

## Sale of U.S. Real Estate

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Canadians should keep in mind that the sale of any U.S. real property interest will not only attract Canadian tax, but U.S. as well. Canada will generally give you a foreign tax credit for any federal and state tax.

If the sale price is under \$300,000 U.S. and the property is acquired as a principal residence by the purchaser, the 10% federal withholding tax on gross proceeds is waived. The purchaser must sign an affidavit to this effect. The withholding tax must be remitted within 20 days of the date of closing with IRS Form 8288-A. Specific regulations define the meaning of "principal residence" for purposes of this withholding exemption. Some States like South Carolina have a withholding tax provision.

These IRS forms require a taxpayer's identification number ("TIN") for the vendor and also the purchaser where the purchaser is not a U.S. person. You attach the 8288 forms to ITIN application, IRS Form W-7.

For properties held over a year, the maximum federal tax rate is 15% on personal capital gains for sales before 2013. As a result of the January 1, 2013 legislation, the top tax rate on capital gains increases to 20% after 2012 if income exceeds \$400,000. If you owned the property on September 26, 1980, the Canada/U.S. Tax Treaty may allow you to exclude the portion of the gain accruing up to December 31, 1984. A treaty position is claimed by filing IRS Form 8833 with your U.S. 1040NR tax return. Most states where the property is situated will levy tax, payable on filing a state tax return. You should consult with the state to determine your obligations.

Tax returns may not be filed until the year following the year of sale. Thus you could end up waiting over a year from the sale date for your refund. You may apply for a lesser amount of withholding tax if you believe the 10% rate will be in excess of your actual tax liability. This application may be more imperative if there is a mortgage on the property and the 10% will have to come out of your pocket.

You may apply for a reduced withholding by filing an application for a withholding certificate on IRS Form 8288-B. You will need an ITIN to properly file Form 8288-B. You attach the 8288-B to your IRS Form W-7 with a copy of the sales contract. Once approved, the IRS will notify your lawyer to remit the required amount of tax held in escrow with Form 8288-A, within 20 days. The IRS must act within 90 days to process the 8288-B, but it could take as long as 3 to 5 months.

You must file your U.S. individual tax return by the June 15<sup>th</sup> the following the year of sale.

Where real estate interests are held through a partnership, trust or corporation, similar rules apply.

For example, the FIRPTA rules in Section 897 of the IRS Code and Regulations will also affect the movement of the shares of a Canadian corporation where US real property held by Canco is greater than 50% of total fair market value of assets, with a 5-year look-back rule. Movement to distribute real property to the shareholder may or not be a tax-exempt transaction for US tax purposes but may not be for Canadian tax purposes. Professional advise should be obtained to determine the compliance requirements and the combined U.S. & Canadian tax implications.

Some states such as South Carolina have withholding requirements on the transfer of US real property held by non-U.S. persons.

U.S. forms are available on the IRS website (at <http://www.irs.ustreas.gov/pub>).

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*Contact your professional advisor prior to implementing any of the outlined strategies*

### **Internal Revenue Service Circular 230 Disclosure**

*Pursuant to Internal Revenue Service Circular 230, we hereby inform you that the advice set forth herein with respect to U.S. federal tax issues was not intended or written to be used, and cannot be used, by you or any taxpayer, for the purpose of avoiding any penalties that may be imposed on you or any other person under the Internal Revenue Code.*

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