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# Wills, Taxes and Estate Planning Law

Issues in Law You Need To Know

## US Real Estate – Ownership Considerations

*A strong Canadian dollar combined with the epic collapse of the U.S. housing market in recent years has helped turn many Canadian heads south to consider purchasing US real estate at a “bargain.” For some, the purchase is solely for personal use but others see a sweet investment opportunity. Informed professionals may see a potential problem.*

Canadians contemplating a purchase of US property are well advised to fully investigate the associated tax rules and planning requirements of any prospective purchase with the same attention to detail as to the nature of the property they are considering buying. They should consider income tax, estate tax and gift tax ramifications related to the ownership of US real property. Failure to conduct the proper tax planning may result in adverse tax consequences for the buyer(s) or their estate.

This newsletter will shine a light on the different ownership structures available. It is important to remember that there is no single approach that works best in every situation and many factors need to be considered in determining which ownership structure to adopt.

### Ownership Structures

There are several ownership struc-

tures available to Canadians, the most common being personal ownership (joint ownership and tenancy in common), ownership through a trust, and ownership through a corporation. Each has their advantages and their drawbacks.

Let’s review the advantages and drawbacks that should be considered prior to making a US purchase. For example, you may want to consider the U.S. estate and gift tax, the issue of U.S. rental income, the taxation of gain under the 1980 Foreign Investment in Real Property Tax Act (FIRPTA), the deemed disposition on death and the income attribution rules. Those cross-border tax issues may have to be dealt with at some point and failure to have recognized the tax obligations may result in unfortunate consequences.

One needs to be aware that the US imposes a federal estate tax on the taxable estate of a decedent who was not a US citizen or domiciliary for transfers of “US situs property” upon death.

### Personal Ownership, Joint Ownership or Tenancy in Common

In common-law provinces, joint ownership is the most common form of ownership of real estate by couples. In joint tenancy the property will



transfer on death to the surviving owner. The alternative is tenancy in common in which case property devolves on death pursuant to the instructions in the deceased owner’s Will.

Individual ownership of US real estate is probably the simplest ownership structure for Canadians. It is worth noting that personal ownership offers no shelter from the US estate tax but with the proper estate tax planning it is possible to mitigate exposure to the estate tax. In many instances, depending on the value of the individual’s estate, he or she may not have to worry about the US estate tax as they will be entitled to claim the pro rata US estate tax exemption

based on the ratio of US assets to worldwide assets.

Consider one example showing how complex (and expensive) proper tax planning can be for personal ownership of US real estate. A couple owns a U.S. property jointly with right of survivorship. The first spouse to die may be liable to pay U.S. estate tax because the full value of the property will be included in that spouse's estate (unless the surviving spouse proves that he or she also contributed to the purchase of the property). Upon the death of the first spouse, the surviving spouse will own 100 percent of the property and, if he or she did not sell the property before his or her death, then the U.S. estate tax may again be applicable on the property on the death of that spouse.

### Corporate Ownership

Until recent policy changes, corporate ownership was commonly used for tax convenience. By holding U.S. real estate in a single-purpose corporation, the direct personal ownership of the asset was avoided and, consequently, so was the US estate tax on death. This method was also advisable as the CRA had a liberal administrative policy of not assessing a shareholder benefit (under §15 of the Income Tax Act) on the use of US real estate; that is the CRA would not include the value of the benefit conferred on the shareholder by the personal use of corporate assets as the shareholder's income.

However, the CRA reversed their policy and, as a result, a taxable shareholder benefit may now be assessed to

the shareholder of the single-purpose corporation holding US real estate. The "new" policy applies for any single-purpose corporation incorporated since 2005 (there is a grandfather provision for property held in a single-purpose corporation prior to 2005).

Corporate ownership also raises concerns on the taxable capital gain on the sale of the property, the IRS piercing the corporate veil and the FIRPTA rules. The preferential long-term capital gain rate is not available and the corporation will be taxed at the graduated tax rates. It is important to know that in some States individuals are not subject to personal tax but corporations are.

