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Life events: Selling U.S. property

Financial checklist

If you've owned a U.S. property for several years and you're thinking of selling it, you'll have to report a capital gain to both U.S. and Canadian tax agencies. The following explains in greater detail what kind of taxes you may be liable for on both sides of the border when you sell your U.S. property.

U.S. taxation

The 2014 maximum U.S. federal long-term capital gains tax rate is 20%. You would pay the long-term capital gains tax rate on the sale of your property provided you owned it for more than one year prior to sale. If you owned the property for one year or less, graduated U.S. federal income tax rates would apply to short-term capital gains. People who are subject to low marginal tax rates may also pay a rate lower than 20%. Depending where the property is located, state taxes may also apply.

Upon sale, the purchaser of the property is generally required to withhold 10% of the gross proceeds of the sale under the Foreign Investment Real Property Tax Act or FIRPTA. This is not a tax but rather a withholding the U.S. Internal Revenue Service (IRS) will apply against your tax payable. You may apply to the Internal Revenue Service (IRS) for a withholding certificate that would allow withholding taxes to be reduced or eliminated, such as when the ultimate income tax liability is expected to be less than the withholding amount. If, for example, your U.S. property sells for $1million, you will be obligated to remit 10% or $100,000 to the IRS. But if your net capital gains tax on the property is $47,500 and you're entitled to the difference – $52,500 – you may be able to prevent them from holding the entire $100,000. Complete Form 8288 and file it with a U.S. Income Tax Form 1040NR together with a completed W-7 Form requesting an Individual Taxpayer Identification Number (ITIN). The IRS will generally act on these requests within 90 days after receipt of a complete application including the ITINs of all the parties to the transaction. A transferor who applies for a withholding certificate must notify the transferee in writing that the certificate has been applied for on the day of or the day prior to the transfer. To review the criteria used to determine when a certificate will be issued, visit the IRS website: Withholding Certificates.

Forms required to request a withholding certificate are below:

- IRS Form 8288 (US withholding tax application)
- IRS Form 1040NR (Non-resident alien tax return)
- Form W-7 (Individual taxpayer identification number application)

If you owe the IRS more money than you are entitled to, you can claim the withholding tax as a credit against any tax owing when you file a U.S. tax return. To find out more about FIRPTA and other U.S. withholding taxes as they apply to foreign trusts, partnerships and estates, consult the 2014 IRS guide for us in the 2015 taxation year.

What is a capital gain?

A capital gain arises if the proceeds from the sale exceed the cost of the property after selling expenses have been deducted. Keep in mind, monies spent to improve the property can be added to the original cost reducing the overall capital gain so hang onto your receipts.

Canadian taxation

If you sell your U.S. property at a profit, 50% of the capital gain is considered taxable income in Canada. You may be able to claim the Principal Residence Exemption (PRE) to reduce or eliminate the capital gain. Each family unit – spouses, common-law partners and their minor children are considered a family unit – may claim the PRE for one home whether it's in Canada or the U.S. If you're selling more than one home in a year, you'll have to decide which to claim as your PRE. If you claim the PRE for all years of ownership, there will be no capital gains levied on the property.

In Canada, any taxable gain from your U.S. vacation property, after claiming the PRE, is taxed at graduated federal and provincial tax rates. A foreign tax credit is generally available for tax paid on capital gains in the U.S. to reduce the size of the tax bill in Canada. Since the foreign tax credit is not refundable, you will not be able to recoup U.S. taxes that exceed your Canadian tax liability. As such, if you have a U.S. tax liability, you may want to consider preserving the PRE for another property that you owned at the same time as your U.S. property.

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