



Canada Revenue
Agency

Agence du revenu
du Canada

Rental Income

Includes Form T776

Before you start

Is this guide for you?

This guide is for you if you had rental income from real estate or other property in the current tax year. The information relates mainly to renting real estate, but some of the information will apply to other types of rental property.

This guide will help you determine:

- your gross rental income;
- the expenses you can deduct; and
- your net rental income or loss for the year.

To determine if your income is from property or from a business, read Chapter 1. To find out if you are a partner of a partnership or a co-owner, read "Are you a co-owner or a partner of a partnership?" on page 6.

Glossary – We have defined some of the terms used in this guide in a glossary on page 4. You may want to read it before you start.

Forms and publications – In the middle of this guide, you will find two copies of Form T776, *Statement of Real Estate Rentals*. Throughout this guide we mention forms, pamphlets, interpretation bulletins, information circulars, and other guides that give more details on specific tax

topics. You can get most of our publications, on our Web site at www.cra.gc.ca/forms or by calling 1-800-959-2221.

More information – In this guide, we use plain language to explain the most common situations. If you need more help after reading this guide, please visit our Web site at www.cra.gc.ca or call our Individual Enquiries line at 1-800-959-8281.

What's new for 2004?

Canada Revenue Agency – In this publication, we use the name "Canada Revenue Agency" and the acronym "CRA" to represent the Canada Customs and Revenue Agency. This reflects recent changes in the structure of the Agency.

Principal residence – A legal representative (executor, administrator, or a liquidator in Quebec) of a deceased person should now use new Form T1255(LEGREP), *Designation of a Property as a Principal Residence by the Legal Representative of a Deceased Individual*, to designate a property as a principal residence for the deceased. For more information on principal residence, see Chapter 4, on page 22.

Point... Click... Done...

That's all it takes to get tax information when you need it. Visit www.cra.gc.ca today and find out how easy managing your taxes can be.

CRA wants to decrease the demand for paper. It is our practice to send out this guide to you, if you declared business income in either of the previous two years. However, the accessibility of the Internet continues to increase. In the future, we encourage you to view this guide on our Web site at www.cra.gc.ca/E/pub/tg/t4036, as well as print the parts you need.

Visually impaired persons can get our publications in braille, large print, or etext (computer diskette), or on audio cassette by visiting our Web site at www.cra.gc.ca/alternate or by calling 1-800-267-1267 weekdays from 8:15 a.m. to 5:00 p.m. (Eastern Time).

La version française de cette publication est intitulée *Revenus de location*.

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Glossary

This glossary explains, in a general way, the technical terms used in this guide.

CCA – Capital cost allowance

FMV – Fair market value

MURB – Multiple-unit residential building

UCC – Undepreciated capital cost

Arm's length transaction – This is an expression used to describe a transaction between unrelated parties. Each party acts in his or her own self-interest.

Related persons are not considered to deal with each other at arm's length. Related persons include individuals connected by blood relationship, marriage, or common-law partnership, or adoption. Also, a corporation and a shareholder who control the corporation are related.

Unrelated parties may not be dealing with each other at arm's length if, for instance, one is under the influence or control of the other, if one is acting in concert with the other, or if they have a common mind. For more information, see Interpretation Bulletin IT-419, *Meaning of Arm's Length*.

Available for use – You can claim CCA (see the definition on this page) on a rental property only when it becomes available for use.

A **rental property, other than a building**, usually becomes available for use on the earliest of:

- the date you first use it to earn income;
- the second year after the year you acquire the rental property; or
- the time immediately before you dispose of the property.

A **rental property that is a building**, or part of a building, usually becomes available for use on the earliest of:

- the date when construction of the building is complete or a fully constructed building is bought, as long as it can be used at once as a rental building;
- the date that you rent out 90% or more of the building;
- the second year after the year you acquire the building; or
- the time immediately before you dispose of the building.

For the above-stated times, a renovation, alteration, or addition to a building is considered a separate building.

You may be able to claim CCA on a building that is under construction, renovation, or alteration before it is available for use. You can deduct CCA that you have available on such a building when you have net rental income from that building. The CCA that you can deduct is restricted to the amount of net rental income you have after you deduct any soft costs for constructing, renovating, or altering the building. For an explanation of soft costs, see "Costs relating to construction, renovation, or alteration" on page 9.

Capital cost – This is the amount on which you first claim CCA (see the definition on this page). The capital cost of a rental property is usually the total of:

- the purchase price, not including the cost of land;
- the part of your legal, accounting, engineering, installation, and other fees that relates to the purchase or construction of the rental property, excluding the part that applies to the land;
- the cost of any additions or improvements you made to the rental property after you acquired it, provided you have not claimed these costs as current expenses; and
- for a building, soft costs (such as interest, legal and accounting fees, and property taxes) related to the period you are constructing, renovating, or altering the building, if you have not deducted these expenses as current expenses.

For more information on current expenses, see "Current or capital expenses?" on page 8. For more information on soft costs, see "Costs relating to construction, renovation, or alteration" on page 9.

Legal and accounting fees for buying a rental property are allocated between the cost of the land and the capital cost of the building. If land is acquired for rental purposes or for constructing a rental property, the legal and accounting fees apply to the land.

Capital cost allowance (CCA) – In the year you buy a depreciable property, such as a building, you cannot deduct the full cost. However, since this type of property wears out or becomes obsolete over time, you can deduct its capital cost over a period of several years. The deduction for this is called capital cost allowance.

You usually group depreciable properties into classes. For example, appliances and furniture belong to Class 8. You have to base your CCA claim on a rate assigned to each class of property.

For the most common classes of depreciable properties, see "Classes of depreciable properties" on page 14.

Common-law partner – A person of the opposite or same sex who is **not your spouse** with whom you live and have a relationship and to whom at least **one** of the following situations applies. He or she:

- is the natural or adoptive parent (legal or in fact) of your child; or
- has been living and having a relationship with you for at least 12 continuous months.

Note

Under proposed changes, a person (other than the parent of your child) will be your common-law partner only after your **current** relationship with that person has lasted at least 12 continuous months. This proposed change will apply to 2001 and later years once it becomes law.

A reference to “12 continuous months” in this definition includes any period that you were separated for less than 90 days because of a breakdown in the relationship.

Depreciable property – This is any property on which you can claim CCA. It is usually capital property used to earn income from a business or property. The capital cost can be written off as CCA over a number of years.

Fair market value (FMV) – Fair market value is generally the highest dollar value that you can get for a property or service in an open and unrestricted market between an informed and willing buyer and an informed and willing seller who are dealing at arm’s length with each other.

Non-arm’s length transaction – This is a transaction between persons who were not dealing with each other at arm’s length at the time of the transaction.

Proceeds of disposition – This is usually the amount you received or will receive for your property. In most cases, it refers to the sale price of the property. This could also include compensation you received for property that has been destroyed, expropriated, or stolen. For more information about proceeds of disposition, see Interpretation Bulletin IT-220, *Capital Cost Allowance – Proceeds of Disposition of Depreciable Property*, and its Special Release, and Interpretation Bulletin IT-285, *Capital Cost Allowance – General Comments*.

Spouse – For tax purposes, you have a spouse when you are legally married.

Undepreciated capital cost (UCC) – Generally, UCC is equal to the total capital cost of all the properties of the class **minus** the capital cost allowance you claimed in previous years. If you sell depreciable property in a year, you also have to subtract from the UCC one of the following two amounts, whichever is **less**:

- the proceeds of disposition of the property **minus** the related outlays and expenses; or
- the capital cost of the property.

Chapter 1 – General Information

This chapter explains the general information you need to know before you complete Form T776, *Statement of Real Estate Rentals*.

Rental income is income you earn from renting property that you own or have use of. You can own the property by yourself or with someone else. Rental income includes income from renting:

- houses
- apartments
- rooms
- space in an office building
- other real or movable property

Rental income can be either income from property or business. Income from rental operations is usually income from property. Use this guide only if you have rental income from property.

Do you have rental income or business income?

To determine whether your rental income is from property or from business, consider the number and kinds of services you provide for your tenants.

In most cases, you are earning income from property if you rent space and provide basic services only. Basic services include heat, light, parking, and laundry facilities. If you provide additional services to tenants, such as cleaning, security, and meals, you may be carrying on a business. The more services you provide, the greater the chance that your rental operation is a business.

For more information about how to determine if your rental income is income from property or income from business, see Interpretation Bulletin IT-434, *Rental of Real Property by Individual*, and its Special Release.

Note

If your rental operation is a business, do not use this guide. Instead, see our guide T4002, *Business and Professional Income*.

GST/HST new residential rental property rebate

The GST/HST new residential rental property rebate applies to eligible rental accommodation and to land leased as a residence. The rental accommodation or land must be intended for long-term use as a residence. Properties that qualify includes:

- newly purchased or built residential rental properties;
- substantially renovated residential rental property;
- additions to a multiple-unit rental complex;
- conversion of a commercial property into a residential rental property; and
- land leased for residential purposes.

The construction, renovation, or conversion of the property must have started after February 27, 2000. For leased land, the lease agreement must have been entered into after February 27, 2000.

The rebate goes to the person who paid the GST/HST, the landlord for rental accommodation, or to the lessor of the land for the leased land. For more information on this matter, see guide RC4231, *GST/HST New Residential Rental Property Rebate*.

If you are applying for a new residential rental property rebate, see Form GST524, *New Residential Rental Property Rebate Application*, or Form GST525, *Supplement to the New Residential Rental Property Rebate Application-Multiple Units*.

Keeping records

Keep detailed records of all the rental income you earn and the expenses you incur. You have to support your purchases and operating expenses with:

- invoices;
- receipts;
- contracts; or
- other supporting documents.

Do not send us these records when you file your return. Keep them in case we ask to see them. We may disallow all or part of your expenses if you do not have receipts or other documents to support them.

For more information on operating expenses, see “Expenses” on page 8.

Generally, you must keep your records for six years from the end of the tax year to which they relate. For more information about keeping records, see Information Circular 78-10, *Books and Records Retention/Destruction*.

Chapter 2 – Calculating Your Rental Income or Loss

If you received income from renting real estate or other real property, you have to file a statement of income and expenses.

We have provided copies of Form T776, *Statement of Real Estate Rentals*, in the middle of this guide to help you calculate your rental income and expenses for income tax purposes. Although we accept other types of financial statements, we encourage you to use Form T776.

