

If You Own Property In The United States, You Need To Rethink Your Strategy!

By Pascale Blanchet

For years now, Canadian residents who own a secondary residence in the United States have been concerned with American estate taxes. This concern comes from the fact that property located in the United States and owned by Canadian residents is subject to American estate taxes upon the owner's death, taxes which can sometimes reach significant amounts.

Since American estate taxes generally do not apply to the shares of Canadian corporations held by individuals who are not American residents or citizens, the strategy usually recommended to Canadian residents was for them to have a corporation be the owner of their residence. This type of corporation is commonly referred to as a "single purpose corporation".

With respect to Canadian taxation, it was, until very recently, the administrative policy of the Canada Revenue Agency ("CRA") not to assess the shareholder of a single purpose corporation provided that certain conditions were met.



This administrative policy was applied by the CRA in an effort to lighten the tax burden of Canadian residents who owned real estate in the United States and were being double-taxed following abolition in 1972 of the Canadian estate tax and the *Estate Tax Convention with the U.S.*

The CRA is of the opinion that under the third protocol of the *Canada-United States Income Tax Convention* which took effect on November 9, 1995, the whole issue of double taxation on American property worth less than \$60,000 US or on the world-wide estate of a Canadian worth, in the aggregate, less than \$1,500,000 US, had been resolved. Consequently, the CRA revised its policy concerning the use of a single purpose corporation and will no longer provide administrative relief. From now on, the shareholder of a single purpose corporation will be required to include in his or her income tax return, as a taxable benefit, the use of any property owned by his or her corporation.

However, arrangements currently in effect will still benefit from the old administrative policy until the occurrence of one of the following events, whichever comes first:

- disposal of the property by the single purpose corporation;
- disposal of shares in the capital stock of the single purpose corporation, other than through a transfer to the shareholder's spouse.



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Due to the abolition of the CRA's administrative policy, Canadians whose property and/or estate is worth in excess of the various tax credits allowed under the *Canada-United States Income Tax Convention* will be subject to double taxation. However, this double taxation problem can be solved by putting in place alternative structures to the single purpose corporation, such as partnerships or trusts. Moreover, by using a partnership, it will be possible, among other things, to benefit from the recent lowering in the United States of the tax rate on the capital gains realized upon the subsequent sale of the property.

The legal and fiscal rules under which the appropriate structure can be set up are very complex. They need to be carefully examined, in order, especially, to ensure harmonization between the fiscal rules in effect in Canada and in the United States. One cannot emphasize enough the need to avoid any solutions that are not supported by a comprehensive fiscal and legal analysis.

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