So… you wanna be a landlord?
Income tax considerations for rental properties

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Considering becoming a landlord? You're not alone. According to a CIBC poll, more than one in four Canadian homeowners are either already landlords (15%) or plan to earn rental income (11%) by renting out space in their primary residence or from a separate rental property. And, nearly two in five (37%) homeowners say they'd opt for a home with a source of rental income if buying a home today.

While there are many financial and legal issues to consider as a landlord, make sure that you don't overlook tax considerations of earning rental income. Whether you're purchasing a residential or commercial property for the purpose of leasing it out, or you are considering renting your home or part of your home, this report highlights some of the more common tax issues you should consider before taking the plunge!

Rental property or business?

The first question you need to consider is whether the rental income you earn will be treated as income from property (i.e. investment income) or as income from a business, since each has different tax implications. When you rent out real estate, your income is treated as property income if you provide only basic services, such as utilities (e.g. light and heating), parking and laundry facilities. If you provide additional services, such as cleaning, security and / or meals, then it may be considered a business.

If your corporation owns the property, then rental income will be treated as income from property unless the corporation has more than five full-time employees. This is important because active business income in a corporation is taxed at a more favourable rate than income from property.

In this report, we assume that you own the real estate personally and earn property income, unless otherwise stated.

What do you need to include in your rental income?

A third of all landlords who own a separate rental property say their top reason to invest is to generate income now (15%) or upon retirement (19%). You need to include all amounts that are paid to you as rent, including income earned by renting your home through services such as Airbnb. As well, if you receive goods or services instead of rent, the fair market value of the goods or services must be included. For instance, if your tenant offers to plow your parking lot in exchange for a reduction of rent, you would need to include the value of the snow plowing as "other related income" when reporting your rental income. If you receive an amount for a lease extension, a sublease or a lease cancellation, they are also included in this category.

Most people report rental income on an "accrual basis" – they include the income in the year it is receivable and deduct expenses in the year they are incurred.

In certain cases you can deduct uncollectible rent from your income. This is considered a "bad debt" for tax purposes. To claim the deduction, you must have previously included the amount in your income and the amount must have become uncollectible during the year. You should have proof that it is uncollectible. For instance, you might have received a notice if the tenant has gone bankrupt, or be able to show that you tried collecting the rent but were unsuccessful. If you later receive a payment on the bad debt, then you will later have to include that amount in income again.

What expenses can you claim?

The CIBC Landlord poll found that most (74%) homeowners believe that even with a negative cash flow, the tax deductions can help make an income property a worthy investment. It is important, however, to understand whether expenses are properly deductible for tax purposes.

There are many expenses that you can deduct against your rental income, so long as they are reasonable. Expenses are divided into two categories: capital expenses and current expenses.

Capital expenses provide a long-lasting benefit over a number of years. Your cost of acquiring the rental property and costs to improve it beyond its original condition or to extend its life would be capital in nature. If you buy an older building and pay for renovations to bring it up to a condition suitable to rent, the renovation costs would likely be capital in nature. Most costs incurred to sell the property, such as real estate commissions or the cost of improvements to make the property more marketable, will be considered capital expenses. Capital expenses are deducted over a multi-year period.

Current expenses provide a short-term benefit. One example is a payment for repairs to fix or restore a property so that it will be in the same condition as it was when you purchased it. These expenses are often recurring in nature and are generally deductible in the year they arise.

Example 1

Susan owns a rental house with wooden siding. The paint on the siding has worn away. If Susan hires someone to paint the siding, it will likely be considered a current expense.

Suppose Susan is concerned about having to repaint the siding again in a few short years and instead decides to install vinyl siding. The cost of this installation would likely be a capital expense, since it improves the house beyond its condition when she purchased it and has a long-lasting benefit.

Capital expenses

Capital expenses are sometimes referred to as "capital costs" and are generally added to the cost of the property.

If property you purchase could depreciate in value over time, such as a building, furniture or equipment, then the capital cost is allocated over a number of years. For tax purposes, this deprecation is called capital cost allowance, or "CCA." The tax rules set out the maximum percentage of CCA that can be claimed on an annual basis, which differs depending on the type of property. You cannot claim CCA on land since it's not considered a depreciable property (land values generally go up, rather than down, over time). Where the purchase price covers both land and a building, it will need to be allocated between the two categories.

In the year you acquire the property, you may only claim half of the CCA (known as the "half-year rule") that would otherwise be permitted for the year, regardless of when the property is purchased. You cannot use CCA to create or increase a rental loss.