Form T776 includes areas for you to enter your gross rents, your rental expenses, and any capital cost allowance. To calculate your rental income or loss, complete the areas of the form that apply to you.

This chapter explains how to complete Form T776, *Statement of Real Estate Rentals*, as far as line 9946, “Your net income (loss).” The back of the form contains charts to calculate your capital cost allowance, which we explain in Chapter 3.

Note

Rental losses are not allowed if your rental operation is a cost-sharing arrangement rather than an operation to make a profit. For more information, see “Renting below fair market value” on page 13.

Form T776, *Statement of Real Estate Rentals*

If you are a **sole proprietor**, complete all the areas and lines on Form T776 that apply to you.

Identification

For the period from:

If this is the first year of operation, enter the year, month, and day your rental operation began. Otherwise, enter January 1 of the current year. Since all rental properties have a December 31 year-end, you just need to enter the current taxation year in the area after “to:”.

Partnership filer identification number

Are you a co-owner or a partner of a partnership?

Most of the time, if you own the rental property with one or more persons, we consider you to be a co-owner. For example, if you own a rental property with your spouse or common-law partner, you are a co-owner.

In some cases, you have to determine if you are a co-owner or if a partnership exists. A partnership is a relationship between two or more people carrying on a business, with or without a written agreement, to make a profit. If there is no business in common, there is no partnership. That is, co-ownership of a rental property as an investment does not in itself constitute a partnership. To help you determine if you are in a partnership, see the partnership law for your province or territory. For more information, see Interpretation Bulletin IT-90, *What is a Partnership?*

Partnerships of six or more partners at any time during the year have to file a T5013 Summary, *Partnership Information Return*. Partnerships that have five partners or less throughout the year also have to file a partnership information return if one or more of the partners is a partner of another partnership. If you are a partner of either of these types of partnerships, the partnership has to give you a T5013 slip, *Statement of Partnership Income*, to file with your income tax and benefit return.

If you determine that you are a partner of a partnership and you received a T5013 slip, you do not need to complete all of Form T776. Indicate the partnership identification number, as well as your share of the income and percentage of the ownership of your rental property in the Identification area. Then, enter on line 9946 the amount from box 20 of your T5013 slip.

If you are a partner in a partnership and you do not receive a T5013 slip, or if you are a co-owner, complete all of the areas of Form T776 that applies to you. Follow the special instruction in this chapter to complete lines 8299, 9369, 9936, 9943 and 9946. If you are such a partner or co-owner, make sure you complete the “Details of other co-owners and partners” area of the form.

Tax shelter identification number

Enter your tax shelter identification number, if applicable.

We consider a tax shelter to be an investment that can be reasonably expected, based on any statement, representation, or promotional literature, to provide federal tax credits, or a combination of federal tax credits and losses or other deductible amounts, in excess of a buyer’s net cost in any of the first four years. The total of the federal tax credits and the losses or other deductible amounts would be equal to, or greater than, the cost of your share of the investment after deducting the prescribed benefits.

For this purpose, the cost of your interest in the property has to be reduced by the prescribed benefits you or a person with whom you do not deal at arm's length will receive or enjoy. Prescribed benefits include provincial or territorial tax credits, revenue guarantees, contingent liabilities, limited recourse debt, and rights of exchange or conversion.

To claim deductions or losses from tax shelter investments, attach to your return any applicable T5003, *Statement of Tax Shelter Information*, T5013 slips, and a completed Form T5004, *Statement of Tax Shelter Loss or Deduction*. Make sure your form shows the tax shelter identification number.

Note

An identification number is issued for administrative purposes only. It does not give an investor entitlement to claim any tax benefits associated with the tax shelter.

If this is the first year you are making a claim for your tax shelter, include with your return a copy of Form T5003. If the tax shelter is a partnership, include a T5013 slip with your return.

You only have to complete Form T776 if you have a rental operation and you are reporting rental income or a rental loss.

For more information on tax shelters, see Information Circular 89-4, *Tax Shelter Reporting*.

Details of other co-owners and partners

Complete this section if you are a co-owner or a partner of a partnership.

Income

List the address of your rental property and the number of units you rented.

You can receive rental income in the form of:

- cash or cheques;
- kind (goods or commodities instead of cash); or
- services.

If your tenant pays you in cash, include the total rents you earned in the year on line 8141 in the "Gross rents" column on Form T776. If your tenant pays you in kind or with services, report the fair market value as "Other related income" on line 8230.

Example

Glenn is a tenant in an apartment building. He owns a truck with a plough on it. His landlord, Sonya, asked him to plough the parking lot after every snowfall. Sonya does not pay Glenn cash for his work, but she reduces his monthly rent accordingly.

On Form T776, Sonya reports the rent she charges Glenn on line 8141 "Gross rents," and the fair market value of Glenn's services as "Other related income" on line 8230. She then claims the fair market value of Glenn's snow ploughing services that relate to her rental operation as an expense.

How to calculate your rental income

Report the rental income you earned in the calendar year (from January 1 to December 31).

In most cases, you calculate your rental income using the **accrual method**. With this method, you:

- include rents in income for the year in which they are due, whether or not you receive them in that year; and
- deduct your expenses in the year you incur them, no matter when you pay them.

However, if you have practically no amounts receivable and no expenses outstanding at the end of the year, you can use the **cash method**. With this method, you:

- include rents in income in the year you receive them; and
- deduct expenses in the year you pay them.

You can use the cash method only if your net rental income or loss would be practically the same if you were using the accrual method.

In the examples in this guide, we use the accrual method of reporting rental income.

Who reports the rental income or loss?

The person who owns the rental property has to report the rental income or loss. If you are a co-owner of the rental property, your share of the rental income or loss will depend on your share of ownership.

Report the rental income the same way for each year you own that rental property. In other words, you cannot change the percentage of the rental income or loss you report each year unless the percentage of your ownership in the property changes.

Note

Someone else may have guaranteed your loan or mortgage. However, as the owner, you are the only one who can use the related interest expense to calculate your rental income or loss. For more information, see "Line 8710 – Interest" on page 10.

For more information on reporting rental income between family members, see Interpretation Bulletin IT-510, *Transfers and Loans of Property Made After May 22, 1985 to a Related Minor*, and Interpretation Bulletin IT-511, *Interspousal and Certain Other Transfers and Loans of Property*.

Line 8230 – Other related income

Rental income may include more than the rent you receive each month. It can also include income from the following sources.

Premiums and leases – You may receive an amount for:

- granting or extending a lease or sublease;
- permitting a sublease; or
- cancelling a lease or sublease.

Report all or part of these amounts as "Other related income" on line 8230 of Form T776.

Sharecropping – You can earn income from renting farmland either in cash or as a share of the crop. Report any cash payments as rent in the “Gross rents” column on Form T776. Report the fair market value of any crop share you earn on a sharecrop basis as “Other related income” on line 8230 of Form T776.

Line 8299 – Gross rental income

Your gross rental income is your total “Gross rents” on Form T776. Enter this amount on line 160 of your return. If you are a co-owner of the rental property or a partner of a partnership that does not need to provide you with a T5013 slip, enter the gross rental income for the **entire** property on line 160. Do not split the gross income according to your ownership share.

Expenses

Generally, you can deduct any reasonable expenses you incur to earn rental income. The two basic types of expenses are:

- current expenses
- capital expenses

Current or operating expenses are recurring expenses that provide a short-term benefit. For example, a current expense is the cost of repairs you make to keep a rental property in the same condition as it was when you

acquired it. You can deduct current expenses from your gross rental income in the year you incur them.

Capital expenses provide a benefit that usually lasts for several years. For example, costs to buy or improve your property are capital expenses. Generally, you cannot deduct the full amount of these expenses in the year you incur them. Instead, you can deduct their cost over a period of several years as capital cost allowance (CCA) For more information on CCA, see Chapter 3.

Capital expenses can include:

- the purchase price of rental property;
- legal fees and other costs connected with buying the property; and
- the cost of furniture and equipment you are renting with the property.

Current or capital expenses?

Renovations and expenses that extend the useful life of your property or improve it beyond its original condition are usually capital expenses. However, an increase in a property’s market value because of an expense is not a major factor in deciding whether the expense is capital or current. To decide whether an amount is a current expense or a capital expense, you should consider your answers to the questions in the following chart.

Criteria	Capital expenses (see “Capital expenses – Special situations” on page 9)	Current expenses
Does the expense provide a lasting benefit?	A capital expense generally gives a lasting benefit or advantage. For example, the cost of putting vinyl siding on the exterior walls of a wooden house is a capital expense.	A current expense is one that usually recurs after a short period. For example, the cost of painting the exterior of a wooden house is a current expense.
Does the expense maintain or improve the property?	The cost of a repair that improves a property beyond its original condition is probably a capital expense. If you replace wooden steps with concrete steps, the cost is a capital expense.	An expense that simply restores a property to its original condition is usually a current expense. For example, the cost of repairing wooden steps is a current expense.
Is the expense for a part of a property or for a separate asset?	The cost of replacing a separate asset within that property is a capital expense. For example, the cost of buying a refrigerator for use in your rental operation is a capital expense. This is the case because a refrigerator is a separate asset and is not a part of the building.	The cost of repairing a property by replacing one of its parts is usually a current expense. For instance, electrical wiring is part of a building. Therefore, an amount you spend to rewire is usually a current expense, as long as the rewiring does not improve the property beyond its original condition.
What is the value of the expense? (Use this test only if you cannot determine whether an expense is capital or current by considering the three previous tests.)	Compare the cost of the expense to the value of the property. Generally, if the cost is considerable in relation to the value of the property, it is a capital expense.	This test is not a determining factor by itself. You might spend a large amount of money for maintenance and repairs to your property all at once. If this cost was for ordinary maintenance that was not done when it was necessary, it is a maintenance expense, and you deduct it as a current expense.

You were asking . . .

Q. My brother and I own an old apartment building that we have been renting for several years. In the current tax year, we had the roof and outside walls repaired. The repairs to the roof involved waterproofing and reshingling several patches that had developed leaks. The building is made of brick, and the outside walls

were redone using the original bricks. Can we deduct these expenses in calculating our rental income for the year?

A. Yes. The repairs to the building simply restored it to its original condition. As a result, they are current expenses.

