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Marmer Penner Inc. Newsletter

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Principal Residence Year End Deadlines

Family law practitioners need to remember that a matrimonial home and principal residence are not the same. A taxpayer and a spouse are generally allowed one principal residence designation for each year of marriage between the two of them. The number of matrimonial homes may exceed this. A beneficiary of a trust which owns a home may also make a principal residence designation on behalf of the trust.

Since 1981, a married couple has been limited to one principal residence designation between the two taxpayers. Where spouses own more than one residential property with each having increased in value, it is important to calculate the present value of income tax on disposition on at least one of them. It is important to remember that the principal residence designation should be made on the property with the largest accrued taxable capital gain per annum. Because the designation is made on a year-by-year basis, it is better to use the exemption on a cottage that has appreciated \$100,000 in three years than on all the years of a house whose value has increased \$200,000 in ten years. One must also remember that a property outside Canada, such as a Florida condominium, may be designated as a principal residence as long as the owner or his or her spouse or children habitually reside in that home for each year the designation is

made. And the definition of “habitually reside” is quite generous – it needs only be used as such for one day per year.

If both of the house and cottage mentioned above were sold in the same year, the principal residence designation should be applied to the cottage for the three years it was owned leaving only seven years of principal residence designation available for the ten years that the house was owned. While these calculations are somewhat oversimplified, only 7/10 of the \$200,000 gain would be sheltered leaving \$60,000 of capital gain (only half of which is a taxable capital gain) in the sellers’ incomes.

While the designation does not have to be made until the property is disposed, a race to make a designation may occur on separation. For example, two spouses separate with one keeping the house and one keeping the cottage. Each property has an accrued gain. If the separation agreement is silent as to which property may be claimed as the principal residence, it becomes “first come, first served”. Whoever disposes of his other property first, designating it as the couple’s principal residence for all the years it was owned, wins this race and may use the exemption. The loser is unable to claim the principal residence on the remaining property for the common years it was owned.

Once the spouses are separated pursuant to a written agreement or order, they are each allowed a separate principal residence designation for the calendar year which means such a formal document is more valuable to a multiple-property couple if signed in December 2014 than in January 2015.

A non-resident owning property in Canada cannot designate it as a principal residence. However, a Canadian taxpayer may designate a U.S. property as a principal residence. So if the Florida condominium has risen in value more than the Toronto home, consideration should be given to designating the U.S. property as the principal residence.

Be careful giving tax advice in this area. First of all, the gain in US dollars may not be of the same order as in Canadian dollars due to foreign exchange fluctuation. Secondly, designating the home as a principal residence for Canadian income tax purposes does not alleviate the taxpayer from paying US income tax on any US dollar gain. If the property is not designated as a principal residence and there is both a US and a Canadian taxable gain on it, the taxpayer will likely qualify for a foreign tax credit in Canada for all or a portion of the US taxes paid. See? We told you it's not that simple.

This newsletter is not intended to substitute for proper professional planning. It is intended to highlight areas where professional assistance may be required or enough to discuss at the next hoedown. The professionals at Marmer Penner Inc. will be pleased to assist you with any matters that arise. Please feel free to visit our website at www.marmerpenner.com.