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What Canadians Need to Know About Buying U.S. Real Estate

by Jim Adair

A recent survey conducted for BMO Bank of Montreal says that one in five Canadians are interested in buying property in the United States. According to the National Association of Realtors, 23 per cent of international buyers were from Canada last year – making us the largest group of foreign buyers for the past three years.

It's not hard to understand why Canadians are being drawn to U.S. property. Canadian "snowbirds" have been spending their winters in southern states for years to escape the cold. Housing prices have fallen by 30 per cent during the last four years and the strong Canadian dollar has made buying in the U.S. even more attractive.

Several U.S. developers and investment groups have been pitching Canadians on the benefits of buying U.S. property, but before you jump into the market it's essential to do your due diligence first. There's a wide range of tax, insurance, legal and lifestyle issues to consider before making the plunge.

The first big question is why do you want to buy a property in the U.S.? Is it for a second or vacation home, or strictly as an investment?

If you're a Canadian who doesn't spend more than 121 days in the U.S. in any tax year, you are not considered a U.S. resident for income tax purposes. However, stay longer and without proper tax planning you risk having to pay income tax in both countries. There may be ways to avoid this but you need to get professional help from people who understand the U.S. tax laws.

If you plan to live in the property part of the year but leave it vacant the rest of the time, you will probably need to hire a property manager to take care of it while you're away, to avoid burglary and vandalism.

If you're planning to rent the property out for part or all of the year, the U.S. Internal Revenue Service will consider you a "non-resident alien" and you must pay U.S. income tax on the rental income. There's a 30 per cent withholding tax on the rent you collect, which must be deducted by you or the property management firm and sent to the IRS.

Accountant Jim Yager, in a contribution to the book Fire Sale by Philip McKernan, says you can avoid this withholding tax by filing a U.S. tax return and paying tax on net rental income, after expenses such as mortgage interest, maintenance, insurance, property management and property taxes have been deducted.

If you sell your U.S. property, there's a withholding tax of 10 per cent of the gross sale price. Yager says there are two exceptions to this rule: if the sale price is less than $300,000 and the purchaser plans to use the home as a residence; or if a withholding certificate is obtained. This certificate can be issued if the tax liability will be less than 10 per cent of the sale price, and will show what amount should be withheld by the purchaser rather than the full 10 per cent.

Tax issues can get complicated in a hurry, and to make things even murkier, some states have their own income tax regulations in addition to the federal laws.

Property taxes are also a consideration. Some states charge higher property taxes to out-of-state owners.

BMO also says it's important to be aware of the differences in mortgage financing between the two countries, and to know how interest is charged in the U.S.

"Understand the terms of the property. For instance, is it labeled as short-sale or foreclosure?" says BMO. "The status of the property can have a variety of implications. Be sure to consult with an expert before making any buying decisions."

Real estate is all about location, and although Canadians have always favoured Florida and Arizona in particular, choosing the right location for your vacation or investment property is critical.

Don't buy a property without visiting it in person. Even if you are not planning to live there yourself, it's important that you determine if it's a good neighbourhood for your investment dollars. Drive around the area during both day and night. In his Fire Sale book, McKernan includes a list of warnings that your potential purchase may be in a bad neighbourhood. Stay away if property management and good tenants are hard to find. Check to see if resale values are on the decline and look at local crime rates. Do other investors report higher maintenance costs and repair bills than other neighbourhoods? Is there a high rate of tenant turnover and a high vacancy rate?

Insurance is another major consideration. Most Canadians realize that if they travel to the U.S., they require medical insurance. When insuring the property, be aware that some coastal areas that often have hurricanes and flooding will have higher insurance costs. You'll also want to make your sure have adequate liability insurance. If you'll be hiring tradespeople to work on your property, make sure they are covered with workers compensation.

For financing options, BMO suggests using a U.S. financial institution that has ties to a Canadian bank. BMO and other major Canadian banks have U.S. subsidiaries. "Staying within the family can save a lot of time and headache," says Laura Parsons, BMO mortgage specialist. "Alternatively, seek out Canadian banks that are already established in the U.S. and the area you are looking to purchase in."