If you need more information on the difference between current expenses and capital expenses, see paragraph 4 of Interpretation Bulletin IT-128, *Capital Cost Allowance – Depreciable Property*.

Capital expenses – Special situations

Modifications to buildings to accommodate persons with disabilities

You may renovate your existing rental property to accommodate persons with disabilities. You can deduct outlays and expenses you have for eligible disability-related modifications in the year you paid them, instead of having to add them to the capital cost of your building. Eligible disability-related modifications are changes you make to accommodate individuals who have a mobility impairment.

These changes include:

- installing hand-activated electric door openers;
- installing interior and exterior ramps; and
- modifying a bathroom, elevator, or doorway so a person in a wheelchair can use it.

You can also deduct expenses you pay to install or acquire the following disability-related devices and equipment:

- elevator car-position indicators (such as braille panels and audio indicators);
- visual fire-alarm indicators;
- listening or telephone devices for people who have a hearing impairment; and
- disability-specific computer software and hardware attachments.

Buying an older building

If you buy an older building that you have to repair or renovate to make it suitable to rent, the cost of the work is a capital expense. This is the case even though you would usually treat these costs as current expenses.

Selling your property

If you make repairs to your property because you want to sell it, or you make the repairs as a condition of sale, the repairs are capital expenses. However, we consider the repairs to be current expenses if they were necessary and you made them to your property or were making them before you decided to sell.

Costs relating to construction, renovation, or alteration

You may have certain costs relating to the period you were constructing, renovating, or altering your rental building to make it more suitable for renting. These expenses are sometimes called **soft costs**. Soft costs for the ownership of land are not deductible and cannot be added to the cost of a building. Soft costs include:

- interest;
- legal fees;
- accounting fees; and
- property taxes.

Soft costs related to a building may be deductible as a current expense or added to the cost of the building, depending on your situation.

Soft costs, other than those related to the ownership of land, may be deductible as a current expense if you meet **all** the following conditions:

- you incur the costs after 1989;
- the costs relate to the period you were constructing, renovating, or altering the building; and
- the costs relate only to constructing, renovating, or altering the building.

We consider the period of construction, renovation, or alteration to be completed on whichever date is earlier:

- the date the work is completed; or
- the date you rent 90% or more of the building.

When these conditions are met, the amount you can deduct as soft costs is limited to the amount of rental income received from the building. Also, you have to deduct these soft costs before you can deduct any capital cost allowance (CCA).

Soft costs that do not meet the above conditions are capital expenses. Add them to the capital cost of the building and not the land. Soft costs do not include any amounts that relate to land. In addition, a cost for land cannot be added to the capital cost of a building.

Note

CCA, landscaping costs, and costs for disability-related modifications to buildings are not soft costs. Therefore, they are not subject to the soft cost rules. For more information on CCA, see Chapter 3. For more information on landscaping costs, see “Landscaping costs” on page 12. For more information on costs for disability-related modifications, see “Modifications to buildings to accommodate persons with disabilities” on this page.

Personal portion

If you rent part of the building where you live, you can claim the amount of your expenses that relate to the rented part of the building. You have to divide the expenses that relate to the whole property between your personal part and the rented part. You can split the expenses using square metres or the number of rooms you are renting in the building, as long as the split is reasonable.

For example, if you rent 4 rooms of your 10-room house, you can deduct:

- 100% of the expenses that relate only to the rented rooms, such as repairs and maintenance of the rooms; **plus**
- 40% (4 out of 10 rooms) of the expenses that relate to the whole building, such as taxes and insurance.

If you rent rooms in your home to a lodger or roommate, you can claim expenses for the part you are renting. You can also claim an amount for the rooms in your home that you are not renting that both you and your lodger or roommate use. Factors such as availability for use, or the number of persons sharing the room, can be used to

calculate the allowable expenses. You can also calculate these amounts by estimating the percentage of time the lodger or roommate spends in these rooms (for example, the kitchen and living room).

Enter your expenses from the property on Form T776. In the first column, "Total expense," enter the full amount of each expense. In the second column, "Personal portion," enter the part of each expense that was for personal use. Enter the totals of each column on the appropriate lines to calculate your deductible expenses. Then subtract them from your gross rental income (line 8299). If you are a co-owner or partner of a partnership, you have to show the personal portion of the expenses for all co-owners or partners.

You **cannot** claim the expenses for renting part of your property if you have no reasonable expectation of making a profit.

For more information on renting part of your personal residence, see "Changing part of your principal residence to a rental property" on page 24.

Example

Rick rents out 3 rooms of his 12-room house. He is not sure how to split the expenses when he reports his rental income. Rick's expenses were property taxes, electricity, fire insurance, and the cost of advertising for tenants in the local newspaper.

Rick can claim the part of his expenses that relates to the part of the property he rented in the current taxation year. Since Rick rented 25% of his residence (3 out of 12 rooms), he can deduct 25% of his property taxes, electricity, and fire insurance costs from his rental income. He can deduct the full amount of the advertising expense, since this expense relates only to the rented part.

When he completes Form T776, Rick enters the full amount of each expense in the "Total expense" column. Then, in the "Personal portion" column, he shows the part of each expense that relates to his personal use. In this case, he enters 75% of the property taxes, electricity, and fire insurance costs for the property. He will not enter anything for advertising in the "Personal portion" column. Rick can also claim capital cost allowance (CCA) on the rented part of the property if it does not create or increase a rental loss and he is not designating the building as his principal residence.

Expenses you can deduct

Prepaid expenses

Prepaid expenses are expenses you pay ahead of time. You can deduct only the part of those expenses that relates to the current tax year.

Example

Maria paid \$2,100 for insurance on her rental property. The insurance was for the current tax year and the two following years. Although she paid the insurance for three years, she can deduct only the part that applies to the current tax year from her gross rental income.

Therefore, Maria can deduct \$700 in the current tax year and \$700 in each of the following two years.

For more information, see Interpretation Bulletin IT-417, *Prepaid Expenses and Deferred Charges*.

Line 8521 – Advertising

You can usually deduct amounts for advertising that your rental property is available for rent.

Line 8690 – Insurance

You can deduct the premiums for insurance coverage on your rental property for the current year. If your policy gives coverage for more than one year, you can deduct only the premiums that relate to the current year. Deduct the remaining premiums in the year to which they relate.

Line 8710 – Interest

You can deduct interest on money you borrow to buy or improve your rental property. You can also deduct interest you paid to tenants on rental deposits. If you are claiming interest as a rental expense on Form T776, do not include it as a carrying charge on Schedule 4, *Statement of Investment Income*.

Lump-sum amounts paid for interest, such as fees to reduce the interest rate on a mortgage, are not fully deductible in the year, but are prorated over the remaining original term of the mortgage or loan. A penalty or bonus paid to a financial institution to pay off your mortgage loan before it is due is treated in the same way. For example, if the term of your mortgage is five years, and in the third year you pay a fee to reduce your interest rate, treat this fee as a prepaid expense and deduct it over the remaining term of the mortgage.

You can deduct certain fees you have when you get a mortgage or loan to buy or improve your rental property. These fees include:

- mortgage applications, appraisals, processing, and insurance fees
- mortgage guarantee fees
- mortgage brokerage and finder's fees
- legal fees related to mortgage financing

You deduct these fees over a period of five years. Deduct 20% in the current taxation year and 20% in each of the following four years. However, if you repay the mortgage or loan before the end of the five-year period, you can deduct the remaining financing fees at that time. The number of years for which you can deduct these fees is not related to the term of your mortgage.

If you have standby charges, guarantee fees, service fees, or any other similar fees, you may be able to deduct them in full for the year you incur them. To do so, they have to relate only to that taxation year.

You can choose to treat finance fees you paid and the interest on money you borrowed to acquire depreciable property as capital expenses. For more information on this

topic, see Interpretation Bulletin IT-121, *Election to Capitalize Cost of Borrowed Money*, and its Special Release.

You might refinance your rental property to get money for a reason other than buying or improving your rental property. If you use the funds for a business or other investments, you may be able to claim the interest expenses on Schedule 4. See line 221 in the *General Income Tax and Benefit Guide*, or the “Expenses” chapter in guide T4002, *Business and Professional Income*. If the funds are for personal use, you cannot deduct the interest expenses.

You were asking . . .

Q. I own and rent a semi-detached house. This year, I refinanced the property to increase the mortgage because I needed money for a down payment on my personal residence. Can I deduct the additional interest on the mortgage against my rental income?

A. No. You are making personal use of the funds you got from refinancing your rental property. As a result, you **cannot** deduct the additional interest when you calculate your net income or loss from your rental property.

Line 8960 – Maintenance and repairs

If you pay for repairs to your property, you can deduct the cost of labour and materials. However, you **cannot** deduct the value of your own labour.

Line 8871 – Management and administration fees

You can deduct the amounts you pay for managing the property. You can also deduct amounts paid or payable to agents for collecting rents or finding new tenants. If you have commissions when selling your rental property, include them as “Outlays and Expenses” on Schedule 3, *Capital Gains (or Losses)*, when you report the disposition of your property.

Line 9281 – Motor vehicle expenses

You can deduct motor vehicle expenses in the following circumstances:

■ If you own one rental property:

You can deduct reasonable motor vehicle expenses if you meet **all** the following conditions:

- you receive income from only one rental property that is in the general area where you live;
- you personally do part, or all, of the necessary repairs and maintenance on the property; and
- you have motor vehicle expenses to transport tools and materials to the rental property.

You **cannot** deduct motor vehicle expenses you incur to collect rents. These are personal expenses.

■ If you own two or more rental properties:

- In addition to the expenses listed above, you can deduct reasonable motor vehicle expenses you incur to do any of the following:
- collect rents;

- supervise repairs; and
- generally manage the properties.

This applies whether your rental properties are located in or outside the general area where you live. However, your rental properties have to be located in at least two different sites away from your principal residence. The motor vehicle expenses that we consider to be reasonable depend on the circumstances of your situation.

For information on how to calculate the motor vehicle expenses that you can deduct, see guide T4002, *Business and Professional Income*.

Line 8810 – Office expenses

You can deduct the cost of office supplies. These include small items such as pens, pencils, paper clips, stationery, and stamps.

