

DAVIDSON

TALKS 

U.S. REAL ESTATE

Buying, Owning, Renting &
Selling as a Foreign Investor


**& Davidson
Company**
CHARTERED PROFESSIONAL ACCOUNTANTS

- Submit questions aux via Zoom Q&A function
- Survey, link to PD Certificate, slides and video recording emailed to you following the webinar

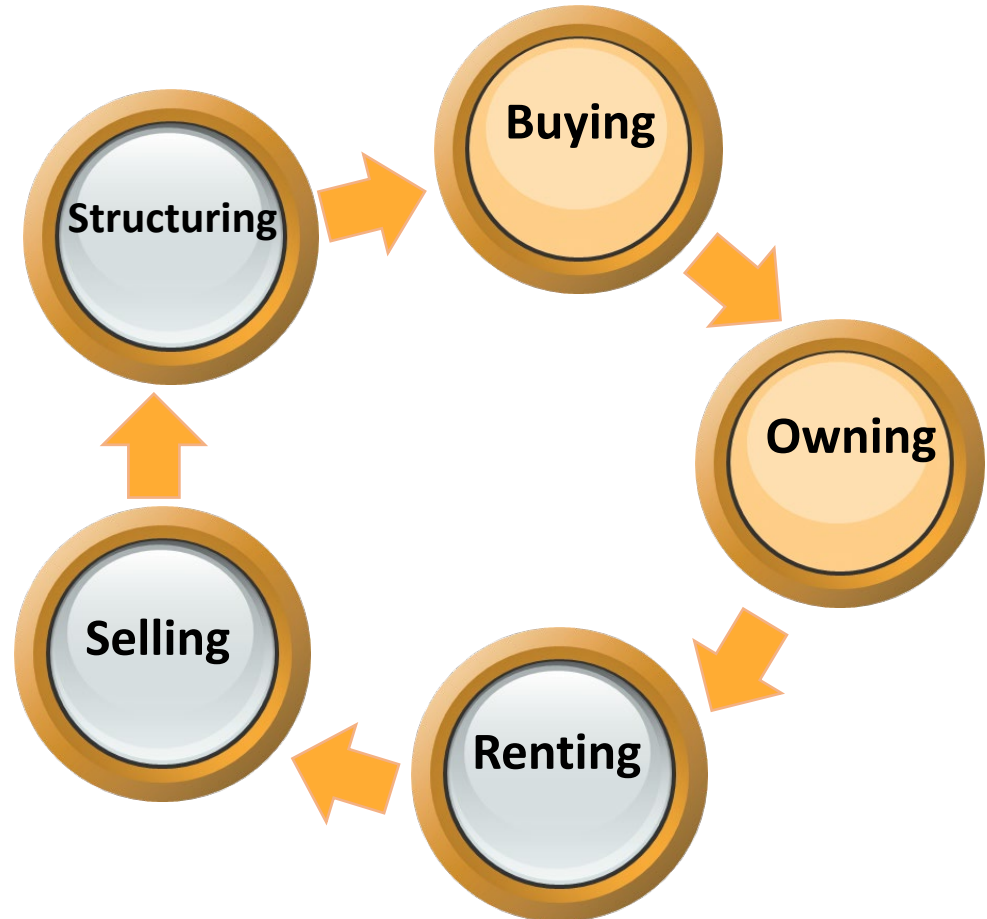


- **Buying & Owning U.S. Real Estate**
Mai Hoang, CPA
- **Renting & Selling U.S. Real Estate**
Manesa Ho, CPA, CGA, CPA (WA)
- **Structuring for U.S. Real Estate**
Namir Hallak, CPA, CA, CPA (KS), CGMA
- **Q&A Session**
- **Door Prize Draw**



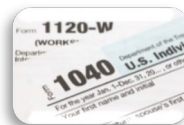
Buying & Owning U.S. Real Estate

Presenter: Mai Hoang,
CPA



Buying & Owning U.S. Real Estate

10 ITEMS TO BE AWARE OF



Who is the IRS?

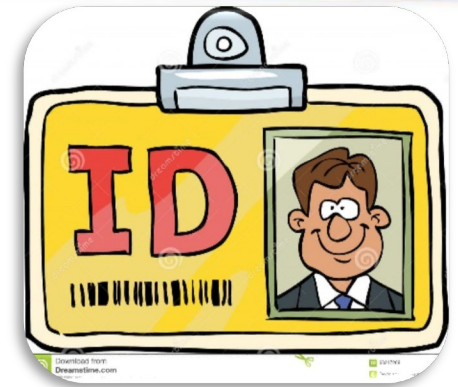
- Internal Revenue Service
- Do they know you own U.S. real estate?
- Why are they interested?



