CASE IN POINT

Sales Tax Estate Planning Underwriting & Product Newsletter

Lake property as new principal residence

So you've decided to retire to the cottage. What are the long-term tax implications of making this move?

Meet Darwin and Elisha. They decided to sell their home in town which was their principal residence and move to the lake house which they have owned since 1995. They rent a small condo in town to be close to friends, entertainment and as a safeguard against bad weather when they go back to the city. Besides, Elisha has decided to do some consulting work, so a place in town works for business too. How will capital gains on their lakefront home be calculated now?

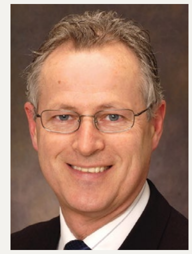
Principal residence exemption on capital gain = a × b/c*

a =.capital gain otherwise determined

b = 1+ number of tax years ending after the acquisition date that cottage was the principal residence and owner was Canadian resident

c= number of taxation years ending after Dec. 31, 1971 or when the property was acquired if later, during which the property was owned by the family unit

* Income Tax Folio S1-F3-C2, Principal Residence



Peter A. Wouters,
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Peter works with independent advisors and other professionals raising awareness on issues and concerns faced by affluent individuals, professionals and business owners. He supports efforts in researching and developing optimal solutions for clients aimed at improving their financial well-being and supporting their personal wishes and lifestyles. He has provided 1000s of workshops, seminars and technical support throughout the country on tax, retirement income and estate planning issues, concepts and strategies to both advisors and consumers. As an accredited Registered Financial Gerontologist, a good deal of his time is spent on building awareness and educating people of all professions who work with or specialize in the needs, expectations and issues of elders. Comprehensive lifestyle planning is an important element of these processes.

The Sales, Tax, Estate Planning, Underwriting & Product (STEPUP) team provides internal and broker support, including seminars, education, advanced concept illustrations & Client case technical consultations.

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Empire Life

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Darwin and Elisha bought the lake house in 1995 (after the personal capital gains exemption was gone). They sell their home in 2016; then designate the cottage as their principal residence after adding an addition to the lakefront property costing $250,000. Darwin and Elisha pass away in 2036 when the value of the property has gone up by $750,000.

Assuming no change in the applicable tax treatment in the intervening years; What is the capital gains reduction? The purchase price of the property is not included and forms part of the cost base. Remember that the cost of improvements can factor into the adjusted cost of the property. Keep those receipts. The adjusted cost base of the property has gone up by $250,000. The total capital gain is now only $500,000.

So what portion of the gain is now considered to be attributed to the principal residence exemption?

$$\frac{\$500{,}000 \times (1 + 21)\ [\text{years } 2016\text{–}2036]}{42\ [\text{years } 1995\text{–}2036]} = \$261{,}904.76$$

The reduced capital gain is $500,000 - $261,904.76 = $238,095.24

Remember that 50% of the capital gain is taxable.

The taxable capital gain is $119,047.62

The actual tax owed will vary somewhere between 40-54% depending on the province where the couple was living.

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