, and recapture
  - Personal trusts
  - Transfer of a principal residence
  - Partnership property
  - A principal residence outside Canada

- Non-resident owner of a principal residence in Canada
- Section 116 certificate for a disposition of a principal residence in Canada by a non-resident owner
- Ownership
- Ownership issues in the province of Quebec
- Sole or joint ownership
- Ownership in dispute
- Share in the capital stock of a co-operative housing corporation
- Interest or right in a property under an enforceable agreement for sale
- Ownership issues with condominium units
- Property on leased land
- Acquisition of a property by way of gift or inheritance
- Appendix A
- Appendix B
- Application
- Reference
- History

Discussion and interpretation

Introduction

2.1 Various topics concerning the principal residence exemption are discussed in this Chapter. It should be noted that some of these topics are not relevant for all taxpayers. For example, a resident of Canada who owns only one housing unit which is situated in Canada on land of one-half hectare or less and which has been used since its acquisition strictly as his or her residence, will usually find that ¶2.32 to 2.78 have no particular relevance.

2.2 If a property qualifies as a taxpayer's principal residence, he or she can use the principal residence exemption to reduce or eliminate any capital gain otherwise occurring, for income tax purposes, on the disposition (or deemed disposition) of the property. The term **principal residence** is defined in section 54. The principal residence exemption is claimed under paragraph 40(2)(b), or under paragraph 40(2)(c) where land used in a farming business carried on by the taxpayer includes his or her principal residence.

2.3 Unless otherwise stated, any reference in this chapter to a tax year or year means a particular tax year for which the principal residence exemption is being claimed.

2.4 Various references are made throughout this chapter to a taxpayer's spouse or common-law partner and child. For the 1993 to 2000 tax years, former subsection 252(4) extended the meaning of the term spouse to include a common-law spouse of the opposite sex. Effective in 2001, the extended meaning of spouse in subsection 252(4) has been replaced with the term common-law partner in subsection 248(1) which can now also include a person of the same sex. A transitional rule for the 1998, 1999 and 2000 tax years allowed same-sex couples to elect to be treated as common-law partners under the Act for those years. For more information about the meaning of the terms spouse and common-law partner, see the current version of the Guide 5000-G, General Income Tax and Benefit Guide. For purposes of applying the rules in subsections 70(6) and 73(1) as discussed in ¶2.69, see also the extended meaning of spouse and former spouse in subsection 252(3), as it reads for the particular tax year being considered. Subsection 252(1), as it reads for the particular tax year being considered, extends the meaning of child for purposes of applying all the rules in the Act, including the principal residence exemption rules, for that year.

2.5 It is also possible for a personal trust to claim the principal residence exemption on the disposition of a property. This is discussed in ¶2.65 to 2.66.4 and ¶2.69.

When the sale of a property results in business income

2.6 Where the gain from the sale of a taxpayer's personal residence results in business income (as opposed to a capital gain), the gain cannot be exempt from income tax as a result of the principal residence exemption under paragraph 40(2)(b). An individual does not have to be involved in the housing construction industry to have business income from the sale of houses, and the sale of one house can result in business income. For more information about taxpayers buying and selling their own houses for the purpose of earning income, see Interpretation Bulletin IT-218R, Profits, Capital Gains and Losses from the Sale of Real Estate, Including Farmland and Inherited Land and Conversion of Real Estate from Capital Property to Inventory and Vice Versa, and Interpretation Bulletin IT-459, Adventure or Concern in the Nature of Trade.

Types of property that can qualify as a principal residence

2.7 As indicated in the definition in section 54, the following types of property can qualify as a principal residence:

- a housing unit, which the CRA has accepted could include:
  - a house;
  - an apartment or unit in a duplex, apartment building or condominium;
  - a cottage;

    - a mobile home;
    - a trailer; or
    - a houseboat.
- a leasehold interest in a housing unit; or
- a share of the capital stock of a co-operative housing corporation, if such share is acquired for the sole purpose of obtaining the right to inhabit a housing unit owned by that corporation. The term co-operative housing corporation means an association, incorporated subject to the terms and conditions of the legislation governing such incorporation, and formed and operated for the purpose of providing its members with the right to inhabit, by reason of ownership of shares therein, a housing unit owned by the corporation.

2.8 Land on which a housing unit is situated can qualify as part of a principal residence, subject to certain restrictions (see ¶2.32 to 2.46).

Ownership is required

2.9 For a property to be a taxpayer's principal residence for a particular year, he or she must own the property in the year. This requirement is met where the taxpayer is the owner (including a beneficial owner) of the property. The taxpayer's ownership of the property qualifies for purposes of the section 54 definition of principal residence whether such ownership is **jointly with another person or otherwise**. These latter words include sole ownership or a form of co-ownership. The meaning of **ownership of property** is discussed in more detail in ¶2.79 to 2.80. The meaning of beneficial ownership of property as applied in the Province of Quebec is discussed in more detail in ¶2.83 to 2.85.

The ordinarily inhabited rule

2.10 Another requirement is that the housing unit must be ordinarily inhabited in the year by the taxpayer or by his or her spouse or common-law partner, former spouse or common-law partner, or child.

2.11 The question of whether a housing unit is ordinarily inhabited in the year by a person (that is, the taxpayer, the taxpayer's spouse, common-law partner, former spouse, former common-law partner or child) must be resolved on the basis of the facts in each particular case. Even if a person inhabits a housing unit only for a short period of time in the year, this is sufficient for the housing unit to be considered ordinarily inhabited in the year by that person. For example, even if a person disposes of his or her residence early in the year or acquires it late in the year, the housing unit can be considered to be ordinarily inhabited in the year by that person by virtue of his or her living in it in the year before such sale or after such acquisition, as the case may be. If the main reason for owning a housing unit is to gain or produce income then that housing unit will not generally be considered to be ordinarily inhabited in the year by the taxpayer where it is only inhabited for a short period of time in the year. With regard to whether the main reason for owning a housing unit is to earn income, a person receiving only incidental rental income from a housing unit is not considered to own the property mainly for the purpose of gaining or producing income. However, if the main reason for owning a housing unit is to earn income but the housing unit is rented to the taxpayer's child who also ordinarily inhabits the housing unit in that year, the taxpayer could still designate that housing unit as the taxpayer's principal residence provided the other conditions are met.

2.12 If the housing unit is not ordinarily inhabited in the year by any of the above-mentioned persons, it is still possible for the property to be considered to be the taxpayer's principal residence for the year, by means of an election under subsection 45(2) or (3). For a discussion of these provisions, see ¶2.48 to 2.56.

Designation of a property as a principal residence

2.13 For a property to be a taxpayer's principal residence for a particular year, he or she must designate it as such for the year and no other property may have been so designated by the taxpayer for the year. Furthermore, no other property may have been designated as the principal residence of any member of the taxpayer's family unit for the year. For purposes of the latter rule, which applies if the taxpayer is designating a property as his or her principal residence for 1982 or a subsequent year, the taxpayer's family unit for the year includes, in addition to the taxpayer, the following persons (if any):

- the taxpayer's spouse or common-law partner throughout the year, unless the spouse or common-law partner was throughout the year living apart from, and was separated under a judicial separation or written separation agreement from, the taxpayer;
- the taxpayer's children, except those who were married, in a common-law partnership or 18 years of age or older during the year; and
- where the taxpayer was not married, in a common-law partnership or 18 years of age or older during the year:
  - the taxpayer's mother and father; and
  - the taxpayer's brothers and sisters who were not married, in a common-law partnership or 18 years of age or older during the year.

2.14 As discussed in ¶2.4, for the 1993 to 2000 tax years, a spouse included a common-law spouse of the opposite sex. Accordingly, these individuals will be considered a family unit for the purposes of the principal residence exemption for the 1993 and subsequent tax years (see

Example 2 in Appendix A). In the case of same-sex common-law partners, they will be considered a family unit for the 2001 and subsequent tax years. However, if a same-sex couple filed a joint election to be treated as common-law partners for the 1998, 1999 and/or 2000 tax years, then they will be considered a family unit for those years.

2.15 According to section 2301 of the Regulations, a taxpayer's designation of a property as a principal residence for one or more tax years is to be made in his or her income tax return for the tax year in which he or she has disposed of the property or granted an option to another person to acquire the property. Beginning with the 2016 tax year, taxpayers who sell or dispose of their principal residence are required to report certain basic information on their income tax return. The designation for individuals (other than trusts) is made by completing the relevant section on Schedule 3 of the T1 income tax and benefit return and, for 2017 and beyond, by completing Form T2091(IND), Designation of a Property as a Principal Residence by an Individual (Other than a Personal Trust). Form T2091(IND) requires certain prescribed information such as the address of the property, the date it was acquired and the amount of the proceeds of disposition.

2.15.1 Under certain circumstances the Minister of National Revenue may accept a late-filed principal residence designation. Subsection 220(3.2) generally allows the Minister to extend the time for making an election under a prescribed provision. For the purpose of subsection 220(3.2), paragraph 220(3.21)(a.1) deems a designation under the definition of a principal residence in section 54 to be an election under a prescribed provision. Paragraph 220(3.21)(a.1) is applicable for tax years that end after October 2, 2016. For more information on late filed elections, refer to the webpage Late, amended, or revoked elections.

2.15.2 For sales or dispositions that occurred prior to 2016, the CRA did not require reporting on the taxpayer's income tax return where a full principal residence exemption otherwise applied to that disposition. However Form T2091(IND) was required to be filed with the taxpayer's income tax return if:

a) a taxable capital gain on the disposition of the property remains after using the principal residence exemption formula (as shown in ¶2.17 to 2.26); or

b) form T664 or T664(Seniors), Election to Report a Capital Gain on Property Owned at the End of February 22, 1994 was filed with respect to the property by the taxpayer, or his or her spouse or common-law partner; and the property was the taxpayer's principal residence for 1994, or it was designated in the year as the principal residence for any tax year.

2.16 Note that for dispositions prior to the 2016 tax year, a taxpayer who is using the principal residence exemption formula to eliminate a gain on the disposition, and who is not required to complete and file Form T2091(IND) because of the practice mentioned in ¶2.15, is still considered to have designated the property as his or her principal residence. That is, the taxpayer is considered to have claimed the principal residence exemption for that property for the years in question as far as the limitations discussed in ¶2.13 and 2.14 are concerned.

Calculating the gain on the disposition of a principal residence – the principal residence exemption

2.17 Under the principal residence exemption provision contained in paragraph 40(2)(b), a taxpayer's gain from the disposition (or deemed disposition) of any property that was his or her principal residence at any time after his or her **acquisition date** (see definition below) with respect to the property, is equal to his or her **gain otherwise determined** (see explanation below) less two amounts, which are described in ¶2.20 to 2.26.

2.18 The taxpayer's **acquisition date** with respect to the property is the later of the following two dates:

- December 31, 1971; and
- the date on which the taxpayer last acquired or reacquired the property, or is deemed to have last acquired or reacquired it.