A number of different expenses fall into the category of capital costs, including the following:

- Costs to purchase the property: The total purchase price includes the amount you pay for your property and sales taxes, as well as closing costs including legal fees, land transfer taxes, and fees paid to real estate agents.
- Costs to improve the property: For instance, if you renovate a property so that it attracts tenants, the renovation costs would be capital expenses.
- Furniture and equipment: If you furnish your rental property or own equipment that you use to maintain the property, such as garden equipment, the cost of these items are also capital expenses.

Current expenses

Numerous expenses fall into the category of current expenses, which are deductible in the year they are incurred, including:

- **Insurance:** You can deduct the premiums that you pay to insure a rental property for the current year.
- **Interest / loan costs:** You can deduct interest that you pay on loans taken out to buy or repair your rental property, as well as fees that were charged to you in taking out a loan (such as appraisal fees and mortgage application fees). If you pay tenants interest on their rent deposits, you can also deduct that interest.
- **Legal fees and accounting fees:** You can deduct legal fees for preparing a lease, or assisting in the collection of outstanding rents. You can also deduct legal fees that you paid if they relate to mortgage financing. You can deduct bookkeeping fees, and fees paid to assist with an audit.
- **Management fees:** If you pay someone to manage your property, including the collecting of rents, you can deduct those fees. You can also deduct fees paid to someone for finding you new tenants.
- **Repairs / maintenance:** You can deduct expenses for repairing your rental property and maintaining it in proper condition. This includes salaries and benefits paid to a superintendent of a property. It also includes landscaping costs, but only those that relate to the year. If the rental property is a condominium, you can deduct your monthly condominium maintenance fees.
- **Property taxes:** Property taxes are deductible.
- **Utilities:** You can deduct utility costs for the property, but only if the terms of the lease require you as landlord to cover such costs.
- **Motor vehicle expenses:** If you personally do repairs and maintenance on your rental property, then you are permitted to deduct motor vehicle expenses incurred to transport your tools and materials to work on the property. In addition, if you own more than one rental property, you can also deduct motor vehicle expenses associated with collecting rents or supervising repairs and managing the rental properties.

- **Lease cancellation costs:** You can deduct the portion of a payment you make to cancel a lease relating to the current year.

Some expenses that you might think should be capitalized can actually be deducted as current expenses. These include:

- **Soft costs:** Certain costs that you incur during the time that a building is being constructed or renovated, including interest, legal fees, accounting fees, and property taxes, are called “soft costs” and are generally deductible as a current expense, up to the amount of rental income earned during that period. Any amounts in excess of the rental income are treated as capital expenditures.
- **Renovations to accommodate persons with disabilities:** These are deductible in the year paid, rather than treating them as a capital cost. They can include expenses to install ramps, electric door openers and modifications to accommodate wheelchairs.

Non-deductible expenses

If you spend time working on your property as a landlord, unfortunately the value of the services you provide cannot be deducted. Keep this in mind when deciding whether to do tasks yourself, or to hire a third party to take those on. You also need to be careful not to deduct personal expenses. Finally, any principal repayments (as opposed to interest expenses) on a mortgage are not deductible for tax purposes.

Allocating expenses for a mixed use property

According to the CIBC survey, nearly a third (31%) of landlords rent out a portion of their primary residence for short or long-term stays. This is particularly popular among younger Canadians aged 18-34, who cite surplus income for spending on non-essentials (29%) and assisting with housing costs (26%) as their top reasons for renting out space.

When you live in a property, and also rent some of it out, only a portion of your expenses will be deductible. All of the expenses that relate specifically to the rental area, such as repairs to that part of the property, will be deductible. For the rest of the expenses, such as utilities, you will need to do some reasonable proration of the shared expenses and divide these between the area you used personally, and the area that you rent out. You can do this by determining either the area (by square metres) or the number of rooms used for each purpose.

Example 2

Luke owns a home with 10 rooms, and he rents out two of those rooms. He pays utilities, property taxes and insurance during the year for his home. He also pays for painting of the rental rooms. Luke can deduct the entire cost of the painting, as this cost relates only to the area rented out. For the other expenses, he should be able to deduct 20% of the total costs, as two out of the total of 10 rooms are used for rental purposes.

What if you incur a loss?

You may be able to deduct a rental loss to reduce your other taxable income and reduce your overall tax bill.

Tread cautiously in this area, however, as the Canada Revenue Agency (CRA) has said that if you rent out a part of your home and your expenses exceed your income, you cannot claim your expenses if you are not incurring the expenses to earn income. So, if your expenses exceed your income on a consistent basis, you may not be able to claim any losses.

In some cases where you ask a person living with you, such as a relative, to contribute a small amount to cover part of the upkeep of your home or common expenses such as a portion of groceries, the CRA will view the situation as a “cost-sharing arrangement.” In this case, the amount received should not be included in income, nor should expenses be deducted.

