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New Restrictions to the Principal Residence Exemption

As most solicitors will know, the sale of real property will typically result in a taxable capital gain. If the property is the primary home of its owner, the principal residence exemption normally applies. The result is that individuals who sell the home in which they live are not required to pay tax with respect to the increase in value of the property upon its sale. In Toronto and other Canadian cities where property values have seen a marked increase in recent years, this tax exemption can represent a significant benefit to the taxpayer.

Beginning with the 2016 taxation year, the Canadian government will require Canadians to report the sale of a primary residence to Canada Revenue Agency ("**CRA**"). The new reporting requirement applies to all property sales occurring on or after January 1, 2016.

Along with the new reporting requirement, CRA now has the ability to assess or re-assess the disposition of a principal residence by a taxpayer if the disposition has not previously been reported. In prior years, the period during which CRA could assess or re-assess expired three years after the date on which CRA issued the corresponding Notice of Assessment.

Another change to the principal residence exemption may affect when a property owned by a trust can be designated as a principal residence. In order to qualify as a primary residence, the beneficiary of the trust must live in the property. The types of trusts capable of owning a primary residence will now also be limited to spousal or alter ego trusts that exclusively benefit the settlor and the settlor's spouse, qualified disability trusts, and testamentary trusts benefitting the minor child of the settlor.

Lastly, the upcoming changes to the *Income Tax Act* prohibit a taxpayer from claiming the principal residence exemption in respect of two different properties during the same tax year.

These new changes to CRA's requirements regarding principal residences should be kept in mind by drafting solicitors when advising clients with respect to real property that is held in trust and/or intended to be held in a testamentary trust for the benefit of a surviving spouse and/or children. Solicitors who may be advising clients with respect to the preparation of terminal tax returns should also be aware of the new developments to ensure that the sale of a principal residence is properly reported.