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RENTAL PROPERTIES

Are you collecting rent on a portion of your home, or do you have an investment property? The topics below discuss potential tax traps. Rental properties can be great investments, but they also come with lots of tax risk.

Change in Use (PLEASE, PLEASE, PLEASE READ)

WARNING: We see this a LOT and it can really trip people up. If you are concerned, please reach out.

- A change in use happens when you change all or part of your principal residence into a rental property, or vice versa. An example is when you move out of your condo and into your boyfriend/girlfriend's residence. If you start renting out your condo it has changed from personal use to income producing.
- A change in use is important because it triggers a 'deemed disposition' for tax purposes. Essentially CRA 'deems' you to have sold your property to yourself at its fair market value. THIS IS TAXABLE.
- The good news is there are ways to plan for this including elections and principal residence exemptions; BUT, timing is crucial. Many of these forms need to be filed in the same tax year that the change in use occurred. Speak with your accountant if this applies to you.

Renting a Portion of Your Principal Residence

There is a risk that capital gains tax could be applied on the rented portion of your home when it is sold. The principal residence exemption (PRE) that allows you to sell your home tax free may not cover the rented portion:

- CRA does allow a 'reasonably small' portion of your home to be used for income purposes without impacting your PRE. Sadly, CRA does not define 'reasonably small'. Conservative estimates range from 5% – 15% while more aggressive claims are usually around 20% – 30%.
- The portion of your home used is calculated by square footage or number of rooms. When calculating your rented portion exclude any personal or common use areas like hallways or laundry rooms to reduce risk.

Short Term Rental Complexities

Renting a property on a short-term basis (tenancy less than 30 days) has a few important considerations:

- GST (Goods and Services Tax) - if your total collected short term rental income exceeds $30,000 (before write-offs) in a 12-month period then you are required to register, collect, and remit GST.
- GST may apply on the purchase or sale of your property if it has been used for short term rentals. This is a complex area of tax and worth seeking professional advice.
- Depending on location you may have to pay speculation tax, vacancy tax, or provincial sales (PST).

What You Can Deduct

There are lots of deductions available for rental properties:

- Mortgage interest (not the full payment), property taxes, home insurance, utilities (gas, electric, water / sewer), repair and maintenance, and accounting fees are all deductible.
- Adjustments are made for personal use portions of the above expenses.
- Purchase and sale costs (legal fees / real estate / property transfer taxes) can be claimed if the property sold is an investment property. These costs are generally not deductible on your principal residence. Likewise, renovation costs are generally not deductible in the year they occur but can be utilized in the event that your investment property is sold, or your principal residence has taxable components (see the discussion above).

Some Final Notes

- Prepare to pay more taxes. Profits from rental properties are quite common. We recommend saving between 25 – 50% of your rental profits (depending on your income) in anticipation of extra taxes.
- Seek professional accounting advice. Rental properties are complex and hiring a CPA is <u>highly</u> recommended.
- Please note the above information is general in nature and may not reflect your unique situation.