# Buying, Owning, and Selling a Home

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The purchase of one's own home represents both a lifetime goal for most Canadians as well as the largest single purchase and biggest financial commitment that most of us will ever make. It's also, for many, a significant part of their overall financial and retirement planning. All in all, there's a lot of money and many expectations tied up in this single asset.

Generally speaking, the Canadian tax system is designed to encourage and facilitate home ownership by Canadians. That's done through tax "breaks" making it easier to save for the initial down payment, a credit provided to first-time homebuyers, and finally, preferential tax treatment received when the family home is eventually sold.

What follows is an outline of many of the rules

which can affect homeowners and would-be homeowners under our tax system.

## Getting into the market—buying your first house

### Coming up with the downpayment

Trying to save enough to make a down payment on a house while still covering one's current living costs poses a significant obstacle for many Canadians who want to get into the housing market. The federal government provides a couple of programs to allow would-be homebuyers to save on a tax-assisted basis.

The first of those programs is the Home Buyers' Plan (HBP), which allows taxpayers to withdraw funds, on a tax-free basis, from their registered retirement savings plans (RRSPs) to use for a down payment on a first home. The funds so withdrawn must be repaid to the RRSP over the next 15 years.

As with all things tax-related, there are caveats and conditions involved. In order to participate in the HBP, the taxpayer must be a first-time home buyer. For purposes of the HBP, "first-time buyer" means that the neither the home purchaser nor his or her spouse have owned a home within the previous four years. It's still possible, therefore, where someone sells a home and doesn't purchase another for a period of at least four years, for that person to qualify as a "first-time buyer" for purposes of the HBP with respect to their next home purchase.

There are, as well, limits set on the amount which can be withdrawn from an RRSP under the HBP program. Until January 27, 2009, that limit was $20,000. However, the amount of a permitted withdrawal was increased in the 2009 federal budget to $25,000, effective for home purchases made after the budget date of January 27, 2009. Where funds are withdrawn from an RRSP as part of the HBP, there is no tax withheld from the withdrawal—in other words, where $25,000 is withdrawn, the taxpayer will receive the full amount. Such a withdrawal can be made in one lump sum or as a series of withdrawals, with the only restrictions being that all withdrawals made for the purpose of the HBP must be made during the year, or in January of the following year, and that the home must be purchased or built before October 1 of the year which follows the year of withdrawal. And, finally, where the first-time home buyers are spouses (keeping in mind that both must separately qualify as first-time home buyers) each spouse may withdraw up to $25,000 from his or her RRSP for HBP purposes, meaning that the total possible withdrawal is $50,000.

Of course, no matter how much or how little is withdrawn, all such funds must be repaid to the RRSP. The first repayment is due the second year following the year in which the withdrawal was made. Generally, for each year of the repayment period, 1/15th of the withdrawal amount must be repaid. The Canada Revenue Agency (CRA) sends taxpayers who have participated in the HBP a statement of account each year, included with the Notice of Assessment received with respect to that year's tax return. The statement will include:

- the amount the taxpayer has repaid (including any additional voluntary payments);
- the taxpayer's HBP balance; and
- the amount of the next repayment the taxpayer must make.

Where a taxpayer fails to make a required repayment under the HBP, the amount of that payment is treated as an RRSP withdrawal and is added to the taxpayer's income for the year. The amount is then taxed in the same manner as any other RRSP withdrawal.

The second federal program which allows taxpayers to save for a down payment on a tax-assisted basis is the tax-free savings account (TFSA), also introduced as part of the 2009 federal budget. While the TFSA program was not created specifically for the purpose of saving for home ownership, many of its features lend itself to that


purpose. Under the TFSA rules, any Canadian resident 18 years of age or older can contribute up to $5,500 per year to a TFSA (prior to 2013, the limit was $5,000, and in 2015 it was $10,000). While no deduction is allowed for the TFSA contribution, any investment income earned within the plan is not taxed and any amount can be withdrawn from the TFSA at any time and used for any purpose, with no tax payable on the withdrawn amount. And, unlike the HBP withdrawals, there is no requirement that withdrawals made from a TFSA must be repaid to the plan.

Where a taxpayer and his or her spouse each use a TFSA to put money aside for a down payment, the total possible savings, not including any tax-free investment income earned on those savings, could amount to $55,000 over a five-year period ($5,500 per taxpayer × 5 years = $27,500). And, since TFSA amounts are withdrawn free of tax, the full $55,000 would be available to use as a down payment.

