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Rental and sale of U.S. real estate

"The U.S., like Canada, has specific tax rules with respect to the ownership of real estate by non-U.S. persons."

BY LARRY STOLBERG

The economic landscape in the U.S. has made it very attractive for Canadians to purchase vacation or rental properties in the warmer climates. Interest has increased as a result of much lower pricing as well as the stronger Canadian dollar with anticipation of realizing significant capital gains when the market recovers.

The U.S., like Canada, has specific tax rules with respect to the ownership of real estate by non-U.S. persons. Often the simple things to be in compliance are not provided to the investor as part of the marketing process, causing unnecessary grief for the unwary.

Rentals

Withholding tax – Canadians who intend to rent their vacation home or have a secondary residence situated in the U.S. are subject to a U.S. withholding tax of 30% on the gross rental. The agent who collects the rent is responsible to remit the tax to the IRS.

The agent should tell you that you need to apply for an individual taxpayer's identification number ("ITIN") by properly completing IRS Form W-7. The ITIN is noted on the tax information slip reporting the gross rental and tax withheld to the IRS.

Waiver of withholding tax – Under U.S. rules, a waiver from withholding on the gross rental is available by providing the agent with IRS Form W8-ECI every three years. The W8-ECI requires the ITIN. Until a properly completed W8-ECI is accepted by the agent, the agent may still withhold.

The completion of the W8-ECI obligates the owner to file an annual tax return (IRS Form 1040NRs, due June 15th for individual owners), reporting net rental income and pay U.S. tax on the net. Net real income is gross rent less expenses less U.S. depreciation on the building and on furniture and fixtures.

Filing tax returns – Without the waiver, you may still elect to file a tax return and claim credit for any tax withheld. The election covers all rental properties. Once you elect, it is binding until you revoke the election.

Filing the return on a timely basis will allow you to utilize accumulated losses against net rental income and on capital gains from the sale of the property.

Filing will also allow you to properly claim credit for U.S. tax on your Canadian tax return.

With joint ownership or tenants in common, each party must complete their own W-7 and tax returns.

W-7 applications – The W-7 requires proof of identity and foreign status. A certified copy of your passport issued by a Canadian passport office and attached to the W-7 will ensure that there is no problem with proof of identity and foreign status. Otherwise original documents must be submitted.

If you apply for the ITIN prior to filing a tax return, you need a letter issued by the withholding agent indicating that the ITIN is needed for reporting and withholding purposes.

To ensure that the W-7 is completed accurately, it is recommended that you engage an IRS Acceptance Agent practicing in your area to assist in the completion of the W-7 and to attach a Certificate of Accuracy. With this procedure, it usually takes about 6 to 8 weeks to obtain the ITIN.

Sale of U.S. real estate

Capital gains realized on the sale of any U.S. real property interest will attract Canadian and U.S. tax. Canada will generally provide a foreign tax credit for the U.S. federal and state tax.

Withholding tax – If the sale price is under $300,000 U.S. and the property is acquired as a principal residence by the purchaser, the 10% federal withholding tax on gross proceeds is waived. The purchaser must sign an affidavit...

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...to confirm this. Specific regulations define the meaning of "principal residence" for purposes of this withholding exemption.

The 10% withholding tax must be remitted within 20 days of the date of closing with IRS Form 8288. A stamped copy of 8288-A will be mailed to you to claim credit on your tax return. If you never rented the property, you should apply for the ITIN by your closing date.

Ultimate tax liability – For properties held over a year, the maximum federal tax rate is 15% for sales before 2013. After 2012, the 15% rate increases to 20% if reported income is over $400K.

If you owned the property on September 26, 1980, the Canada/U.S. Tax Treaty may allow you to exclude the portion of the gain accruing up to December 31, 1984.

Reduced withholding – Tax returns may not be filed until the year following the year of sale. Thus you could end up waiting over a year from the sale date for your refund.

You may apply for a lesser amount of withholding tax if you believe the 10% rate will be in excess of your actual tax liability. This application should be considered if there is a mortgage or a line of credit on the property as the 10% will have to come out of your pocket.

