

Tax Implications of Canadians Purchasing US Property

Overview

The purchase of US vacation or rental property has become very appealing to many Canadians due to the combination of the recent subprime mortgage crisis and the strong Canadian dollar against US currency. However, prospective purchasers should be aware of a number of possible US income and estate tax ramifications before buying property in the US.

We briefly address, below, some of the relevant US tax rules and regulations.

Residence Rules

Canadians who spend a substantial amount of time in the US – at least half of any given year – can be caught under the IRS “substantial presence” test and be considered a US resident for income tax purposes. They would be subject to US tax on their worldwide income. (Fortunately, the Canada-US Income Tax Treaty provides relief for double taxation.)

Rental Income

Generally, a 30% withholding tax applies to the gross amount of rent paid to a resident of Canada on real estate located in the US. However, a Canadian can make an election to file a US tax return and pay tax on their net rental income. The taxpayer can deduct expenses related to the rental property, such as property tax, mortgage interest, maintenance fees, insurance and utilities.

Capital Gains on the Sale of US Real Estate

Canadians are also subject to a 10% US withholding tax on the gross proceeds that arise from the sale of real estate located in the US. There are certain exceptions that apply to this withholding tax. One of the most common is when the sales price is less than \$300,000 and the buyer intends to use the property as a personal residence. Another exception to paying the full amount of US withholding tax is when the seller applies for a withholding certificate and the IRS determines that the tax liability would be less than 10%.



US Tax Filing Requirements

Canadians reporting net rental income from US property must file annual US federal tax returns and may also have state filing requirements depending on the location of the property. Also, any gain resulting from the sale of US real estate must be reported on US federal and state tax returns. Any withholding tax from either the gross rental income or the sale of real estate can be used to offset the tax liability reported on the tax returns.

US Estate Tax

Canadians who die owning US real estate must file a US estate tax return if the total value of their gross assets situated in the US on the date of death exceeds \$60,000. For 2011, the estate tax rate goes from 18% to 55%. Although the estate tax has been repealed for 2010 and will fall back to 2001 exclusion and tax rates, it is uncertain at the present time what future plans the US Congress has for this tax.

Contact Us

As you can see, careful planning should be considered for Canadians before acquiring US real estate to minimize US income and estate taxes. If you own or aim to own (or someone close to you owns or intends to own) US vacation or rental property, we encourage you to contact your Manning Elliott representative or a member of our tax group to plan the acquisition in the most cost effective manner.