Note that, by virtue of subsection 40(7.1), if a subsection 110.6(19) capital gains election was made in respect of the property, the deemed reacquisition of the property under that election is not considered to be a reacquisition for purposes of determining the acquisition date used in paragraph 40(2)(b).

2.19 The taxpayer's **gain otherwise determined** means the amount that the gain (if any) from the taxpayer's disposition (or deemed disposition) of the property would be – before the two reductions described in ¶2.20 to 2.26 – if the capital gains election provision in subsection 110.6(19) and the related provision in subsection 110.6(21) were not taken into account. Thus, if a subsection 110.6(19) capital gains election has been made in respect of the property, the taxpayer's gain otherwise determined is calculated without reference to the deemed disposition and reacquisition of the property under that election. That is, the gain otherwise determined is calculated without taking into account the increase to the adjusted cost base of the property under subsection 110.6(19) or the decrease to that adjusted cost base under subsection 110.6(21).

2.20 The first amount by which the taxpayer's gain otherwise determined is reduced under paragraph 40(2)(b) is calculated by using the following formula:

A × (B ÷ C)

The variables in the above formula are as follows:

A is the taxpayer's gain otherwise determined, as described above.

B is:

- if the taxpayer was resident in Canada during the year that includes the acquisition date, 1 + the number of tax years ending after the acquisition date for which the property was the taxpayer's principal residence **and** during which he or she was resident in Canada; or
- if the taxpayer was not resident in Canada during the year that includes the acquisition date, the number of tax years ending after the acquisition date for which the property was the taxpayer's principal residence **and** during which he or she was resident in Canada.

C is the number of tax years ending after the acquisition date during which the taxpayer owned the property (whether jointly with another person or otherwise – see ¶2.9).

For dispositions of property before October 3, 2016, "1+ the number of tax years" in variable B was available regardless of whether the taxpayer was resident in Canada during the year that included the acquisition date.

2.21 For a discussion of the meaning of **resident in Canada**, refer to Income Tax Folio S5-F1-C1, Determining an Individual's Residence Status. The word **during** in reference to a tax year means **at any time in** rather than **throughout the whole of** the tax year.

2.22 The second amount by which the taxpayer's gain otherwise determined is reduced is shown in paragraph 40(2)(b) as variable D and it is referred to in this Chapter as the **capital gains election reduction amount**. It occurs only if:

- the taxpayer's acquisition date with respect to the property (as described above) is before February 23, 1994; and
- the taxpayer, or his or her spouse, or common-law partner made a subsection 110.6(19) capital gains election for the property or for an interest in the property, or for civil law, a right therein – if such an election was made, Form T664 or T664(Seniors), would have been filed.

2.23 The inclusion of the 110.6(19) election amount of a spouse or common-law partner of the taxpayer, when calculating the capital gains election reduction amount for the taxpayer, ensures that any elected gain reported by the spouse or common-law partner in 1994 with respect to a property that was subsequently transferred to the taxpayer through a spousal or common-law partner rollover provision after February 1994, is properly reflected in the ultimate disposition of the property by the taxpayer. In other words, in situations where a spouse or common-law partner has transferred property to the taxpayer subsequent to 1994 and pursuant to the roll-over provisions of subsection 73(1) or 70(6), the calculation of the capital gains reduction amount of the taxpayer at the time the property is sold, must include any 1994 elected gain reported by the spouse or common-law partner with respect to the transferred property. Qualifying transfers of property under these subsections are discussed in ¶2.69.

2.24 The capital gains election reduction amount essentially represents the total amount of the gains that resulted from the taxpayer's and his or her spouse or common-law partner's capital gains elections for the property, after taking into account any reduction in calculating those gains by virtue of the property having been designated as the principal residence of the taxpayer or his or her spouse or common-law partner for any tax year up to and including the tax year that included February 22, 1994. The capital gains election reduction amount cannot, however, be more than such gains – after taking into account any reduction thereto by virtue of the property having been the principal residence of the taxpayer or his or her spouse or common law partner for any tax year up to and including the tax year that included February 22, 1994 – that would have resulted from such capital gains elections if the fair market value of the property as at the end of February 22, 1994 had been used as the designated proceeds for the property.

2.25 The taxpayer calculates the capital gains election reduction amount on Form T2091(IND)-WS, Principal Residence Worksheet, which the taxpayer files with the T2091(IND) designation form (see ¶2.15 to 2.16).

2.26 The remaining discussions in this Chapter regarding paragraph 40(2)(b) are concerned with the first reduction to the gain otherwise determined, that is, the reduction provided for by means of the above-mentioned formula, A × (B ÷ C). Unless stated to the contrary, it is assumed for purposes of those discussions that the taxpayer did not make a capital gains election and thus that there is no second reduction to the gain otherwise determined, that is, no capital gains election reduction amount.

Ownership of a property by both spouses or common-law partners

2.27 Where there is a gain on the disposition of a property owned both by a taxpayer and his or her spouse or common-law partner in one of the forms of ownership described in ¶2.9, both spouses or common-law partners will generally have a gain on the disposition. It should be kept in mind that if one of the spouses or common-law partners designates the property as his or her principal residence for any tax year after the 1981 year, the other spouse or common-law partner will be able to designate only that same property as his or her principal residence for that year if the rule described in ¶2.13 to 2.14 prevents him or her from so designating any other property for that year.

More than one residence in a tax year

2.28 While only one property may be designated as a taxpayer's principal residence for a particular tax year, the principal residence exemption rules recognize that the taxpayer can have two residences in the same year, that is, where one residence is sold and another acquired in the same year. The effect of the **one plus** in variable B in the formula in ¶2.20 is to treat both properties as a principal residence in such a year, even though only one of them may be designated as such for that year.

Construction of a housing unit on vacant land

2.29 If a taxpayer acquires land in one tax year and constructs a housing unit on it in a subsequent year, the property may not be designated as the taxpayer's principal residence for the years that are prior to the year in which the taxpayer, his or her spouse or common-law partner, former spouse or common-law partner, or child commences to ordinarily inhabit the housing unit. Such prior years (when the taxpayer owned only the vacant land or the land with a housing unit under construction) would not be included in variable B in the formula in ¶2.20 (or in the years included in the statement in ¶2.43(b)). However, all years, commencing with the year in which the taxpayer acquired the vacant land, would be included in variable C. Therefore, it is possible that when the property is later disposed of, only part of the gain otherwise determined will be eliminated by the principal residence exemption.

Example 1

In 2002, Mr. A acquired vacant land for $50,000. In 2005, he constructed a housing unit on the land, costing $200,000, and started to ordinarily inhabit the housing unit. In 2011, he disposed of the property for $300,000. Mr. A's gain otherwise determined on the disposition of the property is equal to his $300,000 proceeds minus his $250,000 adjusted cost base = $50,000 (assume there were no costs of disposition). Mr. A can designate the property as his principal residence for the years 2005 to 2011 inclusive, but not for the years 2002 to 2004 inclusive because no one lived in a housing unit on the property during those years. The principal residence exemption formula cannot, therefore, eliminate his entire $50,000 gain otherwise determined, but rather can eliminate only $40,000 of that gain, as shown in the following:

Applying the formula **A × (B ÷ C)**:

A is $50,000

B is 1 + 7 (being tax years 2005 to 2011)

C is 10 (being tax years 2002 to 2011)

= $50,000 × (8 ÷ 10)

= $40,000

Property owned on December 31, 1981

2.30 A property may not be designated as a taxpayer's principal residence for any tax year after the 1981 year if another property has been designated for that year as the principal residence of another member of his or her family unit (for further particulars on this rule, see ¶2.13 to 2.14). If the taxpayer disposes of a property he or she has owned (whether jointly with another person or otherwise) continuously since before 1982 and the property cannot be designated as the taxpayer's principal residence for one or more years after the 1981 year because of the above-mentioned rule, a transitional provision in subsection 40(6) puts a cap on the amount of the taxpayer's gain (if any) on the disposition. Appendix A at the end of this Chapter provides examples which illustrate how the rule in subsection 40(6) works.

Loss on the disposition of a residence

2.31 A property which is used primarily as a residence (that is, for the personal use and enjoyment of those living in it) – or an option to acquire a property which would, if acquired, be so used – is **personal-use property**. Therefore, a loss on the disposition of such a property or option is deemed to be nil by virtue of subparagraph 40(2)(g)(iii).

Land contributing to the use and enjoyment of the housing unit as a residence

2.32 By virtue of paragraph (e) of the section 54 definition of **principal residence**, a taxpayer's principal residence for a tax year shall be deemed to include, except where the property consists of a share of the capital stock of a co-operative housing corporation, the land upon which the housing unit stands and any portion of the adjoining land that can reasonably be regarded as contributing to the use and enjoyment of the housing unit as a residence. Evidence is not usually required to establish that one-half hectare of land or less, including the area on which the housing unit stands, contributes to the use and enjoyment of the housing unit as a residence. However, where a portion of that land is used to earn income from business or property, such portion will not usually be considered to contribute to such use and enjoyment. Where the taxpayer claims a portion of the expenses related to the land (such as property taxes or mortgage interest) in computing income, the allocation of such expenses for this purpose is normally an indication of the extent to which he or she considers the land to be used to earn income.

Land in excess of one-half hectare

2.33 Where the total area of the land upon which a housing unit is situated exceeds one-half hectare, the excess land is deemed by paragraph (e) of the section 54 definition of principal residence not to have contributed to the use and enjoyment of the housing unit as a residence and thus will not qualify as part of a principal residence, except to the extent that the taxpayer establishes that it was necessary for such use and enjoyment. The excess land must clearly be necessary for the housing unit to properly fulfill its function as a residence and not simply be desirable. Generally, the use of land in excess of one-half hectare in connection with a particular recreation or lifestyle (such as for keeping pets or for country living) does not mean that the excess land is necessary for the use and enjoyment of the housing unit as a residence.

2.34 Land in excess of one-half hectare may be considered necessary where the size or character of a housing unit together with its location on the lot make such excess land essential to its use and enjoyment as a residence, or where the location of a housing unit requires such excess land in order to provide its occupants with access to and from public roads. Other factors may be relevant in determining whether land in excess of one-half hectare is necessary for the use and enjoyment of the housing unit as a residence, such as, for example, a minimum lot size or a severance or subdivision restriction (see ¶2.35). In all cases, however, it is a question of fact as to how much, if any, of the excess land is necessary for the use and enjoyment of the housing unit as a residence.

2.35 A municipal or provincial law or regulation may require, for example, a minimum lot size for a residential lot in a particular area that would be in excess of one-half hectare, or impose a severance or subdivision restriction with respect to a residential lot in a particular area restricting the lot from being one-half hectare or below. If such a law or regulation existed in any given year during which the taxpayer owned the property, the portion that is in excess of one-half hectare would normally be part of the principal residence for that particular year.

Example 2

Mrs. B disposes of her principal residence which she owned for ten years for a total capital gain of $100,000. The portion of the gain attributable to the house and one-half hectare of land is $60,000, and the portion attributable to the excess land is $40,000. Assuming that Mrs. B’s house and one-half hectare of land qualify as her principal residence for all the years during which she owned the property, and assuming that the excess land could not be subdivided from the remainder of the property because of a municipal regulation for five of the ten years ownership period (the third year to the seventh year of ownership), the formula would be applied as follows.

