Synergy Real Estate Network
The Principal Residence Exemption – the last bastion of tax savings
By Michael Louie
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MLS stats, released January 2017
2011-2016
Summary - single family home detached

Summary	% increase	Median $ increase	Estimated tax
Vancouver Westside	**69%**	**$1,425,000**	**$334,875**
West Vancouver	**80%**	**$1,420,000**	**$333,700**
Maple Ridge	**49%**	**$238,241**	**$55,987**
Port Coquitlam	**62%**	**$339,038**	**$79,674**

Year	**Vancouver Westside** # of sales	# of listings	% sales to listings	Median Selling price		**West Vancouver** # of sales	# of listings	% sales to listings	Median Selling price	
2016	1,591	3,073	52%	$3,500,000	***69%***	834	1,876	44%	$3,200,000	***80%***
2015	2,031	3,165	64%	$2,838,000		1,075	2,002	54%	$2,500,000	
2014	1,783	3,250	55%	$2,396,500		828	1,737	48%	$2,100,000	
2013	1,661	3,200	52%	$2,177,500		769	1,780	43%	$1,900,750	
2012	1,243	3,598	35%	$2,060,000		609	1,702	36%	$1,852,000	
2011	1,986	3,589	55%	$2,075,000		1,163	1,975	59%	$1,780,000	

Year	**Maple Ridge** # of sales	# of listings	% sales to listings	Median Selling price		**Port Coquitlan** # of sales	# of listings	% sales to listings	Median Selling price	
2016	1,915	2,592	74%	$720,000	***49%***	578	906	64%	$881,888	***62%***
2015	1,806	2,120	85%	$555,000		587	676	87%	$672,000	
2014	1,362	2,178	63%	$496,750		476	590	81%	$570,000	
2013	1,113	2,146	52%	$480,000		390	635	61%	$540,000	
2012	1,049	2,273	46%	$479,000		390	716	54%	$541,500	
2011	1,148	2,259	51%	$481,759		453	706	64%	$542,850	

Canada

How does the Canada Revenue Agency address non-compliance in the real estate sector?

On October 3, 2016, the Government of Canada announced an administrative change to the Canada Revenue Agency's reporting requirements for the sale of a principal residence. For more information, go to Reporting the sale of your principal residence for individuals (other than trusts).

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Introduction

The Canada Revenue Agency (CRA) uses a combination of advanced risk-assessment tools, analytics, leads, and third-party data to detect and address non-compliance. The CRA audits the files of taxpayers that it identifies as being high risk.

The real estate sector is one of many sectors that the CRA addresses through its risk-based method. Audits related to real estate occur regularly across the country, including in regions of Canada where economic factors may increase the risk of non-compliance. In 2015 for instance, the CRA doubled its level of effort focused on the real estate sector in British Columbia. The CRA has also started a review of 500 high dollar value real estate transactions in British Columbia in 2015 to uncover any tax issues that may not have already been identified.

What are the key areas of compliance risk in the real estate sector?

There are five main areas of concern:

- questionable source of funds
- property flipping
- unreported goods and services tax/harmonized sales tax (GST/HST) on the sale of a new or substantially-renovated property / GST/HST new housing rebate
- unreported capital gains
- unreported worldwide income

Questionable source of funds

The source of funds used to buy or maintain Canadian properties could be an unreported source that was never taxed, either in Canada or another country. In certain circumstances, a large down payment on a home, or a property that is expensive to maintain, may indicate any of the following:

- Unreported income, if the lifestyle of the buyer is not compatible with the income reported;
- Tax evasion
- Purchase of real estate by a low-income person hiding a wealthy buyer.

The CRA can establish correlations between a taxpayer's reported income and their lifestyle. The acquisition of expensive assets, such as a high-end home, without an obvious income source, can be an indicator of potential unreported income earned from legal or illegal sources.

Property flipping

People, including real estate agents, who buy and resell homes in a short period for a profit are engaged in property flipping. There are three main categories of people engaged in this:

Professional contractors or renovators – They rapidly buy and sell real estate at a profit (sometimes demolishing or renovating the property).

