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# ESTATE PLANNING WITH REAL ESTATE

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# TOPICS

## Deemed Dispositions on Death

- Residential Property – Capital Gain
- Recreational Property – Capital Gain
- Investment Property – Capital Gain/Recapture

## Tax Implications, Planning, and Compliance Issues

## US Real Property Estate Issues

# RESIDENTIAL PROPERTY

## PRINCIPAL RESIDENCE EXEMPTION

- Availability on Deemed Disposition
- Eligibility: Ownership and Occupancy Tests
- Spousal Rollovers and PR Exemption

# RESIDENTIAL PROPERTY

## PRINCIPAL RESIDENCE EXEMPTION, cont'd

- Consider pre-1982 transitional rules
- Filing Requirements
- Personal Use Property – loss denial

# RESIDENTIAL PROPERTY

## Ownership Through Alter-Ego/Joint Partner Trusts

- Rollover to Trust
- Eligibility for Exemption
- Filing Requirements on Death
- Capped Assessments

# RECREATIONAL PROPERTY

## Principal Residence Exemption is a Possibility

- Occupancy Test is not burdensome
- Where is the greater gain?
- Consider pre-1982 rules

# RECREATIONAL PROPERTY

- Initial transfer to a spouse/spousal trust
- Consider V-Day Value
- Consider 1994 Elections
- Consider Cost of Additions

# RECREATIONAL PROPERTIES

## SOLUTIONS:

- Put it in kids names when acquired
- Ownership through trust
- “Cottage” Trust
- Corporate Ownership?
- NPO



# INVESTMENT PROPERTY

## No Principal Residence Exemption

- Property does not qualify, corporate owned

## Capital Gains and Recapture

## Double Tax

- Problem is exemplified with real property due to buyers asset sale bias

# INVESTMENT PROPERTY

## DOUBLE TAX SOLUTIONS

- Share redemption and Loss Carryback
  - Capital Gain on shares incurred on death
  - Building is sold by company (CDA, RDTOH)
  - Shares are redeemed
  - Capital Loss is carried back to the terminal return

# INVESTMENT PROPERTY

## DOUBLE TAX SOLUTIONS

### – Pipeline Strategy

- After Capital Gain on death, estate has full ACB in company's shares
- Estate sells shares to Newco for no further gain due to full ACB
- Realco is wound up into Newco
- Bump up ACB of land
- Property is then sold at reduced gain



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# Acquisition of US Real Property by Canadian Residents



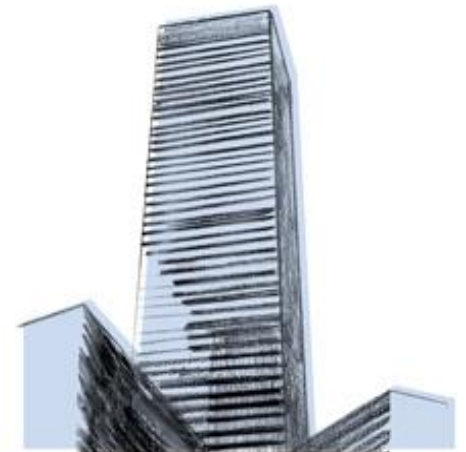
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# Agenda

## Tax Considerations When Purchasing US Real Property by Residents of Canada

- Rental Income from US Property
- US Estate Tax
- Ownership of US Property
- Sale of US Property



# Basic overview of US tax system

The U.S. tax system is comprised of the following:

- 1) Income tax
- 2) Estate tax
- 3) Gift tax
- 4) Generation skipping tax
- 5) State and Local Taxes



All have significant penalties for non-compliance and not filing appropriate forms

# Rental Income

- Subject to US withholding tax at 30% of gross rents
- Election to file US tax return and pay tax on net rental income
- Deductions for rental expenses and depreciation (mandatory)
- Proration of expenses for personal use of the property



# US Estate Taxes

December 2010 US Tax Relief Act reinstated the US Estate Tax for decedents dying after 2010.

- \$5 million exemption (indexed for inflation after 2011)
- 35% top rate
- special rules for 2010 deaths



# US Estate Taxes

- Applicable to US citizens even if resident in Canada
- Applicable to Canadians who are not US citizens or residents with respect to specific assets
- Treaty provisions reduce Estate Taxes for Canadians and provide for foreign tax credits
- Treaty apportionment of exemption:  
$$= \frac{\text{US SITUS ASSET VALUE}}{\text{TOTAL WORLD ASSET VALUE}}$$
- Special definitions of assets and values.



# US Estate Taxes

- US Assets owned by Canadians which are subject to the tax:
  - Real property situated in the US
  - Stocks issued by a US corporation (even if in an RRSP or RRIF)
  - Bonds issued by US debtor
  - Debt obligations of US citizens
  - US Partnership interest with a US trade or business
  - US pensions, annuities and IRAs
  - Cash in US bank if related to a US trade or business



# US Estate Taxes

- Complex calculations
- Filing of return required 9 months following death (application for extension for additional 6 months)
- Penalties for failure to file
- Filing required when US assets exceed \$60,000 US for a US non-resident (even if no tax owing)
- Need to file to claim treaty benefits
- Some US States also impose an estate tax



# Ownership Options

- Personal Ownership
- Canadian Company
- Canadian Partnership
- Canadian Discretionary Trust



# Personal Ownership

## Factors for consideration:

- Lower individual tax rates on gain from sale.
- Value of property: Does current and future value warrant planning/structuring costs?
- Held by spouse with lowest net worth to take advantage of unified credit exemption under tax treaty
- Life insurance to cover US liability
  - (issues: cost of insurance/escalating property value)
- Use of non-recourse debt to reduce net estate value

# Canadian Company

- Historical perspective: Single Purpose Holding Companies (SPC)

## PROS:

- Avoided US estate Tax
- No Canadian taxable benefit to shareholder use of property: CRA administration policy if certain conditions met

## CONS:

- Higher corporate tax rates on sale
  - Jan 1, 2005 : CRA administration policy on taxable benefits cancelled (existing SPC's grandfathered on policy)
  - Taxable benefit on new corporate holdings equal FMV rent or value based on cost of capital
- With demise of SPC, CDN corporate ownership not a good option

# Canadian Partnership

- Lower personal tax rates on sale
- High risk that IRS will attribute partnership assets to partners and levy US estate tax
- Consider: Check the box election to treat partnership as a corporation for US purposes (this creates other issues such as higher corporate income tax rates and risk of IRS challenge)

**NOTE: The use of partnerships more appropriate to real estate development or other related business and not to ownership of personal use real estate**

# Canadian Discretionary Trust

- Avoids US estate tax for mother/father on ownership of US property
- Access lower personal tax income rates on sale during lifetime
- Funding of trust by gift from one spouse
- Requires planning to deal with trust's 21 year deemed disposition
- No annual T3 filing required unless income earned by trust



# Sale of US Property

- Subject to US tax on capital gain which requires tax returns and withholding taxes
- 10% US Tax withheld on sale (subject to certain exceptions)
- Require US ITIN if personal ownership
- US Tax return to be filed
- Early refund procedures
- Canadian tax with foreign tax credit for US tax

*Any Questions?*

*Thanks for your time!*