## Qualifying for mortgage financing

For all but a very fortunate few, buying a home means taking out a mortgage. As well, taking on a mortgage means qualifying for that mortgage under the Canadian mortgage lending rules. By and large, those rules are fairly stringent, certainly by comparison to the standards applied in recent years in the United States. As well, the Canadian government, mindful of the role that mortgage defaults played in the financial crisis which began in the U.S. in the fall of 2007, has twice made changes since that time to impose even more stringent requirements on Canadian borrowers. Note that these and other rules regarding mortgage financing apply only to mortgages arranged through Canadian financial institutions. Where a homebuyer can obtain private mortgage financing (for instance, from parents or other family members), the allowable terms and conditions are simply those which can be negotiated between the parties.

In order to make sense of the recent changes made by the federal government, some background is required. Where a home purchase is to be made and the down payment is less than 20 percent of the purchase price, a commercial lender will require that the purchaser obtain mortgage insurance through a federal agency—the Canada Mortgage and Housing Corporation (CMHC). A fee is paid by the borrower for such insurance, under which the lender is protected by the federal government against any failure by the borrower to repay the mortgage according to its terms.

While Canadian mortgage financing requirements have always been fairly conservative, the federal government felt that what it called "financial innovations" in the mortgage market were increasing the risk of a U.S.-style housing bubble. Accordingly, the federal government moved, in the fall of 2008, the spring of 2010, and again in the summer of 2012, to tighten the lending requirements which are imposed on such government-insured mortgages.

As a result of those changes, any new home purchasers in Canada who will be taking out a CMHC-insured mortgage must provide a minimum down payment of 5% or 10% (depending on the type of house being purchased) of the purchase price. In addition, the maximum amortization period (the period over which the mortgage must be repaid) is limited to 25 years. Finally, the new rules set minimum requirements with respect to a borrower's credit history and current financial obligations. Specifically, they required that any new borrower on a CMHC-backed mortgage have a credit score of at least 620 (out of a possible 900) and that the total amount needed to pay all debt service and housing-related fixed or essential payments (which would generally include mortgage payments, property taxes and heating costs) is no more than 44% of the borrower's gross income for the year.

### Tax credits for first-time home buyers

Would-be buyers who manage to put together the required down payment and qualify for mortgage financing can obtain a tax "break" during their first year of home ownership, in the form of the refundable tax credit for first-time home buyers. That credit, which is claimed on the taxpayer's income tax return for the year, is $750. While such an amount is relatively small in relation to the overall cost of acquiring a home, it would in many cases be sufficient to cover at least part of the closing costs (like legal fees) and new homeowner costs (like window coverings and maintenance costs) which often catch first-time home buyers by surprise.

## Living in your house—tax rules applied to home ownership

### Moving expense deduction

Buying and moving into your first (or subsequent) home doesn't automatically make moving expenses deductible. Rather, the deductibility of moving expenses is determined by whether the move brings one closer to one's place of work. The rule, in all cases, is that moving expenses will be deductible where the new home is at least 40 kilometres closer to the taxpayer's place of work. If that criterion is met, then a number of moving-related expenses can be deducted from employment or business income earned at the new location. The CRA issues a very useful fact sheet detailing the types of costs which may or may not be deducted under the moving expense deduction, and that fact sheet is available on the CRA Web site at www.cra-arc.gc.ca/E/pbg/tf/t1-m/t1-m-15e.pdf.

### Deducting home ownership costs

First-time home buyers are almost always surprised at the never-ending stream of bills that accompany home ownership. Unfortunately, virtually none of those costs are deductible for income tax purposes, except in the limited circumstances associated with having a home office.

Homeowners often wish, in particular, that the interest cost associated with paying the mortgage could qualify for some tax relief. However (again, except in the limited circumstances outlined below), mortgage interest paid on an owner-occupied home is not and has never been deductible for Canadian tax purposes.

### Home office expense deduction

The one instance in which costs associated with the running of an owner-occupied home can be deducted for tax purposes is where the homeowner has a home office (or in tax parlance, a workspace) in that home.

As is usually the case in tax matters, the rules differ for employed taxpayers and for the self-employed, as the latter enjoy a greater degree of latitude in the deductions which may be claimed. That said, both the employed and the self-employed must meet the same basic two-part test in order to be eligible to deduct home-related expenses, and that test is as follows:

- the home office must be the place at which the taxpayer principally (defined by the CRA as more than 50% of the time) performs the duties of employment or must be the taxpayer's principal place of business: or
- the home office must be both used exclusively for the purpose of earning income from employment or from the business and must be used on a regular and continuing basis for meeting customers or clients of the employer or the business.