Interestingly, more than two-thirds (69%) of landlords in the CIBC poll say they’d discount the rate if renting to family or friends.

If you choose to rent your property at less than market rates, for instance if the tenant is a personal friend, and you do not cover your expenses, no loss can be claimed for tax purposes. Only if your friend pays the same amount as you would charge any tenant (i.e. fair market value rent), and you expect to earn a profit, would you be able to deduct a loss against your other income.

When it's time to sell

If you sell your rental property, any gain will be taxable, unlike the gain when you sell your principal residence, which is tax-free.

You may also contemplate purchasing a property in your name, renting to a child and eventually selling or gifting the property to the child. If you gift the property to your child, you will be treated for tax purposes as having sold it for market value, and this amount becomes your child's tax cost of the property. If instead you sell the property to your child for an amount that is less than the market value of the property, you will still be treated for tax purposes as having disposed of it for market value; however, your child will only be treated as having acquired it for the price paid. This could lead to double tax when your child ultimately sells the property, so it's best to either make a gift or sell at fair market value to a relative.

No CCA claimed

If you have not claimed CCA, you will realize a capital gain or loss on the sale. If the selling price is more than your cost (the total of your original cost plus any additional capital costs since the purchase one-half of the capital gain is included in your taxable income. If the selling price is less than your cost, the same portion of the capital loss may be used to offset capital gains in the year of sale, or a net capital loss may be carried over and used to offset capital gains in any of the prior three years or in any future year.

Example 3

For example, suppose Salma purchased a rental property with an original cost $650,000, paid $50,000 for capital improvements, and claimed no CCA. Her cost, which is called her "adjusted cost base" ("ACB") will be $700,000. Figure 1 shows Salma's capital gain or loss if she sold the property for $900,000 (more than her ACB) or $600,000 (less than her ACB).

Figure 1: Examples of selling rental property when CCA was not claimed

Description	Sale price: More than ACB	Sale price: Less than ACB
Selling price	$900,000	$600,000
ACB	(700,000)	(700,000)
Capital gain (loss) – 50% taxable (allowable)	**$200,000**	**($100,000)**

CCA claimed

If you claimed CCA, then the undepreciated capital cost ("UCC"), calculated as the ACB of the building less the CCA that you claimed, also comes into play when you sell your rental property. Generally, in these circumstances, you will be required to allocate the purchase price and ultimate proceeds between the land and building. For simplicity, we have ignored the allocation to land, as the calculation of the gain (loss) on land is generally straightforward, while the allocation of proceeds is complex and beyond the scope of this report.

If the selling price is more than your ACB, you will still have a capital gain (calculated as the selling price less the ACB) and the appropriate percentage will be included in your taxable income. Your income will also have to include "recapture," which is the difference between your ACB your UCC. Recapture is fully taxable.

If the selling price is between your UCC and your ACB, there is no capital gain or loss. The difference between selling price and the UCC is included in your income as fully-taxable recapture, as a result of excess CCA that was claimed while you owned the property.

If the selling price is less than your UCC you will have what is called a “terminal loss” (calculated as the difference between your UCC and the selling price) that can be fully deducted against other income. A terminal loss represents depreciation in the value of your property that you were not allowed to deduct previously as CCA.

Example 4

For example, suppose Andrei also purchased a rental property with an ACB of $700,000, and claimed CCA of $200,000, leaving a UCC of $500,000.

Figure 2 shows Andrei’s capital gain, recapture and terminal loss if he sold the property for $900,000 (more than the ACB), $600,000 (between the UCC and the ACB) or $300,000 (less than the ACB and the UCC).

If you sell a home that you live in, which also contained a rental unit, you may need to allocate the selling price between the part you used for your principal residence and the part you used for rental purposes.

Figure 2: Examples of selling rental property when CCA was claimed

Amounts used in calculations

Description	Sale price: More than cost	Sale price: Between UCC and cost	Sale price: Less than UCC
Proceeds from sale	900,000	600,000	300,000
ACB	700,000	700,000	700,000
UCC	500,000	500,000	500,000

Tax treatment

Description	Sale price: More than cost	Sale price: Between UCC and cost	Sale price: Less than UCC
Capital gain (50% taxable)	200,000 (Proceeds minus ACB)	0	0
Recapture (100% taxable)	200,000 (ACB minus UCC)	100,000 (Proceeds minus UCC)	0
Terminal loss (100% deductible)	0	0	200,000 (UCC minus proceeds)

Change in use: moving into or out of your rental property

Changing your principal residence to a rental property

If the property was your principal residence prior to the change in use, you don’t have to pay tax on any accrued gain up to that point. The concern is that when you subsequently sell the home, part of the gain that arose while it was a rental property may be taxable.