Line 8860 – Legal, accounting, and other professional fees

You can deduct fees for legal services to prepare leases or collect overdue rents. If you incur legal fees to buy your rental property, you cannot deduct them from your gross rental income. Instead, allocate the fees between land and building and add them to their respective cost. For example, you buy a property worth \$200,000 (\$50,000 for the land and \$150,000 for the building) and incur legal fees of \$10,000. Split the \$10,000 proportionately between the land and building. In this case, \$2,500 is added to the cost of the land (for a total of \$52,500) and \$7,500 is added to the cost of the building (for a total of \$157,500). For more information, see “Land” on page 17.

Note

Any legal fees you paid when selling your rental property are deducted from your proceeds of disposition when calculating your capital gain or loss. The deduction also applies when calculating a recapture of Capital Cost Allowance or terminal loss.

You can also deduct amounts paid for bookkeeping services, audits of your books and records, and preparing financial statements. You may be able to deduct fees and expenses for advice and help to prepare your return and any related information returns. You can deduct these fees if you needed the help because of your rental operation.

Line 9180 – Property taxes

You can deduct property tax assessed by a province or territory and by a Canadian municipality that relate to your rental property for the period when it was available for rent. For more information, see “Vacant land” on page 12 and “Costs relating to construction, renovation, or alteration” on page 9.

Line 9060 – Salaries, wages, and benefits

You can deduct amounts paid or payable to superintendents, maintenance personnel, and others you employ to take care of your rental property. You **cannot** deduct the value of your own services.

As an employer, you can deduct your portion of Canada Pension Plan or Quebec Pension Plan contributions, Employment Insurance premiums, and workers' compensation board amounts.

You can also deduct any premiums you pay for an employee for sickness, accident, disability, or income insurance plan.

For more information on wages, see the Employers' Guide, T4001, *Payroll Deductions (Basic Information)*.

Line 9200 – Travel

You might travel to collect rents, supervise repairs, and manage your properties. To claim the expenses you incur, you need to meet the same requirements discussed at "Line 9281 – Motor vehicle expenses" on page 11.

Travelling expenses include the cost of getting to your rental property. Travelling expenses do not include board and lodging, which we consider to be personal expenses.

Line 9220 – Utilities

You can deduct expenses for utilities, such as gas, oil, electricity, water, and cable, if your rental arrangement specifies that you pay for the utilities in question.

Line 9270 – Other expenses

On this line, include the total amount of other expenses you incur to earn rental income and that you have not included on a previous line of Form T776. We explain some of these expenses in the following sections.

Landscaping costs

You can deduct the cost of landscaping the grounds around your rental property only in the year you paid the cost, even if you use the accrual method for calculating your rental income.

Lease cancellation payments

You can deduct amounts paid or payable to tenants to cancel their leases. The deductible amount is calculated as follows:

If you made the cancellation payment in the year:

$$\text{Cancellation payment} \times \frac{\text{Number of days to the end of the year when payment is made}}{\text{Number of days left on the lease}}$$

If you made the cancellation payment in a previous year:

$$\text{Cancellation payment} \times \frac{\text{Number of days in the year left on the lease}}{\text{Number of days left on the lease}}$$

For this calculation, the life of the lease (including all renewal periods) cannot be longer than 40 years.

Example

Samir, the landlord, paid his tenant \$1,000 to cancel a lease on August 18 of the current taxation year. The lease was due to expire on December 31 of the next year.

When he made the payment, there were 135 days left in the current year and 500 days left on the lease.

For the current tax year, Samir deducts \$270, calculated as follows:

$$\$1,000 \times \frac{135}{500} = \$270$$

For the next year, Samir deducts \$730 calculated as follows:

$$\$1,000 \times \frac{365}{500} = \$730$$

If you dispose of the property, the tax treatment will vary depending on your situation. For more information, see Interpretation Bulletin IT-359, *Premiums and Other Amounts With Respect to Leases*.

Condominiums

If you earn rental income from a condominium unit, you can deduct the expenses that you would usually deduct from rental income. You can also deduct condominium fees representing your share of the upkeep, repairs, maintenance, and other current expenses of the common property. For more information, see Interpretation Bulletin IT-304, *Condominiums*.

Vacant land

You might earn rental income from vacant land. You can deduct your operating expenses from this income. However, there are limits on how much you can deduct for:

- interest on money you borrowed to acquire the land, or on an amount payable for the land; and
- property taxes on the land assessed by a province or territory and a Canadian municipality, including assessments for school taxes and local improvements.

The amount you can deduct for these two expenses is limited to the amount of rental income left after you deduct all other expenses. You cannot create or increase a rental loss, or reduce other sources of income, by claiming a deduction for interest or property taxes. However, you can add to the cost of the land the part of the interest and property taxes that you cannot deduct. By doing so, you will decrease your capital gain or increase your capital loss when you dispose of the land.

You cannot deduct your mortgage interest and property taxes for vacant land if you are not earning any income from that land. Also, you cannot add these expenses to the adjusted cost base of your land. In addition, you cannot deduct income taxes, profit taxes, or land transfer taxes you have for the vacant land.

For more information on vacant land, see Interpretation Bulletin IT-153, *Land Developers – Subdivision and Development Costs and Carrying Charges on Land*, and Interpretation Bulletin IT-456, *Capital Property – Some Adjustments to Cost Base*, and its Special Release.

You were asking . . .

- Q. In 1995, I bought vacant land as an investment. In the current tax year, I rented this land to a farmer for pasture.

Can I deduct my mortgage interest and property taxes from my rental income?

- A. Yes. After deducting all your other allowable expenses, you can deduct the amount of your mortgage interest and property taxes for the year that you need to reduce your remaining rental income to zero. If you do not need to use the full amount of your taxes and interest, you can add the rest to the adjusted cost base of the land.

Expenses you cannot deduct

Land transfer taxes

You cannot deduct land transfer taxes you paid when you bought your property. Add these amounts to the cost of the property.

Mortgage principal

You cannot deduct the repayments of principal on your mortgage or loan on your rental property. For information about the interest part of your mortgage, see “Line 8710 – Interest” on page 10.

Penalties

You cannot deduct any penalties shown on your *Notice of Assessment* or *Notice of Reassessment*.

Value of your own labour

You cannot deduct the value of your own services or labour.

Line 9949 – Total personal portion of expenses

Enter the total amount from the column called “Personal portion.” For more information, see “Personal portion” on page 9.

Deductible expenses

Your deductible expenses equal your total expenses **minus** your personal portion.

Line 9369 – Net income (loss) before adjustments

Enter the gross income minus the deductible expenses (line a **minus** line b). This amount is the net rental income of all co-owners or partners before any claim for capital cost allowance.

Co-owners – Your share of line 9369

If you are a co-owner, enter your share of the amount from line 9369 on line c. This amount is based on your share of ownership of the rental property.

If you are a co-owner or partner, also complete the area called “Details of other co-owners and partners” on Form T776.

Line 9945 – Other expenses of the co-owner

Enter the amount of deductible expenses you have as a co-owner that you did not deduct elsewhere on Form T776.

Line 9947 – Recaptured capital cost allowance

If you had a recapture of capital cost allowance (CCA), enter it on this line. If you are a co-owner, enter your share of the amount. We explain recapture of CCA on page 17.

Line 9948 – Terminal loss

Enter any terminal loss you had on the sale of rental property on this line. If you are a co-owner, enter your share of the amount. We explain terminal loss on page 17.

Line 9936 – Capital cost allowance

Enter the amount of your capital cost allowance (CCA) as calculated in Area A on the back of Form T776. For details on how to calculate CCA, see Chapter 3.

If you are a partner of a partnership that does not need to issue you a T5013 slip, enter the total CCA allocated on the financial statements the partnership gave you.

Do not use this line if you are a member of a partnership that has to file Form T5013 Summary, *Partnership Information Return*. Your CCA amount is already included in box 20 of your T5013 slip.

Net income (loss)

Enter on line d your net income (or loss) after subtracting your claim for CCA on line 9936.

Partnerships – Your share of line d

If you are a member of a partnership, enter your share of line d.

Line 9943 – Other expenses of the partner

Enter the amount of deductible expenses you have as a partner that you did not deduct elsewhere on Form T776.

Line 9946 – Your net income (loss)

Enter this amount on line 126 of your return. If you have a rental loss, show the loss in brackets.

Rental losses

You have a rental loss if your rental expenses are more than your gross rental income. If you incur the expenses to earn income, you can deduct your rental loss against your other sources of income.

Renting below fair market value

You can deduct your expenses only if you incur them to earn income. In certain cases, you may ask your son or daughter, or another relative living with you, to pay a small amount for the upkeep of your house or to cover the cost of groceries. You do not report this amount in your income, and you cannot claim rental expenses. This is, in fact, a cost-sharing arrangement, so you cannot claim a rental loss.

If you lose money because you are renting a property to a relative for a lower rate than you would rent it to other tenants, you cannot claim a rental loss. When your rental expenses are consistently more than your rental income, you may not be allowed to claim a rental loss because your

rental operation is not considered to be a source of income. However, you can claim a rental loss if you are renting the property to a relative for the same rate as you would charge other tenants and you reasonably expect to make a profit.

Chapter 3 – Capital Cost Allowance

What is capital cost allowance (CCA)?

You might acquire a depreciable property, such as a building, furniture, or equipment, to use in your rental operation. You cannot deduct the cost of the property when you calculate your net rental income for the year. However, since these properties wear out or become obsolete over time, you can deduct their cost over a period of several years. The deduction for this is called capital cost allowance (CCA).

How much CCA can you claim?

The amount of CCA you can claim depends on the type of rental property you own and the date you acquired it. You group the depreciable property you own into classes. A different rate of CCA applies to each class. The main classes of depreciable rental property and the rates that apply to each class are discussed in “Classes of depreciable properties” on this page.

In most cases, you should use the declining balance method to calculate your CCA. This means that you claim CCA on the capital cost of the property **minus** the CCA, if any, you claimed in previous years. The remaining balance declines over the years as you claim CCA.

Example

Last year, Gwen bought a rental building for \$60,000. On her return for last year, she claimed CCA of \$1,200 on the building. This year, she bases her CCA claim on the remaining balance of \$58,800 (\$60,000 – \$1,200).

You do not have to claim the maximum amount of CCA in any given year. You can claim any amount you like, from zero to the maximum allowed for the year. For example, if you do not have to pay income tax for the year, you may not want to claim CCA. Claiming CCA reduces the amount of CCA available to you for future years.

