

Feasibility analysis of a tax deferral mechanism for residential real estate dispositions in Canada

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August 25, 2026

Introduction & Background

This research background document supports a multi-phase policy analysis examining the feasibility of introducing a tax deferral mechanism for residential real estate dispositions in Canada, modelled on the US Section 1031 exchange. Section 44 of the Income Tax Act allows real property owners to defer their Capital Gains Tax bill if the proceeds are reinvested into a business property of equal or greater value.

However, the definition of “former business property” in subsection 248(1) excludes property used principally to earn rental income, which shuts rental housing out of the rollover, and a parallel exclusion applies to the CCA recapture rollover under subsection 13(4). An owner who sells a rental building and reinvests the full proceeds therefore faces the same tax bill as one who sells and spends them.

As governments at all levels in Canada pursue ambitious housing supply and affordability objectives, this research will contribute by assessing a core capital-market inefficiency created by this exclusion. The overarching policy objective is to increase liquidity for private residential developers and rental property owners. This would be done by removing the Section 44 exclusion for properties used primarily for rental income. Placing rental property on a level with other property types would encourage reinvestment in additional residential supply and support governments’ supply and affordability targets.

Removing the exemption could have further economic impacts. Specifically, improving capital market efficiency can help address the homebuilding sector’s lacklustre productivity. As residential homebuilding becomes a larger share of the economy, and as more resources are deployed toward homebuilding, policy efforts to improve the sector’s productivity and efficiency become crucial.

Two conditions make the question timely. Purpose-built rental now accounts for 59 percent of housing starts (CMHC, Starts and Completions Survey), so any policy meant to increase supply must work through the rental market. At the same time, residential construction productivity has lagged for two decades (Statistics Canada, Table 36-10-0480-01).

Evidence Base and Gap

US evidence supports the proposed mechanism. Research using US data finds that exchange buyers reinvest more equity at lower leverage, and the provision defers rather than forgives tax: basis carries over, recapture grows, and only about 12 percent of exchange-acquired properties are later disposed of through another exchange (Ling & Petrova, 2008, 2020a, 2020b). Furthermore, Somerville and Wetzel (2014) make the theoretical case for a Canadian rollover, highlighting its potential for redevelopment and a more efficient urban form. However, no study has quantified the market or fiscal effect for Canadian rental housing. This research fills that gap and tests how far American estimates, drawn from a broader provision and a different market, transfer to Canada.

Research Objectives

The research will evaluate the feasibility and potential of removing the rental property exclusion from the Capital Gains Tax rollover provision. It will do so through three separate phases, each building up to the final deliverable:

- Phase 1 — Problem Scoping and Stakeholder Analysis:
Specify and refine the issues the current rollover eligibility exception for rental housing creates for rental housing supply. Confirm technical feasibility and legal nuances involved with the proposed change.
- Phase 2—Preliminary Research Validation:
Identify relevant data, sources, and background research to evaluate the core research thesis, quantify the potential impact, and identify relevant gaps. This phase will lay the foundation for the formal modelling and analysis
- Phase 3—Comprehensive Policy Development and Report:
Using available data and relevant past research, this phase will quantify the potential market size, impact, and outcomes of removing the current rental property exemption. The final analysis will outline a policy recommendation on the conditions, scope, implementation timeline, and evidence-based justification.

Data and Methods

The legal review covers sections 13(4), 44, and 248(1) of the Income Tax Act, CRA interpretations, and the US section 1031 rules. The market analysis draws on CMHC starts data, Statistics Canada tables on construction productivity, residential capital age, and renovation spending, the Canadian Housing Statistics Program, property assessment records, and Altus transaction volumes. Stakeholder interviews will test whether the tax barrier binds in practice. As an indication of scale, C\$12.4 billion in 2025 Canadian apartment transactions, at the US exchange participation rate of 22 percent and the observed reinvestment differential, implies roughly C\$400 to C\$900 million in additional private capital deployed each year before any increase in transaction counts.

Scope and Boundaries

The study draws on publicly available data, published research, stakeholder interviews, and proprietary data where available. The analysis aims to produce a policy-ready assessment of removing the Section 44 exclusion. Where data are unavailable or inferential grounds are weak, we will report this explicitly and clarify any assumptions.

Key Sources

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