

U.S. Real Estate:

The basics of buying, selling and renting



The enduring appeal of owning U.S. real estate arises for many reasons for Canadians. Some own a vacation property to escape our long winters. Others purchase a home or condo for a child pursuing a post-secondary education in the U.S. during their studies. Some buy property for the purpose of earning rental income. Whether you are buying, selling, or receiving rent from a U.S. property, there are financing and tax issues on both sides of the border to consider.

Owning U.S. Real Estate

Financing Considerations

When considering the purchase of a U.S. property with a mortgage, 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 be aware of when looking to securing 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 can be compounded semi-annually on fixed-rate mortgages.

U.S. Tax Considerations

There can be varying tax implications depending 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 **non-resident alien**. Resident aliens are subject to U.S. tax on worldwide income from all sources and generally, are required to file an annual U.S. income tax return. In contrast, non-resident aliens are generally only taxed on income from U.S. sources.

To be considered a **resident alien** the “substantial presence test” must be satisfied. Here are the factors involved:

- 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, he or she 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, he or she is considered to be a non-resident alien.

If the substantial presence test is satisfied, an individual may still be treated as a non-resident alien if he or she meets the “closer connection” exception:

- He or she spends less than 183 days in the U.S. in the year;
- He or she maintains a “tax home” in Canada during the year; and,
- He or she has 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* with the Internal Revenue Service (IRS) would need to be filed by April 15th of the following year.

If the closer connection exception is not satisfied, U.S. income taxes may be avoided under the *Canada-United States Tax Convention (the Treaty)*. However, where someone is considered a Canadian resident under the Treaty and are not otherwise subject to U.S. income taxes, a U.S. non-resident alien income tax return would still be required to file to claim any Treaty benefits, and complete any other applicable foreign reporting required under U.S. tax laws.

Canadian Tax Considerations

Canadian residents who own foreign investment property (called “specified foreign property”) at any time during the year, which cost 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 mainly for personal enjoyment. For example, if Mr. Jones owns a condominium in Florida that costs over \$100,000, but it is for exclusively personal use, he would not need to report it on Form T1135.

However, if Mr. Jones occupies the condominium for personal use a few months of the year, and rent it out

for the remainder for the year, it would be considered an income-earning investment property. As a result, he would be required to report the property on a Form T1135.

Where specified foreign property has a total cost over \$100,000, but less than \$250,000 throughout the year the property can be reported under a simplified reporting method. There are substantial penalties for failing to complete and file Form T1135 accurately and on time.

Renting out U.S. Real Estate

Rental income from a U.S. property will generally be treated as gross rental income and would be subject to a 30% U.S. non-resident withholding tax. However, for Canadian tax purposes it is the net rental income that is reported on a Canadian tax return. A foreign tax credit may be available under the *Canadian Income Tax Act (ITA)* for U.S. withholding taxes paid to mitigate double taxation.

Rental income from a U.S. property will generally be treated as gross rental income and would be subject to a 30% U.S. non-resident withholding tax.

Alternatively, to avoid the 30% U.S. non-resident withholding tax, a U.S. non-resident tax return may be filed with any U.S. tax determined on a net rental income basis. To do so requires making an election on a U.S. tax return. The election would generally apply to all subsequent tax years. In addition, Form W-8ECI – *Certificate of Foreign Person's Claim That Income Is Effectively Connected with the Conduct of a Trade or Business in the United States* would need to be provided to a withholding agent or payer of the income to avoid the withholding tax.

Selling U.S. Real Estate

U.S. Tax Considerations

When a non-resident alien sells their U.S. real estate, the resulting gain or loss is required to be reported to the IRS by filing Form 1040NR. The purchaser is generally required to withhold 15% of the gross sale price if the sale price exceeds US\$300,000. Withholding is not required where the purchaser acquires the property for use as a residence for US\$300,000 or less.

The tax normally required to be withheld on a disposition can be reduced or eliminated where a withholding certificate is obtained from the IRS. An application for a withholding certificate would need to be submitted on Form 8288-B – *Application for Withholding Certificate for Dispositions by Foreign Persons of U.S. Real Property Interests*. Where the tax liability on the sale of U.S. property is expected to be less than 15% of the gross sale price consider requesting a withholding certificate and file it before the closing date of the sale. The certificate, if granted, will specify the amount of tax to be withheld instead of the full 15%.

Canadian Tax Considerations

When a capital gain is realized on the sale U.S. property, the taxable capital gain would be subject to Canadian taxes.

For property bought and sold in a foreign currency, the adjusted cost basis (ACB) and proceeds of the sale must be converted to Canadian dollars for tax reporting purposes. Any foreign exchange component associated with the sale would typically need to be reported on a capital gain (or loss) report. A foreign tax credit for any U.S. taxes paid may be claimed to offset Canadian taxes arising from the sale of the property.

The principal residence exemption may be available for all or part of the gain on the sale. However, if there is no Canadian tax payable due to the exemption, U.S. taxes paid that are eligible for foreign tax credit relief may go unused.

Tax Considerations on Death

Canadians will be subject to U.S. estate taxes if, at the time of their death, the value of their U.S. situs assets exceeds US\$60,000 and the value of their worldwide assets is more than US\$11.18 million (in 2018).

The maximum federal estate tax rate is currently 40%. Please note that if at the time of death, the value of a Canadian's U.S. property is over the US\$60,000 threshold, a U.S. estate tax return is required, whether or not U.S. estate tax is payable. The deadline to file this return is nine months following the date of death.

It should be noted that the recently enacted U.S. *Tax Cuts and Jobs Act*, doubled the lifetime exclusion amount from US\$5.6 million to US\$11.18 million (indexed annually) for 2018 through 2025. However, unless new legislation is enacted, the exclusion amount will return to the pre-2018 exclusion amount, subject to inflation adjustments for 2026.

Conclusion

Consider speaking with your TD advisor and a cross-border tax advisor about the financing and tax involved in buying, selling, or receiving rent from U.S. real estate.



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