



Tax Implications on Changing Your Use of Real estate

There are tax implications where there is a change of use of a property. For this article, we'll consider a situation that we see very commonly - where real estate property changes from personal use to one of earning income, or from an earning income use to personal use.

Personal Use to Income Earning Use

Let's assume that a person owns a condo unit that they were living in as their personal residence in 2023. If they decide to live elsewhere and rent out the condo unit in 2023, there would be a "change of use". The tax implication on a "change of use" is a *deemed* disposal of the property at its fair market value. That means that it is *presumed* that the individual received sale proceeds in 2023 and that they would have to report any gain on the property on their 2023 personal tax return. Maybe the person could claim a full principal residence exemption on the property and not pay any tax on the gain.

Income Earning Use to Personal Use

The same issue arises when that same condo unit was always used to earn rental income, but the owner decides to move into it and make it their personal residence. In this situation, the change of use causes cash flow problems because there's the deemed disposition, but there's no principal residence exemption to offset the gain. The individual would have to report any gain on their tax return and pay taxes on the gain - without having received any sale proceeds to pay the taxes.

Special elections - there is a special tax election that can be filed in both above situations, to avoid having to report this deemed disposition on change of use. It's not always available for all taxpayers. One of the conditions is that in the case of rental properties changing to personal use, the taxpayer never claimed tax depreciation as an expense against the rental income. Also, the election can provide an advantage in being able to extend by 4 years, or more in the case of job transfers, the ability to claim the principal residence exemption. Depending on your situation, there may be an obvious benefit to making the election. The main point is that many taxpayers are not aware of the tax implications on a change of use and of this potential election. It's always best to provide your Padgett advisor with all the facts about your past, current, and intended use of your real estate properties.