First, the application of the formula in paragraph 40(2)(b) results in the gain allocable to the house and the one-half hectare of land being entirely exempt. That is because variable B is 11 (that is, 1 plus the total number of years for which the house and the one-half hectare of land was Mrs. B's principal residence, which is ten years). The formula would give the following result:

$60,000 – ($60,000 × 11 ÷ 10) = - $6,000 (this negative amount is deemed to be zero under section 257).

The gain on the excess land would however not be fully exempted under paragraph 40(2)(b) as variable B would be 6 (1 plus 5), with the formula providing the following result:

$40,000 – ($40,000 × 6 ÷ 10) = $16,000

Disposition of part of a principal residence

2.36 Where only a portion of a property qualifying as a taxpayer's principal residence is disposed of (for example, the granting of an easement or the expropriation of land), the property may be designated as the taxpayer's principal residence in order to use the principal residence exemption for the portion of the property disposed of. It is important to note that such a designation is made on the entire property (including the housing unit) that qualifies as the principal residence, and not just on the portion of the property disposed of. Accordingly, when the remainder of the property is subsequently disposed of, it too will be recognized as the taxpayer's principal residence for the tax years for which the above-mentioned designation was made. No other property may be designated as a principal residence for any of those years by the taxpayer (or, for any of those years that are after the 1981 tax year, by the taxpayer or any of the other members of his or her family unit) as discussed in ¶2.13 to 2.14.

Disposition of a property where only part of it qualifies as a principal residence

2.37 In some cases, only a portion of a property that is disposed of for a gain will qualify as a principal residence (see ¶2.32 to 2.35). If such qualifying portion of the property is designated as the taxpayer's principal residence, it will be necessary to calculate the gain on such portion separately from the gain on the remaining portion of the property which does not qualify as the taxpayer's principal residence. This is because the gain otherwise determined on the portion of the property designated as the principal residence may be reduced or eliminated by the principal residence exemption, whereas the gain on the remaining portion of the property results in a taxable capital gain. The allocation of the proceeds of disposition and adjusted cost base of the total property between the two portions does not necessarily have to be on the basis of area – consideration should be given to any factors which could have an effect on the relative value of either of the two portions.

2.38 The comments in this section do not apply if the property includes land used in a farming business (see instead ¶2.39 to 2.46).

Example 3

Mr. A's house is on a property with a total land area of three-quarters of a hectare. He sells the property at fair market value and realizes an actual gain on the disposition. The house and one-half hectare of land qualify as his principal residence for all the years he has owned it. The extra one-quarter hectare does not qualify as part of his principal residence for these reasons:

- There has never been any law or regulation requiring the extra one-quarter hectare to be part of the property as a residence (see ¶2.35) – it has always been severable from the one-half hectare on which the house is situated.
- There has never been, as elaborated on below, any other valid reason for considering the extra one-quarter hectare to be necessary for the use and enjoyment of the house as a residence (see ¶2.33 to 2.34).

If the extra one-quarter hectare were severed, it would still be accessible from the road by which the principal residence's one-half hectare is accessed. However, it would be difficult to sell the extra one-quarter hectare on its own because it forms part of a shallow gully through which a small brook flows. In fact, the only feasible use for the extra one-quarter hectare is to enhance the enjoyment of Mr. A's residence or, if severed, the residence of his next door neighbour, that is, by providing the owner with the enjoyment of such additional land with its natural beauty. Nevertheless, the extra one-quarter hectare is not necessary for the use and enjoyment of Mr. A's house as a residence. Note that in these circumstances, the portion of Mr. A's gain that is considered to pertain to the extra one-quarter hectare may not simply be one-third of the gain pertaining to the entire three-quarters of a hectare of land he sold, but would probably be a lower amount (a determination of the actual amount in such a case could require a real estate appraisal).

Principal residence on land used in a farming business

2.39 If a taxpayer disposes of land used in a farming business which he or she carried on at any time and such land includes property that was at any time his or her principal residence, paragraph 40(2)(c) provides that any gain on the disposition of the land may be calculated using either of the two methods discussed below. It should be noted that the reference to land in paragraph 40(2)(c) includes the buildings thereon.

2.40 First Method: The taxpayer may regard the property as being divided into two portions: the principal residence portion and the remaining portion, part or all of which was used in the farming business. The proceeds of disposition and adjusted cost base of the total property must be allocated on a reasonable basis between the two portions in order to determine the gain for each portion. The gain otherwise determined for the principal residence portion may be reduced or eliminated by the principal residence exemption provided for in paragraph 40(2)(b), as described in ¶2.17 to 2.26 (including, if applicable, the capital gains election reduction amount, that is, variable D in paragraph 40(2)(b)). The gain on the remainder of the property results in a taxable capital gain (see, however, ¶2.47). For purposes of determining what portion of the proceeds of disposition of the land may reasonably be allocated to the principal residence, it is our usual practice to accept the greater of the following two amounts:

a) the fair market value, as of the date of disposition of the land, of one-half hectare of land estimated on the basis of comparable sales of similar farm properties in the same area (the fair market value of more than one-half hectare could be used to the extent that such excess land was necessary for the use and enjoyment of the housing unit as a residence – see ¶2.33 to 2.35); and
b) the fair market value, as of the date of disposition of the land, of a typical residential lot in the same area.

2.41 Whichever basis is chosen, ¶2.40(a) or (b), for allocating a portion of the proceeds of disposition of the land to the principal residence, the same basis should be used to allocate a portion of the adjusted cost base of the land to the principal residence. For purposes of making this allocation of the land's adjusted cost base, the fair market value of the land referred to in (a) or (b), as the case may be, would be as of the taxpayer's acquisition date for the land rather than as of the date of its disposition.

2.42 Appendix B at the end of this Chapter provides an example which illustrates the use of the first method allowed under paragraph 40(2)(c).

2.43 Second Method: The taxpayer may elect under subparagraph 40(2)(c)(ii) to compute the gain on the disposition of the total property (including the property that was the principal residence) without making the allocations described above or using the principal residence exemption provided for in paragraph 40(2)(b) as described in ¶2.17 to 2.26. With regard to this election under subparagraph 40(2)(c)(ii), section 2300 of the Regulations requires that a letter signed by the taxpayer be attached to the income tax return filed for the tax year in which the disposition of the property took place. The letter should contain the following information:

a) a statement that the taxpayer is electing under subparagraph 40(2)(c)(ii);
b) a statement of the number of tax years ending after the acquisition date for which the property was the taxpayer's principal residence and during which he or she was resident in Canada (for the meanings of **resident in Canada** and **during**, see ¶2.21); and
c) a description of the property sufficient to identify it with the property designated as the taxpayer's principal residence.

2.44 Under the subparagraph 40(2)(c)(ii) election, the gain on the disposition of the total property is equal to the gain otherwise determined less the total of $1,000 plus $1,000 for each tax year in ¶2.43(b) above. Two points should be noted for purposes of calculating the gain under subparagraph 40(2)(c)(ii):

- The **acquisition date** mentioned in ¶2.43(b) is the later of:
  - December 31, 1971; and
  - the date on which the taxpayer last acquired or reacquired the property or is deemed to have last acquired or reacquired it. If the taxpayer made a subsection 110.6(19) capital gains election in respect of the property, the deemed reacquisition of the property immediately after the end of February 22, 1994 under that election is considered to be a reacquisition for purposes of determining the acquisition date when calculating the gain otherwise determined. The reason for this is that, although subsection 40(7.1) prevents a subsection 110.6(19) deemed reacquisition from being considered a reacquisition for purposes of determining the acquisition date used in paragraph 40(2)(b), neither subsection 40(7.1) nor any other provision prevents a subsection 110.6(19) deemed reacquisition from being considered a reacquisition for purposes of determining the acquisition date used in subparagraph 40(2)(c)(ii).
- If the acquisition date is in fact the date of the deemed reacquisition under a subsection 110.6(19) capital gains election, that is, immediately after the end of February 22, 1994, the gain otherwise determined is calculated by taking into account the taxpayer's

cost of the property under that deemed reacquisition rather than his or her actual cost at some earlier date. (Variable A in paragraph 40(2)(b) does not apply for the purposes of subparagraph 40(2)(c)(ii)).

2.45 Appendix B at the end of this Chapter provides an example which illustrates the use of the second method allowed under paragraph 40(2)(c).

2.46 When the second method is used, the exemption of $1,000 per year, which is to allow for the fact that a portion of the total property pertains to the principal residence rather than the farm, is not reduced where part of the residence itself is used to earn income (for example, there could be an office in the house which is used in connection with a business). However, any gain or recapture of capital cost allowance (CCA) pertaining to the portion of the residence (that is, building) so used to earn income (either or both of which can occur, for example, where the use of such portion of the residence is changed back from income-producing to non-income-producing – see ¶2.57 and ¶2.64) cannot be reduced by the $1,000 per year exemption.

2.47 Where an individual has a taxable capital gain from the disposition of a farm property, a section 110.6 capital gains deduction (which is a deduction in calculating taxable income) may be possible on the basis that the property is **qualified farm or fishing property**. For further particulars on this topic, see either Guide T4002, Self-employed Business, Professional, Commission, Farming, and Fishing Income or Guide RC4060, Farming Income and the AgriStability and AgriInvest Programs Guide.

Complete change in use of a property from principal residence to income-producing

2.48 If a taxpayer has completely converted his or her principal residence to an income-producing use, he or she is deemed by paragraph 45(1)(a) to have disposed of the property (both land and building) at fair market value and reacquired it immediately thereafter at the same amount. Any gain otherwise determined on this deemed disposition may be eliminated or reduced by the principal residence exemption. The taxpayer may instead, however, defer recognition of any gain to a later year by electing under subsection 45(2) to be deemed not to have made the change in use of the property. This election is made by means of a letter to that effect signed by the taxpayer and filed with the income tax return for the year in which the change in use occurred. For e-filers, see the Paper documentation page on the CRA website. If the taxpayer rescinds the election in a subsequent tax year, he or she is deemed to have disposed of and reacquired the property at fair market value on the first day of that subsequent year (with the above-mentioned tax consequences). If CCA is claimed on the property, the election is considered to be rescinded on the first day of the year in which that claim is made.

2.49 Subsection 220(3.2), in conjunction with section 600 of the Regulations, provides the authority for the CRA to accept a late-filed subsection 45(2) election. Such a late-filed election may be accepted under certain circumstances, one of which is that no CCA has been claimed on the property since the change in use has occurred and during the period in which the election is to remain in force. For further particulars on the acceptance of late-filed elections, see the current version of Information Circular IC07-1, Taxpayer Relief Provisions.