What is an ITIN?

**Individual Taxpayer Identification
Number for tax purposes**

- ✓ Form W-7
- ✓ Proof of identity & foreign status documents
- ✓ 7 weeks



Who to ask?

- **Cross-border tax CPAs**
- <https://www.irs.gov/individuals/how-do-i-apply-for-an-itin>

Withholding tax - how much and when to pay?

- **15% of the purchase price**

- ✓ Withheld by the Buyer upon closing
- ✓ Form 8288



- **Exceptions**

Available with additional filing requirements

Who to ask?

- Escrow company
- Closing attorneys
- Other real estate professionals

Financing

Ability to deduct interest

- ✓ \$750,000 (per home) limitation
- ✓ 90 days rule



Who to ask?

- Cross-border tax CPAs
- Lender

What is “Tax residence”?

- “Non-resident Alien” versus “Resident” for US tax
- **183 days rule**
 - ✓ 1/3 of the days in the **first** preceding calendar year
 - ✓ 1/6 of the days in the second preceding calendar year
- **Foreign-tax-home/closer-connection test**

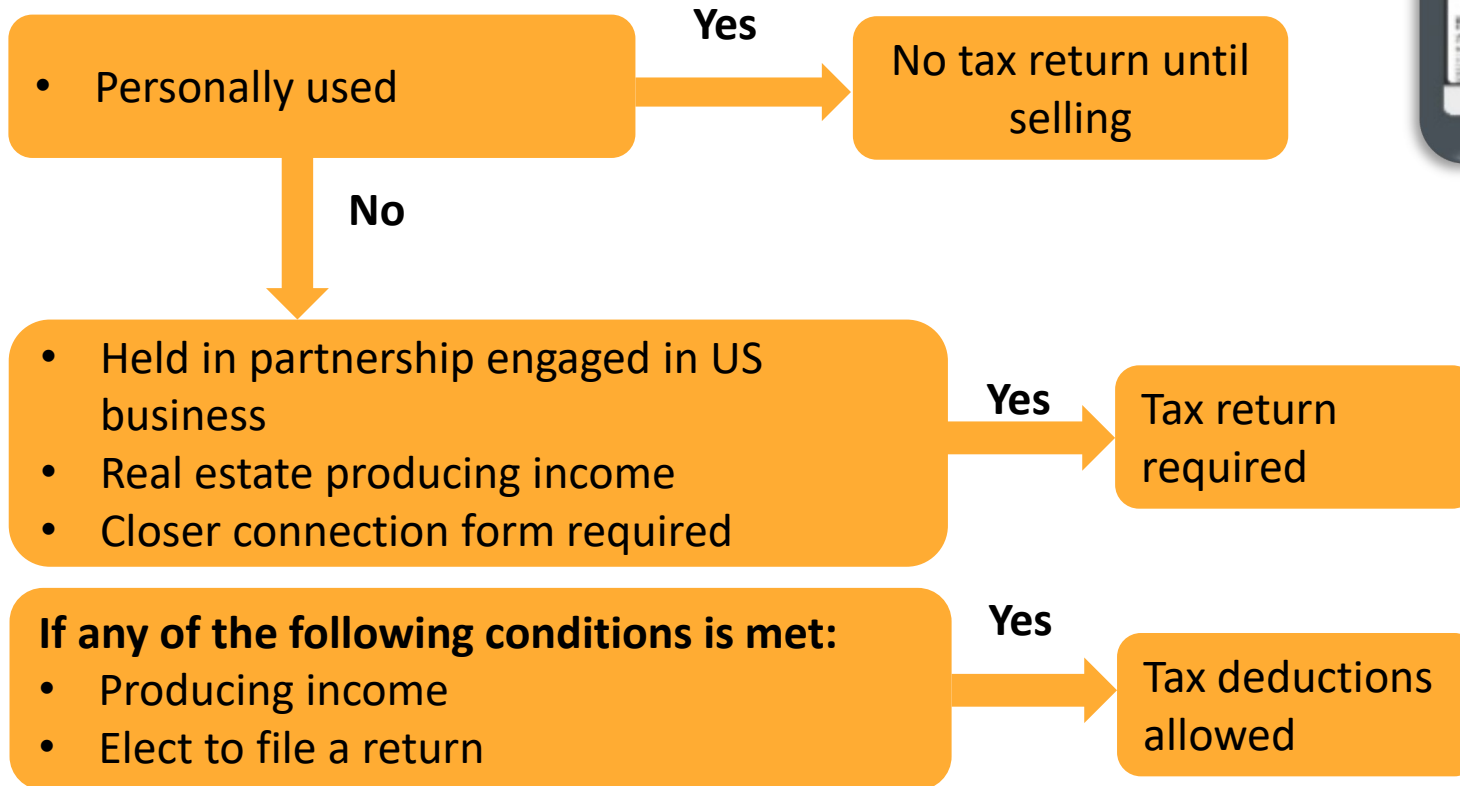


Who to ask?

• **Cross-border tax CPAs**

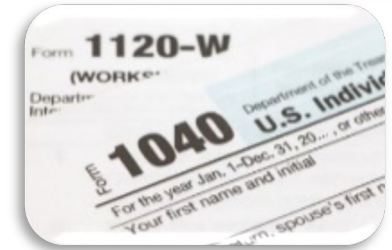
Do I need to file a US tax return?

Scenario 1: Ownership by Non-residents for US tax purposes



Do I need to file a US tax return?

Scenario 2: Ownership by US Tax Residents



If any of the following conditions is met:

- US domestic corporation
- US individual tax residents
- Partnership engaged in US business

Yes

Tax return
required

If the taxpayer has any of the following expenses:

- Mortgage interest
- Property tax
- And much more...

Yes

Tax deductions

When to file US tax return?

• Individual Federal tax return

- April 15th of the following calendar year for US tax resident
- June 15th of the following calendar year for NR

• Corporation

- 15th day of the 4th month after the end of its tax year
 - ✓ Domestic entities
- 15th day of the 6th month after the end of its tax year
 - ✓ Foreign entities with election
- 15th day of the 3rd month after the end of its tax year
 - ✓ Entities with June 30 year-end



Will I pay both Canadian and US taxes?

- Is there double taxation?



- What is a treaty country?



- How to utilize Foreign Tax Credits?



Don't forget...

Accounting for Fixer-uppers

- **Capital expenses**
 - ✓ What are they?
 - ✓ Why do we track them?

