the **Scrivener**

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President of the British Columbia Notaries Association

ALLIED PROFESSIONS TO BC NOTARIES

WINTER 2024 | VOLUME 34 | NUMBER 03 Published 3 Times a Year by the BC Notaries Association

BC Notaries Association

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Working Together with Chartered Professional Accountants

➔ In our previous issue, I referred to the nexus in much of the knowledge required to be competent in both the professions in which I practise (BC Notary and Accountant).

Specifically, the nexus exists where the work I do as a BC Notary Public intersects with the *Income Tax Act*. Indeed, to one degree or another, there is an intersection between the *Income Tax Act* (ITA) and the work many of our readers do, regardless of the profession to which we belong.

There are obvious instances when clients should be encouraged to seek the advice of an income tax practitioner. Over the past 2 years, one example has been the confounding reporting requirements for bare trusts. There are less obvious examples of seemingly mundane transactions many taxpayers take for granted that can result in a significant tax liability for the unwary.

Notaries are oftentimes challenged when they attempt to convince their clients of the necessity to seek the advice of an income tax practitioner. One way to overcome such resistance is for the Notary to have an established relationship with a trusted CPA to whom the clients can be referred.

In this article, we'll explore one deceptively simple example: The Principal Residence Exemption (PRE).

Most taxpayers take for granted that the proceeds from the sale of their home are received tax-free. Complications can arise, however—to name a few . . .

- where the characterization of the property for tax purposes is unclear;
- where the property is larger than half a hectare; or
- where the disposition of the property is the result of a breakdown of marital relations.

The taxpayer's occupation can also impact eligibility for the PRE.

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Capital Property Requirement

Only gains on account of capital property qualify for the PRE—even if the taxpayer has occupied the property for the entire period of ownership. In simplified terms, the ITA defines "capital property" as any depreciable property that results in a capital gain. The implication by omission is that capital property held on account of income does not qualify for the PRE.

While there is no provision in the ITA that describes when gains from the sale of real estate are determined to be on account of either capital or income, the Courts have considered various factors, such as

- the taxpayer's intention with respect to the real estate;
- the feasibility of the taxpayer's intention and extent to which that intention has been carried out; and
- the geographical location and zoning of the property.

The nature of the business, profession, or calling of the taxpayer and associates is also a factor the Courts have considered. In other words, the more closely a taxpayer's business or occupation is related to real estate transactions, e.g., a builder or Realtor, the more likely a gain on real estate will be considered business income rather than a capital gain and thus not eligible for the PRE.

Dispositions Where Land Exceeds One Half Hectare

The ITA states the principal residence of a taxpayer includes the housing unit and such portion of any immediately contiguous land as can reasonably be regarded as contributing to the use and enjoyment of the housing unit as a residence. Where the total area of the land exceeds half a hectare (approximately 1.235 acres), the excess is deemed not to have contributed to the use and enjoyment of the housing unit as a residence—unless the taxpayer establishes it was necessary to such use and enjoyment.

Whether this deeming provision can be rebutted is a question of fact. For instance, the CRA has stated that where a severance restriction has been imposed on the land (and the land is not used for income earning purposes), such a restriction will be considered in determining whether the land in excess of half a hectare is necessary for the owner's use and enjoyment of the residence as a principal residence.

That can occur, for example, in situations where municipal zoning or agricultural land reserve restrictions have been imposed. It can also occur where there are restrictions concerning waterways, such as drainage ditches, creeks, streams, rivers, ponds, and lakes.

If a minimum lot size or severance restriction is removed in a particular year, the excess land would generally no longer be considered necessary for the use and enjoyment of the housing unit as a principal residence for that year and any subsequent year—regardless of whether the taxpayer actually took steps to sever the land.

Dispositions on Marital Breakdown

For the purposes of the PRE, only one property may be designated as the principal residence of any member of the taxpayer's family unit for a given year. For the purposes of the PRE, a family unit includes the taxpayer's spouse or common law partner—unless the spouse or common law partner was throughout the year living apart from the taxpayer and was separated from the taxpayer under a judicial separation or a written separation agreement.

When a marriage breaks down, one of the results is often a disposition of the family home. When that occurs, if each spouse owned a separate property (either because the family owned multiple properties or because each purchased another property) before a judicial separation was obtained, or before a written separation agreement was signed, only the first spouse to designate their property as a principle residence will be eligible for the PRE.

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In a situation where a divorcing couple jointly owns two properties and as part of their settlement each spouse receives one of the properties, absent any election to the contrary, the ITA will deem each spouse to have owned 100 per cent of their property while it was jointly owned. If the parties do not mutually agree which property will be designated as the principal residence for the years during which they were married and before they divorced, only the first party to designate their property will be entitled to claim the PRE for those years.

On the surface, the Principal Residence Exemption can appear to be relatively simple. The examples I have described here are but a few to illustrate the intricacies and complexities that exist in even seemingly simple aspects of the *Income Tax Act*.

Notaries working together with other professions, such as Chartered Professional Accountants, and leveraging our respective areas of expertise, is one important way to ensure we best serve the interests of our respective clients.

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