2.50 A property can qualify as a taxpayer's principal residence for up to four tax years during which a subsection 45(2) election remains in force, even if the housing unit is not ordinarily inhabited during those years by the taxpayer or by his or her spouse or common-law partner, former spouse or common-law partner, or child. However, the taxpayer must be resident, or deemed to be resident, in Canada during those years for the full benefit of the principal residence exemption to apply (see variable B in the formula in ¶2.20 or the years included in the statement in ¶2.43(b), as the case may be). It should also be noted that the rule described in ¶2.13 to 2.14 prevents the designation of more than one property as a principal residence for any particular year by the taxpayer (or, for any particular year after the 1981 tax year, by the taxpayer or any other member of his or her family unit). Thus, for example, a taxpayer's designation for the same year of one property by virtue of a subsection 45(2) election being in force, and another property by virtue of the fact that he or she ordinarily inhabited that other property, would not be permitted.

Example 4

Mr. A and his family lived in a house for a number of years until September 30, 2003. From October 1, 2003 until March 31, 2008 they lived elsewhere and Mr. A rented the house to a third party. On April 1, 2008, they moved back into the house and lived in it until it was sold in 2011. When he filed his 2011 income tax return, Mr. A designated the house as his principal residence for the 2004 to 2007 tax years inclusive (that is, the maximum four years) by virtue of a subsection 45(2) election (which he had already filed with his 2003 income tax return) having been in force for those years. (He was able to make this designation because no other property had been designated as a principal residence by him or a member of his family unit for those years.) He designated the house as his principal residence for all the other years in which he owned it by virtue of his having ordinarily inhabited it during those years, including the 2003 and 2008 years.

Having been resident in Canada at all times, Mr. A's gain otherwise determined on the disposition of the house in 2011 was, therefore, completely eliminated by the principal residence exemption.

2.51 Any income in respect of a property (for example, the rental income in the above example), net of applicable expenses, must be reported for tax purposes. However, for tax years covered by a subsection 45(2) election, CCA should not be claimed on the property (see ¶2.48 to 2.49).

2.52 Section 54.1 removes the above-mentioned four-year limitation for tax years covered by a subsection 45(2) election if all of the following conditions are met:

a) the taxpayer does not ordinarily inhabit the housing unit during the period covered by the election because the taxpayer's or his or her spouse's or common-law partner's place of employment has been relocated;
b) the employer is not related to the taxpayer or his or her spouse or common-law partner;
c) the housing unit is at least 40 kilometers farther from such new place of employment than is the taxpayer's subsequent place or places of residence; and
d) either:

- the taxpayer resumes ordinary habitation of the housing unit during the term of employment by that same employer or before the end of the tax year immediately following the tax year in which such employment terminates; or
- the taxpayer dies during the term of such employment.

2.53 With regard to condition (d), two corporations that are members of the same corporate group, or are otherwise related, are not considered to be the same employer.

Complete change in use of a property from income-producing to principal residence

2.54 If a taxpayer has completely changed the use of a property (for which an election under subsection 45(2) is not in force) from income-producing to a principal residence, he or she is deemed by paragraph 45(1)(a) to have disposed of the property (both land and building), and immediately thereafter reacquired it, at fair market value. This deemed disposition can result in a taxable capital gain. The taxpayer may instead defer recognition of the gain to a later year by electing under subsection 45(3) that the above-mentioned deemed disposition and reacquisition under paragraph 45(1)(a) does not apply. This election is made by means of a letter to that effect signed by the taxpayer and filed with the income tax return for the year in which the property is ultimately disposed of (or earlier if a formal demand for the election is issued by the CRA). For e-filers, see the Paper documentation page on the CRA website. Also, subsection 220(3.2), in conjunction with section 600 of the Regulations, provides the authority for the CRA to accept a late-filed subsection 45(3) election. Such a late-filed election may be accepted under certain circumstances. For further particulars on the acceptance of late-filed elections, see the current version of Information Circular IC07-1.

2.55 Even if a subsection 45(3) election is filed in order to defer recognition of a gain from the change in use of a property from income-producing to principal residence, the net income from the property for the period before the change in use must still be reported. However, for purposes of reporting such net income, it should be noted that an election under subsection 45(3) is not possible if, for any tax year ending after 1984 and on or before the change in use of the property from income-producing to a principal residence, CCA has been allowed in respect of the property to:

- the taxpayer;
- the taxpayer's spouse or common-law partner; or
- a trust under which the taxpayer or his or her spouse or common-law partner is a beneficiary.

CCA so allowed would cause subsection 45(4) to nullify the subsection 45(3) election.

2.56 Similar to the treatment for a subsection 45(2) election (see ¶2.50 to 2.51), a property can qualify as a taxpayer's principal residence for up to four tax years prior to a change in use covered by a subsection 45(3) election, in lieu of fulfilling the ordinarily inhabited rule (discussed in ¶2.10 to 2.12) for these years. As in the case of a subsection 45(2) election, residence or deemed residence in Canada during these years is necessary for the full benefit of the principal residence exemption to apply. Furthermore, the rule described in ¶2.13 to 2.14 prevents the designation of more than one property as a principal residence for any particular year by the taxpayer (or, for any particular year after the 1981 tax year, by the taxpayer or any other member of his or her family unit).

Example 5

Mr. X bought a house in 2003 and rented it to a third party until mid-2009. Mr. X and his family then lived in the house until it was sold in 2011. Mr. X has been resident in Canada at all times. When he filed his 2011 income tax return, Mr. X designated the house as his principal residence for the 2009 to 2011 tax years inclusive, by virtue of his having ordinarily inhabited it during those years. He also designated the house as his principal residence for the 2005 to 2008 years inclusive (that is, the maximum 4 years) by virtue of a subsection 45(3) election, which he filed with his 2011 income tax return (he was able to make this designation because (i) no other property had been designated by him or a member of his family unit for those years, and (ii) he did not claim any CCA when reporting the net income from the property before the change in use). However, his gain otherwise determined on the disposition of the house in 2011 could not be fully eliminated by the principal residence exemption formula because he could not designate the house as his principal residence for the 2003 and 2004 years.

Partial changes in use

2.57 If a taxpayer has partially converted a principal residence to an income-producing use, paragraph 45(1)(c) provides for a deemed disposition of the portion of the property so converted (such portion is usually calculated on the basis of the area involved) for proceeds equal to its proportionate share of the property's fair market value. Paragraph 45(1)(c) also provides for a deemed reacquisition immediately thereafter of the same portion of the property at a cost equal to the very same amount. Any gain otherwise determined on the deemed disposition is usually eliminated or reduced by the principal residence exemption. If the portion of the property so changed is later converted back to use as part of the principal residence, there is a second deemed disposition (and reacquisition) thereof at fair market value. A taxable capital gain attributable to the period of use of such portion of the property for income-producing purposes can arise from such a second deemed disposition or from an actual sale of the whole property subsequent to the original partial change in use. An election under subsection 45(2) or (3) cannot be made where there is a partial change in use of a property as described above.

2.58 The above-mentioned deemed disposition rule applies where the partial change in use of the property is substantial and of a more permanent nature, that is, where there is a structural change. Examples where this occurs are the conversion of the front half of a house into a store, the conversion of a portion of a house into a self-contained domestic establishment for earning rental income (a duplex, triplex, etc.), and alterations to a house to accommodate separate business premises. In these and similar cases, the taxpayer reports the income and may claim the expenses pertaining to the altered portion of the property (that is, a reasonable portion of the expenses relating to the whole property) as well as CCA on such altered portion of the property.

2.59 It is the CRA's practice not to apply the deemed disposition rule, but rather to consider that the entire property retains its nature as a principal residence, where all of the following conditions are met:

a) the income-producing use is ancillary to the main use of the property as a residence;
b) there is no structural change to the property; and
c) no CCA is claimed on the property.

2.60 These conditions can be met, for example, where a taxpayer carries on a business of caring for children in the home, rents one or more rooms in the home, or has an office or other work space in the home which is used in connection with business or employment. In these and similar cases, the taxpayer reports the income and may claim the expenses (other than CCA) pertaining to the portion of the property used for income-producing purposes. Certain conditions and restrictions are placed on the deductibility of expenses relating to an office or other work space in an individual's home – see Income Tax Folio S4-F2-C2, Business Use of Home Expenses (if the income is income from a business) or Interpretation Bulletin IT-352R2, Employee's Expenses, Including Work Space in Home Expenses. In the event that the taxpayer commences to claim CCA on the portion of the property used for producing income, the deemed disposition rule is applied as of the time at which the income-producing use commenced.

Change in use rules regarding CCA, deemed capital cost, and recapture

2.61 If a taxpayer has completely or partially changed the use of property from principal residence to income-producing, subsection 13(7) provides for a deemed acquisition of the property or portion of the property so changed that is depreciable property. For purposes of claiming CCA, the deemed capital cost of such depreciable property is its fair market value as of the date of the change in use unless that fair market value is greater than its cost to the taxpayer. In that case, the deemed capital cost of such depreciable property is equal to its cost to the taxpayer plus an amount which represents the taxable portion of the accrued gain on the property (before any reduction to that gain by means of the principal residence exemption) to the extent that a section 110.6 capital gains deduction has not been claimed in respect of that amount (this latter rule has no particular significance for dispositions of residence properties occurring after February 22, 1994, because of the elimination of the $100,000 lifetime capital gains exemption for dispositions after that date).

Example 6

Mr. A completely converted his house to a rental property in January 2011, at which time its cost to him and its fair market value were $160,000 and $200,000 respectively (both amounts pertain only to the housing unit and not the land). The change in use resulted in a deemed disposition of the property at fair market value (see ¶2.48 to 2.51 – assume that Mr. A did not make a subsection 45(2) election in respect of the property because he wanted to use the principal residence exemption for his cottage for the years after 2011). Mr. A was able to use the principal residence exemption to bring his gain on the January 2011 deemed disposition of the house to nil. Mr. A's deemed capital cost for the house (that is, for CCA purposes) at the time of its change in use to a rental property was $180,000. This amount was calculated by taking the $160,000 cost and adding $20,000, the latter amount being one-half of the excess of the $200,000 fair market value over the $160,000 cost. (Note that the $20,000 potentially taxable portion of the gain was included in Mr. A's deemed capital cost for CCA purposes even though he eliminated the gain by means of the principal residence exemption.)

2.62 In the case of a complete change in use of a property from principal residence to income-producing, a subsection 45(2) election will cause subsection 13(7), as described above, not to apply. However, if the election is rescinded in a subsequent tax year (for example, by claiming CCA on the property – see ¶2.48 to 2.49), a subsection 13(7) deemed acquisition of depreciable property will occur on the first day of that subsequent year.

2.63 Because a subsection 45(2) election is not available where there is only a partial change in use of a property from principal residence to income-producing, subsection 13(7) applies in such a situation in the manner described above (except where conditions (a) to (c) in ¶2.59 have been met, including the condition not to claim CCA on the portion of the property used to earn income).

2.64 If a taxpayer completely or partially changes the use of a property from income-producing to principal residence, there is a deemed disposition at fair market value, by virtue of subsection 13(7), of the portion of the property so changed that is depreciable property. This can result in a recapture of CCA previously claimed on the property. A subsection 45(3) election cannot be used to defer such a recapture (for example, a recapture of CCA claimed for a tax year ending before 1985 – see the comments regarding CCA in ¶2.54 to 2.55).

