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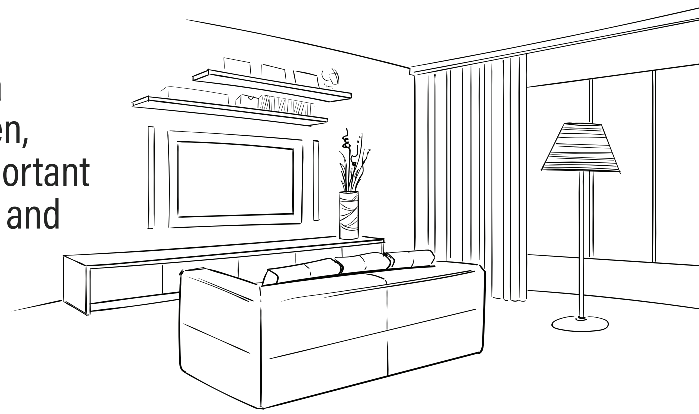
Adding a Secondary Suite to Your Home - What You Need to Know

Adding a secondary suite to your home can provide numerous benefits, including extra income and increased property value. Renovating and renting out a portion of your home in Ontario, Canada also comes with several tax implications, both in terms of capital gains and potential tax write-offs.

What is a Secondary Suite?



A secondary suite is a self-contained living space within a single-family home, typically with its own entrance, kitchen, bathroom, and living area. For financing purposes, it's important to recognize how the suite might impact the home's value and mortgage options.

Lender's Perspective on Secondary Suites

Lenders may view secondary suites in various ways:

Rental Income

If you rent out the secondary suite, you can use the rental income to help qualify for a larger mortgage or a lower interest rate. This income must be verified and factored into your overall debt-to-income ratio.

Appraisal Value

A secondary suite may increase the market value of the property, especially if it's a desirable rental space. An appraiser will assess whether it adds value to the home.

Zoning & Legal Considerations

Make sure your secondary suite is legally registered and compliant with local zoning regulations. If it's not legally approved, it may affect your ability to refinance or secure a loan.

1. Capital Gains Tax Implications

When you rent out a portion of your home, it may affect your **Principal Residence Exemption (PRE),** which is a tax benefit that allows homeowners to avoid paying capital gains tax on the sale of their primary residence.

Rental Portion: If you rent out a portion of your home, such as a basement apartment or a room, the rented area may lose its "principal residence" status, and a portion of the capital gains on the sale could become taxable. The CRA (Canada Revenue Agency) will generally consider the portion of the home you rented as a business-use area, and this could lead to a capital gains tax liability when you sell the property, based on the proportion of the home rented out.

For example, if you rent out 25% of your home, then 25% of the capital gains on the sale of the home may be subject to tax.

2. Tax Write-Offs for Renovations

When you renovate a portion of your home to make it suitable for renting, you may be able to claim certain **tax deductions** related to the rental portion of the property. These expenses can reduce your taxable rental income and lower your overall tax liability.

Eligible Renovation Costs

Repairs and Maintenance: You can deduct costs associated with making repairs or maintaining the rental portion of your home. For example, fixing plumbing, upgrading electrical systems, or replacing worn-out flooring in the rental unit.

Renovations for Rentable Space: If the renovation includes work that makes part of the home a more suitable living space (e.g., adding a kitchen, bathroom, or separate entrance), the costs of these improvements can also be deductible, though there are nuances around whether these expenses are considered capital or current expenses.

Capital vs. Current Expenses

Capital Expenses: If your renovation is a substantial improvement (such as adding a new room, upgrading a kitchen, or other major structural work), the cost is typically considered a capital expense. While capital expenses cannot be written off entirely in the year they are incurred, they may be eligible for capital cost allowance (CCA), which allows you to gradually write off the costs over time.

Current Expenses: Expenses that are necessary for the operation and maintenance of the rental unit such as cleaning, repairs etc can generally be deducted in the calendar year they are incurred.

Depreciation (Capital Cost Allowance - CCA)

For the portion of your home you rent out, you can claim a Capital Cost Allowance (CCA) for the depreciation of the rental space. This allows you to deduct a portion of the original cost of the property each year as a tax deduction.

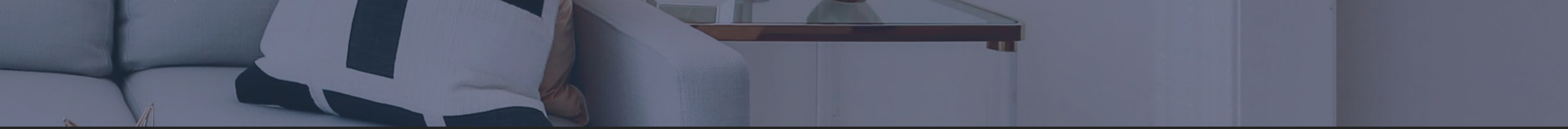
However, keep in mind that CCA can reduce the Principal Residence Exemption when you sell the home. If you've claimed CCA on the rented portion, the amount of depreciation claimed will be deducted from the portion of the home's gain that qualifies for the PRE, potentially increasing your taxable capital gain when you sell.

