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BUYING FOREIGN PROPERTY

We are not qualified or licensed to provide legal, accounting or tax advice to people who want to purchase property outside of Ontario but are occasionally asked about such purchases, particularly in Florida. We provide the following information as a matter of common sense but do not presume to provide you with any legal advice on foreign property purchases. **We strongly recommend that you consult with a lawyer, notary or other qualified professional in the jurisdiction in which you propose to make a purchase before you sign any form of document which may relate to a purchase or potential purchase of real estate, even if the document does not look like a contract to you and even if you are told that it is "only an offer" or "a standard contract" or something similar. Obviously, you must never sign a document in a foreign language before consulting a local lawyer and having the document translated and explained.**

ITEMS TO REVIEW AND CONSIDER

The laws, customs, taxes and public services in foreign countries are not the same as in Canada, and even in Canada differ from province to province. As a general guideline, at the very least you should consider and investigate the following:

FOR ALL PURCHASES:

- Do you need resident, citizenship or other legal status to own land? or to visit whenever you want? Is there a maximum time that visitors can stay in the country?
- How will you finance your purchase ? Can you get a mortgage in the foreign country ?
- Who manages the condominium complex or gated community you plan on living in ? What is the cost ? How often can management fees be increased and by how much ? Do you, as an owner, have a say in management ?
- How do they deal with significant future repairs and replacements of building and machinery ? Do they have anything similar to what we describe as a "reserve fund"? How are these regulated, if at all ?
- What access do you have from your property to public roads and streets? Do you have to travel over anyone else's (private) property? How do you get permanent permission to do so ? At what cost, one-time or annual? Can an easement or right of way (however described) be registered on title, if there is such a thing as title and registry/land titles systems?

- How do you get access to the beach or ocean or do you even have such access? Again, at what cost? Is the beach private or does the public have a right to use the beach? and to access it through your property?
- What about building and recreational facilities ? Is the use of swimming pool, tennis courts, amenities or other common areas included with your monthly fees or do you have to pay something extra by way of joining a "club" of some sort?
- Who supplies the basics such as electricity, phones, water, sewage disposal, garbage disposal? Is it public or private? How much does it cost?
- Does the local jurisdiction charge property or other taxes and if so, how much and how is it determined? Are there any extra or increased charges or taxes to non-residents or in the alternative, do permanent residents get a “homesteader rate” or discount that non-residents do not get?
- What type of zoning control to they have? Are there any restrictions on activities that can be carried on in a private house or in a condominium complex or in the individual units? What about adjoining or nearby properties ? What is the potential for development of adjoining or nearby vacant lands?
- Are you allowed to rent your property? Are there minimum or maximum periods for rentals? Are there restrictions on the number of renters? Are children permitted?
- Can you use the property all year or is it only seasonal ?
- Are there age restrictions on who can live in the complex or community or on who can visit? Are children allowed at all ? Are they restricted from using facilities?
- Are there any health hazards in the area ? Are there any local malaria problems or problems with other diseases. You can check the website of the U.S. Centre for Disease Controls and the Government of Canada site for travel advisories.
- What about health care while you are there? How do you get it and at what cost?
- What type of security is there ? Is it private or local police force ? How reliable are the local police ? How stable is the local government ? What is the crime situation in the local area ?
- What disclosure of condominium or private community finances, repairs, rules and regulations should you be getting? In Florida, condominium sellers (who are not developers) must provide prospective buyers a disclosure from the Florida Department of Business and Professional Regulation which details the rights and responsibilities of condominium boards and unit owners, voting rights, meeting notices and other governance matters in addition to other matters, such as financial statements, required by law. A purchaser has three days (excluding Saturdays, Sundays, and legal holidays) from the time he or she receives the disclosure documents to terminate the contract. Are there similar laws in the jurisdiction you intend to purchase in ?
- Are there restrictions on sales of the property ?
- What taxes and fees to you pay on the purchase of a property (often described as land transfer taxes, documentary stamp taxes, intangible taxes, recording fees) What other costs are there such as, inspection costs, other closing fees ? What are the legal fees ? Is title insurance available or mandatory and what is the cost ? Is a survey required and if so, who pays for it?
- What taxes do you pay on sale ? on the increased value of the property ? Are there withholding taxes ? In the United States, the Foreign Investment in Real Property Tax

Act of 1980 requires a tax holdback on the sale of a property and requires the buyer, or agent, to withhold 10% of the sale price.

