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Padgett

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Residential Property Flipping Rule

Property flipping means that the property is held for a shorter period, sometimes with renovations carried out, with the intent to make a profit on the sale.

As of January 1, 2023, there is a new tax rule for sales of homes or residential rental properties that have been held for less than 365 days. 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.

Why this new rule?

- The federal government is introducing this new rule to help reduce speculative demand in the housing market, which will hopefully make home ownership more affordable for Canadians.
- The tax rules already provide that real estate that is owned for the purpose of selling at a profit is taxable as business income. If the property is held for the purpose of earning rental income or for personal use, then upon sale the gain will generally be treated as a capital gain. The lines between these two different tax treatments can get blurred and with 50% of a capital gain being tax free, we know which side a taxpayer wants to argue. The CRA is concerned that taxpayers are flipping properties and reporting them as capital gains instead of business income and may also be claiming their principal residence exemption to shelter the gain from tax. It's a costly process for CRA to argue each case independently so they are simply legislating the tax treatment for shorter term property ownership. There are exceptions which will be highlighted further in this article.

Which properties are affected?

- Housing units in Canada – residential use or rental properties – that are owned for less than 365 days. This new rule does not apply to sales of foreign properties by Canadian residents.
- However, as mentioned above, any gain on the sale of a property, whether it is owned out of the country or held for a year or more, could be taxed as business income rather than a capital gain if the main purpose for holding the property was to sell it at a profit.

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Exceptions:

As always, life comes with twists and turns and these exceptions consider circumstances which could trigger a sale of the property before a year has passed since purchase.

- Death of the owner or someone related
- 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

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.

Other

- There is proposed legislation, with retroactive effect to January 1, 2023, that these same rules apply to the profit on assignment sales. The 365-day period resets if the taxpayer who entered into a purchase and sale agreement secures ownership of the property.