Long-term care and the principal residence exemption, Part 2 – Renting to a child

In an earlier article, we wrote about the principal residence exemption and whether an individual would be able to claim the exemption for her home for a period during which she resides in a long-term care facility. In the case discussed, Tracy, a widower, moved into a nursing home to access care and better manage restricted mobility. She continued to own her home after the move, which was occupied by a non-related third-party renter. Tracy wondered if she would be able to claim the principal residence exemption for the period during which she resides in the nursing home. See here for the article: http://trep.ci.com/tax-efficient-investing/long-term-care-and-principal-residence-exemption.

As per principal residence exemption rules, in order to claim the exemption for a given year, a taxpayer must "ordinarily inhabit" the home and no other property can be claimed by the taxpayer or his/her family unit (normally a spouse, common-law partner (CLP) or minor child) for the year. Where the taxpayer does not inhabit the home, the exemption is still available if a spouse, CLP, former spouse or CLP or child (of any age) occupies the home.

Whether Tracy would be able to claim the exemption would depend on the circumstances. If Tracy's stay in the nursing home is regarded as temporary in nature, it's likely that she would be considered to continue to "ordinarily inhabit" her home, in which case the principal residence exemption would be available to fully shelter the property from tax on sale or death, even if incidental rental income is earned. On the other hand, if Tracy's stay in the nursing home is viewed as permanent, the "ordinarily inhabited" requirement would likely not be met, meaning taxation on disposition of the property for the period during which Tracy resided in the care facility.

Unlike the first article where Tracy rented her home to an unrelated third-party and was unable to claim the exemption for the period she permanently resided in the care facility, the question for this article is, if the home is rented to a child, would the exemption be available for the same period? Consider the following:

Tracy, age 72, recently moved to a local nursing home after the death of her spouse, Kent. After Kent's passing, it was determined that Tracy would require permanent long-term care in the nursing home to meet her immediate day-to-day needs. It is not expected that Tracy will return to the home in the future.

For 40 years, Tracy and Kent jointly owned and lived in their home until Kent's passing. Not wishing to immediately sell the home, Tracy decided to rent the home to her daughter, Keri, charging fair market value rent. Rent paid by Keri would be used to help cover Tracy's nursing home expenses.

Thinking ahead to the future, Tracy wondered if the principal residence exemption would be available to shelter her home from tax on a future sale.

There is flexibility to claim the principal residence exemption when a child inhabits a home owned by a parent. This is the case regardless of rent charged (fair market value or otherwise) as indicated by CRA technical interpretation #2016-0625161C6. Applying this concept to Tracy's scenario, provided Keri occupies the home until sale or Tracy's death, Tracy can claim the property as her principal residence for each year of ownership, fully sheltering it from income tax provided no other property is claimed as such by Tracy. Of course, any rental income paid from Keri to Tracy each year must be reported as taxable income on Tracy's income tax return offset by eligible rental expenses for the year.

Taking this a step further, what if Keri and non-related roommates, Sue and Troy, jointly occupy Tracy's home with each paying fair market value rent? Would Tracy be able to claim the principal residence exemption in this case, and if yes, to what extent?

While the outcome would depend on the facts of the case, normally, CRA's practice is to consider that an entire property retains principal residence exemption status when the following conditions are met:

- The property is primarily used as a principal residence and is used only incidentally to produce income;
- No structural changes are made to the property;
- No capital cost allowance (CCA) is claimed for the property.

Where one or more of the above criteria are not met, only the portion used for personal use will be allowed as a principal residence. From the discussion above, we know that Keri, a child of the property owner, can inhabit the property to satisfy the "ordinarily inhabited" requirement allowing the home to continue to be a principal residence for purposes of the exemption. However, given that Keri is now occupying the property jointly with non-related roommates Sue and Troy, each paying

FMV rent, an argument can be made that the property is no longer being used primarily as a principal residence compromising, in part, the principal residence exemption. As per CRA technical interpretation #2014-0527591E5, if income-producing activity is significant, structural changes have been made to the property or CCA has been claimed for the property, only the part of the home used for personal purposes by the child (Keri in this case) will qualify for the principal residence exemption. The portion used for income-producing purposes would be subject to tax, requiring a determination of the eligible portion based on reasonable criteria such as rooms used or some other basis as is applicable.

Having an understanding of these rules – and where potential challenges might arise – can help when planning and managing tax implications.

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