

ADVISORS POINT OF VIEW

WHAT CANADIAN TAXPAYERS OWNING FOREIGN REAL ESTATE SHOULD KEEP IN MIND

Many Canadians have taken the opportunity over the years to acquire real estate outside of Canada. Some purchased for reasons of owning a vacation home or a second residence. Some purchased for personal investments such as owning an income producing property to earn rental income. There may be other reasons, and this article is meant to help Canadian taxpayers identify tax-related and certain non-tax issues that may arise in owning foreign real estate for personal use or personal investment purposes. This article does not address owning foreign real estate for business or commercial purposes.

CANADIAN INCOME TAX ISSUES

Personal-use real estate is perhaps the most common form of foreign real estate ownership. Since personal-use real estate does not generate income, there is no income to report on the individual's personal income tax return.

Disclosure of one's ownership of personal-use foreign real estate on Canada Revenue Agency (the "CRA") Form T1135 - Foreign Income Verification Statement is not required if the property is primarily for personal use.

Foreign rental real estate is treated in the same manner as domestic rental real estate for Canadian income tax reporting purposes because a Canadian taxpayer is required to report his or her worldwide income. The individual has to complete Form T776 – Statement of Real Estate Rentals to report income and expenses for the foreign rental property on his or her Canadian income tax return. The reporting should be in Canadian dollars. To avoid double taxation, income taxes paid to the foreign jurisdiction on the rental income can be applied as a foreign tax credit to reduce the Canadian tax liability on the taxpayer's Canadian income tax return.

Disclosure of one's ownership of foreign rental real estate on CRA Form T1135 - Foreign Income Verification Statement is required because the property is used to earn income.

FOREIGN INCOME TAX ISSUES

Every jurisdiction has its own system and methods of taxing income earned by a foreigner from rental activities. You should seek advice from a professional who knows the rules of that jurisdiction. Find out whether there is a withholding tax imposed on the gross rental income or net rental income and whether there is a tax reporting requirement with respect to the rental activities.

DISPOSING OF FOREIGN REAL ESTATE

A Canadian taxpayer is required to report the disposition of foreign real estate on his or her Canadian income tax return. If the property is a personal-use residence (i.e. a vacation home or a second home situated in a foreign country), it may, depending on the facts and circumstances, qualify to be designated as the Canadian taxpayer's principal residence for a particular year. You can find guidance on the subject of principal residence in Income Tax Folio S1-F3-C2 (Principal Residence) on the CRA website. If an individual wishes to make a designation of the foreign home as a principal residence, CRA Form T2091 (IND) – Designation of a Property as a Principal Residence by an Individual should be completed and included in the tax return of the year that the disposition occurred.

As for the disposition of foreign rental real estate, a Canadian taxpayer must report the gain or loss on the disposition on his or her income tax return. Recapture of capital cost allowance previously claimed will apply in the year of disposition.

The disposition must be reported in Canadian dollars on the Canadian income tax return. Foreign exchange gains and losses on the currency conversion will be included in the calculation.

Every jurisdiction has its own system and methods of taxing the disposition of real estate of a foreign owner. Real estate falls under the category often referred to as an immovable property in tax terminology. This is also the terminology used in most income tax treaties that Canada has with its tax treaty partners. The domestic taxation and reporting requirements of that jurisdiction must be respected in conjunction with the relevant income tax treaty that Canada has with that jurisdiction. It is highly recommended to seek advice from a professional who knows the rules of that jurisdiction and the tax treaty with Canada.

To avoid double taxation, income taxes paid to the foreign jurisdiction on the gain from the sale can be applied as a foreign tax credit to reduce the Canadian tax liability on the taxpayer's Canadian income tax return.

WHAT ELSE TO KEEP IN MIND

No matter how attractive a foreign real property may appeal to the buyer, it is highly recommended to consult with reputable and knowledgeable professionals who understand the rules and practices of that jurisdiction before making the purchase. Aside from costs of maintaining the property, the following are some of the issues that should be considered:

- The legal system, land ownership rights and title may differ from country to country. It is best to have a complete understanding of it so there are no unpleasant surprises after making the purchase.
- Political and economic stability of the jurisdiction cannot be overlooked. The currency exchange/control imposed by the jurisdiction and inflation have to be considered.
- Some sense of the geography and climate would help towards the purchase property insurance coverage. Some places may be susceptible to natural disasters such as earthquakes, floods, hurricanes, etc.
- Be aware of all the taxes associated with the ownership of the real property, such as property taxes, in the particular foreign country. Some countries may have a different treatment for foreign property owners than for their own citizens/residents.
- Some jurisdictions impose a transfer tax/stamp tax when ownership or title changes. It is best to get an understanding on how much and when it is imposed and whether there is a two-tier system such as one for foreigners and one for local citizens/residents.

- Some countries such as the United States have an estate/inheritance/gift tax system that must be taken into account especially in planning the ownership structure. Be mindful of the planning that could minimize the impact of this tax. Certain structures may work for a local owner but not for a Canadian owner.

A Canadian taxpayer investing in real estate outside of Canada should always seek professional advice to understand the rules and requirements.



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