Personal trusts

2.65 It is possible for a **personal trust** (as defined in subsection 248(1)) to claim the principal residence exemption to reduce or eliminate a gain that the trust would otherwise have on the disposition of a property. Subject to the additional rules discussed in ¶2.66.1 for dispositions after 2016, the normal principal residence exemption rules generally apply, taking into consideration the following modifications:

a) When a personal trust designates a property as its principal residence for one or more tax years, the trustee of the trust must complete and file Form T1079, Designation of a Property as a Principal Residence by a Personal Trust. For purposes of calculating a capital gains election reduction amount (see ¶2.17 to 2.26) for the trust, the trustee should complete Form T1079-WS, Principal Residence Worksheet, and file it with the T1079 designation form.
b) For each tax year for which the trust is designating the property as its principal residence, the trust must specify in the above-mentioned designation each individual who, in the calendar year ending in that tax year:

- was beneficially interested in the trust; and
- ordinarily inhabited the housing unit or who had a spouse or common-law partner, former spouse or common-law partner, or child who ordinarily inhabited the housing unit (a subsection 45(2) or (3) election can be used, however, in essentially the same manner as, and subject to the limitations discussed in, ¶2.50 to 2.51 and ¶2.56, to remove the requirement that the ordinarily inhabited rule be fulfilled for the year by one of these persons).

Any individual specified by the trust to be an individual as described above is referred to as a **specified beneficiary** of the trust for the year.
c) For each tax year for which the trust is designating the property as its principal residence, there must not have been any corporation (other than a registered charity) or partnership that was beneficially interested in the trust at any time in the year.
d) For each tax year for which the trust is designating the property as its principal residence (including years before 1982), no other property may have been designated as a principal residence, for the calendar year ending in the year, by any specified beneficiary of the trust for the year, or by any person who throughout the calendar year ending in the year was a member of such a beneficiary's family unit. For this purpose, a specified beneficiary's **family unit** includes, in addition to the specified beneficiary, the following persons (if any):

- the specified beneficiary's spouse or common-law partner throughout the calendar year ending in the year, unless the spouse or common-law partner was throughout that calendar year living apart, and was separated pursuant to a judicial separation or written separation agreement, from the specified beneficiary;

- the specified beneficiary's children, except those who were married, in a common-law partnership or 18 years of age or older during the calendar year ending in the year; and
- where the specified beneficiary was not married, in a common-law partnership or 18 years of age or older during the calendar year ending in the year:
  - the specified beneficiary's mother and father; and
  - the specified beneficiary's brothers and sisters who were not married, in a common-law partnership or 18 years of age or older during that calendar year.

2.66 Furthermore, if a personal trust designates a property as its principal residence for a particular tax year, the property is deemed to be property designated, for the calendar year ending in the year, as the principal residence of each specified beneficiary of the trust. This deeming rule can be applied, in conjunction with the other principal residence exemption rules, to various situations not explicitly described in those rules.

Example 7

Personal Trust A owned a house in its tax year ended December 31, 2011. The house was ordinarily inhabited in 2011 by Mr. X, a specified beneficiary of Personal Trust A (and also by his spouse, Mrs. X). The trust has designated the house as its principal residence for its tax year ended December 31, 2011. The house is therefore deemed to have been designated as Mr. X's principal residence for 2011.

Personal Trust B owned a cottage in its tax year ended December 31, 2011. The cottage was ordinarily inhabited in 2011 by Mrs. X, a specified beneficiary of Personal Trust B (and also by Mr. X). As discussed in ¶2.13 to 2.14, a taxpayer and his or her spouse or common-law partner cannot designate different properties for the same year. Therefore, since the house has already been deemed to have been designated as Mr. X's principal residence for 2011, Personal Trust B cannot designate the cottage as its principal residence for 2011 because that would have resulted in the cottage being deemed to have also been designated as Mrs. X's principal residence for 2011.

2.66.1 For tax years beginning after 2016, additional rules in subparagraph (c.1)(iii.1) of the principal residence definition in section 54 apply. In order for a property to qualify as a principal residence of a personal trust, the trust must be a trust described in one of the three following categories during the tax year.

a) The trust is an alter ego trust; spousal or common-law partner trust; joint spousal or common-law partner trust; or in certain circumstances a trust for the exclusive benefit of the settlor during the settlor's lifetime. For each tax year in which the particular trust is designating the property as its principal residence, the specified beneficiary of the trust must be the settlor, spouse or common-law partner, or former spouse or common-law partner, of the settlor (as the case may be) and this person must be resident in Canada during the year.

b) The trust is a qualified disability trust, as long as the electing beneficiary of the trust for the year is:

- resident in Canada during the year;
- the specified beneficiary of the trust for the year; and
- a spouse, common-law partner, former spouse or common-law partner or child of the settlor.

For more information on qualified disability trusts, please refer to the T4013, T3 Trust Guide for more information.

c) A trust, the specified beneficiary of which for the year is an individual:

- who has not attained 18 years of age before the end of the year;
- who is resident in Canada during the year; and
- whose mother or father is a settlor of the trust and either of the following conditions is met:
    - neither the mother or father of the individual is alive at the beginning of the year or
    - the trust arose before the beginning of the year as a result of the death of either the mother or father of the individual.

A trust may qualify under more than one of these categories.

2.66.2 The determination of whether a personal trust is described in ¶2.66.1 and whether the property can be designated as its principal residence must be done each year. Where a trust owned property at the end of 2016 and in the trust's first tax year after 2016 the trust meets one of three categories described in ¶2.66.1, the trust's principal residence exemption and related gain on the eventual disposition of the property, if any, would be calculated similar to ¶2.20, subject to the commentary in ¶2.30. The approach in ¶2.20 and ¶2.30 would also apply where the trust acquires the property after 2016 and the trust meets one of three categories described in ¶2.66.1.

2.66.3 Where a personal trust is not described in ¶2.66.1 in its first tax year after 2016, a transitional rule in subsection 40(6.1) may apply. This rule allows a trust that owned property before 2017 and is no longer able to designate the property as its principal residence, to continue to benefit from the principal residence exemption for the gain accrued up to December 31, 2016. The transitional rule will apply where the trust:

- was otherwise eligible to claim a principal residence exemption for a tax year that begins before 2017;
- owned the property, jointly with another person or otherwise, at the end of 2016, and owns it continuously from January 1, 2017 until the disposition; and
- disposed of the property after 2016.

2.66.4 The transitional rule under subsection 40(6.1) provides a formula which separates the computation of the trust's gain into two parts. The calculation of the trust's gain is determined by the following formula:

A + B – C

Under **element A** of the formula, the trust computes its "first" gain on the basis that the trust disposed of the property on December 31, 2016 for proceeds equal to its fair market value on that date. This portion of the gain is computed under the principal residence exemption rules that apply to the trust for tax years that begin before 2017, using the formula discussed in ¶2.20 (subject to the discussion in ¶2.30).

Under **element B** of the formula, the trust computes its "second" gain on the basis that the trust acquired the property at the start of 2017 at a cost equal to the fair market value of the property on December 31, 2016 (i.e., the proceeds used in determining the first gain). This second gain is computed under the principal residence exemption rules as they apply to dispositions in tax years that begin after 2016, but on the assumption that the "one-plus rule" does not apply.

Element C of the formula reduces the total of A and B to the extent that the property's fair market value on December 31, 2016 (i.e., the proceeds from the first notional disposition under element A) exceeds the proceeds of disposition from the actual disposition after 2016. In other words, the total of A + B is reduced by the amount of any loss that may have occurred in the period after December 31, 2016.

Example 7.1

Personal Trust C is a family trust, the beneficiaries of which are Mr. C, his spouse and their two children. The trust acquired a house in 2011 for $300,000. The house has been ordinarily inhabited each year by Mr. C and his family, who are all specified beneficiaries of Personal Trust C. Personal Trust C sold the house in 2017 for $450,000.

As the trust does not fall into any of the categories described in ¶2.66.1, Personal Trust C cannot designate the house as its principal residence for any year after 2016. As the criteria in ¶2.66.3 are met, the transitional rule in subsection 40(6.1) is applicable. If the house had a fair market value of $400,000 on December 31, 2016, the trust's gain would be determined as follows:

Applying the formula **A + B – C** described in ¶2.66.4:

A The gain on the property up to December 31, 2016

= the amount determined using the formula in ¶2.20 and designating the house as the principal residence for five of the six years from 2011 to 2016

= (gain from 2011 to December 31, 2016) – [(gain from 2011 to December 31, 2016) × ((1+5)/6)]

= $100,000 – $100,000

= 0

B The gain on the property after December 31, 2016 up to the date of disposition, if any

= the amount determined using the formula in ¶2.20 without the "one plus" rule and taking into account the trust cannot designate the house as the principal residence for 2017

= (gain from January 1, 2017 to disposition in 2017) – [(gain from January 1, 2017 to disposition in 2017) × 0/1]

= ($450,000 proceeds of disposition - $400,000 January 1, 2017 cost of acquisition) – [($450,000 proceeds of disposition - $400,000 January 1, 2017 cost of acquisition) × 0/1]

= $50,000 – [$50,000 × 0/1]

= $50,000 – $0

= $50,000

C The loss on the property after December 31, 2016 up to the date of disposition, if any

= (FMV at December 31, 2016 – proceeds of disposition)

= ($400,000 - $450,000)

= $0

The fair market value on December 31, 2016 did not exceed the proceeds of disposition of the house on its disposition in 2017.

Therefore the trust's gain is A + B - C

= $0 + $50,000 - $0

= $50,000

2.67 Where a beneficiary acquired a property from a personal trust in satisfaction of all or any part of the beneficiary's capital interest in the trust, subsection 40(7) provides a deeming rule when the beneficiary disposes of the property provided the following two conditions were met:

- the rollover provision in subsection 107(2) applied (see discussion in ¶2.68 for an exception to this rollover provision); and
- subsection 107(4) did not apply.

For purposes of claiming the principal residence exemption, the beneficiary is deemed by subsection 40(7) to have owned the property since the trust last acquired it.

Example 8

A personal trust acquired a residential property on October 1, 2007 for $200,000. On January 10, 2009, the property was distributed to Mr. X in satisfaction of his capital interest in the trust. Subsection 107(4) did not apply with respect to this distribution, and the rollover provision in subsection 107(2) prevented the gain on the property accrued to January 10, 2009 from being taxed in the hands of the trust. Instead, the potential for taxing that gain was transferred to Mr. X because subsection 107(2) deemed him to have acquired the property at a cost equal to $200,000, that is, the cost amount of the property to the trust. Mr. X lived in the residence from October 15, 2007 until he disposed of the property on December 1, 2011 for $250,000, incurring no costs in connection with the disposition.

Mr. X's gain otherwise determined on the disposition of the property was equal to his $250,000 proceeds minus his $200,000 adjusted cost base, for a gain of $50,000. Subsection 40(7) deemed him to have owned the property from October 1, 2007 rather than from January 10, 2009. Since Mr. X ordinarily inhabited the residence in all of the years from 2007 to 2011 inclusive (that is, all of the years in which he either owned the property or was deemed to have owned it), he was able to designate the property as his principal residence for all those years. Thus, he was able to use the principal residence exemption to fully eliminate his $50,000 gain otherwise determined. However, if neither Mr. X nor his current or former spouse or common-law partner, or child had ordinarily inhabited the residence (see the rule discussed in ¶2.10 to 2.12) until it was distributed by the trust to Mr. X on January 10, 2009, he would have been able to designate the property as his principal residence only for 2009 to 2011. In other words, he would have been able to use the formula in ¶2.17 to 2.26 to eliminate only the following portion of his $50,000 gain otherwise determined:

Applying the formula **A × (B ÷ C):**

A is $50,000

B is 1 + 3 (being tax years 2009 to 2011)

C is 5 (being tax years 2007 to 2011)

= $50,000 × (4 ÷ 5)

= 40,000

2.68 In order to prevent the rollover rule in subsection 107(2) from applying with respect to a trust's distribution, to a beneficiary, of a property that qualifies for designation as the trust's principal residence before the distribution, a personal trust can use an election under subsection 107(2.01). Under this election, the trust would instead be deemed, just before the distribution of the property to the beneficiary, to have disposed of and then to have reacquired the property at fair market value. This could be done, for example, in order for the trust to use the principal residence exemption to eliminate or reduce any gain on the property accrued to that point in time (see ¶2.65 to 2.66), ideal in circumstances where the recipient beneficiary is not the specified beneficiary and has owned another home during the period in which the trust owned the home being distributed. The cost of the property to the beneficiary would be that same fair market value, and the beneficiary would not be deemed by subsection 40(7) (see ¶2.67) to have owned the property during the period of time in which it was owned by the trust prior to the distribution.

Transfer of a principal residence

2.69 Subsection 40(4) can apply if a property of a taxpayer (hereinafter referred to as the **transferor**):

- has been transferred inter vivos to one of the following parties and the subsection 73(1) rollover rule has applied:

- the transferor's spouse or common-law partner;
- the transferor's former spouse or common-law partner;
- a spousal or common-law partner trust;
- a joint spousal or common-law partner trust; or
- an alter ego trust.

or

- has been transferred or distributed, as a consequence of the transferor's death, to his or her spouse or common-law partner or to a spousal or common-law partner trust, and the subsection 70(6) rollover rule has applied.

2.70 If the spouse or common-law partner, former spouse or common-law partner, spousal or common-law partner trust, joint spousal or common-law partner trust, or alter ego trust (hereinafter referred to as the transferee) subsequently disposes of the property, subsection 40(4) can apply with respect to a principal residence exemption, claimed by the transferee, for the property. For purposes of the transferee's claiming the principal residence exemption under either paragraph 40(2)(b) (see the formula in ¶2.17 to 2.26) or paragraph 40(2)(c) (see ¶2.39 to 2.46), the following rules apply under subsection 40(4):

a) The transferee is deemed to have owned the property throughout the period that the transferor owned it.

b) The property is deemed to have been the transferee's principal residence:

- in a case where the subsection 73(1) rollover rule applied – for any tax year for which it was the transferor's principal residence; and
- in a case where the subsection 70(6) rollover rule applied – for any tax year for which it would have been the transferor's principal residence if he or she had so designated it.

c) If the transferee is a trust, it is deemed to have been resident in Canada during each of the tax years during which the transferor was resident in Canada.

2.71 Any year included in the period described in (a) is included by the transferee in variable C in the formula in ¶2.17 to 2.26. Any year described in (b) is included by the transferee in variable B in the formula in ¶2.17 to 2.26 or in the years included in the statement in ¶2.43(b), as the case may be, assuming that the transferee meets the residence requirement mentioned therein, as the case may be, for that year. (If the transferee is a trust, see (c) above with regard to this residence requirement.)

Example 9

Mr. X was the sole owner of a house in Canada, which he had acquired in 1995. In 2000, Mr. X got married and his spouse, Mrs. X, moved into the house with him. In 2005, Mr. X died and the house was transferred to a spousal trust for Mrs. X. The trust was a trust as described in subsection 70(6). The trust's tax year-end was December 31. If Mr. X had not died (and if he had sold his house in 2005), he could have designated it as his principal residence for any of the years 1995 to 2005 inclusive.

Under the rollover rule in subsection 70(6), Mr. X was deemed to have disposed of the house immediately before his death for proceeds equal to his cost of the house. Thus, Mr. X had no gain or loss on the deemed disposition of the house. The spousal trust for Mrs. X was deemed under subsection 70(6) to have acquired the house, at the time of Mr. X's death, at a cost equal to Mr. X's deemed proceeds, that is, at Mr. X's cost of the house.

In 2011, Mrs. X died and the trust sold the house at fair market value. Since this amount was greater than the trust's deemed cost of the house, the trust had a gain otherwise determined from the disposition, which the trust (that is, its trustee) wishes to eliminate by using the principal residence exemption.

Subsection 40(4) deems the trust to have owned the house in all the years in which Mr. X owned it, that is, 1995 to 2005 inclusive, in accordance with the rule described in ¶2.70(a) above. (The house was, of course, owned by the trust in 2005 in any event.) This means that the years that the trust must include in variable C in the principal residence exemption formula in ¶2.17 to 2.26 are 1995 to 2011 inclusive.

Since the trust is a personal trust resident in Canada and also since Mrs. X lived in the house and qualified as a specified beneficiary of the trust for the years 2005 to 2011 inclusive, the trust can designate the house as its principal residence for those years. The trust cannot designate the house as its principal residence for the years 1995 to 2004 inclusive; however, such a designation by the trust is not necessary – the house is already deemed by subsection 40(4) to have been the trust's principal residence for those years, in accordance with the rule described in ¶2.70(b) above, because Mr. X could have designated the house as his principal residence for those years. Also, in accordance with the rule described in ¶2.70(c) above, the trust is deemed to have been resident in Canada for the years 1995 to 2004 because Mr. X was resident in Canada during those years. Therefore, the trust is able to include all of the years from 1995 to 2011 inclusive in variable B in the formula in ¶2.17 to 2.26. In other words, the trust is able to use the principal residence exemption to completely eliminate the gain otherwise determined on its disposition of the house in 2011.

Example 10

Assume all the same facts as in Example 9, except the following: Mr. X could not have designated the house as his principal residence for the years 1995 to 1998 inclusive because he had already designated his cottage as his principal residence for those years. Under these circumstances, the house that was transferred to the spousal trust for Mrs. X cannot be deemed to have been the principal residence of the trust for the years 1995 to 1998 inclusive. Therefore, the trust can only partially eliminate the gain otherwise determined on its disposition of the house in 2011 by means of the principal residence exemption formula.

2.72 In the case of an inter vivos transfer of property under subsection 73(1), the following should be noted for purposes of any subsequent disposition of the property by the transferee:

- A designation of the property as the principal residence of the transferor – for one or more years prior to the transfer – may be needed in order for the property to be deemed to have been the principal residence of the transferee for those years by means of subsection 40(4) (see ¶2.70(b)). Note that as explained in ¶2.13 to 2.14, the transferor will not be able to designate the property as a principal residence for any particular year if another property is designated as a principal residence for that year by the transferor (or, if the year is after the 1981 tax year, by the transferor or any of the other members of the transferor's family unit). If the transferor is able to, and does in fact, designate the property as his or her principal residence for one or more years prior to the transfer, this does not necessarily mean that the transferor must actually file the designation form with the return for the year of the transfer for transfers in tax years prior to 2016 (although the transferor may do so) – for further comments on the necessity to file a designation form, see ¶2.15 to 2.16. The transferor should, in any event, complete the designation form and, if it is not filed by the transferor, **it should be retained by the transferee**. Subsequently, if the transferee disposes of the property (or grants an option to another person to acquire the property) and wishes to use the principal residence exemption, the transferee would need to file the designation forms – that is, the transferee's designation form for any years for which the transferee is designating the property as a principal residence and the transferor's designation form for any years for which his or her designation of the property causes the property to be deemed to have been the principal residence of the transferee:

- if the transferee is the transferor's spouse or common-law partner – only when the situation described in ¶2.15(a) or (b) exists in connection with the transferee's disposition of the property; or
- if the transferee is a personal trust – in every case (see ¶2.65(a)).

- Any taxable capital gain of the transferee (excluding an alter ego trust) from the disposition of the property or substituted property (which might occur, for example, because the transferee was not able to completely eliminate the gain otherwise determined by means of the principal residence exemption) could be deemed to be the taxable capital gain of the transferor by virtue of the attribution rules in section 74.2. For a discussion of these rules, see the current version of Interpretation Bulletin IT-511R, Interspousal and Certain Other Transfers and Loans of Property.

Partnership property

2.73 Although a housing unit, a leasehold interest therein, or a share of the capital stock of a co-operative housing corporation can be a partnership asset, a partnership is not a taxpayer and it cannot use the principal residence exemption on the disposition of any such property. However, an individual who is a member of the partnership could use the principal residence exemption to reduce or eliminate the portion of any gain on the disposition of the property which is allocated to that partner pursuant to the partnership agreement, provided that the other requirements of the section 54 definition of **principal residence** are met (for example, if the partner resides in the partnership's housing unit, this would satisfy the **ordinarily inhabited** requirement discussed in ¶2.10 to 2.12).

A principal residence outside Canada

2.74 A property that is located outside Canada can, depending on the facts of the case, qualify as a taxpayer's principal residence (see the requirements discussed in ¶2.2 to 2.16). A taxpayer who is resident in Canada and owns such a qualifying property outside Canada during a particular tax year can designate the property as a principal residence for that year in order to use the principal residence exemption (see ¶2.17 to 2.26 for the meanings of **resident in Canada** and **during**). Should a non-resident of Canada who owns a property outside Canada become a resident of Canada at any particular time, the provisions of the Act normally apply to deem that person to acquire the property at that time at fair market value, thereby ensuring that any unrealized gain on the property accruing to that time will not be taxable in Canada. Thereafter, the comments in the first two sentences of this paragraph may apply.

Non-resident owner of a principal residence in Canada

2.75 It may be possible for a property in Canada that is owned in a particular tax year by a non-resident of Canada to qualify as the non-resident's principal residence (that is, satisfy all the requirements of the section 54 definition of **principal residence** for the non-resident) for that year. The non-resident's spouse could be the one, for example, who satisfies the **ordinarily inhabited** rule – see ¶2.10 to 2.12 (or, alternatively, a subsection 45(2) or (3) election could make the designation of the property as the non-resident's principal residence possible – see ¶2.50 to 2.51 and ¶2.56). However, the use of the principal residence exemption by a taxpayer is limited by reference to the number of tax years ending after the acquisition date during which the taxpayer was resident in Canada – see ¶2.17 to 2.26 and ¶2.43 to 2.45 (as indicated in ¶2.17 to 2.26, during a year means at any time in the year). Thus, even if a property in Canada owned by a non-resident qualifies as the non-resident's principal residence, the above-mentioned residence in Canada requirement typically prevents the non-resident from using the principal residence exemption to eliminate a gain on the disposition of the property.