If you change your principal residence to a rental property, there is a special tax election that allows you to designate the property as your principal residence for up to four years after the change, provided you don’t claim any CCA against the rental income.[1] Before making this election, you should consider whether you would be better off reporting the disposition in the year of the change in use, where any gain may be sheltered from tax using the principal residence exemption. If you do decide to make the election, when you ultimately dispose of the property, it’s possible, depending on when you sell (i.e. after four years) that only a portion of

[1] You can only make the election if you don’t designate any other property, such as a vacation home or cottage, as your principal residence during this period of time.

the entire gain since the date the property was acquired will be exempt from tax by reason of the principal residence exemption.

Changing part of your principal residence to a rental property

Where there has been a partial change-in-use, such as if you start to rent out your basement, the election discussed above may be available. In addition, you will still be allowed to claim the principal residence exemption if you meet three conditions. First, your rental use of the property must be "relatively small in relation to its use as your principal residence." Secondly, you can't make any structural changes to the property, and, finally, you can't deduct any CCA on the part of your home that you are using for rental purposes.

If you meet these three conditions, at the time of sale, you can claim the principal residence exemption to shelter the gain on the entire property, even though you are using part of it for rental purposes. The CRA has stated that these conditions could be met, for example, if you rent out one or more rooms in the home.

If you don't meet these conditions, when you actually sell the property, you are required to allocate the selling price between the part you used for your principal residence and the part you used for rental purposes, so only part of any capital gain will be non-taxable.

Changing your rental property to your principal residence

What if you decide to move into a home that you previously rented to a tenant? When you change from a rental property to a principal residence, any gain accruing up to that point will be taxable. You can elect to postpone reporting the disposition of your property until you actually sell it, but only if you haven't claimed any CCA on the property.

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

Other forms of rental property ownership

Rather than owning the property by yourself, you may consider having your corporation own the property, or owning the property jointly with another person.

Corporation

Among the CIBC poll respondents, only a small portion of landlords (4%) own their income property through a corporation.

There may be non-tax reasons for having a corporation be the owner of a rental property, such as limited liability. Before you take this step, you should consult with tax and legal advisors to determine the tax and other implications.

As discussed above, unless the rental income is considered business income in the corporation, it will not be taxed at a preferential rate. Whether the income is treated as business or property income in the corporation, in most provinces you will pay slightly more tax overall by earning the rental income in a corporation than you would if you earned the income personally and paid tax at the top marginal rate.[2] With business income, however, you can defer a significant portion of the overall tax until the funds are paid out as a dividend. Further information on this topic and other tax savings tips are available on the CIBC Advice Centre.

If the corporation sells the property and realizes a capital gain, that gain is taxable to the corporation and any capital losses you may have realized in your hands personally cannot be used to offset the corporate taxable gain.

If instead the property is sold at a loss by the corporation or the corporation incurs annual rental losses, those losses are "trapped" inside the corporation and cannot be accessed personally and be used to offset any capital gains you have in your personal name. You also need to be careful if you, or a relative, lives in a

[2] Assuming 2024 tax rates.

property owned by your corporation. In such a case, it's important that your corporation receive fair market value rent for the use of the property. Otherwise, you could have income attributed to you as a taxable shareholder benefit.

Keep in mind that if you own your rental property through a corporation, you will need to file corporate tax returns each year for the corporation, which may involve preparing annual financial statements and other accounting and bookkeeping fees.

Joint ownership

About half (49%) of landlords solely own their property and another 45% hold the property with at least one other person.

You may decide to register title of your rental property jointly with another person (typically a spouse, partner or adult child) for non-tax reasons. For example, avoiding provincial probate fees is a common reason for holding property jointly with "right of survivorship".

If you own the property jointly with someone else, you may not be able to split the rental income equally for tax purposes. For instance, if you and your spouse own the property and you were the only one who provided the funds to purchase the property, you should report all the income, as well as 100% of any capital gain (loss) on ultimate disposition.

As there are many issues to consider before deciding to own a rental property jointly with another party, tax and legal advisors should be consulted prior to finalizing the purchase.

Additional considerations if the property is in the US

US federal and state income tax may apply on any rental income if the property is located south of the border. US tax may also apply to any gain on the sale of the property. You may be able to offset these taxes in Canada by claiming a foreign tax credit. In addition, depending on the total value of your US properties, there could be US tax implications if you gift the property, or US estate tax implications at the time of your death. Further information is available in our report titled Your US vacation property could be quite taxing.

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