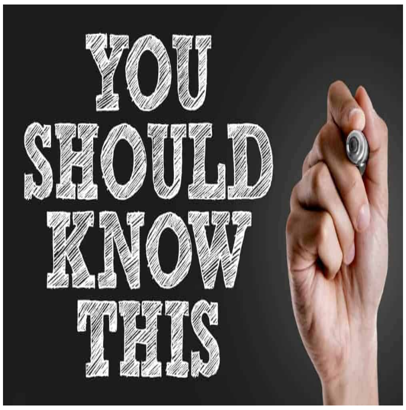

The Primary Residence Tax Exemption Could Be Cancelled

Description

Canada’s housing market is going berserk given the unprecedented home price growth during the pandemic. Rock-bottom interest rates and the desire for bigger spaces away from urban cities drive prices higher. Speculation is increasing too, that it worries bankers and economists.

Government regulators may have to intervene soon to prevent bubble trouble. Robert Hogue, an economist at the **Royal Bank of Canada**, suggests that policymakers should do something to prevent housing markets from overheating. If not, it presents a risk to the economy. There won’t be capital for more productive purposes and could even worsen inequality.

Distortion to housing markets

Hogue mentions the principal residence exemption (PRE) from capital gains tax. Perhaps cancelling the sacred cow that supports home ownership could be an option. The said tax exemption counters the effect of high interest rates. However, rates today are historically low.

An International Monetary Fund (IMF) staff report on Canada recently echoed the sentiment. While there was no direct reference to the principal residence exemption, the IMF report said it’s important to have policies that remove distortions from the red-hot housing markets.

The benefit to home sellers

Canadians who sell their residences can be exempted from paying taxes on capital gains through the PRE. Under Canada’s *Income Tax Act*, you must report the sale of a principal residence on your tax return to qualify for the PRE.

The Canada Revenue Agency (CRA) allows such a claim provided the residence is ordinarily inhabited by family members. The dwellers within the calendar year could be a spouse, common-law partner or children. You can designate only one property per year per family (spouse or common-law partner and children under 18).

CRA verification

Sellers must beware because the CRA analyzes evidence, including the length of stay, income sources, and real estate buying patterns. The tax agency must establish the property is indeed a dwelling place, not a quick flip of real estate holding. A property that generates income or is an inventory does not qualify for PRE.

Earn like a landlord

Canadians have alternatives to buying real estate investment properties. Consider indirect ownership by owning shares of real estate investment trusts (REITs). Hazelview Investments expect Canadian REITs to offer total returns of 10% to 12% per cent in 2021.

Besides a smaller cash outlay, you do away with other costs related to buying physical properties. It's instant rental income for mock landlords. **Nexus** (TSX:NXR.UN), a $280.34 million REIT, is growth-oriented and focuses on industrial assets.

The current share price is $8.42, while the dividend offer is a generous 7.6% yield. A $6,000 investment held in a Tax-Free Savings Account (TFSA) will produce $456 in tax-free passive income. Nexus proved its resiliency in 2020. The REIT reported a 3.4% increase in the full-year net operating income versus 2019.

On year-end 2020, it had $14 million in cash and a $5 million available credit facility. Kelly Hanczyk, Nexus' CEO, said the REIT would deploy capital to purchase and grow industrial assets in the economic recovery phase.

Drastic measure

We're unsure if policymakers will abolish the PRE to calm the buying frenzy and curb housing demand. However, home sellers will lose their benefit since you receive the full fair market value of the residential property tax-free when you sell. Some property owners need the proceeds as retirement funds or nest eggs.

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