

U.S. Real Estate for Canadian Residents: Cross-Border Tax Insights You Can't Ignore

Whether you are a **long-time Canadian resident or have recently moved to Canada**, this article provide guidance on the tax implications for individuals who directly own U.S. real property or a U.S. LLC (disregarded entity) that owns such property. Such direct ownerships are defined as USRPI (U.S. Real Property Interest) under Internal Revenue Code (IRC) §897(c) (1).

U.S. Tax Considerations

(Assuming the U.S. real property is purchased for rental purposes)

1. U.S. Social Security Number (SSN) or ITIN (Individual Taxpayer Identification Number):

If Canadian residents don't have a U.S. SSN or are not eligible to have a U.S. SSN, they need to apply for U.S. ITIN to fulfill U.S. tax obligations.

2. Rental Income is U.S.-Sourced

- **Default rule:** Rental income from U.S. real estate directly owned by Canadians is generally classified as FDAP (Fixed, Determinable, Annual, or Periodical) income, subject to a 30% withholding tax unless reduced under the U.S.- Canada tax treaty.
- **Net income election:** Under IRC §871(d), Canadian owners can elect to treat rental income as effectively connected income (ECI). This allows reporting net rental income (gross income minus expenses such as mortgage interest, property taxes, and depreciation) and being taxed at ordinary U.S. graduated rates, often resulting in lower tax than the flat 30% withholding.

3. State Taxes:

Most U.S. states impose tax on rental income earned by nonresidents. Rates and filing rules vary by state.

4. Form W-8BEN or W-8ECI as applicable:

Canadian resident owners should provide applicable Form W-8 series the U.S. property managers to certify their foreign status and claim applicable treaty benefits. Not having applicable documentation may apply 30% withholding rate on the rental income.

5. Annual U.S. Tax Filing & Quarterly Estimate Payments:

- Owning U.S. real property generally requires filing a U.S. income tax return. In most cases, Canadian residents must file Form **1040-NR** to report their U.S.-sourced rental income.
- Remitting quarterly tax estimates may apply.

U.S. Tax Consequences upon Sale

1. FIRPTA (Foreign Investment in Real Property Tax Act, IRC §1445):

- The sale or transfer of a U.S. real property interest by Canadian resident owners generally triggers FIRPTA withholding, regardless of whether the property was used as a rental, vacation home, or investment.
- Withholding: Typically, 15% of gross proceeds must be withheld at closing unless an exception applies.
- Actual gain: The gain is reported on Form 1040-NR for Canadian owning U.S. real property interest, and any excess withholding can be refunded.

2. Capital Gains Taxation:

- Long-term gains: Gains on property held more than 1 year are taxed at long-term capital gains rates (up to 20%).
- Short-term gains: Property held ≤ 1 year is taxed at ordinary rates.
- Depreciation recapture (Section 1250): Taxed at 25%, irrespective of capital gain treatment.
- State capital gains tax: May also apply depending on the property location.

3. Estate & Gift Tax Exposure:

Direct ownership of U.S. real property and other U.S.-situs assets may expose Canadian individuals to U.S. estate tax at death, as well as U.S. gift tax if the property is transferred during life.

Canadian Tax Considerations

Canadian residents are taxed on worldwide income, including rental income from U.S. properties **such as a Florida rental home**. The Canada Revenue Agency (CRA) has specific rules for reporting and deducting rental income and expenses. Key considerations are summarized below.

1. Apply for a Canadian ITN (Individual Tax Number):

U.S. residents moving to Canada for employment must obtain a **Social Insurance Number (SIN)** for payroll and tax reporting. If they are not eligible for a SIN, they must apply for a CRA **Individual Tax Number (ITN)** to meet Canadian tax filing obligations.

2. U.S.-Sourced Rental Income: Rental income and expenses from U.S. properties must be reported on **Form T776 – Statement of Real Estate Rentals for CRA purposes**.