A self-employed homeowner who meets these criteria is entitled to claim expenses such as property taxes, rent or mortgage interest (but not mortgage principal amounts), insurance, utilities costs, etc. However, such expenses are not deductible in their entirety; rather, the homeowner must apportion the expenses based on the percentage of the total space which


is used as a home office. For example, a self-employed taxpayer whose home office takes up 15% of available floor space and who incurs $2,000 each year in qualifying expenses would be entitled to deduct $300 ($2,000 times 15%) in home office expenses for that year. There is one further caveat, in that the amount of home office expenses claimed in a year cannot be greater than the amount of income from the business. It's not, in other words, possible to run a business which produces $5,000 in income for the year and to then claim $10,000 in home office expenses relating to that business. However, where home office expenses exceed business income in any given year, the excess expenses can be carried over and claimed in a subsequent year in which there is sufficient business income to offset those expenses.

Employed homeowners who meet the two-part test set out above must meet a further condition before being eligible to claim home office expenses, as follows:

- the employer must provide the employee with a specified form (Form T2200), which indicates that the employee is required by his or her contract of employment to provide a home office and to pay for expenses related to the home office;
- the employee must not have been reimbursed by the employer for such expenses; and
- the expenses must have been used directly in the employee's work at home.

Once the required form has been issued, and the other conditions are met, an employee who owns his or her own home can claim a proportionate percentage of utilities and maintenance costs. An employee is not, however, entitled to claim any portion of mortgage interest, property taxes, or home insurance costs paid, and cannot claim capital cost allowance on the home.

Employees working on commission, who usually occupy the tax territory somewhere in between employees and the self-employed, have slightly more latitude in claiming deductions with respect to the use of their own homes for work purposes. Such employees must also provide a Form T2200, but may claim, in addition to the costs outlined above for employees, a portion of property taxes and insurance paid on the home. Mortgage interest and capital cost allowance remain non-deductible.

As is the case with self-employed taxpayers, an employee's deduction for home office expenses cannot be greater than the income from employment income for the year to which the expenses relate. And, once again, carryover to a subsequent taxation year is allowed.

### Claiming capital cost allowance on the family home

One of the tax benefits which is commonly supposed to exist for homeowners who have a home office is the right to claim depreciation (or capital cost allowance (CCA), in tax parlance) on one's home for tax purposes. For employees (including those who work on commission), however, such a claim is simply not allowed. And, while the self-employed may be entitled to claim CCA on a home, making such a claim can create a short-term benefit with long-term costs. Making a CCA claim on one's home is likely to erode the principal residence exemption from capital gains tax which is claimable when a home is sold, and that exemption is almost always more valuable, in monetary and tax terms, than any CCA claim which might have been made.

## Accessing the equity in your home

For much of the time during which you own a home, the focus is on keeping the mortgage paid and on building equity. However, there comes a time, usually after retirement, when the need to tap into that equity can arise.

For many Canadians, a home is the single most valuable asset that they will ever own. It is also likely their most illiquid asset—while they may have a great deal of equity in the home, the problem is getting access to that equity without having to sell the property and move. As well, for the majority of taxpayers who do not belong to an employer-sponsored pension plan, the equity built up in their home represents a significant potential source of retirement income. Such taxpayers can find themselves, after retirement, faced with the difficult reality of having to sell the family home and move, in order to free up capital which will provide needed income.

As the Canadian population ages, more and more Canadians will find themselves in that position and, consequently, financial products have been devised in recent years which will permit homeowners to access their equity without selling the home. The most well-known of those is the reverse mortgage.

In basic terms, a reverse mortgage is a loan, usually available to taxpayers 60 years of age and older, which is secured by the taxpayer's equity in his or her home, and on which interest is charged and accumulates. The amount of the loan is usually between 10% and 40% of the home's value and, unlike a conventional mortgage, no payments are required on the reverse mortgage as long as the homeowner continues to occupy the home. Payments received under a reverse mortgage are tax-free and don't affect the homeowner's eligibility for means-tested government benefits, such as Old Age Security or Guaranteed Income Supplement or tax credits like the goods and services tax credit. On the downside, interest rates charged under a reverse mortgage are usually higher than those levied for a conventional mortgage, and other related fees (home appraisal, application fee, legal fees) can also add up. The taxpayer's equity in his or her home is reduced, not just by the amount of the reverse mortgage, but by the accumulating interest cost over the life of that mortgage. A reverse mortgage can provide real benefits to the taxpayer who is "house-rich" but "cash-poor" (for instance, someone who lacks a regular source of income sufficient to ensure a comfortable retirement but whose home has increased very significantly in value since its purchase, perhaps decades earlier). Reverse mortgages are, however, complex financial instruments, and anyone contemplating acquiring one should obtain professional advice from an independent third party. There are also alternatives to taking out a reverse mortgage, each with its own advantages and disadvantages.