- **Example**

Description of Expenditures

Roofing upgrades

Electric systems

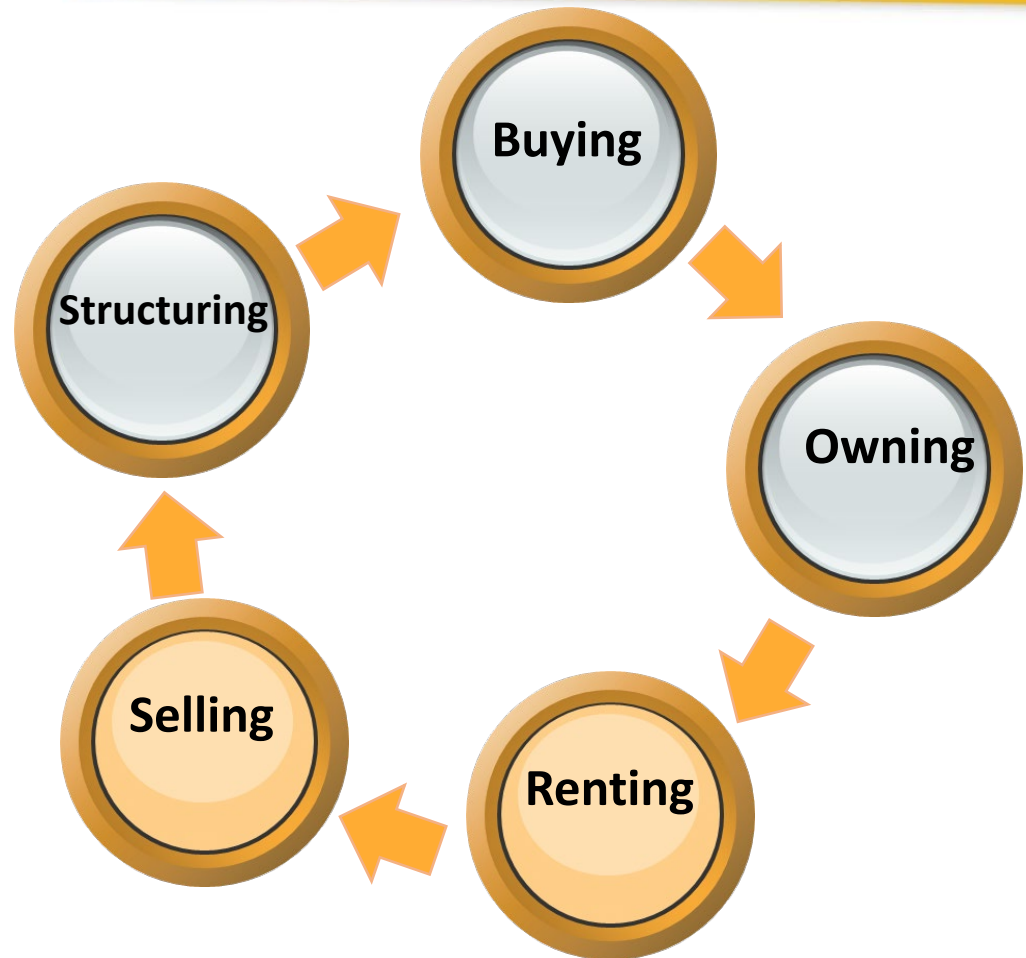
Concrete front porch renovation

Hardwood flooring upgrades



Renting & Selling U.S. Real Estate

Presenter: Manesa Ho,
CPA, CGA, CPA (WA)



Renting – Personal-use residence (vacation home)

Minimal Rental Use

- If you use a dwelling unit as a residence and rent it for less than fewer than **15 days**, not required to report any of the rental income or deduct any expenses.

Vacation Home Limitations

- Use for personal use during the tax year for more than greater of:
 - 1) **14 days**, or
 - 2) **10%** of total days rented out at fair rental price
- Limitations to rental expenses you can deduct

Renting – Passive Activity Loss

Passive Activity Loss Limitation

- Rental – passive activity
 - Subject to passive activity loss limitations
- Active participation
 - 10-percent ownership interest required
 - Management decisions (i.e. approving new tenants, deciding on rental terms, approving expenditures)
 - \$25,000 offset
 - Phase-out based on adjusted gross income

Renting - Withholding Requirements

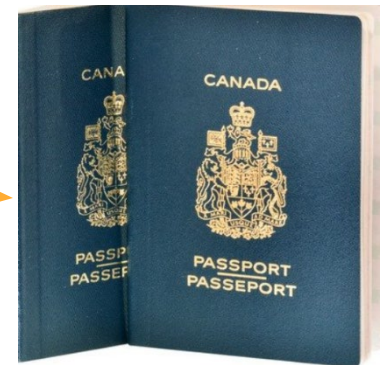
- Rental income is FDAP income (fixed or determinable annual or periodic)
 - ❖ Subject to **30%** withholding tax
 - ✓ No reduced treaty rate for Canada
 - ❖ Form **1042-S tax slip** issued
 - ✓ Claim taxes withheld (and possible refund) on U.S. tax return filed
- Withholding tax generally does not apply to rental income effectively connected with a U.S. trade or business
 - ❖ Must make election (IRC section 871(d) and 882(d))

Renting – Filing Requirements

Need to file annual U.S. tax return

- If held personally, need U.S. Individual Tax Identification Number, if one is not already obtained
 - ❖ **Certified copy of passport**
- State income tax return

- **Cannot claim losses if you don't file**



Renting – Depreciation

• Depreciation on building

- Depreciation is not allowed for land or certain excepted property
- Residential rental property is normally depreciated at 3.64% for 27.5 years
- Unlike Canadian rental property, depreciation cannot be skipped. Even if you don't claim the depreciation, at the time of sale, you still need to reduce your cost basis by the claimed/unclaimed depreciation to match IRS' calculation of the adjusted cost basis.

How we calculate the capital gain for rental property with depreciation?

