Long-Term Care and the Principal Residence Exemption

Many believe that expenses decrease in retirement. While this is generally true, there are some expenses that might increase during this period. The following table discusses common expenses and whether they tend to decrease or increase in retirement. Also, see our whitepaper, *Expenses in Retirement: What to Expect and Income Needs*, for more information on this topic.

Expenses that tend to:	
Decrease in retirement	**Increase** in retirement
• Work related costs • Income tax • Housing (mortgages, downsizing) • Contributions to retirement savings • Cost of items/services ("seniors' pricing")	• Healthcare • Utilities • Travel and entertainment • Maintenance and other household expenses • Gifts and donations

Looking specifically at housing, particularly as we age, specialized housing may be required to address healthcare needs. In fact, according to 2016 Census data, 6.8% of Canadians aged 65 years or older are living in a nursing home or residence for seniors: the proportion jumps to 30% among Canadians aged 85 years and older.

A question recently received from an advisor looked at long-term care in a care facility and impact to the principal residence exemption. Specifically, if an individual is required to leave their principal residence and move to a long-term care facility (e.g., nursing home or other facility that provides for assisted or supportive living), assuming the individual continues to own their principal residence, would the principal residence exemption be available to shelter the property from tax on future sale (or at death)? Consider the following example:

Tracy, age 72, recently moved to a local nursing home after the death of her spouse, Kent. Because of a recent illness, Tracy has restricted mobility and requires consistent, ongoing care. Tracy and Kent had two children together, but Kent was her primary caregiver. With Kent's passing, it was determined that Tracy would require nursing home care to meet her immediate day-to-day needs. It is not known if Tracy will be able to return to her home at some point in the future.

For 40 years, Tracy and Kent jointly owned and lived in their home until Kent's passing in 2020. Not wishing to immediately sell the home, after discussions with her children, Tracy decided to rent the home to a non-related third-party and move to a long-term care facility. Not only would such a move better accommodate her needs, but it would create additional income which would help with her increased healthcare costs.

Thinking ahead to the future, should she not be able to return to her home, Tracy wondered if the principal residence exemption would be available to shelter her home from tax on a future sale.

The principal residence exemption is available for a given year when the owner (or a spouse, common-law partner (CLP), former spouse or CLP or child) ordinarily inhabits the home in the year and no other property is claimed as such by the owner or any member of his/her family unit[1]. When an owner, spouse/CLP or child ceases to occupy the home, access to the exemption normally ceases, resulting in taxes payable going forward.

For the above example, the issue of whether or not Tracy will be considered to ordinarily inhabit her home while in the nursing home is a question of fact – if, in a given year, her stay in the nursing home can be regarded as temporary in nature, it is likely that the "ordinarily inhabited" requirement will be met for that year provided no significant changes to the home are made to convert it to an income-producing property and capital cost allowance (CCA) is not claimed in respect of the property. If, on the other hand, her stay in the nursing home is considered permanent, the "ordinarily inhabited" requirement would likely not be met, meaning taxation of gains going forward.

[1] For these purposes, for adult owners, a family unit consists of a spouse or common-law partner and minor children.

Given that Tracy and Kent jointly owned and occupied their home until Kent's death[2], Tracy became the sole owner of the property on Kent's death. Also, because assets can transfer to a spouse without tax at the time of transfer, the adjusted cost base for the home was not impacted by Kent's death and carried forward to Tracy. Depending on the details of the case (e.g., Tracy's intentions when she moved into the nursing home, her diagnosis and potential for recovery, her ability to care for herself independently, the terms of the agreement with her third-party renter, etc.), the facts of the case would normally indicate whether Tracy's move to the nursing home was temporary or more permanent in nature. If the former, the principal residence exemption would likely continue to be available as she would still be considered to inhabit her home, even if she is earning incidental rental income. On the other hand, if her stay in the nursing home is more permanent in nature, a "change in use" of the property would be deemed to occur for the year in which the property became a rental property, resulting in a deemed sale and repurchase of the property at that time. Because Tracy, and before his death, Kent, occupied the property as their principal residence for each year of ownership until the change in use, the principal residence exemption would shelter the property from tax until that time. Thereafter, if the property appreciates in value, future gains would normally be subject to tax upon sale (or Tracy's death).

When thinking about the above, please note the following:

- Rental income is to be reported for tax purposes regardless of whether or not the principal residence exemption is available in respect of the property;
- Where there is a change in use of a property from principal residence to income-producing, a special election can be filed to allow the principal residence exemption to be available for an additional four years after the change[3]. The election, governed by section 45(2) of the federal Income Tax Act (ITA), provides flexibility and can be claimed by including a letter with the taxpayer's income tax return for the year the change in use occurred. For more information on this provision, see here: https://www.canada.ca/en/revenue-agency/services/tax/individuals/topics/about-your-tax-return/tax-return/completing-a-tax-return/personal-income/line-127-capital-gains/principal-residence-other-real-estate/changes-use/changing-your-principal-residence-a-rental-business-property.html

Where Canadians and their advisors need to make decisions regarding long-term care, understanding the above rules can impact decision-making and bring peace of mind – especially during periods of increasing healthcare costs.

[2] Assume joint with a right of survivorship; This status is not available in Quebec where Kent's interest would flow through his estate and be governed by his will.

[3] Provided capital cost allowance (CCA) is not claimed on the property.

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