Where a homeowner has a substantial amount of equity in his or her home, a home equity line of credit (HELOC) can usually be obtained. Like the reverse mortgage, the HELOC allows a homeowner to borrow funds secured by the equity in the home. The maximum amount which can be obtained through a HELOC is usually calculated as a percentage of the amount of equity held in the home, but it's not necessary to obtain such funds as a lump sum. Rather, the homeowner can obtain funds through the HELOC as they are needed – perhaps to meet large recurring annual costs like property taxes or unexpected costs for home repairs or medical care, with interest payable only on the amount which is currently outstanding. However, unlike a reverse mortgage, the terms of a HELOC require regular (usually monthly) repayment of amounts borrowed. In many cases, the minimum monthly payment required is the amount of any interest cost incurred during the previous month, so that the homeowner has the option of making interest-only payments. However, where the interest rate on a HELOC is tied to the current prime rate (which is often the case), those who have borrowed through a HELOC are vulnerable to increases in prevailing interest rates.

The choice of whether to access one's equity through a reverse mortgage or through a HELOC is a very individual one, which depends to a great degree on the taxpayer's individual circumstances. The only hard and fast rule which applies is the need to fully understand all of the terms and conditions of any lending arrangement entered into.

Finally, for the taxpayer who has a need to access the equity in his or her home, borrowing to get that access isn't always the answer. While in some cases, the homeowner may simply not be willing to sell and move from the family home, in others it may be that the homeowner needs access to the equity and also finds the family home too expensive or difficult to maintain, but doesn't want to give up independent living. In such circumstances, the answer may be to sell and move to a smaller, less expensive home, or to a condominium, solving both problems without a need to go into debt. The answer, as in all such cases, depends on the needs and circumstances of the individual homeowner.

## Renting or selling the family home

### Renting the family home

While a principal residence is most often occupied only by the family which owns it, it is sometimes the case that the need or the opportunity to rent out the family home arises—most often where a temporary work transfer or assignment requires a short-term move to another location. Such a change in use could have a number of negative tax consequences, but there is a special election which may be made to prevent those results.

In effect, when a principal residence is changed to a rental property, the owner can make an election to not be considered to be using the home as a rental property. In effect, the property can continue to be designated as the taxpayer's principal residence for up to four years while it is being rented out, as long as the owner does not designate another property as his or her principal residence during that time.

In order to take advantage of this election, the owner of the property must report as income any net rental or business income earned on the principal residence and, in addition, may not claim any capital cost allowance on the property. The election itself is made by attaching a signed letter to one's return, describing the property, and indicating that an election under section 45(2) of the *Income Tax Act* is being made.

While the election is normally available for a four-year period, there are circumstances in which that four year limit can be extended indefinitely. In order to do so, all of the following conditions must be met:

- you live away from your principal residence because your employer, or your spouse's or common-law partner's employer, wants you to relocate;
- you and your spouse or common-law partner are not related to the employer;
- you return to your original home while you or your spouse or common-law partner are still with the same employer, or before the end of the year following the year in which this employment ends, or you die during the term of employment; and
- your original home is at least 40 kilometres (by the shortest public route) farther than your temporary residence from your, or your spouse's or common-law partner's, new place of employment.

## When it's time to sell—the principal residence exemption

Most of us will, eventually, be in the position of selling a family home, and the proceeds from that sale will likely be the largest sum of money we ever receive on a single transaction. For many taxpayers, as well, the money tied up in a family home represents an asset to be used to finance one's retirement. Our tax system recognizes these realities by providing an exemption from the tax which would normally be imposed on the sale of such an asset, by means of the "principal residence exemption".

Under the usual tax rules, where a taxpayer sells an asset, the sale proceeds received, minus the original cost of the asset, constitutes a capital gain. One-half of that amount, known as a taxable capital gain is included in the taxpayer's income for the year in which the sale takes place. It's easy to see how the tax bite on such a taxable capital gain could significantly erode the net proceeds available to the taxpayer to use for other purposes. However, an exemption from capital gains tax is provided for each year in which the property was occupied as a "principal residence". While there is a specific definition of what constitutes a principal residence, it's safe to say that any residence occupied as a family home throughout the period of ownership would fully qualify as a principal residence and the profit made from its sale would be effectively exempt from tax.

## Conclusion

Buying one's first home and taking on a mortgage represents a huge financial commitment and also, perhaps, the first big step into "adult" responsibilities. There are many decisions to be made in the course of buying and financing a first home, and many of those decisions will have a long-term impact on the homeowner's lifestyle and finances. It's worth taking the time to become educated about the financial and tax implications of home ownership, and to make certain that any tax "breaks" or benefits that are available—on the purchase of the home, during the period of home ownership and on the sale of that home—are utilized to the homeowner's best advantage.