Note

If you are a partner of a partnership, the amount of CCA you can claim has already been determined by the partnership. If you receive a T5013 slip, *Statement of Partnership Income*, your CCA amount is already included in box 20. If you are a partner of a partnership that does not need to issue this slip, the total partnership CCA will be shown on the financial statements you receive.

Limits on CCA

In the year you **acquire** rental property, you can usually claim CCA only on one-half of your net additions to a class.

This is the 50% rule, which we explain under “Column 6 – Adjustment for current-year additions” on page 18. The available-for-use rules may also affect the amount of CCA you can claim. See the definition of “Available for use” in the glossary on page 4.

In the year you **dispose** of rental property, you may have to add an amount to your income as a recapture of CCA. Conversely, you may be able to deduct an amount from your income as a terminal loss. We explain recapture and terminal loss under “Column 5 – UCC after additions and dispositions” on page 17.

If you own more than one rental property, you have to calculate your overall net income or loss for the year from all your rental properties before you can claim CCA. Combine the rental incomes and losses from all your properties, even if they belong to different classes. This also applies to furniture, fixtures, and appliances that you use in your rental building. You can claim CCA for these properties, the building, or both.

You **cannot** use CCA to create or increase a rental loss.

Example

Salvador owns three rental properties. Two of these properties are Class 1 buildings and one is a Class 3 building. All the buildings contain Class 8 appliances. Salvador earns net rental income from these properties as follows:

Building		Net rental income (or loss)
1 (Class 1)		\$ 1,500
2 (Class 1)	+	\$ 2,000
3 (Class 3)	+	(\$ 4,000)
Total	=	<u><u>(\$ 500)</u></u>

Salvador has an overall net loss of \$500. Since he cannot increase his rental loss by claiming CCA, he cannot claim any CCA on his rental buildings or appliances.

For more information about loss restrictions on rental and leasing properties, see Interpretation Bulletin IT-195, *Rental Property – Capital Cost Allowance Restrictions*, and Interpretation Bulletin IT-443, *Leasing Property – Capital Cost Allowance Restrictions*, and its Special Release.

Classes of depreciable properties

This section explains the most common classes of depreciable rental property and the rates that apply to each class.

Land is not depreciable property. Therefore, when you acquire rental property, only include in Area C and Area A of Form T776 the cost of the building.

Buildings

A rental building may belong to Class 1, 3, 6, 31, or 32, depending on what the building is made of and the date you acquire it.

You also include in these classes the parts that make up the building, such as:

- electric wiring
- lighting fixtures
- plumbing
- sprinkler systems
- heating equipment;
- air-conditioning equipment (other than window units)
- elevators
- escalators

Class 1 (4%)

Class 1 includes most buildings acquired after 1987, unless they specifically belong in another class. Class 1 also includes the cost of certain additions or alterations you made after 1987 to a Class 3 building.

For information about other costs to include in Class 1, see “Class 3 (5%)” and “Class 6 (10%)” below.

Class 3 (5%)

Most buildings acquired before 1988 are now included in Class 3 or Class 6. If you acquired a building before 1990 that does not fall into Class 6, you can include it in Class 3 if **one** of the following applies:

- you acquired the building under the terms of a written agreement entered into before June 18, 1987; or
- the building was under construction by you or for you on June 18, 1987.

Do not transfer rental property you previously included in Class 3 to Class 1. Include in Class 1 the cost of any additions or alterations made after 1987 to a Class 3 building if the total cost is more than whichever amount is less:

- \$500,000; or
- 25% of the building’s capital cost (including the cost of additions or alterations to the building included in Class 3, Class 6, or Class 20 after 1987).

Class 6 (10%)

Subject to the conditions explained below, include a building in Class 6 if it is made of frame, log, stucco on frame, galvanized iron, or corrugated iron. If you acquired the building after 1987, also include it in Class 6 if it is made of any other kind of corrugated metal.

A building acquired after 1978 is only included in Class 6 if **one** of the following conditions apply:

- the building must have no footings or other base supports below ground level; or
- the building must be used for producing income from farming or fishing. Farming and fishing income is not rental income.

If either of the above conditions applies, you also add to Class 6 the full cost of **all** additions and alterations to the building.

If neither of the above conditions applies, include the building in Class 6 if **one** of the following situations applies:

- you acquired the building before 1979;
- you entered into a written agreement before 1979 to acquire the building, and footings or other base supports of the building were started before 1979; or
- you started construction of the building before 1979 (or it was started under the terms of a written agreement you entered into before 1979), and footings or other base supports of the building were started before 1979.

For additions or alterations to such a building:

- add to Class 6:
 - all additions made before 1979; and
 - the first \$100,000 of additions or alterations made after 1978;
- add to Class 3:
 - the additions or alterations of more than \$100,000 that were made after 1978 and before 1988; and
 - the additions or alterations of more than \$100,000 that were made after 1987, but only up to \$500,000 or 25% of the building’s capital cost, whichever is less;
- add to Class 1 any additions or alterations that are more than these limits.

For more information on this topic, see Interpretation Bulletin IT-79, *Capital Cost Allowance – Buildings or Other Structures*.

Class 31 (5%) and Class 32 (10%)

Class 31 and Class 32 include multiple-unit residential buildings (MURBs) certified by the Canada Mortgage and Housing Corporation (CMHC) to which **all** the following conditions apply:

- they are located in Canada;
- they contain two or more units; and
- they provide their occupants with a relatively permanent residence.

To be included in Class 32, the building must have been acquired before 1980. To be included in Class 31, the building must have been acquired after 1979 and before June 18, 1987.

Note

For 1994 and following years, you can no longer create or increase a rental loss by claiming CCA on a Class 31 or Class 32 property.

When a MURB no longer qualifies as a Class 31 or Class 32 rental property, you have to transfer it to the correct class. For more information about the 1994 change in the CCA limit on MURBs, see Interpretation Bulletin IT-195, *Rental Property – Capital Cost Allowance Restrictions*.

Condominiums – A condominium unit in a building belongs to the same class as the building. For example, if you own a condominium in a Class 3 building, the unit in the building is Class 3 rental property. If the whole building

qualifies as a Class 31 or 32 rental property (a MURB), then each unit within the building is a Class 31 or 32 rental property.

For more information on capital cost allowance and condominiums, see Interpretation Bulletin IT-304, *Condominiums*.

Class 8 (20%) – Furniture and equipment

Class 8 includes rental property that is not included in any other class. For example, furniture, household appliances, fixtures, machinery, and equipment you use in your rental operation are all in this class.

How to complete the CCA charts

Use Area A on the back of Form T776 to calculate your CCA claim.

If you acquired or disposed of rental buildings or equipment during the year, you will also need to complete Area B, C, D, or E (whichever applies) before you complete Area A. Even if you are not claiming a deduction for CCA, you should still complete these areas to show any additions or dispositions during the year.

The following sections explain how to complete these areas.

Column 1 – Class number

If this is the first year you are claiming CCA, see “Classes of depreciable properties” on page 14 to determine the classes to which your property belongs.

If you claimed CCA in the previous taxation year, you can get the class numbers from your copy of that year’s form.

Separate classes

Generally, if you own several properties in the same CCA class, combine the capital cost of all these properties into one class. Then enter the total in Area A. However, if you acquired a rental property after 1971 and it had a capital cost of \$50,000 or more, you have to put it in a separate class. Calculate your CCA separately for each rental property that is in a separate class. Do this by listing the rental property on a separate line in Area A. For CCA purposes, the capital cost is the part of the purchase price that relates to the building only.

When you dispose of a rental property that you have set up in a separate class in Area A, you base any CCA recapture or terminal loss on the disposition of that rental property only. When calculating these amounts, do not consider other rental property you own that has the same class number as the rental property you disposed of. For more information on recapture of CCA and terminal losses, see “Column 5 – UCC after additions and dispositions” on page 17.

For more information about CCA for rental properties with a capital cost of over \$50,000, see Interpretation Bulletin IT-274, *Rental Properties – Capital Cost of \$50,000 or More*.

Column 2 – Undepreciated capital cost (UCC) at the start of the year

If this is the first year you are claiming CCA, skip this column.

Otherwise, enter in this column the UCC for each class at the end of the previous year. If you completed Area A on Form T776 for the previous year, you will find these amounts in Column 10 of that year’s form.

Column 3 – Cost of additions in the year

If you acquired or made improvements to depreciable property in the year, we generally consider them to be additions to the class in which the rental property belongs. For the exceptions to this rule, see “Class 3 (5%)” and “Class 6 (10%)” on page 15. Enter the details of your current-year additions on Form T776 as explained below:

- complete areas B and C on Form T776, if applicable; and
- for each class, enter in Column 3 of Area A the amounts from Column 5 for each class in areas B and C.

Do not include the value of your own labour in the cost of a rental property you build or improve. Include the cost of surveying or valuing a rental property you acquire in the capital cost of the rental property. A rental property usually has to be available for use before you can claim CCA. See the definition of “Available for use” in the glossary on page 4. To find out if any special considerations apply in your case, also see “Changing from personal to rental use” on page 18 and “Grants, subsidies, and other incentives or inducements” and “Non-arm’s length transactions” on page 19.

Note

When completing areas B and C, enter the part of the property that you **personally** use in the column called “Personal portion,” separate from the part you rent. For example, if you rent 25% of your personal residence, your personal use portion is the other 75%.

Area B – Details of equipment and other property additions in the year

List in this area the details of all equipment or other property you acquired or improved in the current tax year. Group the equipment or other property into the applicable classes, and put each class on a separate line. Equipment includes appliances (such as a washer and dryer), maintenance equipment (such as a lawn mower or a snow blower), and other property (such as furniture and fixtures) you acquire to use in your rental operation. Enter on line 9925 the total rental portion of the cost of the equipment or other property. See also “Grants, subsidies, and other incentives or inducements” on page 19.

Area C – Details of building additions in the year

List in this area the details of all buildings you acquired or improved in the current tax year. Group the buildings into the applicable classes, and put each class on a separate line. Enter on line 9927 the total rental portion of the cost of the buildings. The cost includes the actual purchase price of the building, **plus** any related expenses that you should add to the capital cost of the building, such as legal fees, land

transfer taxes, and mortgage fees. See also “Grants, subsidies, and other incentives or inducements” on page 19.

