

Selling Your Property

Excerpt from: South of 49 by Philip McKernan, Dan Sampson, and Mike Cuning

If a Canadian sells real estate located in the US, a withholding tax of 10% of the gross sales price is normally payable under FIRPTA (the Foreign Investment in Real Property Tax Act of 1980). The tax withheld can be offset against the US income tax payable on any gain realized on the sale, and refunded if it exceeds the tax liability. The 10% withholding requirement on the gross sales price applies regardless of the seller's adjusted basis in the property.

There are two exceptions to FIRPTA's 10% withholding requirement, which may reduce or eliminate the requirement:

Exception 1: Sales Price Less Than US\$300,000

First, withholding under FIRPTA will not apply if the property is sold for less than US\$300,000, and the purchaser intends to use it as a principal residence. The buyer need not be a US resident. For this exception to apply, the purchaser must have definite plans to reside at the property for at least half of the time that the property is in use during each of the two years following the sale. However, the gain on the sale will still be taxable in the US, and a US tax return must therefore be filed. Thus, if a Canadian is selling a Florida condo or any other US real estate, for less than US\$300,000 to a buyer who intends to occupy it as a principal residence, the seller will receive the full purchase price rather than having 10% withheld by the buyer and remitted to the IRS.

Exception 2: Withholding Certificate

The second exception allows for reduced, or eliminated withholding, where the Canadian obtains a withholding certificate from the IRS on the basis that the expected US tax liability will be less than 10% of the sale price. The certificate will indicate what amount of tax should be withheld by the purchaser rather than the full 10%. A withholding certificate issued after the transfer of the property may allow the seller to receive an early refund.

Filing Requirements

For Income-tax purposes, a Canadian must file a US tax return and report the gain on the sale of the US real estate. A credit may then be claimed for the FIRPTA tax withheld.

If an individual owned the property and has been resident in Canada since before September 27, 1980 he/she can likely take advantage of the Canada-US tax treaty to reduce the gain. In such a case, only the gain accruing since January 1, 1985 will be taxed. This transitional rule does not apply to business properties that are part of a permanent establishment in the US.

To claim the benefit under the treaty, a Canadian will need to make the claim on a US tax return and include a statement containing certain information about the transaction.

US tax on the sale of US property will generate a foreign tax credit that can be used to reduce the Canadian tax on the sale. However, if the amount of the gain taxed in Canada was reduced due to the capital gains exemption or the principal residence exemption, the foreign tax credit available may be limited.