3. Income from Renting Out a Portion of Your Home

Any income you receive from renting out part of your home is taxable, and you must report it on your income tax return.

Rental Income: You are required to report the rental income on your tax return, and the CRA considers rental income as taxable income. You can deduct eligible expenses (such as repairs, utilities, and property taxes) related to the rental portion of your home to reduce the taxable income.

Proportional Deductions: The expenses you claim for the rental portion must be proportional to the amount of the home that is rented out. For example, if you rent out 30% of your home, you can generally deduct 30% of the household expenses (e.g., utilities, property taxes, mortgage interest, insurance).



4. Harmonized Sales Tax (HST)

For most individuals renting out part of their home, HST/GST will not apply to rental income, as residential rent is typically exempt from HST. However, if you provide additional services (such as cleaning or meals) to your tenants, HST could apply.

5. Other Considerations

Separate Utilities and Expenses: It's a good idea to keep separate records for the rental portion of your home. If you're sharing utilities (e.g., electricity, water), keep track of what portion is attributable to the rented space to accurately claim deductions.

Application Process

1. **Project Planning:** Develop a detailed plan for your secondary suite, ensuring it meets local regulations.
2. **Documentation:** Gather necessary documents, including building plans, permits, and cost estimates.
3. **Submission:** Apply through the Canada Mortgage and Housing Corporation (CMHC) once the program is active.

Conclusion

Renovating and renting out part of your home in Ontario can generate rental income but comes with tax implications, including potential impacts on the Principal Residence Exemption and capital gains taxes upon sale. Homeowners should maximize tax write-offs for eligible renovations, maintain clear financial records, and consult a tax professional for compliance.

To support secondary suite development and increase affordable housing, the Canadian government introduced the **Canada Secondary Suite Loan Program, doubling the loan limit to $80,000 as of December 2024, with a 2% fixed interest rate and a 15-year repayment term.** Additionally, starting **January 15, 2025, homeowners can refinance up to 90% of their home's post-renovation value (up to $2 million) with a 30-year amortization**, benefiting from tax incentives like the Multigenerational Home Tax Credit (up to $2,000). The federal government also plans to adjust mortgage insurance rules, increasing the insured mortgage limit to $2 million to encourage densification.

While secondary suites offer financial and housing benefits, careful planning and professional guidance are essential to ensure long-term success.

Key Features

Loan amount up to **$80,000**

Interest rate **fixed at 2%** and amortized **over 15 years** translates into an additoinal payment of

$514.50 per month

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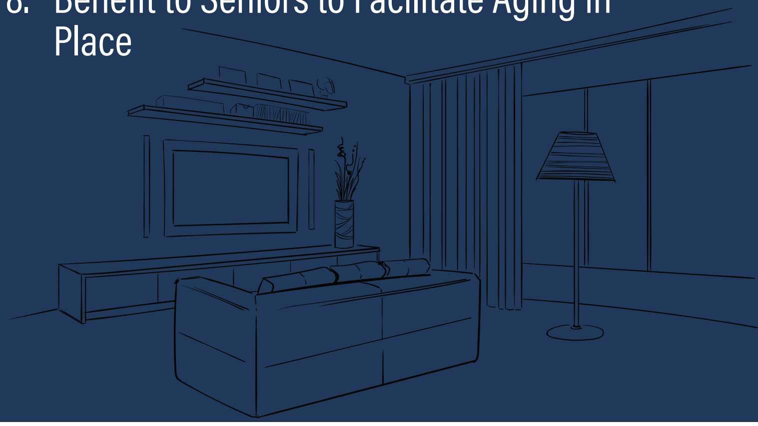
8 REASONS WHY A SECONDARY SUITE IS MORE THAN JUST A RENOVATION

IT'S A SMART INVESTMENT THAT OFFERS NUMEROUS LONG-TERM BENEFITS:

1. Take Advantage of Secondary Suite Incentive Programs
2. Generate Extra Income
3. Increase Your Property's Value
4. Provide Housing for Family Members
5. Flexible Living Arrangements for Changing Needs
6. Eco-Friendly and Sustainable Living
7. Future-Proof Your Home
8. Benefit to Seniors to Facilitate Aging in Place



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