Land

Land is not depreciable property. Therefore, you cannot claim CCA on its cost. If you acquire a rental property that includes both land and a building, enter in Column 3 of Area C only the cost of the building. To determine the building’s capital cost, you have to split between the land and the building any fees that relate to the purchase of the rental property. Related fees can include legal and accounting fees.

Calculate the part of the related fees that you can include in the capital cost of the building as follows:

Building value		Legal,	The part of the fees
Total purchase price	×	accounting, or other fees	= you can include in the building’s cost

Do not split a fee if it relates specifically to the land or the building. Instead, add the amount of the fee to the cost to which it relates, either the land or the building.

Area F – Details of land additions and dispositions in the year

Enter in this area the total cost of acquiring land in the current taxation year. The cost includes the actual purchase price of the land, **plus** any related expenses that you should add to the capital cost of the land, such as legal fees, land transfer taxes, and mortgage fees. Enter on line 9923 the total cost of all land additions in the year. You cannot claim CCA on land. Do **not** enter this amount in Column 3 of Area A.

Column 4 – Proceeds of dispositions in the year

If you disposed of depreciable property in the current tax year, you **should**:

- complete areas D and E on Form T776, if applicable; and
- for each class, enter in Column 4 of Area A the amounts from Column 5 for each class in areas D and E.

When completing areas D and E, enter in Column 3 whichever amount is **less**:

- your proceeds of disposition **minus** any related expenses; or
- the capital cost of your rental property.

Your **proceeds of disposition** are usually the amount you receive or that we consider you to have received when you dispose of your rental property. This could include compensation you receive for rental property that someone destroys, expropriates, steals, or damages. Special rules may apply if you dispose of a building for less than both its undepreciated capital cost and your capital cost. If this is the case, see “Disposing of a building” on page 20 for details.

If you sell a rental property for **more** than its cost, you may have a capital gain. You may be able to postpone or defer including a capital gain or recapture of CCA in income. For more information, see “Selling your rental property” on page 20 and “Replacement property” on page 21.

If you need more information about CCA, see Interpretation Bulletin IT-220, *Capital Cost Allowance – Proceeds of Disposition of Depreciable Property*, and its Special Release.

Area D – Details of equipment and other property dispositions in the year

List in this area the details of all equipment and other property you disposed of in the current tax year. Group the equipment and other property into the applicable classes, and put each class on a separate line. Enter on line 9926 the total rental portion of the proceeds of disposition of the equipment and other property. You will find information about proceeds of disposition in the previous section.

Area E – Details of building dispositions in the year

List in this area the details of all buildings you disposed of in the current tax year. Group the buildings into the applicable classes, and put each class on a separate line. Enter on line 9928 the total rental portion of the proceeds of disposition of the buildings. You will find information about proceeds of disposition on this page.

Note

When completing areas D and E, enter the part of the property that you **personally** use in the column called “Personal portion,” separate from the part you rent. For example, if you rent 25% of your personal residence, your personal use portion is the other 75%.

Area F – Details of land additions and dispositions in the year

Enter on line 9924 the total of all amounts you have received or will receive for disposing of land in the year.

Column 5 – UCC after additions and dispositions

You cannot claim CCA when the amount in Column 5 is:

- negative (see “Recapture of CCA” on this page); or
- positive, and you do not have any property left in that class at the end of the current tax year (see “Terminal loss” on this page).

In either case, enter “0” in Column 10.

Recapture of CCA

If the amount in Column 5 is negative, you have a recapture of CCA. Enter your recapture on line 9947, “Recaptured capital cost allowance,” of Form T776. A recapture of CCA can occur, for example, when the proceeds from the sale of depreciable rental property are more than the total of:

- the UCC of the class at the start of the year; and
- the capital cost of any additions during the year.

Terminal loss

If the amount in Column 5 is positive and you no longer own any property in that class, you have a terminal loss. More precisely, you have a terminal loss when you have no more property in the class at the end of a year, but you still have an amount that you have not deducted as CCA. In the year you dispose of your rental property, you can subtract

this terminal loss from your rental income and, if the loss is more than your rental income, you can create a rental loss. Enter your terminal loss on line 9948, "Terminal loss," of Form T776.

For more information on terminal losses and recapture of CCA, see Interpretation Bulletin IT-478, *Capital Cost Allowance – Recapture and Terminal Loss*.

Column 6 – Adjustment for current-year additions

In the year you acquire or make additions to a rental property, you can usually claim CCA only on one-half of your net additions (the amount in Column 3 **minus** the amount in Column 4). We call this the **50% rule**.

Calculate your CCA claim only on the net adjusted amount. Do not reduce the cost of the additions in Column 3, or the CCA rate in Column 8. For example, if you acquired a rental property for \$30,000, you would base your CCA claim on \$15,000 ($\$30,000 \times 50\%$) in the year you acquired the property.

If you acquired and disposed of depreciable rental property of the same class in the current tax year, the calculation in Column 6 restricts your CCA claim. Calculate the CCA you can claim as follows:

- Determine which of the following amounts is **less**:
 - the proceeds of disposition of your rental property **minus** any related costs or expenses; or
 - the capital cost.
- Subtract the above result from the capital cost of your addition.
- In Column 6, enter 50% of the result. If the result is negative, enter "0."

In some cases, you do not make an adjustment in Column 6. For example, you may have bought rental property in a non-arm's length transaction and, until you bought it, the seller continuously owned the property for at least 364 days before the end of the current year.

Also, some properties are not subject to the 50% rule. Some examples are those in Class 13 (leasehold interests), Class 34 (energy conservation equipment), as well as some in Class 12, such as small tools that cost **less** than \$200.

The 50% rule does not apply when the available-for-use rule denies a CCA claim until the second year after you acquired a rental property. If you need more information on the 50% rule, see Interpretation Bulletin IT-285, *Capital Cost Allowance – General Comments*.

Column 7 – Base amount for capital cost allowance

This is the amount in Column 5 **minus** the amount in Column 6. Base your CCA claim on this amount.

Column 8 – Rate (%)

Enter the rate (percentage) for each class of property you have listed in Area A. See "Classes of depreciable properties" on page 14.

Column 9 – CCA for the year

Enter the CCA you would like to deduct for the current tax year. The CCA you deduct cannot be more than the amount you get when you multiply the amount in Column 7 by the rate in Column 8. You can deduct any amount up to the maximum. However, the amount of CCA you can claim could be restricted. For more information, see "Limits on CCA" on page 14.

Add up all the amounts in Column 9 for all your classes of depreciable property. Enter the total CCA being claimed on line 9936 of Form T776. If you are a co-owner, enter only your share of the CCA.

Column 10 – UCC at the end of the year

This is the undepreciated capital cost (UCC) at the end of the current tax year. This will be the amount you enter in Column 2 when you calculate your CCA claim next year. If you have a terminal loss or a recapture of CCA, enter "0" in Column 10.

Special situations

Changing from personal to rental use

If you bought a property for personal use and then started using it in your rental operation in the current taxation year, there is a change in use. You need to determine the capital cost of the property for rental purposes.

If the fair market value (FMV) of a depreciable property (such as equipment or a building) is less than its original cost when you change its use, the amount you put in Column 3 of either Area B or C is the FMV of the property (do not include the land, if the property includes land and a building). If the FMV is more than the original cost of the property when you change use, use the following chart to determine the amount to enter in Column 3.

Capital cost calculation (Change in use)

1.	Actual cost of the property		\$			1
2.	FMV of the property	\$		2		
3.	Amount from line 1	-				3
4.	Line 2 minus line 3 (if negative, enter "0")	= \$				4
5.	Enter any capital gains deduction claimed for the amount on line 4*	\$		$\times 2$	$\blacktriangleright -$	5
6.	Line 4 minus line 5 (if negative, enter "0")	= \$		$\times 1/2$	$\blacktriangleright +$	6
7.	Capital cost: line 1 plus line 6	= \$				7

* Enter only the amount that relates to the depreciable property.

Note

We consider you to have acquired the land for an amount equal to the FMV when you changed its use. Enter this amount on line 9923 in Area F of Form T776.

You may get an incentive from a non-government agency to buy depreciable property. If this happens, you can either include the amount in income or subtract the amount from the capital cost of the rental property.

Grants, subsidies, and other incentives or inducements

You may get a grant or subsidy from a government or a government agency to buy depreciable property. When this happens, the grant reduces the cost of the land and depreciable property proportionately. For example, you buy a rental property at a cost of \$200,000 (\$50,000 for the land and \$150,000 for the building) and receive a \$50,000 grant. The \$50,000 grant is split in a similar way between the land and building. The total cost of the purchase is reduced to \$150,000: \$37,500 for the land and \$112,500 for the building. Do this before you enter the capital cost in Column 3 of Area B or C.

If the purchase price of your property was reduced due to poor quality or other reasons, see Interpretation Bulletin IT-285, *Capital Cost Allowance – General Comments*, for more information about how to calculate your capital cost.

Non-arm's length transactions

When you acquire rental property in a non-arm's length transaction, there are special rules to follow to determine the cost of the property. These special rules will not apply if you get the property because of someone's death. For a definition of a "non-arm's length transaction", see the glossary on page 4.

For more information, see Interpretation Bulletin IT-273, *Government Assistance – General Comments*.

If you pay **more** for the rental property than the seller paid for the same rental property, calculate the cost as follows:

Capital cost calculation (Non arm's length transaction)

1.	The seller's cost or capital cost		\$			1
2.	The seller's proceeds of disposition	\$		2		
3.	Amount from line 1	-				3
4.	Line 2 minus line 3 (if negative, enter "0")	= \$				4
5.	Enter any capital gains deduction claimed for the amount on line 4	\$		$\times 2$	$\blacktriangleright -$	5
6.	Line 4 minus line 5 (if negative, enter "0")	= \$		$\times 1/2$	$\blacktriangleright +$	6
7.	Capital cost: line 1 plus line 6	= \$				7

Enter this amount in Column 3 of either Area B or Area C, whichever applies. Do not include the cost of the related land, which you have to include on line 9923, "Total cost of all land additions in the year," in Area F of Form T776.