1. Separate the cost/sale price/sale expense of land and buildings

2. Calculate the capital gain for land

- Capital gain = Gross sale price – purchase cost – sale expenses

3. Calculate the capital gain for building

- Capital gain = Gross sale price – adjusted cost basis (ACB)
- ACB = Purchase cost + building improvement (if any) + sale expenses - depreciation

Renting – Canadian Filing Requirements

- Report worldwide income for Canadian residents
 - U.S. taxes paid claimable as foreign tax credit
 - Federal and State
 - Account transcript or proof of payment to CRA
 - Limited to Canadian tax otherwise payable
-
- Canadian Form T1135 Foreign Reporting

Selling – Withholding Taxes

FIRPTA (Foreign Investment In Real Property Act) applies

- Federal **15% withholding tax**, no treaty reduction
- Other state specific withholding taxes may also apply
- Responsibility of the buyer
- Must be remitted within **20 days** after date of transfer

Exceptions

- Buyer, who is an individual, acquires the property for use as a residence, AND sales price is not more than \$300,000

Selling – Withholding Tax Forms

- Form 8288

- Form 8288-A

- Withholding agent name
- Withholding agent ID – IRS uses to identify the transaction
- Transferor’s (seller) name(s)
- Transferor’s ITIN, if any

Form 8288-A (example)

Withholding agent's name, street address, city, state, and ZIP code		1 Date of transfer	Statement of Withholding on Dispositions by Foreign Persons of U.S. Real Property Interests	
		2022-5-24	OMB No. 1545-0902	
		2 Federal income tax withheld		
		150,000		
Withholding agent's federal identification number	Identification number of foreign person subject to withholding (see instructions)	3 Amount realized	4 Gain recognized by foreign corporation	
000-000-000	000-000-000	1,000,000		
Name of person subject to withholding		5 Description of property transferred		
Foreign address (number, street, and apt. or suite no.)		6 Person subject to withholding is: An individual <input type="checkbox"/>		
City, province or state, postal code, and country (not U.S.)		A corporation <input type="checkbox"/> Other (specify) <input type="checkbox"/>		
		7 Country code	Mailing address of person subject to withholding (if different)	

Form **8288-A** (Rev. 4-2018) Cat. No. 62261L **Attach Copies A and B to Form 8288** Department of the Treasury - Internal Revenue Service

Copy A For Internal Revenue Service Center
For Privacy Act and Paperwork Reduction Act Notice, see the Instructions for Form 8288.

Selling – Filing Requirements

- **Must file a U.S. tax return**
 - ❖ If tax number not previously obtained, must have one to file a tax return or file together with the application for individuals
 - ❖ State income tax return may also apply, not all states have income tax
- **Due dates**

Type of taxpayer	Filing due date	Tax payable due date
Individuals	June 15	April 15
Corporations	April 15 (additional two months extension to June 15 for foreign corporations)	April 15

Selling – Capital Gain

Selling expenses

- **Only expenses not borne by buyer**
 - ✓ Commissions
 - ✓ Legal Fees, Transfer taxes, Title insurance
 - ✓ Recording fees, survey fees and other costs incurred to sell/transfer the property
 - ✓ Does not include future payment of items such as taxes and insurance
- **Prior year unallowed passive activity losses**
 - ✓ Offsets and reduces any capital gain
 - ✓ Aggregate activities

Selling

How is it Taxed?

Individuals

Short-term

- Held for less than a year
- Normal marginal rates

Long-term

- 0% for the first US\$40,000 or so (depends on filing status)
- 15% and 20% depending on tax bracket

Corporations

- 21% flat rate (no differentiation between short and long-term)

Claim a possible federal refund of taxes over-withheld

US estate tax for non-resident (Form 706-NA)

- **Who needs to file:**

Deceased foreign resident who owned U.S. situs property (i.e. US real estate property) with a FMV of more than **\$60,000** at death

- **Canada-U.S. tax treaty relief**

Example: A Deceased Canadian taxpayer only has a US real estate property and the FMV is 1 million at his date of death (2022), his worldwide assets' FMV is 20 millions. With the treaty, he can claim the tax credit of the greater of:

- ✓ \$13,000 (tax credit for filing threshold of \$60,000)
- ✓ $\$4,769,800 \times \frac{\text{value of US real estate property}}{\text{value of your worldwide assets}}$ ($\$4,769,800 \times \frac{1 \text{ million}}{20 \text{ millions}} = \$238,490$)

How much is the estate tax?