- What is required to transfer the property to your spouse or family on death ? Will your Canadian will be recognized in the foreign jurisdiction or will you need a special will or other document there ?
- What special problems are there in the local area which must be inspected as part of the due diligence prior to closing and precautions taken while you are back home in Canada (mould, termites, drywall problems, hurricane protection, maintenance of seawalls, environmental problems such as asbestos or fuel oil tanks)?

NEW DEVELOPMENT PROJECTS:

In addition to all of the above, you need to find out about the following matters:

- Are the plans subject to change and are there any restrictions on how significant the changes can be?
- What do local authorities say the developer is legally allowed to build on the site? How do you verify that the developer is in compliance ?
- What are local building standards and what is the enforcement like? Who will be inspecting the finished product and providing you with assurances about the quality of construction ? What remedies do you have if the quality is not acceptable ?
- What type of warranty is being given? Who enforces the warranty? Do they have any government protection similar to our Ontario New Home Warranty Program? How are the building and common facilities warranted and inspected and what remedies do you have for any major and minor defects?
- What rules and regulations, if any, will apply to the development? Is there anything similar to what we have here such as Declaration, By-laws and Rules? You need to review these items in advance to see if there any restrictions on the use of your units or if the other units in the project can be used for purposes which might not be acceptable.
- Who is getting your deposit and what assurance do you have that you will get it back if the project is not approved or completed? If the Builder is holding the funds and it becomes insolvent or bankrupt, you will lose the money. It would be best if a lawyer held the deposit in trust until the final closing.
- Is the purchase price subject to any increase? If so, by how much and under what circumstances?
- What extras are charged? For example are there costs for installation of public services such as electricity, water, telephone, cable and internet?
- When will the project be finished and what rights does the builder have to extend the time?
- What are the costs to close the transaction? Is there a government tax or fee on the transfer of land (similar to our Land Transfer Tax) and if so, how much? What other charges will there be for legal, notarial, registration or other expenses, including those which relate to the preparation of a public deed, as well as its registration at a public registry?

INSURANCE:

You should also consider the availability and cost of insurance. Homeowners insurance rates, especially in coastal areas of the United States, tend to be higher than elsewhere, and coverage can be hard to find depending on the location, age of the home and the type of construction. This is a result of recent hurricane seasons which caused significant losses and significant insurance payouts. Also consider flood insurance and termite insurance. U.S. government disaster-relief payment programs in the event of occurrences such as major hurricanes may not be available to non-residents. Find out if there any special insurance required where a home is not occupied for long periods.

ESTATE AND DEATH TAXES

Unlike Canada, many foreign jurisdictions impose estate or death taxes, which are taxes on the value of a person's property at the time of death. This can include federal, state and local taxation. Taxes may be imposed on citizens of other countries who own property in the foreign jurisdiction.

When Canadian residents die, for Canadian tax purposes, they are deemed to dispose of all of their capital property at fair market value. In the United States non-residents, including Canadians, who own property in the U.S. are taxed on the fair market value of that property. As a result, in the year of death, if you are a Canadian resident and you own U.S. real property, for Canadian purposes you may have a large "deemed" capital gain with respect to such property, in addition to a possible U.S. estate tax liability. In some cases, the combination of these taxes could end up being a substantial percentage of the value of the property.

Under U.S. law, a non-resident, non-U.S. citizen decedent ("NRA") has only a $60,000 estate tax exemption equivalent. The Canada - U.S. Tax Treaty provides some relief. Under the Treaty the estate of a NRA is eligible for an expanded estate tax exemption (the "pro-rated exemption") which is determined by multiplying the applicable U.S. estate tax exemption by a fraction, the numerator of which is the value of the decedent's U.S. assets and the denominator of which is the value of the decedent's worldwide assets. As of January 1, 2013 the exemption was permanently set at $5,000,000 based upon worldwide assets. As a result, if title is held in an individual name and the worldwide assets exceed the present exemption amount, the surviving spouse may be hit with a significant estate tax that climbs all the way up to 45% based on the value of the estate

Serious consideration must be given to holding property as "joint tenants" which is the way most husbands and wives hold property in Canada. In some jurisdictions, particularly the U.S., holding a property as joint tenants may result in double taxation. See the tax planning note below.

If a Canadian (or anyone else) dies holding U.S. property, then in addition to the estate tax noted above, the person's estate will have to have a probate in every U.S. state in which the deceased owned. This involves a lot of work and can be expensive.