Corporate ownership may have been an advisable option in the past but in light of the CRA's reversal on its shareholder benefit policy concerning single-purpose corporations combined with the US tax implications on the sale of such properties, this option may appear less favorable.

### Ownership Through a Trust

Another ownership structure available is a discretionary inter vivos trust which, if properly structured, may avoid US estate tax.

Indeed, the use of a trust for a couple may be an advisable option if implemented prior to the purchase. The strategy is for one spouse to create the trust for the benefit of his or her spouse and children and then to fund the trust with the required amount of cash to purchase the property. The drawback for the

spouse that creates the trust is that he or she cannot be a beneficiary of that trust and may not have any powers or interest in the trust.

The advantages are that ownership within a discretionary inter vivos trust avoids US estate tax and may also minimize the Canadian taxation of accrued capital gains that would result from the deemed disposition on death of property owned by a Canadian-resident individual. Such ownership structure may be an effective estate-planning approach. However, consideration on the application of the reversionary trust rule in the Income Tax Act (§75(2)) as well as the 21-year deemed disposition rule must also be reviewed carefully.

We can see that in the right circumstances the use of a trust as an ownership structure may be an interesting option and that there are several tax rules that ought to be considered prior to the implementation of the trust. Used appropriately, a trust ownership may allow the most flexibility to its beneficiaries.

### US Estate Tax and Gift Tax

The U.S. estate tax is complex in itself and even a general overview far exceeds the extent of this newsletter. What is important to understand is that Canadians owning US assets at the time of their death may be subject to the US estate tax.

Under the Canada-U.S. Tax Treaty, a Canadian resident is entitled to benefit from a tax credit exemption prorated based on the ratio of the U.S. assets to the decedent's worldwide



assets. Depending on the value of the individual's US assets, he or she may be subject to the US estate tax.

What is key to remember is that the U.S. taxation on death stands in stark contrast to Canadian taxation on death as where in Canada, upon the death of a Canadian resident, the deceased is deemed to have disposed of all of his or her capital property at fair market value unless the property transfers to a spouse or a spousal trust. It can be seen that failure to consider the ramifications of the US estate tax may sour your plans for your estate.

### Conclusion

The ownership structure of US real estate is only the first consideration of many. A thorough review of the regulations is essential to assess whether one ownership structure is more appropriate than another. Therefore, if you are thinking of purchasing US real estate, it is advisable that you do your due diligence in considering all appropriate ownership structures.

If you personally own U.S. real estate in joint tenancy or in tenancy in common, you may want to review

your estate planning to avoid double taxation on the death of you or your joint owner. Similarly, if you own U.S. real estate by a Canadian corporation or a trust, you ought to familiarize yourself with the relevant U.S. and Canadian taxation rules.

If you have any questions, please do not hesitate to contact me directly 613.288.3220 or by email at [sdesmarais@tslawyers.ca](mailto:sdesmarais@tslawyers.ca)

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### CALL TO THE BAR

Law Society of Upper Canada, 2007

### EDUCATIONAL BACKGROUND

- University of Ottawa, LL.L., 2007
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### PRACTICE SUMMARY:

Sébastien joined Tierney Stauffer LLP as an Associate in the Wills, Estates & Trusts Planning & Administrative Practice Group in 2009. His practise focuses on estate planning, will drafting and personal and corporate taxation. Sébastien has experience in resolving disputes with the Canada Revenue Agency (CRA), filing voluntary disclosures, assisting individuals with their tax related issues and tax planning for families and businesses. Sébastien is bilingual and practices in both official languages.

He has spoken at various seminars on estate, trust and tax matters. Sébastien has also appeared on radio and television discussing legal issues. He is a tutor for the Law Society of Upper Canada for the Estate Practice section.

Prior to joining Tierney Stauffer LLP, Sébastien practiced with another Ottawa law firm where he gained experience in tax law, charity law, estate planning and will drafting.