2.76 In spite of the limitation mentioned in ¶2.75 in connection with the principal residence exemption, an election under subsection 45(2) or (3) could allow a non-resident owning a property in Canada to defer a taxable capital gain which would otherwise result from a deemed disposition of a property on a change in its use (see ¶2.48 to 2.49 and ¶2.54 to 2.55).

2.77 Where a non-resident owner of a property in Canada has rented out the property in a particular tax year and has filed a subsection 45(2) or (3) election in respect of the property, see ¶2.48 to 2.49 and ¶2.54 to 2.55 regarding the restrictions on claiming CCA. These restrictions apply where the non-resident elects to report the rental income under section 216. (That election is discussed in the current version of Interpretation Bulletin IT-393R2, Election re: Tax on Rents and Timber Royalties Non-Residents.)

Section 116 certificate for a disposition of a principal residence in Canada by a non-resident owner

2.78 Where a non-resident wishes to obtain a certificate under section 116 for a property in Canada which the non-resident proposes to dispose of or has disposed of within the last 10 days, a prepayment on account of tax must be made or security acceptable to the CRA must be given before the certificate will be issued. Form T2062, Request by a Non-Resident of Canada for a Certificate of Compliance Related to the Disposition of Taxable Canadian Property, or a similar notification, must be filed in connection with a request for a section 116 certificate. Further particulars regarding the above are contained in the current version of Information Circular IC72-17R6, Procedures Concerning the Disposition of Taxable Canadian Property by Non-Residents of Canada – Section 116. Where part or all of any gain otherwise determined on the disposition of the property by the non-resident is or will be eliminated by the principal residence exemption, the amount of prepayment on account of tax to be made or security to be given may be reduced accordingly. An application for such a reduction should be made by means of a letter signed by the taxpayer and attached to the completed Form T2062 or similar notification. Such letter should contain a calculation of the portion of the gain otherwise determined that is or will be so eliminated by the principal residence exemption.

Ownership

2.79 In the common law jurisdictions, two forms of property ownership are recognized – legal and beneficial. Normally legal ownership exists when title is transferred to, recorded in, registered in or otherwise carried in the name of a person. Legal owners are generally entitled to enforce their ownership rights against all other persons. The distinction between legal and beneficial ownership does not exist in civil law; ownership is a unitary concept.

2.80 In the common law jurisdictions, one person's legal ownership of a property may be subject to another person's beneficial ownership of that property. The term **beneficial ownership** is used to describe the type of ownership of a person who is entitled to the use and benefit of the property whether or not that person has concurrent legal ownership. A person who has beneficial ownership rights but not legal ownership can enforce those rights against the holder of the legal title. For example, beneficial ownership frequently arises when property is held in trust for a person in circumstances where, according to the terms of the trust, that person has authority to instruct the trustee to deal with the property as requested. (Where a personal trust, including a spousal trust, is involved, see also the rules mentioned in ¶2.65 to 2.68.)

2.81 Beneficial ownership must be distinguished, however, from the other types of physical possession of property which a person may enjoy. For example, a tenant of a property, or a person who is allowed to occupy it only because the true owner has no objection, is not the beneficial owner of the property. In determining whether a person has beneficial ownership, one should consider such factors as the right to possession, the right to collect rents, the right to call for the mortgaging of the property, the right to transfer title by sale or by will, the obligation to repair, the obligation to pay property taxes and other relevant rights and obligations. Not all of these incidents of ownership need occur concurrently before it is concluded that the person has beneficial ownership of the property, which is a question of fact in each particular case (subject to any determination under the law regarding beneficial ownership such as, for example, in the manner described in ¶2.83 to 2.87).

2.82 Since in most cases the same person has both legal and beneficial ownership, determining ownership on the basis of beneficial ownership alone is not often required. The comments below deal with some situations where a taxpayer is considered to own, and other situations where a taxpayer is considered not to own, a property for purposes of the principal residence exemption.

Ownership issues in the province of Quebec

2.83 Because the province of Quebec is a civil law jurisdiction, not a common law jurisdiction, subsection 248(3) provides a special set of rules for income tax purposes in relation to property subject to certain institutions or arrangements governed by the laws of that province. Subsection 248(3) deems each of the following to be a trust:

a) a usufruct;
b) a right of use or habitation; or
c) substitution.

The trust is deemed to be created by will where (a), (b) or (c) was established by will. The property subject to (a), (b) or (c) is deemed to have been transferred to, and to be held in trust by, the trust. The transfer is deemed to have occurred on, and as a consequence of, the death of the testator where (a), (b) or (c) arises on the death of that person. If the property is the type of property that can otherwise qualify as a principal residence, the deemed trust may be able to use the rules referred to in ¶2.65 to 2.68 to claim the principal residence exemption to reduce or eliminate any gain that would otherwise occur (for tax purposes) as a result of a disposition of the property.

2.84 Subsection 248(3) also deems any person who has a right (whether immediate or future and whether absolute or contingent) to receive all or any part of the income or the capital in respect of property subject to (a), (b) or (c) to be a person who is beneficially interested in the deemed trust. Finally, subsection 248(3) deems property in relation to which any person has, at any time:

d) the right of ownership;
e) a right as a lessee under an emphyteusis; or
f) a right as a beneficiary in a trust (including a right as a deemed beneficiary of a deemed trust described above);

to be beneficially owned by that person, whether or not the property is subject to a servitude.

2.85 Thus, if a person sells his or her rights with respect to property which is subject to (a), (b), (c), (d) or (e) above and the property itself is a property that can otherwise qualify as a principal residence (that is, a housing unit, leasehold interest or co-operative housing corporation shares), that person might be able to use the principal residence exemption to reduce or eliminate any gain that would otherwise occur (for tax purposes) as a result of that disposition of rights. In order for this to occur, of course, all the other requirements of the section 54 definition of principal residence, as described in this Chapter, would have to have been met. For example, the ordinarily inhabited requirement could have been satisfied by the person who sold the rights with respect to the property having inhabited the property during the relevant years.

Sole or joint ownership

2.86 For purposes of claiming the principal residence exemption for a property, the section 54 definition of principal residence requires that the taxpayer own the property **jointly with another person or otherwise**. These words include sole ownership, joint tenancy, tenancy-in-common and co-ownership. Provincial laws are therefore often relevant in determining the ownership of property (including, for example, provincial laws relating to marital property) and should, therefore, be considered along with the comments in this Chapter.

Ownership in dispute

2.87 When a taxpayer's ownership of property is in dispute or in doubt, he or she may resort to the courts for a resolution of the question. In a situation involving a marriage dissolution, for example, one spouse may request the courts to resolve the ownership of property considered to be owned by the other spouse. In such a case, where the first-mentioned spouse acquires ownership pursuant to a court order, such ownership will generally be considered to have been acquired on the effective date specified in the court order regardless of the legal basis or reasons for the order, or on such other date as is considered reasonable if no effective date is specified in the order.

Share in the capital stock of a co-operative housing corporation

2.88 A share in the capital stock of a co-operative housing corporation can qualify as a principal residence property provided that the share was acquired for the sole purpose of obtaining the right to inhabit a housing unit owned by the corporation and the other requirements of the section 54 definition of principal residence, as indicated above, are met. In any event, where a corporation or an association formed solely to hold residential property is really a bare trustee of the property and the terms of the trust arrangement give the beneficiary, that is, shareholder of the corporation or member of the association:

a) the same rights of possession and use of a particular housing unit as the beneficial owner of any housing unit would normally enjoy, and
b) the right to require the corporation or association to deal with the housing unit (for example, sell or mortgage it) as instructed by the shareholder or member,

the shareholder or member is considered to be the beneficial owner of the housing unit. These comments do not apply to ownership of a condominium unit that usually vests in the person acquiring it. However, see ¶2.90 concerning the time of acquisition of ownership of a condominium unit.

Interest or right in a property under an enforceable agreement for sale

2.89 A purchaser’s interest or, for civil law, a right in property under an enforceable agreement for sale will, subject to ¶2.90, be considered to constitute ownership of the property. A purchaser’s interest or right in a house bought under the Veterans’ Land Act will also be considered to be ownership of property. In these instances, the taxpayer has made a down payment and entered into an obligation to make monthly payments. When the total purchase price is paid, the taxpayer is entitled to acquire title in his or her name.

Ownership issues with condominium units

2.90 When acquiring a residential condominium unit, it is not unusual for a taxpayer to make a down payment, to enter into an agreement of purchase and sale, to enter into an occupancy agreement and to take possession prior to the registration of the condominium. The occupancy agreement may provide for payments which reflect the carrying costs of the condominium until the purchase transaction can be completed. Normally in such a situation, the taxpayer does not own the condominium unit until the condominium is registered under the relevant provincial legislation and the purchase transaction has closed.

Property on leased land

2.91 A taxpayer may in some cases be considered to own, for purposes of the principal residence exemption, a housing unit situated on land not owned by the taxpayer in circumstances where, by reason of the law or according to the terms of the lease, he or she has a leasehold interest in the land. This can occur, for example, in any of the following circumstances:

a) the taxpayer is assigned the leasehold interest in government-owned land and pays a builder to construct a house on the land,
b) the taxpayer builds a house on leased land, or
c) the taxpayer "purchases" (that is, pays what amounts to a purchase price for) a house on leased land.

Acquisition of a property by way of gift or inheritance

2.92 A taxpayer acquires ownership of property by way of gift or inheritance on the date he or she obtains a right to possess the property for his or her enjoyment.

Appendix A

Illustration of the rule in subsection 40(6)

If a taxpayer disposes (or is deemed to dispose) of a property which the taxpayer has owned (whether jointly with another person or otherwise) continuously since before 1982, the rule in subsection 40(6) (see ¶2.30) provides that the gain calculated under the usual method, using the principal residence exemption formula in ¶2.17 to 2.26, cannot be greater than the maximum total net gain determined under an alternative method. Under the alternative method, there is a hypothetical disposition on December 31, 1981 and reacquisition on January 1, 1982 of the property at fair market value.

The maximum total net gain determined under the alternative method is then calculated as follows:

maximum total net gain = pre-1982 gain + post-1981 gain – post-1981 loss where:

- the **pre-1982 gain** is the gain (if any), as reduced by the principal residence exemption formula in ¶2.17 to 2.26, that would result from the hypothetical disposition at fair market value on December 31, 1981;
- the **post-1981** gain is the gain (if any), as reduced by the principal residence exemption formula in ¶2.17 to 2.26 without the 1 + in variable B in that formula, that would result from the hypothetical acquisition at fair market value on January 1, 1982 and the subsequent actual (or deemed) disposition; and
- the **post-1981 loss** is the amount of any loss that has accrued from December 31, 1981 to the date of the subsequent actual (or deemed) disposition, that is, the excess (if any) of the fair market value on December 31, 1981 over the proceeds (or deemed proceeds) from the subsequent actual (or deemed) disposition.