INCOME TAXES

If you are in the U.S. for more than 183 days a year you are considered a resident for tax purposes. Unless you can qualify for an exemption, you must file a U.S. return stating your worldwide income. Also, you must consider potential loss of health care and other Canadian benefits and the tax consequences on deemed disposition of capital properties and on RRSP's, RRIF's and otherwise on "leaving" Canada. Follow this link to the Canada Revenue Agency website for general information on this topic:
http://www.cra-arc.gc.ca/tx/nnrsdnts/ndvdls/lvng-eng.html

It is possible to be considered a resident in both the U.S. and Canada which would require filing returns and paying taxes in both countries, however the Canada - U.S. Tax Treaty generally relieves against the potential penalty of paying double taxation. Even if you are a non-resident of the U.S. you should note that if you rent out a U.S. property you are expected to pay a 30% withholding tax from that rental income each month and to file a U.S., and perhaps state, tax return annually.

You may be tempted to add your children on to the title after you purchase a property in the U.S. and other jurisdictions. This may trigger gift tax. It does in the U.S. Therefore, consider adding your children on title at the time of purchase. If it is too late, consider tax planned gifting programs, which take advantage of the exemptions in the U.S. tax laws for gifts to children and spouses, to reduce the tax burden.

If you obtain a U.S. "Green Card" you will be taxed in the same manner as a U.S. citizen and will be liable for taxes on your worldwide income and will be liable for U.S. taxes on your estate. Again there will be some relief against double U.S and Canadian tax but the net effect is that you will effectively pay the highest tax charged by either government. In addition because of U.S. tax and reporting requirements, having American beneficiaries will affect Canadian trusts and estates.

WITHHOLDING TAXES

Under U.S. law a buyer of land from non-residents or from foreign corporations has a legal obligation to withhold 10% of the purchase price and to remit that money to the U.S. Internal Revenue Service (IRS). If the buyer purchases the property for his or her personal residence and if the purchase price is less than $300,000 then there is no obligation. A seller can get a reduction by applying to the IRS before the closing.

PROPERTY TAXES

In most parts of Florida you should expect to pay between 1.5 and two percent of your home's assessed value when you get your tax bill. Florida residents ("homesteaders") get a reduced rate by way of a deduction from the market value, and the effect is to have non-residents pay much more than residents. Recent reforms limit the rate of increase to non-residents to 10% per year. Limits on increases to homesteaders are lower so the differential will continue and be increased over time.

TAX PLANNING

Again, it is necessary to consult with a qualified professional in the jurisdiction in which you plan to purchase your property. You should also consult with your Canadian tax advisors to make sure you do not incur any unnecessary tax liability in Canada. In some jurisdictions, trusts can be created. Trusts are a special way to hold title to property. A trust can be structured so that it allows you to maintain the important property rights, like possession, income, the right to sell and decide how the property will eventually be transferred. A trust may however give the Trustee (who can be you or some or all of you, your spouse and your adult children) the actual title.

Trust. For U.S. property, an effective planning tool is the use of a trust to hold real property. There are many different types of trusts available including a “residence trust”, “cross-border trust”, “Florida Land Trust” and “QDOT”. These are designed to eliminate probate procedures and to reduce or defer potential US estate taxes. Depending on which type of trust chosen, the trust may be revocable or irrevocable.

For a “Cross-Border Trust”, either a husband or wife (the “Settlor” or “Grantor”) creates the trust and contributes funds to the trust. There is no taxable event when the trust is created or funded for U.S. gift tax purposes, if the source of the funds is outside the U.S. Typically, the Grantor’s spouse and descendants are the beneficiaries of the trust. In order for the trust not to be included in the estate of the Grantor for U.S. estate tax purposes, the Grantor cannot be a beneficiary or a trustee of the trust. The Grantor’s spouse can be the Trustee, so long as distributions of income and capital to the spouse are for the purposes of “health, education, maintenance or support”. The U.S. property is then purchased by the trust with the Canadian assets contributed to the trust by the Grantor. It is essential that the purchase contract be in the name of the trust and the funds for closing come from a trust account.

The Grantor’s spouse and descendants, as beneficiaries of the trust, can use the property rent-free during their lifetimes. Under certain provisions of U.S. law, the Grantor is also permitted to use the property rent-free during his or her spouse’s lifetime. The Grantor can also continue to contribute funds to the trust to cover any related costs. Upon the death of the Grantor, the property held in the residence trust is not includable in his or her estate for U.S. estate tax purposes. The same is true at the death of the Grantor’s spouse (even if he or she is the Trustee, so long as distributions from the trust are limited to “health, support, maintenance or education”). The residence trust also has the added benefits of avoiding probate, protecting the property held in the trust from creditor claims and potentially allowing the U.S. long term capital gains rate to be available on a sale if the property is held for more than one year. This rate is presently 15% federally for 2012 (as opposed to the 34% capital gain rate applicable if the real property is held by a corporation). One of the disadvantages is that if the Grantor’s spouse predeceases the Grantor, the Grantor will have to pay fair market rent to continue to use the property. In addition, if the Grantor and his or her spouse divorce, the spouse can continue to use the property to the exclusion of the Grantor, unless the trust agreement is structured to protect the Grantor.

