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US Tax Implications of Canadians Investing US Real Estate

Canadian individuals and entities have long been investors and even active participants in a diverse range of U.S. residential, commercial and retail real estate projects. They have accomplished this by making acquisitions either directly, or using different forms of business entities including corporations, partnerships and trusts.

Foreign investors who own US real estate interests (i.e. "USREI") either directly or indirectly, are subject to U.S. income tax in connection with rental income from such interests that qualify as being "effectively connected to a U.S. trade or business. Such tax would be at the applicable U.S. rates depending on whether the investor is an individual, a corporation or some other form of business entity. Where ownership of a US real estate interest is held through a U.S. corporation, any dividend distribution of earnings by the corporation to Canadian investors would be subjected to a second tier U.S. withholding tax at applicable U.S. withholding rates under the Canada-U.S. Treaty. Under the Treaty, Canada will generally grant a foreign tax credit for U.S. taxes paid on income from a USREI as an offset to Canadian taxes otherwise due on such income. Where a USREI interest generates passive rental income to a Canadian investor, in most cases they would be well advised to treat such income as attributable to a U.S. trade or business. Failure to do so, may cause the investor to suffer a harsh 30% U.S. withholding tax rate imposed on the gross income from their USREI, without even an allowance for any of the usual deductions associated with real estate operations and customarily approved by the IRS.

On the disposition of USREI, a foreign investor would be subject to U.S. taxation in connection with any gains from such disposition (as well as depreciation recapture.) In the case of a foreign individual investor, they would be eligible for taxation at long term capital gains rate (20% plus any applicable state taxes.) However, if a foreign corporation acquires a USREI, the corporation would be subject to full U.S. corporate rates of up to 44% on capital gains when the interest is disposed of. With respect to the balance of the proceeds received by the foreign corporation after U.S. taxes have been paid, further U.S. withholding taxes would apply to any subsequent dividend distribution made to its Canadian shareholders. Under the Treaty the withholding amount has been reduced from the 30% required under the Code to 5%-15% of the amount of the distribution when received by Canadian taxpayers entitled to the Treaty reduction.

If you have U.S. real estate interests (i.e. USREI) and are a Canadian resident and have questions on effectively connected to a U.S. trade or business, U.S. withholding taxes, W-8BEN, or W-8ECI forms, or Canadian Tax Reporting, or US Tax Reporting – this may be of interest to you. Contact Tax Experts today!