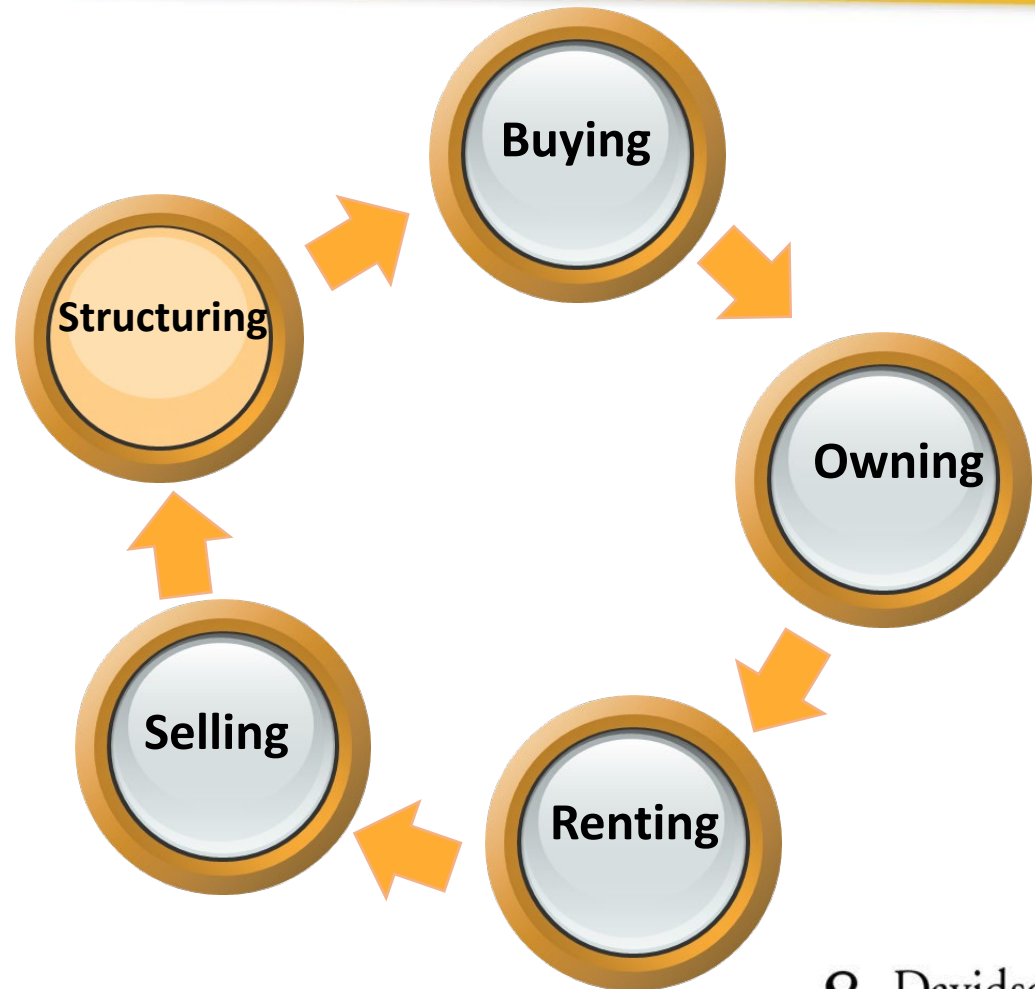
Estate tax on 1 million U.S. real estate:
* \$345,800 (calculated per the marginal tax rate)

Tax credit under Canada-US tax treaty:
* \$238,490

Net U.S. estate tax:
* \$107,310 ($\$345,800 - \$238,490$)

Structuring

Presenter: Namir Hallak,
CPA, CA, CPA (KS), CGMA



How to structure real estate ownership as a Canadian?

Factors to Consider:

- Purpose of investment
- Do you need a complex structure?
- Why a cross-border lens is critical
- Future acquisition plans?



How to structure real estate ownership as a Canadian?

Cross-Border Structure Objectives:

- Minimize U.S. taxation on income and exit
- Mitigate exposure to U.S. estate or gift tax
- Simplify U.S. tax reporting obligations
- Access to Canadian foreign tax credits
- Asset protection and legal risks

Direct Ownership

- **Simplest: Why choose this structure?**

- **Joint Ownership: Why this isn't advisable**

- ✓ What about Tenancy in Common?

- **Concerns:**

- ✓ Unlimited liability
- ✓ Lose anonymity
- ✓ Very limited estate tax planning opportunities
 - Ways to mitigate the estate tax impact

Limited Partnership

• Why choose this structure?

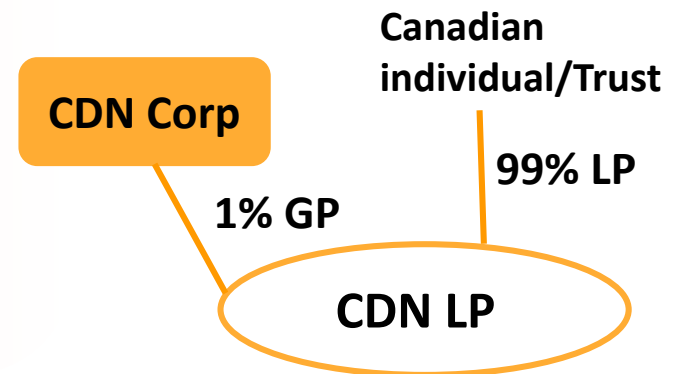
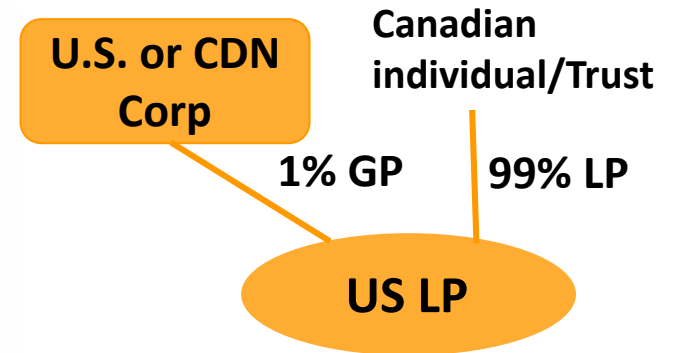
- ✓ Limited Liability for LPs
- ✓ Flow-Through
- ✓ Asset Protection
- ✓ Avoid Double Tax

• Withholdings

• When does this structure work best?

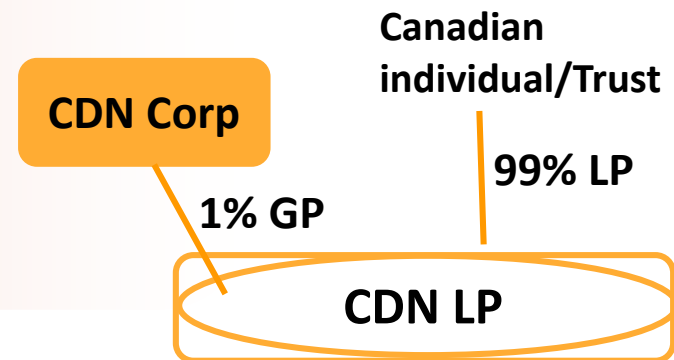
• Concerns?

• Tax planning ideas?



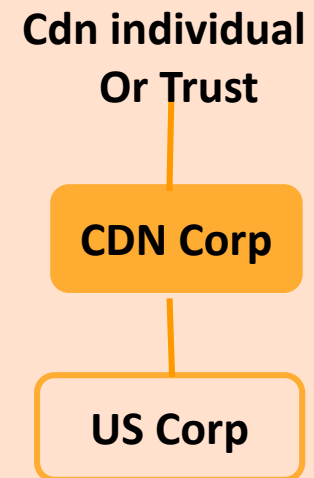
"Checks the Box" Canadian LP

- Traditional setup → CTB Election
- Why CTB on an LP?
- When does this structure work best?
- Concerns?
- Planning?



U.S. C-Corporation

- Why choose this structure?
- Active or FAPI (investment income)?
- FIRPTA (indirectly)
- When does this structure work best?
- Concerns? Planning opportunities?



Limited Liability Company (LLC)

- Popular, but can snowball into big tax exposure!
- Hybrid Entity Mismatch
- Planning Opportunities?

SORRY
I'M
CANADIAN

Canadian Corporation

- Why choose this structure?
- FIRPTA
- Concerns?
- Tax Planning Opportunities?



Trust

- Why choose this structure?
- Non-Grantor vs Grantor Trust
- When does this structure work best?
- Concerns?
- Tax Planning Opportunities?





Thank YOU!

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Q&A Session

- Survey, link to PD Certificate & Slides e-mailed shortly
- Video recording will be posted to our website
- Upcoming Events – save the date!
 - Annual Tax Update: September 22, 2022
 - IFRS Update: October 20, 2022
- Door prize draws



THANK YOU!

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