**** The following categories of expenses are presented with a focus on Canadian taxation rules; distinct rules may apply for U.S. tax purposes.**

a. Deductible Expenses

- Deduction rules are conceptually similar to the U.S. but not identical.
- Only reasonable, rental-related expenses are permitted.

b. Capital Cost Allowance (CCA) – Depreciation Expense

- Buildings acquired after 1987: CCA rate 5%.
- Buildings acquired before 1988: CCA rate 4%.
- Half-year rule applies in the year of purchase or when the property begins to be used as a rental.
- CCA not claimed in a year, can be carried forward.
- CCA cannot create or increase a rental loss.
- If a building's cost exceeds \$50,000, it must be placed in a separate CCA class.
- Land is not depreciable.

c. Interest and Financing Expenses

- Only interest is deductible, not principal.
- Mortgage statements separating interest vs. principal are required for tax reporting.

d. Operating Expenses

Common deductible expenses include:

- Repairs and maintenance

- Utilities
- Advertising, property management, insurance, etc.

Not deductible:

- Home office expenses
- Personal or non-rental expenses

e. Personal Use of the Rental Property

- CRA has strict rules regarding mixed personal and rental use.
- Only expenses directly tied to the rental period or portion are allowable.

f. Renovations & Capital Improvements

- Routine repairs are generally deductible.
- Renovations that extend the building's useful life or enhance its value are capital in nature and must be depreciated through CCA.

g. Co-Ownership: Each co-owner must report:

- Their share of rental income.
- Their share of related expenses in proportion to ownership.

h. Disposition of the Rental Property: On sale, the following may apply:

- Capital gains or losses based on CRA rules for proceeds of disposition and adjusted cost base (ACB).
- Recapture of previously claimed CCA.
- Terminal losses, if applicable.

Key Takeaways

- Canadian residents are subject to **U.S and Canadian tax implications on both rental income and capital gains** from U.S. real estate.
- **Foreign Tax Credits:** Both the IRS and the Canada Revenue Agency (CRA) allow foreign tax credits to minimize double taxation. Generally, taxpayers can claim a credit in one country for taxes paid to the other, although certain limitations may apply. The U.S.-Canada Income Tax Treaty provides guidance on where U.S. sourced rental income gets taxed, helps reduce withholding rates and minimize double taxation.

- U.S. FIRPTA withholding is **mandatory at sale** unless a specific exception applies, and the buyer is responsible for withholding even if no gain is realized by the seller. Failure to withhold can result in **buyer liability** for taxes, penalties, and interest.
- **Planning ahead** is crucial:
 - ✓ Confirm FIRPTA requirements early.
 - ✓ As applicable, obtain any IRS clearances needed to reduce or eliminate withholding.
 - ✓ Ensure all documentation, including **proof of seller's status**, is properly documented before closing.
- **FIRPTA** may also apply when Canadian residents hold U.S. real property interests indirectly through U.S. entities such as corporations or partnerships, or when Canadian entities directly or indirectly own U.S. real property interests. Professional advice should be sought in these situations.
- **Recordkeeping:** U.S. and Canadian tax laws differ in numerous ways, making it essential for U.S. real property owners & investors to maintain complete and accurate records of all rental income and expenses. Proper documentation ensures the correct preparation of both U.S. and Canadian income tax returns and helps minimize potential disputes or errors.

Disclaimer: “The information contained in this article is provided solely for general informational purposes and does not constitute legal or tax advice. Canadian investors or owners of U.S. real property interests should consult with a qualified tax advisor regarding their specific facts and circumstances, particularly in the context of cross-border transactions. No liability is assumed by the author or firm for any reliance on this information.”

Whether you are investing in U.S. real estate or planning an exit strategy, understanding your ongoing Cross border Tax & FIRPTA implications and its potential impact on your financial outcomes is essential. The expert tax team at **Bahl & Co., P.C.**, led by Himanshu, a Certified Public Accountant (CPA), works closely with international clients to minimize tax exposure, provide comprehensive bookkeeping services, optimize cash flow, and ensure full compliance with U.S. & Canadian tax regulations. To learn more about our International Tax Services and schedule a personalized consultation, contact **Himanshu@smarntaxcpa.com**