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Duplexes, triplexes and elections under section 45 of the Income Tax Act

Whenever the use of a property changes—i.e. a property goes from being an income-producing property to a personal-use property, or vice versa—the property is considered to have been disposed of at fair market value. This fictional sale may result in a capital gain that can be avoided through an election under subsection 45(2) or 45(3) of the *Income Tax Act*. The election allows the taxpayer to defer the recognition of the capital gain on the property until the actual disposition of the property.

Up to this point, this tax relief seems advantageous for taxpayers. But the problem is that it does not apply the same way to owners of duplexes, triplexes, etc., as is it does to owners of single-family homes or condominiums; in fact, this situation creates an imbalance of taxation among these taxpayers. This is due to the fact that, since 2012, the Canada Revenue Agency (CRA) has viewed duplexes and triplexes as a single property, even though they are made up of separate units, and taxpayers cannot make the election under subsections 45(2) and 45(3) on only a portion of the property (even if only that part of the property's use is changing). This means that when an owner-occupant decides to rent out a unit of their duplex/triplex instead of living in it, no election can be made for this unit, since it's only a partial change of use for the entire property and does not qualify for the election. In comparison, an owner of a single-family home who decides to rent out their property will be able to make the election. The essential thing to understand here is this: when a principal residence becomes a rental property, in some cases there will be less of a tax impact, because the taxpayer can use the principal residence exemption and eliminate the entire capital gain generated by the deemed disposition. However, if the property changes from a rental property to a principal residence, the taxpayer will be taxed on the deemed capital gain in the year of the change of use.

You may wonder how the CRA justifies this difference in tax treatment for owner-occupants of duplexes and triplexes versus owner-occupants of "regular" houses, especially given that the election is available to condo owners, who only own one unit in a multi-unit building. The CRA's position is relatively new; prior to 2012, the CRA indicated on many occasions that it deemed each unit/dwelling in a duplex or triplex to be separate properties, which allowed owners of those buildings to make an election under subsection 45(2) or 45(3) whenever the use of a single unit/dwelling changed. Today, this election is no longer available, and the unequal application of this tax policy seems totally unjustified to us.

The key takeaway: the rules for a change of use of a property are complex, so if you're in this situation, you'll want to be sure to meet with one of our tax specialists. Just give us a call for an appointment!

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