Estate Planning Tips – Principal Residence Exemption
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Principal Residence Exemption

Choosing a principal residence to take advantage of the capital gains tax- free status afforded to the sale of a principal residence under the Income Tax Act requires, of course, that you have to own and occupy a property during a taxation year, but what happens if you own and occupy two properties?

The good folks at the CRA will let you have only one at a time. For most people, this means they have to choose between a home and a cottage. If you do sell one residence and claim full tax-free status for that residence, then you can start the clock running on the remaining residence until such time as it is sold. Assuming that the remaining residence would be a cottage and it is sold at a later date, you would still be able to claim some tax-free status using the CRA's "1+ formula".

i.e.

- 1 + the number of taxation years after you last acquired the property (or 1971 if you acquired before 1972) for which the property was your principal residence and during which you were resident in Canada
- the number of taxation years ending after you last acquired the property (or after 1971 if acquired before 1972) during which you owned the property.

You can use major renovations or improvements to add to the cost base of your house to reduce the capital gains otherwise determined before applying the formula to the capital gain.

Making the choice to apply the formula to one principal residence or the other does not have to be made until one of them is to be sold. The matter becomes complicated with the introduction of common law spouses, new spouses and shared ownership. Since the formula described above can become quite complicated, it would probably be useful to contact an accountant to assist you with the calculation to make the right choice.

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