Speculators or middle investors – They buy a property and then, for a profit, assign the right-to-sell clause that is in the contract to another speculator or the final buyer. This is called "shadow flipping". It can occur many times between the first sale and the final sale of a property. The original seller often does not know that their property has been assigned to another buyer until the signing date.

Individual renovators – They buy real estate, renovate it, live in it for a short time, and sell it so they can claim the principal residence exemption several times in their lifetimes.

The CRA acquires and analyzes third-party data and has found that some flips are not being reported or are being reported incorrectly. The profits from flipping real estate are generally considered to be fully taxable as business income. The facts of each case determine whether such profits should be reported as business income or as a capital gain.

Unreported GST/HST on the sale of a new or substantially-renovated home / GST/HST new housing rebate

Generally, the builder of a new or substantially-renovated home must charge and collect GST/HST when the home is sold and report that tax to the CRA. The CRA uses various analytical techniques to identify builders who are not complying.

If a builder leases a new or substantially-renovated home, the builder is deemed to have sold the home to themselves. The GST/HST is payable and collectible at once on the fair market value of the home, including the land value, and the builder must report that tax to the CRA.

Generally, the deemed sale of a new or substantially-renovated home is not considered to have occurred if **both** of the following are true:

- The builder builds or substantially renovates a home to be used primarily (more than 50%) as their place of residence, or a place of residence for a relative
- The builder has not claimed an input tax credit to recover any GST/HST payable for the construction or substantial renovation

There may also be GST/HST implications for flipping transactions, if a property is new or has been substantially renovated. In most cases, the sale of used housing is exempt from GST/HST.

One of the main conditions for the new housing rebate to be available is that you must buy or build the house for use as your or your relation's primary place of residence.

If you buy or build a new house in Canada, but your primary place of residence is outside Canada, then your house in Canada would be a secondary place of residence and would not qualify for the new housing rebate.

Also, if the intention at the outset is to flip the property, the eligibility requirement for the new housing rebate is not satisfied, as confirmed by several recent court decisions.

Unreported capital gains on the sale of property

The sale of a property for an amount greater than its cost generally leads to a capital gain. In most cases, capital gains are taxable and must be reported to the CRA. Whether the capital gain is taxable or not can vary depending on whether the property is a principal residence, or whether the seller of the property is a resident or non-resident of Canada.

If the seller of a property has **lived** in Canada **and,** if during that period the property was their main residence, they may avoid having to pay all or part of capital gains tax on the gain resulting from the sale of the property, due to the **principal residence exemption.**

A **non-resident** who invests in property in Canada is liable to pay tax on gains that arise from the sale of that property and is generally not eligible for the principal residence exemption. There are rules related to the disposition or acquisition of certain Canadian property that require non-residents who sell Canadian property to notify the CRA and to pay an amount to cover their estimated Canadian tax liability. This protects the Canadian government's ability to collect tax that would otherwise be payable on the sale of a property.

Unreported worldwide income

An individual's residency status is critical in establishing their Canadian tax liability and the tax treatment of the individual's worldwide income. Residency status should not be confused with citizenship. For example, a citizen of a country other than Canada who has significant residential ties in Canada may be deemed to be a resident of Canada.

Residents of Canada have to report their **worldwide** income to the CRA. Non-residents only have to report their **Canadian-source** income, unless a tax treaty provides otherwise. An individual's residency status is therefore essential in determining what income must be reported.

An individual's residency status is determined on a case-by-case basis in light of many facts which include:

- Residential ties in Canada
- Purpose and duration of visits outside Canada
- Social and economic ties outside of Canada

For more information, go to Income Tax Folio S5-F1-C1, Determining an Individual's Residence Status.

Getting results

The CRA regularly monitors tax compliance in real estate transactions. Transactions in the Greater Toronto Area have been the subject of greater scrutiny, including audits, for some years. More recently the CRA has been actively monitoring and auditing real estate transactions in British Columbia.

The CRA uses a comprehensive approach to dealing with suspected non-compliance in any industry, including the real estate sector: