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What Drives Us

Fall 2022

We've officially marked the end of another summer. Although we're continuing to navigate our 'new normal', it was satisfying to enjoy our first summer in over 2 years without widespread COVID restrictions.

Just as we've been adjusting, so too have financial markets. Inflation and interest rates are continuing to dominate the headlines. We've seen a doubling of mortgage interest rates while consumer prices increased and stayed persistently high. As a result, real-estate markets are slowing and businesses are looking closely at their costs and carefully evaluating new investments.

What is important to remember is that businesses and our financial system are resilient. Since the turn of the century we've witnessed a dot-com bust, terrorist attacks, multiple wars, the great financial crisis, a U.S. bank collapse, political uncertainty, debt ceiling debates, a U.S. housing collapse and, of course, a global pandemic that brought the world to a screeching halt. Throughout all of this, businesses and our economy have adapted and, despite high volatility and uncertainty at times, many investors were rewarded for owning a balanced and diversified portfolio of investments.

In this edition, we've included an excerpt from a TD Wealth article titled Owning U.S. Real Estate, that discusses some important considerations for Canadians who are considering owning U.S. real-estate, a topic that our clients often bring up. We've also included an update from a Canadian company with ambitious plans to 'democratize private equity' for investors.

Stay Well,

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Owning U.S. Real Estate

Owning real estate in the U.S. may be appealing to Canadians for many reasons. Some own a vacation property to escape the winter months, while others purchase a home or condo for a child pursuing post-secondary education in the U.S. Whether you are buying, selling, or earning rental income from a U.S. property, there are a myriad of planning and compliance issues to consider on both sides of the border.

This article is intended for Canadian residents who are not U.S. citizens or green card holders and are not U.S. residents (collectively referred to as a 'U.S. person'). The tax considerations discussed in this article may not be applicable for Canadian residents who are U.S. persons.

Financing Considerations

When considering a mortgage for the purchase of real estate in the U.S., please note that not all Canadian lenders offer mortgages on U.S. properties. In addition, there are a number of key differences between the Canadian and U.S. market that you should consider when looking to secure a U.S. mortgage;

• In the U.S., a mortgage application may take longer than a typical mortgage application process in Canada.

• Securing a U.S. mortgage may require additional documentation.

• There may be higher costs involved in obtaining a U.S. mortgage. Buyers can expect to pay higher third-party expenses such as property appraisal, title and other insurance requirements.

• U.S. fixed-rate mortgages are typically compounded monthly, while in Canada they may be compounded semi-annually on fixed-rate mortgages.

U.S. Tax Considerations

The U.S. tax implications will depend on whether a property was purchased for personal use or for investment/rental purposes. This choice may affect how many days someone chooses to spend in the U.S., which in turn may result in a U.S. tax filing obligation.

Depending on how many days an individual spends in the U.S., residency for U.S. tax purposes could change. If an individual is not a U.S. citizen, for U.S. tax purposes, he or she is considered either a resident alien or a nonresident alien. Resident aliens are subject to U.S. tax on worldwide income from all sources and are generally required to file an annual U.S. income tax return. In contrast, nonresident aliens are generally only taxed on income from U.S. sources.

A resident alien is an individual who is either a green card holder or has satisfied the "substantial presence test". Factors for the substantial presence test are as follows:

• If someone spends 183 days or more in the U.S. during the current year, the substantial presence test has been met and that individual would be considered a resident alien.

• If someone spends between 31 and 183 days in the U.S. during the current year, they will need to determine the number of days spent in the U.S. over a rolling three-year period (the current and the two previous years) using the "183-day test". The test is calculated by adding the sum of: (i) all of the days of physical presence in the U.S. in the current year, (ii) one-third of the days of physical presence in the first preceding year and (iii) one-sixth of the days of physical presence in the second preceding year. If the total equals 183 days or more, then the substantial presence test has been met, and that individual may be considered a resident alien.

• If someone spends less than 31 days in the U.S. during the current year, they are considered a nonresident alien.

If the substantial presence test is satisfied, an individual may still be treated as a nonresident alien if they meet the "closer connection" exception:

• They spend less than 183 days in the U.S. in the year;

• They maintain a "tax home" in Canada during the year; and

• They have a closer connection, such as maintaining more significant ties, to Canada than to the U.S.

In order to claim the closer connection exception, Form 8840 Closer Connection Exception Statement for Aliens would need to be filed with the Internal Revenue Service (IRS) by April 15th of the following year.

If the closer connection exception cannot be claimed, U.S. income taxes may be avoided under the residency tie-breaker rules in the Canada-United States Tax Convention (the Treaty). Where someone relies on the residency tie-breaker rules of the Treaty to maintain Canadian residency, U.S. income taxes may not be payable. However, a U.S. tax filing would still be required to claim the Treaty benefit. In addition, any applicable foreign reporting required under U.S. tax laws may still be necessary.

If you spend a significant amount of time in the U.S., you should speak with a cross-border tax advisor to ensure you understand the tax implications to prevent any unintended consequences.

Canadian Tax Considerations

Canadian residents who own foreign investment property (called "specified foreign property") at any time during the year costing more than $100,000 are required to file Form T1135 - Foreign Income Verification Statement.

"Specified foreign property" includes real estate situated outside of Canada but does not include personal-use property property used primarily for personal use and enjoyment purposes. The Canada Revenue Agency (CRA) takes the view that "primarily" means more than 50%. For example, if Mr. Jones owns a condominium in Florida that costs over $100,000 but it is maintained exclusively for personal use, he would not need to report it on Form T1135. However, if Mr. Jones occupies the condominium for personal use for only four months of the year and rents it out for the remaining eight months of the year, it would likely be considered an income-earning investment property. As a result, Mr. Jones would likely be required to report the property on a Form T1135.

There are substantial penalties for failing to complete and file Form T1135 accurately and on time.

Renting Out U.S. Real Estate

For Canadians owning U.S. real estate, rental income from such U.S. properties will generally be treated as gross rental income in the U.S. and would be subject to a 30% U.S. withholding tax. However, for Canadian tax purposes it is the net rental income that is reported on a Canadian tax return. To mitigate double taxation, a foreign tax credit may be available under the Income Tax Act (Canada) for U.S. withholding taxes paid.

Alternatively, to avoid the 30% U.S. withholding tax, an election may be made by filing a U.S. nonresident alien tax return. The election would generally apply to all subsequent tax years. Where the election is made, Form W-8ECI Certificate of Foreign Person's Claim That Income Is Effectively Connected with the Conduct of a Trade of Business in the United States would need to be provided to a withholding agent or payer of the rental income to avoid the U.S. withholding tax. To determine whether this option is appropriate for your particular circumstances, please consult with your cross-border tax advisor.

For the unabridged version of this report, please visit TD Knowledge Centre: https://bit.ly/3xEO5OV

Getting to know Stack Capital Group

Jeff Parks and Jason Meiers, the founders of Stack Capital Group, recently joined us in Windsor to share business updates. Founded in June 2021, they are an investment holding company whose objective is to invest in equity, debt, and/or other securities of growth-to-late-stage private businesses. By virtue of being a public entity, Stack Capital has 'democratized' access into the private equity asset class by eliminating two of the traditional 'barriers to entry' specifically: eligibility (anyone can own shares) and liquidity (buying / selling on demand). Through ownership of their common shares, investors have access to a diversified portfolio of innovative and disruptive companies operating across a number of sectors: SpaceX (incl Starlink Communications), Hopper and Omio (travel / leisure), Prove Identity (cyber-security), Newfront (insurance & benefits), Bolt Financial (e-commerce), and Varo (neo-bank). The Stack portfolio also includes a sizable cash position, leaving the company in a great position to take advantage of opportunities stemming from recent market volatility.

From left to right: CEO Jeff Parks, Brian Porter, P.J. Dupuis, Brad Brazier, CIO Jason Meiers