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CESTNICK

TAX MATTERS

Three ways the federal government may increase taxes on principal residences

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Last week, I wrote about the possibility that our government might look to tax principal residences in some way. Here are the facts that we have working against homeowners: 1) The comments of those who are advising this government on housing wealth and inequality have revealed an attitude that many Canadians have "won the lottery" with the value of homes increasing so much, and that the glorification of home ownership is a "regressive canard"; 2) the principal residence exemption has been abused by some in the past who have claimed it when perhaps they shouldn't have; 3) the homes of Canadians represent their largest store of value for most people; and 4) the support provided by the government during this COVID-19 pandemic is almost assuredly going to mean tax increases in the future.

The question then becomes: What might the government do to increase taxes on principal residences? I think there are three possibilities.

THE U.S. EXAMPLE

The first possibility is that the government may introduce tax rules similar to those in the United States. South of the border, there's a limit on the gain on the sale of a home that can be sheltered from tax. Specifically, there is a US$250,000 "exclusion" (that is, exempted from tax), which is increased to US$500,000 for a married couple filing jointly.

There's another catch here. To qualify for the exclusion in the U.S., you have to have lived in the home for two years out of the last five years leading up to the sale of the residence (there are a couple of other tests that must be met, but they're generally not an issue for most U.S. taxpayers).

Further, if a taxpayer in the U.S. owns more than one residence (a city home and a cottage, for example), they can't simply choose which residence should be sheltered from tax. There's a test that must be applied to determine which of the properties was really the "main home." In Canada, we can designate any eligible property as our principal residence, albeit we can only fully shelter from tax on one property for each family unit.

As an aside, if you're a U.S. citizen or green-card holder living in Canada and you own your Canadian home, a sale of your home may currently be tax-free in Canada but may be taxable in the U.S. So, speak to a tax professional about this.

Now, there's also the issue of mortgage interest. In Canada, we can't generally deduct it. The government's rationale is that we don't generally pay tax on the sale of a principal residence, and so there shouldn't be a deduction for interest to buy the place. If the government were to start taxing principal residences, you might expect that we'd be entitled to deduct our mortgage interest – but don't hold your breath.

Taxpayers in the U.S. can deduct mortgage interest on up to US$375,000 of debt (US$750,000 for a married couple filing jointly). The limits are higher (US$500,000 and US$1-million, respectively) for mortgages taken out on or before Dec. 15, 2017. There are other limits, too, that can apply in certain situations.

Allowing mortgage interest deductibility is not guaranteed if our tax rules change here in Canada. In fact, I'd be surprised if we were granted this benefit, because it would mean a loss of tax revenue in the short term, which the government might make back at the time a home is sold – potentially years down the road.

THE WEALTH TAX

Rather than simply copying the approach in the U.S., our government could introduce a wealth tax. This type of tax is common in several European countries (France, Spain, the Netherlands, Norway, Switzerland and Italy come to mind). In some cases, the wealth tax has morphed into a tax on real estate alone. In France, for example, the rules changed in 2018 to exclude financial assets and to only tax real estate with a value of €1.3-million ($2-million) or more.

Wealth taxes generally range from 0.5 per cent to 1.5 per cent of the value of the assets being taxed. Could something similar be introduced in Canada? Well, it's being done at the municipal level already. Property taxes are something all homeowners are generally familiar with. It wouldn't be difficult to add a federal tax to a system already being administered by municipalities across the country.

THE GST/HST

Currently, the goods and services tax (or harmonized sales tax) is paid by purchasers of new or substantially renovated homes in Canada. Even resale homes can be subject to GST/HST if the property was used primarily for business purposes. It wouldn't be difficult for our government to collect GST/HST on the sale of all homes, and to change the rules around GST/HST rebates currently available.

There are, of course, problems with all these taxes. That will be a debate for another day.

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