THE GLOBE AND MAIL

CESTNICK

TAX MATTERS

Selling homes frequently can lead to grief from the taxman

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Today I want to share the story of a couple who sold three homes in four years. The couple reported their profits as capital gains and then claimed the principal residence exemption to shelter those gains from tax. The taxman reassessed both spouses under the claim that the profits on these sales should be taxed as business income – not as capital gains. That is, the taxman argued that the homes were more akin to business inventory, not capital property, which would mean that profits would be taxable as business income.

THE STORY

The story of Mr. D and Mrs. O is complicated – as life can be. The couple owned, and then sold, three properties in 2012, 2014 and 2015, respectively. Based on this, it's not surprising that the taxman became suspicious that they were in the business of buying, fixing or building, and flipping properties for a profit. It was Revenue Quebec that reassessed the couple, adding a total of $197,814 to Mr. D's income for 2014 and 2015, and an aggregate of $396,835 to Mrs. O's income for 2012, 2014 and 2015.

The facts, however, paint a different picture than what the taxman saw. The first home was in the name of Mrs. O alone. In 2012, there were changes in the neighbourhood that led the couple to move. A nearby quarry was ramping up production and the number of trucks driving by the home significantly increased, along with the noise and dirt. In addition, a neighbouring campsite was sold, and the new owner was undertaking an expansion that led to reduced privacy and more traffic. Not surprisingly, Mrs. O sold the property and they moved in May, 2012.

Tax tips for buying, building, renovating or selling a home

Renting out your cottage could have tax implications

Mr. D and Mrs. O moved to the second property. The property had no home on it initially, so they put a trailer on the property and began building their dream home. The home was unusual in that it was shaped like a bird, with a lot of odd angles and design features. After completing the home and living in it for a while, they concluded that it was too small since they couldn't easily accommodate guests or family wanting to visit. They considered adding a second floor, but the city wouldn't allow it. So, they moved.

Shortly after moving into their third home in July, 2014, Mrs. O's personal circumstances changed. Her sister was diagnosed with terminal cancer and her son separated from his wife. Mrs. O wanted to move to be closer to these family members. So the home was sold in November, 2015.

In the end, the Court of Quebec issued a judgment in favour of Mr. D and Mrs. O, concluding that they were not in the business of buying and flipping properties, and that their intentions were truly to live in these properties.

THE LESSONS

A few lessons come to mind here:

- The Canada Revenue Agency (and Revenue Quebec) has a project on the go to look closely at real estate transactions to make sure people are not claiming capital gains when they should be reporting business income, and to make sure that the principal residence exemption (PRE) is not claimed to shelter capital gains inappropriately.

- The more frequently you sell real estate, the more suspicious the taxman will become. And the fact is, you're required to report the sale of real estate even if you're claiming the PRE to shelter any gains from tax.

- The CRA (and Revenue Quebec) is notoriously bad at carefully looking at a taxpayer's facts and circumstances, and rarely side with the taxpayer if there's any doubt about the taxpayer's intentions when purchasing a property.

- If your true intention was to keep a property to live in, or rent out, then the property should be a capital property – not business inventory. If your circumstances then change to cause you to sell the property, you should be afforded capital gains treatment, regardless of how many properties you may have sold over a short time horizon. The challenge, of course, is convincing the taxman of this fact quickly and cost-effectively, without having to go to court.

- Rather than spending the time and money to fight the taxman, you're best to avoid a red flag on your tax return if you can, by limiting the number of real estate transactions you undertake over a short time – if possible.

- If a piece of real estate is considered capital property in your hands, then you can potentially shelter any capital gain on the sale using your PRE if you ordinarily inhabit the property, and subject to the rules that allow you to fully shelter just one residence if you own multiple properties that overlap by more than one year.

Tim Cestnick, FCPA, FCA, CPA(IL), CFP, TEP, is an author, and co-founder and CEO of Our Family Office Inc. He can be reached at tim@ourfamilyoffice.ca