PASS THE PRINCIPLE RESIDENCE EXEMPTION

This is the time of year when cottages are closed down, grapes and gardens are harvested and the family sits down to give thanks for the blessings of the good life. It is also a great time to discuss the transition of ownership the family cottage. This requires a little tax talk around the cutting and chopping of family meal fixings.

Where a family owns only one property and lived in the property every year while they owned it, the calculation of the tax exempt principal residence is very straightforward. In these cases, there will not be any taxable capital gain on the property when it is sold. It's when there are more residences in the family, things get a bit complicated.

History of Principal Residence Exemptions. The following are important dates to know when assessing the tax consequences of family residences.

- Pre 1972: no tax on accrued gains on any capital assets
- 1972 to 1981: one principal residence designation allowed for each year for each spouse
- 1982 to date: one principal residence allowed for each year to each family unit in which there was legal married status
- 1993 to date: one principal residence designation allowed for each year to each conjugal relationship (married or common-law)
- 1998 to 2001: same-sex couples could elect conjugal status, thereby limiting their tax-exempt residences to one per unit
- 2001 to date: same-sex couples required to limit themselves to one principal residence designation per year per conjugal relationship

Form T2091 Designation of a Property as a Principal Residence by an Individual (Other Than a Personal Trust) is used to calculate the exempt portion of a capital gain on a principal residence. Procedurally, the capital gain on the property is first calculated, using regular rules for capital gains and losses. Once this has been done, the exempt portion is calculated, and then subtracted from the capital gain. The exempt portion of the gain is calculated as

$$\text{Total Gain X} \quad \frac{\text{(Number of Years designated as Principal Residence + 1)}}{\text{Number of Years the property was owned}}$$

Because the numerator in the exemption formula adds 1 to the number of years that a property is designated as a principal residence, it is only necessary to designate a property for one year less than the total number of years it was owned, in order to exempt the entire gain. This is because two residences will be owned in the year that the taxpayer moves from one residence to another.

More than one residence. Where more than one property is owned, and the family uses both at some time during the year, the calculation may become slightly more difficult. For periods including 1971 to 1981, each spouse can declare one of the properties as their principal residence. This means that any capital gain that accrued in this period can be sheltered on two properties.

Starting in 1982, only one property per year can be designated as a principal residence for the family. This effectively means that any accrued capital gain on one of the properties (that is not designated as a principal residence) will be ultimately subject to tax when sold.

> **Example: The Hendersons**
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> The Hendersons owned their city home for 15 years before selling it. In addition, they had owned a cottage for 6 years, all of which were during the period when they also owned their city home. The cottage was sold for a substantial gain. In the current year, they sold their city home, which had cost them $65,000, for $225,000. When the Hendersons sold their cottage, they designated it as their principal residence for five of the years that they owned it and so paid no taxes on its increase in value.
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> What is the exempt portion of their capital gain for the year, and how much is taxable? The answer is $117,333. The actual capital gain on the house is $160,000 (= $225,000 less $65,000).
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> The Hendersons can designate their city home as their principal residence for 10 years, as only 5 years of the ownership period were identified with the cottage. To calculate the exempt portion, the number of years the house is designated as the principal residence plus 1 (10 + 1 = 11) is divided by the total number of years the house was owned (15 years). When this is done, the formula results in $160,000 * (11/15) = $117,333. Thus, the non-exempt portion of the gain is $42,667, and 50% of this is taxable.

The taxable capital gain arrived at through the designation of principal residence on Form T2091 *Designation of a Property as a Principal Residence by an Individual (Other Than a Personal Trust)*, is further reduced by any capital gains election made to use up the $100,000 Capital Gains Deduction on February 22, 1994. Look for form T664 from the 1994 return to find the amount of the election. Where the capital gains election was made, use Form T2091(IND)-WS *Principal Residence Worksheet* in addition to T2091.