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Capital Gains Tax and your Rental

WRITTEN BY

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What is Capital Gains Tax?

A capital gains tax is a tax on the growth in value of investments incurred when individuals and corporations sell those investments. When the assets are sold, the capital gains are referred to as having been "realized."

Your Rental and Capital Gains Tax

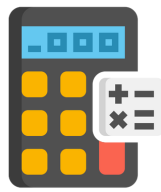
Many of you are aware that your primary residence is usually exempt from capital gains tax, but did you know that in certain circumstances capital gains tax can be applied to your principal residence?

When you decide to move out of your home, and rent it out, there is what is called a deemed disposition. That is, in the eyes of the Canada Revenue Agency, you sold your house. Now because it was your principal residence, no capital gains tax applies. However, now that you are renting it out, it is no longer your principal residence, if you sell it you will have to pay capital gains on the increase in value from the time you started renting it out to the time you sell it. That makes sense to most people, **but did you know that if you move back into the property after renting it out, in the eyes of the government, there is another deemed disposition and it is like you sold a business asset! So capital gains tax would apply.**

Let's look at an example...

Steven and Jill own a house, they decide to take a job in Toronto and rent out their house while they are gone.

The value of their house is $400,000 when they start renting it out. Five years later they decide to return to Canada and move back into their house, but the value of their house is now $500,000.



The house increased by $100,000 of which 50% or $50,000 is taxable as a capital gain.

Assuming they own the house together and have a marginal tax rate of 40%. They will pay $20,000 in capital gains tax just to move back into their house!

So what can you do?

There are three options for people looking mitigate the impact of capital gains tax when they rent out their principal residence:

1. Make an election under section 45(2) of the Tax act which will allow you to defer the capital gains tax payment until you actually sell your house
2. Keep your house as a rental property and purchase a new home
3. Sell your house (you will still have to pay the capital gains tax, but at least you will have the sales proceeds to do so.

Which option is best for you will of course depend on your personal circumstances.

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Jamie Palmer is the President and Broker of Power Properties. He holds a Certified Property Manager (CPM®) designation, the highest designation in Property Management in North America. He earned an Honors degree from the University of Toronto, and he has over 17 years of experience in property management.

Power Properties was established in 1980, and is a member of the Canadian Real Estate Association, the Real Estate Institute of Canada, and the Calgary Residential Rental Association. They currently manage over a quarter billion dollars in residential real estate and collect over one million dollars in rent each month.

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