You can also buy depreciable property in a non-arm's length transaction from an individual who is not resident in Canada, or a partnership where none of the partners is an individual resident in Canada or a member of another

partnership. If you pay **more** for the rental property than the seller paid for the same rental property, calculate the capital cost as follows:

Capital cost calculation (Non arm's length – Non resident transaction)				
1.	The seller's cost or capital cost.....		\$	<u>1</u>
2.	The seller's proceeds of disposition.....	\$	<u>2</u>	
3.	Amount from line 1	-	<u>3</u>	
4.	Line 2 minus line 3 (if negative, enter "0").....	= \$	<u> </u> × 1/2 ▶ +	<u>4</u>
5.	Capital cost: line 1 plus line 4.....	= \$	<u> </u>	<u>5</u>

Enter this amount in Column 3 of either Area B or Area C, whichever applies. Do not include the cost of the related land, which you have to include on line 9923, "Total cost of all land additions in the year," in Area F of Form T776.

You might have bought depreciable property in a non-arm's length transaction, and paid **less** for it than the seller paid. If that is the case, your capital cost is the same amount as the seller paid. We consider you to have deducted as CCA the difference between what you paid and what the seller paid.

Example

Teresa bought a refrigerator from her father Roman for \$400 to use in her rental operation. Roman paid \$1,000 for the refrigerator in 1994. Since the amount Teresa paid is **less** than the amount Roman paid, we consider Teresa's cost to be \$1,000. We also consider that Teresa has deducted CCA in the amount of \$600 in the past (\$1,000 – \$400).

- In Area B, Teresa enters \$1,000 in Column 3, "Total cost."
- In Area A, she enters \$400 in Column 3, "Cost of additions in the year," as the addition for the current taxation year.

For more information on non-arm's length transactions, see Interpretation Bulletin IT-419, *Meaning of Arm's Length*.

Selling your rental property

If you sell a rental property for more than it cost, you may have a capital gain. List the dispositions of all your rental properties on Schedule 3, *Capital Gains (or Losses)*. For details on how to calculate your taxable capital gain, see guide T4037, *Capital Gains*.

If you are a member of a partnership that has a capital gain, the partnership will allocate part of that gain to you. The gain will show on the partnership's financial statements or in box 23 on your T5013 slip. Report the gain at line 174 of Schedule 3, *Capital Gains (or Losses)*.

Note

You cannot have a capital loss when you sell depreciable property. However, you may have a terminal loss. For an explanation of terminal loss, see "Column 5 – UCC after additions and dispositions" on page 17.

Disposing of a building

If you disposed of a building in the current tax year, special rules may apply that make the proceeds of disposition an amount other than the actual proceeds of disposition. This happens when you meet **both** the following conditions:

- you disposed of the building for an amount less than both its cost amount, as calculated below, and its capital cost to you; and
- you, or a person with whom you do not deal at arm's length, owned the land the building is on or the land next to it that was necessary for the building's use.

Calculate the cost amount as follows:

- if the building was the only property in the class, the cost amount is the undepreciated capital cost (UCC) of the class before you disposed of the building.
- if there is more than one property in the same class, you have to calculate the cost amount of each building as follows:

Capital cost of the building	×	UCC of the class	=	Cost amount of the building
Capital cost of all the properties in the class that have not been previously disposed of				

Note

If a building acquired in a non-arm's length transaction was previously used for something other than producing income, the capital cost of such property will need to be recalculated to determine the cost amount of the building.

If you disposed of a building under these conditions and you or a person with whom you do not deal at arm's length disposed of the land in the same year, calculate your deemed proceeds of disposition as shown in Calculation A on the next page. If you or a person with whom you do not deal at arm's length did not dispose of the land in the same year as the building, calculate your deemed proceeds of disposition as shown in Calculation B on the next page.

Calculation A – Land and building sold in the same year

1. FMV of the building when you disposed of it.....	\$	1		
2. FMV of the land just before you disposed of it.....			+	2
3. Line 1 plus line 2.....			=	▶ \$ 3
4. Seller's adjusted cost base of the land	\$	4		
5. Total capital gains (without reserves) from any disposition of the land (such as a change in use) in the three-year period before you disposed of the building, either by you or a person not dealing at arm's length with you, either to you or to another person not dealing at arm's length with you.....			-	5
6. Line 4 minus line 5 (if negative, enter "0").....	\$	6		
7. Line 2 or line 6, whichever is less			-	7
8. Line 3 minus line 7 (if negative, enter "0").....			= \$	8
9. Cost amount of the building just before you disposed of it.....	\$	9		
10. Capital cost of the building just before you disposed of it.....	\$	10		
11. Line 9 or line 10, whichever is less	\$	11		
12. Line 1 or line 11, whichever is more			\$	12
Deemed proceeds of disposition for the building				
13. Line 8 or line 12, whichever is less (enter this amount in Column 3 of Area E of Form T776)			\$	13
Deemed proceeds of disposition for the land				
14. Proceeds of disposition for the building and the land.....			\$	14
15. Amount from line 13			-	15
16. Line 14 minus line 15 (include this amount on line 9924 of Area F of Form T776).....			= \$	16

If you have a terminal loss on the building, include it on line 9948, "Terminal loss," of Form T776.

Calculation B – Land and building sold in different years

1. Cost amount of the building just before you disposed of it.....	\$	1		
2. FMV of the building just before you disposed of it.....	\$	2		
3. Line 1 or line 2, whichever is more			\$	3
4. Actual proceeds of disposition, if any.....			-	4
5. Line 3 minus line 4.....			= \$	5
6. Amount from line 5	\$	x1/2 ▶	\$	6
7. Amount from line 4			+	7
Deemed proceeds of disposition for the building				
8. Line 6 plus line 7 (enter this amount in Column 3 of Area E of Form T776).....			= \$	8

If you have a terminal loss on the building, include it on line 9948, "Terminal loss," of Form T776.

Ordinarily, you can deduct 100% of a terminal loss, but only 50% of a capital loss. Calculation B ensures that you use the same percentage to calculate a capital loss on land as you use to calculate a terminal loss on a building. As a result of this calculation, you add 50% of the amount on line 5 to the actual proceeds of disposition from the building (see "Terminal loss" on page 17).

Replacement property

In a few cases, you can postpone or defer including a capital gain or recapture in income. For example, your rental property might be stolen, destroyed, or expropriated, and you replace it with a similar one.

You can also defer a capital gain or recapture when you transfer rental property to a corporation or partnership. For more information on this topic, see one or more of the following publications:

- IC 76-19 *Transfer of Property to a Corporation Under Section 85*
- IT-291 *Transfer of Property to a Corporation Under Subsection 85(1)*
- IT-378 *Winding-Up of a Partnership*
- IT-413 *Election by Members of a Partnership Under Subsection 97(2)*

Example of how to calculate CCA

During the current year, Paul bought a house to use for rental purposes. The building is classified as Class 1 for CCA purposes with a CCA rate of 4%. It is his only rental property. The total cost was \$95,000 (\$90,000 total purchase price plus \$5,000 total expenses connected with the purchase). The details are as follows:

Building value (Class 1).....	\$ 75,000
Land value.....	+ 15,000
Total purchase price.....	= \$ 90,000
Expenses connected with the purchase	
Legal fees.....	\$ 3,000
Land transfer taxes.....	+ 2,000
Total fees.....	= \$ 5,000

Paul's rental income was \$6,000 and his rental expenses were \$4,900. Therefore, his net rental income before deducting CCA was \$1,100 (\$6,000 – \$4,900). Paul wants to deduct as much CCA as he can.

Before Paul can complete Area A of Form T776, he has to calculate the capital cost of the building. Since land is not depreciable property, he has to calculate the part of the expenses connected with the purchase that relate only to the building. To do this, he has to use the formula in the section called "Column 3 – Cost of additions in the year" on page 16.

Part of the fees Paul can include in the building's cost	=	$\frac{\text{Building value}}{\text{Total purchase price}}$	×	Expenses
	=	$\frac{\$75,000}{\$90,000}$	×	\$5,000
	=	$\$4,166.67$		

This \$4,166.67 is the part of the \$5,000 in legal fees and land transfer taxes that relates to the purchase of the building, while the remaining \$833.33 relates to the purchase of the land. Therefore, the capital cost of the building is:

Building value (Class 1).....	\$ 75,000.00
Related expenses.....	+ 4,166.67
Capital cost of the building.....	= \$ 79,166.67

Paul enters \$79,166.67 in Column 3 of Area C of Form T776. He includes \$15,833.33 (\$15,000 + \$833.33) on line 9923 of Area F of Form T776 as the capital cost of the land.

Paul never owned rental property before the current year. Therefore, he has no undepreciated capital cost to enter in Column 2 of Area A of Form T776.

Since Paul acquired his rental property during the current year, he is subject to the 50% rule explained in "Column 6 – Adjustment for current-year additions" on page 18.

His net rental income before CCA is \$1,100. Paul cannot claim CCA of more than \$1,100 because he cannot use his CCA to create a rental loss (see "Limits on CCA" on

page 14). This is the case even though he would otherwise be entitled to claim \$1,583.33 [(\$79,166.67 × 50%) × 4%].

Chapter 4 – Principal Residence

When you sell your home, you may realize a capital gain. If the property was your principal residence for every year you owned it, you do not have to report the sale on your return. However, if the property was not your principal residence at any time during the period that you owned it, you may have to report all or a portion of the capital gain.

This chapter explains the meaning of principal residence, how you designate a property as such, and what happens when you sell it. It also explains what to do in other special tax situations, such as claiming CCA when you use all or part of your residence for rental purposes.

If you want more information after reading this chapter, see Interpretation Bulletin IT-120, *Principal Residence*.

What is your principal residence?

Your principal residence can be any of the following types of housing units:

- a house
- a cottage
- a condominium
- an apartment in an apartment building
- an apartment in a building such as a duplex or triplex
- a trailer, mobile home, or houseboat

A property qualifies as your principal residence, for any year, if it meets the following **four** conditions:

- it is a housing unit, a leasehold interest in a housing unit, or a share of the capital stock of a co-operative housing corporation you acquire only to get the right to inhabit a housing unit owned by that corporation;
- you own the property alone or jointly with another person;
- you, your current or former spouse or common-law partner, or any of your children lived in it at some time during the year; and
- you designate the property as your principal residence.

The land on which your home is located can be part of your principal residence. Usually, the amount of land that you can consider as part of your principal residence is limited to one-half hectare (1.24 acres). However, if you can show that you need more land to use and enjoy your home, you can consider more than this amount as part of your principal residence. For example, this may happen if the minimum lot size imposed by a municipality at the time you bought the property is larger than one-half hectare.

