the SmallBiz Builder

your monthly newsletter

Padgett

MARCH 2024

Residential Property Flipping Rule

New tax rules came into effect on January 1, 2023, for sales of homes or residential rental **properties that have been held for less than 365 days**. We wrote about this in our May 2023 SmallBiz Builder but thought that a refresher of the rules would be advisable. The impact of these rules is that **the gain on the sale of a "flipped property" will be 100% included in a taxpayer's income as business income.** It will not be treated as a "capital gain" of which normally only 50% of the gain is subject to tax. Also, even if the taxpayer lived in that property**, it will not be possible to claim the principal residence exemption on it.**

Which properties are affected?

- Housing units located in Canada that are owned for less than 365 days, that are not considered inventory to the taxpayer.
- A right to acquire a housing unit. This means that the sale of a right to a pre-construction residential property ("assignment sale") is covered by these new rules as well.

Exceptions:

These exceptions consider circumstances which could trigger a sale of the property before a year has passed since purchase.

- Death of the owner or a related person
- A related person joining the owner's household or vice-versa
- A marriage or common law partnership breakdown
- A threat to the personal safety of the owner
- The owner or a related person suffering from a serious disability or illness
- An involuntary termination of the owner's or the owner's spouse/common law partner's employment
- A job transfer or move to enable the owner to take on a new job, carry on a business, or pursue post-secondary education. The new home must be at least 40 kilometres closer to the new work location.
- Insolvency
- Destruction or expropriation of the property

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Situations to watch out for:

- Using a "rollover" election to transfer property to a corporation. The corporation must own the property for 365 days otherwise it falls into the deeming rule.
- When a constructed property is acquired through a pre-construction contract, there is a reset of the 365-day test. In other words, the period in which the right was held does not count towards the 365 days once the property is acquired.
- There is little clarity from CRA as to how the rules apply in certain trust situations.

What about losses?

- It's important to note that any loss from the sale of a flipped property is deemed to be nil. That means although the income may be taxed as business income, any loss will be denied so that it cannot be a tax advantage to the taxpayer to offset other types of income such as employment, pension, or other business income. Therefore, if possible, it would be better to hold the property until the 365-day ownership test has been met.

Business income

- Since the deeming rule considers the profit to be business income, more expenses can be claimed such as mortgage interest, condo fees, repairs and maintenance, insurance. This would be in addition to the usual selling costs such as real estate commissions and legal fees.
- It may be advisable to hold these properties in a corporation to benefit from the lower tax rates on business profits, but this depends on provincial tax rates and the taxpayer's plans once the property is sold.