Under a "Florida Land Trust" the trustee holds legal title to the property, yet all ownership interest in the property lies with the beneficial owners of the trust. The trustee takes action, solely upon the direction of the beneficiaries. The interest of the beneficiaries are not disclosed except upon sale or court order. Provisions can be made in cases of disability so as to avoid formal guardianship proceedings. Probate is not required and the trust provides direction for distributing the property upon death. The trust agreement can outline the various family members' rights and interest in the property. Transferring interest within a land trust is simple and not subject to state imposed documentary transfer tax. In the event of sale, provided the property has been held for one year or longer, favorable individual U.S. capital gains rates apply rather than the higher corporate rates. The Trustee may be the property beneficial owner, though it does not need to be. Trustees serve a ministerial role as the beneficiaries direct the trustee on how they wish to manage the property. Successor trustees can be listed and set forth in the event of death or incapacity of the initial trustee. If set up properly and if shares of the trust are gifted and held in escrow by children it is possible to completely avoid probate, avoid estate tax, not run afoul of U.S. gift tax laws and upon death, heirs take over the original basis the deceased had in the property for capital gains purposes when they ultimately sell the property.

A "QDOT" may be useful where the spouse who owns land is a U.S. citizen and the non-owning spouse is not. At the first spouse's death, assets go to the trust instead of to the surviving non-citizen spouse. The survivor receives benefits from the trust assets, but doesn't own them. When the second spouse dies, assets pass to other beneficiaries named in the trust typically, the couple's children. If the estate is valuable enough and exceeds the applicable exemptions, estate tax is paid then, as if the assets were in the estate of the first spouse to die. Trust assets are not included in the estate of the second spouse to die.

If a person has already purchased the property, the same beneficial U.S. estate tax result can be achieved by selling U.S. property previously purchased to the trust. The transaction must be dealt with on an arm's length basis one and fair market value must be paid by the trust. Any gain from the sale will need to be reported on both Canadian and U.S. non-resident income tax returns and is subject to tax in the U.S. at a 15% rate but the U.S. tax is creditable against the Canadian tax. For that reason, it is most effective to use this technique for property that has little to no gain. In the current, fairly depressed, market situation, this may be an excellent time to transfer properties to a trust.

Joint Tenancy. While one of the more popular ways to hold real property in Canada, a joint tenancy is generally not recommended for non-residents owning U.S. real property. First, there is the risk of double U.S. estate inclusion. Where the surviving joint tenant is someone other than a U.S. citizen spouse, the entire value of the property is included in the estate of the first to die, unless it can be demonstrated what value the surviving joint tenant contributed toward the property (the "tracing rule"). The entire property passes by operation of law to the surviving spouse, where the entire value will be again be subject to U.S. estate tax at the survivor's death.

Furthermore, a joint tenancy makes it more difficult to defer the U.S. estate tax until the death of the survivor. If the survivor is not a U.S. citizen, the property will not qualify for the marital deduction from U.S. estate tax because it is not passing to a "qualified domestic trust" for the survivor. The Canada-U.S. Tax Treaty marital credit may be available, but may not be sufficient to alleviate the entire U.S. estate tax liability on the first death (particularly with the potential for a lower estate tax exemption of $1,000,000 as of January 1, 2013).

Corporation. In the past, many Canadians used a Canadian corporation (known as a "single purpose corporation") to hold personal-use U.S. real estate to avoid U.S. estate tax on the property. Shares of a Canadian company are not U.S. property for estate tax purposes. A change in policy by CRA in 2004 makes the use of "single purpose" corporations no longer an effective estate tax planning tool. Furthermore, the U.S. may look through the corporation to the underlying asset, especially if the property is the only asset of the corporation, the property is not used by anyone other than the shareholder and the shareholder's family, and the requisite corporate formalities are not followed. In addition, on the sale of the property, U.S. capital gain tax will be due on the difference between the original purchase price (plus capital improvements) and the sale price. The U.S. corporate capital gain rate of 34%, as opposed to the long-term individual capital gain rate of 15%, will apply. Additional state capital gain tax may also be imposed.