Designating a principal residence

When you sell or are considered to have sold all or part of your home, you can designate it as your principal residence for the years that you owned and used it as your principal residence. However, you do not have to designate it each year. For more information, see “Form T2091(IND), *Designation of a Property as a Principal Residence by an Individual (Other Than a Personal Trust)*” on this page.

Can you designate more than one principal residence?

For 1982 and later years, you can only designate one home as your family’s principal residence for each year. For more information, see Interpretation Bulletin IT-120, *Principal Residence*.

For 1982 to 2000, if you had a spouse or were 18 or older, your family included:

- you;
- a person who throughout the year was your spouse (unless you were separated for the entire year under the terms of a court order or a written agreement); and
- your children (other than a child who had a spouse during the year or who was 18 or older).

If you **did not have a spouse and were not 18 or older**, your family **also** included:

- your mother and father; and
- your brothers and sisters (who did not have spouses and were not 18 or older during the year).

For 2001 and later years, the above definition applies except that the reference to spouse is replaced by “spouse or common-law partner.” Neither spouses nor common-law partners can designate different housing units as their principal residence. For the definition of spouse and common-law partner, see the glossary on pages 4 and 5.

For 1993 to 2000, since a spouse included a common-law spouse, common-law spouses could not designate different housing units as their principal residence for any of those years.

Note

If you elected to have your same-sex partner considered your common-law partner for 1998, 1999, or 2000, then, for those years, your common-law partner also could not designate a different housing unit as his or her principal residence.

Disposition of your principal residence

When you sell your home or when you are considered to have sold it, usually you do not have to report the sale on your return or pay tax on any gain from the sale. This is the case if it was your principal residence for every year you owned it.

If your home was **not** your principal residence for every year that you owned it, you have to report the part of the capital gain on the property that relates to the years for

which you did not designate the property as your principal residence.

If only a part of your home qualifies as your principal residence, you have to split the selling price and the adjusted cost base between the part you used for your principal residence and the part you used for other purposes, such as rental or business. You can do this by using square metres or the number of rooms, as long as the split is reasonable. Report only the capital gain or capital loss on the part you used for rental or business purposes.

For more information on how to report the capital gain resulting from the disposition of your principal residence, see guide T4037, *Capital Gains*.

Form T2091(IND), *Designation of a Property as a Principal Residence by an Individual (Other Than a Personal Trust)*

Use Form T2091(IND) to designate a property as a principal residence. This form will help you calculate the number of years that you can designate your home as your principal residence, as well as the part of the capital gain, if any, that you have to report. Complete Form T2091(IND) if you:

- sold, or were considered to have sold, your principal residence or any part of it; or
- granted someone an option to buy your principal residence or any part of it.

You only have to include Form T2091(IND) with your return if you have to report a capital gain.

A legal representative (executor, administrator, or a liquidator in Quebec) of a deceased person should now use new Form T1255(LEGREP), *Designation of a Property as a Principal Residence by the Legal Representative of a Deceased individual*, to designate a property as a principal residence for the deceased.

Did you or your spouse or common-law partner file

Form T664 or T664(Seniors)? – Use Form T2091(IND) to calculate the capital gain if you sell, or are considered to have sold, a property for which you or your spouse or common-law partner filed Form T664 or T664(Seniors), *Election to Report a Capital Gain on Property Owned at the End of February 22, 1994*, and:

- the property was your principal residence for 1994; or
- you are designating it in the current tax year as your principal residence for any year.

Use Form T2091(IND)-WS, *Principal Residence Worksheet*, to calculate a reduction due to the capital gains election. In this case, if the property was designated as a principal residence for the purpose of the capital gains election, you have to include those previously designated years as part of your principal residence designation in the current year.

Note

If, at the time of the election, the property was designated as a principal residence for any tax year other than 1994, you can choose whether or not to designate it again as your principal residence when you sell it or are

considered to have sold it. If you choose to designate it again, you have to include those previously designated tax years as part of your principal residence designation in the current taxation year.

If the property was not your principal residence for 1994 and you are not designating it in the current tax year as your principal residence for any tax year, do not use Form T2091(IND) or Form T2091(IND)-WS to calculate your capital gain. Instead, calculate your capital gain, if any, in the regular way (proceeds of disposition **minus** the adjusted cost base and outlays and expenses). For more information on how to calculate your adjusted cost base as a result of the capital gains election, see guide T4037, *Capital Gains*.

Change in use

You can be considered to have sold all or part of your property even though you did not actually sell it. For example, this is the case when:

- you change all or part of your principal residence to a rental property;
- you change your rental property to a principal residence; or
- you stop using a property to earn or produce income.

Every time you change the use of a property, you are considered to have sold the property at its fair market value (FMV) and to have immediately reacquired the property for the same FMV, unless you make an election as described below. The resulting capital gain or capital loss (in certain situations) must be reported in the year the change of use occurs.

If the property was your principal residence for any year you owned it before you changed its use, you do not have to pay tax on any gain that relates to those years. You only have to report the gain that relates to the years your home was not your principal residence.

Note

Your home is personal-use property. Therefore, if you have a loss when we consider you to have sold your home because of a change in use, you are not allowed to claim the loss.

Special situations

There are situations to which the change-in-use rules stated above do not apply. The following are some of the more common situations.

Changing your principal residence to a rental property

When you change your principal residence to a rental property, you can make an election not to be considered as having started to use your principal residence as a rental property. This means you do not have to report any capital gain when you change its use. If you make this election:

- you have to report the net rental income you earn; and
- you cannot claim capital cost allowance (CCA) on the property.

While your election is in effect, you can designate the property as your principal residence for up to four years, even if you do not use your property as your principal residence. However, you can only do this if you do not designate any other property as your principal residence for this time.

You can **extend** the four-year limit indefinitely if **all** the following conditions are 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 after 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.

If you make this election, there is no immediate effect on your tax situation when you move back into your residence. However, if you change the use of the property again and do not make this election again, any gain you have from selling the property may be subject to tax.

To make this election, you have to file a letter signed by you with your return. The letter should describe the property and state that you are making an election under **subsection 45(2)** of the *Income Tax Act*.

Changing your rental property to a principal residence

When you change your rental property to a principal residence, you can elect to postpone reporting the disposition of your property until you actually sell it.

This election only applies to a capital gain. If you claimed CCA on the property before 1985, you have to include any recapture of CCA in your rental income. Include the income in the year you changed the use of the property. However, you **cannot** make this election if you, your spouse or common-law partner, or a trust under which you, your spouse or common-law partner is a beneficiary, has deducted CCA on the property for any taxation year after 1984 and on or before the day you change its use.

To make this election, you have to submit a letter, signed by you, with your return. The letter should describe the property and state that you are making an election under **subsection 45(3)** of the *Income Tax Act*. You have to make this election by the earlier of the following dates:

- 90 days after the date we ask you to make the election; or
- the date you have to file your return for the year in which you sell the property.

If you make this election, you can designate the property as your principal residence for up to four years before you occupy it as your principal residence.

Changing part of your principal residence to a rental property

You are usually considered to have changed the use of part of your principal residence when you start to use that part for rental purposes. However, you are not considered to have changed its use if:

- the part you use for rental purposes is small in relation to the whole property;
- you do not make any structural changes to the property to make it more suitable for rental purposes; and
- you do not deduct any CCA on the part you are using for rental purposes.

If you meet all the above conditions, the whole property may qualify as your principal residence even though you are using part of it for rental purposes.

However, if you do not meet all of the above conditions, when you sell or change the use of the property, you have to:

- split the selling price between the part you used for your principal residence and the part you used for rental purposes by using either square metres or the number of rooms, as long as the split is reasonable; and
- report any capital gain on the part you used for rental purposes. You do not have to report any capital gain for the part you used for your principal residence.

Note

If there is only a partial change in the use of a property, you cannot file an election under **subsection 45(2)** of the *Income Tax Act*, as discussed in this chapter.

References

You can get the following forms and publications from our Web site at www.cra.gc.ca/forms or by calling 1-800-959-2221.

Interpretation bulletins

- IT-79 *Capital Cost Allowance – Buildings or Other Structures*
- IT-90 *What is a Partnership?*
- IT-120 *Principal Residence*
- IT-121 *Election to Capitalize Cost of Borrowed Money, and its Special Release*
- IT-128 *Capital Cost Allowance – Depreciable Property*
- IT-153 *Land Developers – Subdivision and Development Costs and Carrying Charges on Land*
- IT-195 *Rental Property – Capital Cost Allowance Restrictions*
- IT-220 *Capital Cost Allowance – Proceeds of Disposition of Depreciable Property, and its Special Release*
- IT-259 *Exchanges of Property*
- IT-273 *Government Assistance – General Comments*
- IT-274 *Rental Properties – Capital Cost of \$50,000 or More*
- IT-285 *Capital Cost Allowance – General Comments*
- IT-291 *Transfer of Property to a Corporation Under Subsection 85(1)*
- IT-304 *Condominiums*
- IT-341 *Expenses of Issuing or Selling Shares, Units in a Trust, Interests in a Partnership or Syndicate and Expenses of Borrowing Money*
- IT-359 *Premiums and Other Amounts With Respect to Leases*

- IT-378 *Winding-Up of a Partnership*
- IT-413 *Election by Members of a Partnership Under Subsection 97(2)*
- IT-417 *Prepaid Expenses and Deferred Charges*
- IT-419 *Meaning of Arm's Length*
- IT-434 *Rental of Real Property by Individual, and its Special Release*
- IT-443 *Leasing Property – Capital Cost Allowance Restrictions, and its Special Release*
- IT-456 *Capital Property – Some Adjustments to Cost Base, and its Special Release*
- IT-478 *Capital Cost Allowance – Recapture and Terminal Loss*
- IT-491 *Former Business Property, and its Special Release*

Information circulars

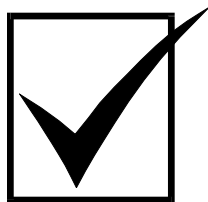
- IC 76-19 *Transfer of Property to a Corporation Under Section 85*
- IC 78-10 *Books and Records Retention/Destruction*
- IC 89-4 *Tax Shelter Reporting*

Guides

- T4001 *Employers' Guide – Payroll Deductions (Basic Information)*
- T4002 *Business and Professional Income*
- T4037 *Capital Gains*

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