You may apply for a reduced withholding by filing an application for a withholding certificate on IRS Form 8288-B. You will need an ITIN to properly file this form. Once approved, the IRS will notify your lawyer to remit the required amount of tax held within 20 days. The IRS must act within 90 days to process the 8288-B.

State issues

Whether or not you file the W8-ECI or a tax return, some states will require the filing of a state non-resident return reporting the net rental and the sale. Most states do not withhold tax on a sale.

Ownership

Where real estate interests are held through a U.S. partnership, estate/trust or corporation, similar rules apply with respect to rentals and sales. Distributions from these entities may attract a 35% withholding tax. For corporate owners, an employer's identification number ("EIN") may be obtained by calling the IRS.

For large dollar purchases, investors should seriously consider the U.S. federal estate tax rules in determining the appropriate method of ownership. After 2012, the marginal estate tax rate becomes 40% after $1-million of taxable value is attained.

Compliance is simple!

Although U.S. tax compliance is an added administrative cost of investing in U.S. real estate, it does not have to be complicated.

By not filing returns or avoiding the 30% withholding tax without a valid W8-ECI, you loose the ability to utilize losses and create unnecessary risk when you endeavor to complete the sale of your interest.

Properly completed tax returns should generally provide for full credit for U.S. taxes on your Canadian returns without the incidence of double taxation.

U.S. forms are available on the IRS website *(at http://www.irs.ustreas.gov/pub).* BL10

The offices of Larry Stolberg, Tax Specialist are located at 245 Commercial Street in Milton. For more information please call Larry Stolberg CA, CPA, CFP at 647.298.1339, email lstolberg@lnsca.com or visit www.lnsca.com.

Contact your professional advisor prior to implementing any of the outlined strategies Internal Revenue Service Circular 230 Disclosure

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Pursuant to Internal Revenue Service Circular 230, we hereby inform you that the advice set forth herein with respect to U.S. federal tax issues was not intended or written to be used, and cannot be used, by you or any taxpayer, for the purpose of avoiding any penalties that may be imposed on you or any other person under the Internal Revenue Code.

IN THE COMMUNITY

■ Oakville Business After 5. From left to right: Angelo Serafini and Patricia Collins, both of Angelo Serafini Law Offices, Kat Downey of Legacy Matters and Karmel Sakran of Green, Germann, Sakran.

■ Oakville Business After 5. From left to right: Nancy Trott, Janice Rowe, Don Vrooman. Mary Dilly of Business Link Media Group, Carol D'Amelio, Pat Wright, executive director of Halton Learning Foundation, Melissa Thompson, Peter Savros and Karmel Sakran – Halton Learning Foundation Board Chair.

■ City of Burlington Special Events at the February Burlington Chamber of Commerce Business After 5. From left to right: Matthew Ardrey of T.E. Wealth; Mary Dilly of Business Link Media Group; Rick Goldring, Mayor of City of Burlington; and Lori Henderson, marketing coordinator.

■ February Burlington Chamber of Commerce Business After 5. From left to right: Phil Evenden, president of Integrity Wealth Management Inc.; Jamie Edwards of J.M. Edwards Realtors; Ellie Munroe of Morison Insurance; Brenda Heatherington, executive director of The Burlington Performing Arts; Carol D'Amelio, former City of Burlington Councillor; Mary Dilly of Business Link Media Group with Lucy (service dog in training for autism), Kim Shippey, director Individual Giving and Major Gifts, United Way Hamilton/Burlington and Christine Fraser of the Burlington Chamber of Commerce.

■ Milton Chamber of Commerce Business After 5 at Boston Pizza, Milton. From left to right: Fred Schewr, Intrigue Milton; Murray McPhail, Chiropractor; Andrew Roach, Dominion Lending Centres and Dan O'Neill, PROforma U-Want-One.

■ Milton Chamber of Commerce Business After 5 at Boston Pizza, Milton. From left to right: Lynda Jamieson, Barbara Bell, Judith Finn and Kylie RIggin all from ECC Cosmetic & Laser Centre Inc.