The examples which follow illustrate the rule in subsection 40(6). It has been assumed in these examples that, on each actual disposition, no costs were incurred in connection with that disposition.

Example 1

Mrs. X acquired a house in 1975 for $50,000. She and her husband lived in it until February 1996, when she sold it for $115,000, resulting in an actual gain of $65,000 ($115,000 – $50,000). Ever since the sale of the house in 1996, Mr. and Mrs. X have been living in rented premises. In filing her 1996 income tax return, Mrs. X designated the house as her principal residence for 1975 to 1995 inclusive, and thus her gain otherwise determined was completely eliminated by the principal residence exemption formula in ¶2.17 to 2.26:

Gain otherwise determined is $65,000 (that is, $115,000 – $50,000).

Reduce by the principal residence exemption based on the formula **A × (B ÷ C)**, where:

A is $65,000

B is 1 + 21 (being tax years 1975 to 1995)

C is 22 (being tax years 1975 to 1996)

= $65,000 × (22 ÷ 22)

= $65,000

Gain is therefore NIL.

Mr. X acquired a lot in 1975 for $7,000 and built a cottage on it in 1979 for $13,000. Mr. and Mrs. X used the cottage as a seasonal residence from 1979 to 2001 inclusive. In the fall of 2001 Mr. X sold the cottage for $65,000, resulting in an actual gain of $45,000 ($65,000 – ($7,000 + $13,000)). In filing his 2001 income tax return, Mr. X designated the cottage property as his principal residence for 1979 to 1981 inclusive, as well as for 1996 to 2001 inclusive. He could not designate the property as his principal residence for 1975 to 1978 inclusive because it was only a vacant lot and thus no one ordinarily inhabited it in those years (see ¶2.29); nor could he designate the property as his principal residence for 1982 to 1995 inclusive because of his wife's designation of the house as her principal residence for those years (see ¶2.13 to 2.14). As a result, not all of his $45,000 gain otherwise determined was eliminated by the principal residence exemption formula in ¶2.17 to 2.26. However, because the property had been owned by

Mr. X continuously since before 1982, subsection 40(6) applied for purposes of computing his gain. The fair market value of the cottage on December 31, 1981 was $30,000.

In addition to the above facts, assume also that Mr. X did not make a subsection 110.6(19) capital gains election with respect to the cottage (see the discussion of this election in ¶2.17 to 2.26) because he had already used up his $100,000 lifetime capital gains exemption before 1994. Therefore, he had no capital gains election reduction amount (as described in ¶2.17 to 2.26) with respect to the cottage.

The calculations under subsection 40(6) in connection with Mr. X's 2001 gain on the cottage are as follows:

Usual method for calculating gain:

Gain otherwise determined is $45,000 (that is, $65,000 – $20,000)

Reduce by the principal residence exemption based on the formula **A × (B ÷ C)**, where:

A is $45,000

B is 1 + 9 (being tax years 1979 to 1981 and 1996 to 2001)

C is 27 (being tax years 1975 to 2001)

= $45,000 × (10 ÷ 27)

= $16,667

Gain is therefore $28,333.

Alternative method – calculation of maximum total net gain:

Maximum total net gain = pre-1982 gain + post-1981 gain – post-1981 loss

Pre-1982 gain:

Gain otherwise determined is $10,000 (that is, $30,000 – $20,000)

Reduce by the principal residence exemption based on the formula **A × (B ÷ C)**, where:

A is $10,000

B is 1 + 3 (being tax years 1979 to 1981)

C is 7 (being tax years 1975 to 1981)

= $10,000 × (4 ÷ 7)

= $5,714

Gain is therefore $4,286

Post-1981 gain:

Gain otherwise determined is $35,000 (that is, $65,000 – $30,000)

Reduce by the principal residence exemption based on the formula **A × (B ÷ C)** , where:

A is $35,000

B is 6 (being tax years 1996 to 2001)

C is 20 (being tax years 1982 to 2001)

= $35,000 × (6 ÷ 20)

= $10,500

Gain is therefore $24,500

Post-1981 loss: Not applicable

Maximum total net gain = pre-1982 gain + post-1981 gain – post-1981 loss

= $4,286 + $24,500 – Nil

= $28,786.

Result: Mr. X's gain remained at the $28,333 calculated under the usual method since that amount did not exceed the maximum total net gain of $28,786 calculated under the alternative method.

Example 2

Assume the same facts in Example 1 except that the couple is in a common-law relationship rather than a married couple.

In filing his 2001 income tax return, Mr. X designated the cottage property as his principal residence for 1979 to 1992 inclusive, as well as for 1996 to 2001 inclusive. He could not designate the property as his principal residence for 1975 to 1978 inclusive because it was only a vacant lot and thus no one ordinarily inhabited it in those years (see ¶2.29); nor could he designate the property as his principal residence for 1993 to 1995 inclusive because of his common-law partner's designation of the house as her principal residence for those years (see ¶2.13 to 2.14). As a result, not all of his $45,000 gain otherwise determined was eliminated by the principal residence exemption formula in ¶2.17 to 2.26.

The calculations under subsection 40(6) in connection with Mr. X’s 2001 gain on the cottage are as follows:

Usual method for calculating gain:

Gain otherwise determined is $45,000 (that is, $65,000 – $20,000)

Reduce by the principal residence exemption based on the formula **A × (B ÷ C)**, where:

A is $45,000

B is 1 + 20 (being tax years 1979 to 1992 and 1996 to 2001)

C is 27 (being tax years 1975 to 2001)

= $45,000 × (21 ÷ 27)

= $35,000

Gain is therefore $10,000

Alternative method – calculation of maximum total net gain:

Maximum total net gain = pre-1982 gain + post-1981 gain – post-1981 loss

Pre-1982 gain:

Gain otherwise determined is $10,000 (that is, $30,000 – $20,000)

Reduce by principal residence exemption based on the formula **A × (B ÷ C)**, where:

A is $10,000

B is 1 + 3 (being tax years 1979 to 1981)

C is 7 (being tax years 1975 to 1981)

= $10,000 × (4 ÷ 7)

= $5,714

Gain is therefore $4,286

Post-1981 gain:

Gain otherwise determined is $35,000 (that is, $65,000 – $30,000)

Reduce by principal residence exemption based on the formula **A × (B ÷ C)**, where:

A is $35,000

B is 17 (being tax years 1982 to 1992 and 1996 to 2001)

C is 20 (being tax years 1982 to 2001)

= $35,000 × (17 ÷ 20)

= $29,750

Gain is therefore $5,250

Post-1981 loss: not applicable

Maximum total net gain = pre-1982 gain + post-1981 gain – post-1981 loss
= $4,286 + $5,250 – Nil
= $9,536

Result: Although Mr. X's gain calculated under the usual method was $10,000, such gain could not exceed the maximum total net gain of $9,536 calculated under the alternative method. Therefore, the gain was reduced to $9,536.

Appendix B

Illustration of calculation of gain on disposition of a farm property

Assume that a taxpayer resident in Canada sold a 50 hectare farm. The taxpayer owned the farm and occupied the house on it from July 30, 1993 to June 15, 2001. The house and one-half hectare of the land have been designated as the taxpayer's principal residence for the 1993 to 2001 tax years inclusive. The taxpayer's calculations of the gain on the disposition of the farm property, using the two methods permitted by paragraph 40(2)(c), are as follows:

First method (see ¶2.40 to 2.42)

Allocate proceeds of disposition:

Proceeds of disposition	Principal Residence	Farm	Total Property
Land	$10,000*	$90,000	$100,000
House	$50,000	–	$50,000
Barn	–	$35,000	$35,000
Silo	–	$15,000	$15,000
Total Proceeds of disposition	**$60,000**	**$140,000**	**$200,000**

Allocate adjusted cost base:

Adjusted cost base	Principal Residence	Farm	Total Property
Land	$2,000*	$58,000	$60,000
House	$20,000	–	$20,000
Barn	–	$11,000	$11,000
Silo	–	$4,000	$4,000
Total adjusted cost base	**$22,000**	**$73,000**	**$95,000**

Calculate gain otherwise determined:

Description	Principal Residence	Farm	Total Property
Total proceeds of disposition	$60,000	$140,000	$200,000
Less: Total adjusted cost base	$22,000	$73,000	$95,000
Gain otherwise determined	$38,000	$67,000	$105,000
Less: Principal residence exemption	$38,000	–	$38,000
Gain	**NIL**	**$67,000**	**$67,000**

* Since the principal residence portion of the land is 1/100 of the total land (that is, one-half hectare divided by 50 hectares), one way (as described in ¶2.40(a)) of assigning values to the principal residence portion of the land would be to simply use $1,000 (that is, 1/100 of $100,000) for the proceeds for such portion of the land and $600 (that is, 1/100 of $60,000) for the adjusted cost base of such portion. Assume, however, that a typical residential lot in the area, although less than one-half hectare in this example, had a fair market value of $10,000 as of the date of sale and $2,000 as of the date of acquisition. As indicated in ¶2.40(b), we would accept the taxpayer's use of the latter amounts, which in this case would result in a greater portion of the gain otherwise determined being eliminated by the principal residence exemption.

Second method (see ¶2.43 to 2.45)

Calculate gain (second method) otherwise determined:

Description	Amount
Proceeds of disposition for total farm property	$200,000
Less: Adjusted cost base for total farm property	$95,000
Gain otherwise determined	$105,000
Less: Principal residence exemption using subparagraph 40(2)(c)(ii) election: $1,000 + (9 × $1,000)	$10,000

Gain	**$95,000**

Result: In this example, the first method results in a lower gain to the taxpayer.

Application

This updated Chapter, which may be referenced as S1-F3-C2, is effective July 25, 2019.

When it was first published on March 28, 2013, this Chapter consolidated, replaced and cancelled Interpretation Bulletin IT-120R6, Principal Residence and Interpretation Bulletin IT-437R, Ownership of Property (Principal Residence).

The history of updates to this Chapter as well as any technical updates from the cancelled interpretation bulletins can be viewed in the Chapter History page.

Except as otherwise noted, all statutory references herein are references to the provisions of the Income Tax Act, R.S.C., 1985, c.1 (5th Supp.), as amended and all references to a Regulation are to the Income Tax Regulations, C.R.C., c. 945, as amended.

Links to jurisprudence are provided through CanLII.

Income tax folios are available in electronic format only.

Reference

The definition of **principal residence** in section 54, and paragraphs 40(2)(b) and 40(2)(c) (also sections 54.1 and 110.6; subsections 13(7), 40(4), 40(6), 40(7), 40(7.1), 45(1), 45(2), 45(3), 45(4), 107(2), 107(2.01), 107(4), 110.6(19) and 220(3.2); paragraphs 104(4)(a) and 220(3.21)(a.1); and subparagraph 40(2)(g)(iii) of the Act; and Part XXIII of the Regulations.)

Date modified:

2019-07-25