US vacation property planning for Canadians

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Did you know that if you own a vacation property in the United States, taxes could be substantial when you eventually gift, transfer or sell the property? And they could be even higher upon death. Let's look at some of the unique tax considerations and planning opportunities if you are a Canadian resident[1] who is thinking of buying or already owns a US vacation property.

Transferring your US vacation property during your lifetime

A "transfer" for tax purposes can include both a sale and gift of your property. In both Canada and the US, you may pay tax on the capital gain if you sell your US vacation property for more than its cost, which also includes amounts you paid for improvements.

The maximum US federal tax rate that you could pay is 20% on long-term capital gains, for properties owned for more than one year; otherwise, graduated US federal income tax rates range up to 37% for short-term capital gains.[2] If you're not a US person, the purchaser of your US vacation home is generally required to

[1] Note that this report only covers tax planning for non-US persons. If you are a US person (including a US citizen), be sure to consult a US tax advisor as the rules and planning opportunities are significantly different.

[2] Although state and local taxes may apply to transfers of your vacation property, they are not considered in this report.

withhold 15% of the gross proceeds and remit this withholding tax to the U.S government on your behalf.[3] You may claim amounts withheld by the purchaser as a credit against US tax owing on capital gains.

Capital gains may also be taxable in Canada at graduated federal and provincial tax rates Any capital gain (or loss) must be calculated in Canadian currency, using exchange rates at the time the property was purchased and sold. Higher taxes may apply to “flipped” properties that are held less than one year.[4] You can generally claim a foreign tax credit for taxes paid in the US against the tax liability in Canada (if any).

If you’re thinking of gifting (rather than selling) your US vacation property, perhaps to a family member so it can be enjoyed by future generations, you should be aware that the US gift tax regime and special Canadian tax rules could result in a significant tax bill in both countries, without appropriate planning.[5]

Tax planning strategies

Here are some tax planning strategies to consider:

- Hold onto receipts to validate amounts you have paid for capital improvements to the property. These amounts may generally be added to the tax cost of the property (the adjusted cost base or ACB), potentially reducing the capital gain and related taxes upon transfer or sale or death.
- Consider holding your property for at least one year, to access the lower 20% US long-term capital gains tax rate and higher tax rates in Canada for flipped properties.
- In Canada, you may be able to claim the principal residence exemption (PRE) to reduce or eliminate any taxable capital gain; however, if you have more than one home during a year, you will have to decide which should benefit from the PRE.
- If there is a capital loss on the sale of your US vacation property, this is generally denied as it’s considered personal use property.
- Prior to making any gifts of US real estate, be sure to consult with Canadian and US tax and legal professionals to avoid costly pitfalls.

Estate planning considerations

US estate tax may apply at graduated rates ranging from 18% to 40% on the value of a US vacation home that you own upon your death. There is an estate tax exemption that may eliminate your estate tax bill if the value of your gross worldwide estate, including your US vacation home, is under USD$13.61 million.[6] If the value of your worldwide estate exceeds this threshold, US estate tax may be payable.

For Canadian tax purposes, there is no estate tax. Instead, you will be treated as if you sold your US vacation property upon death, which could result in a capital gain (as above). A foreign tax credit may be claimed for US estate tax paid on your vacation property on your Canadian return.

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[3] If the purchaser acquires property for use as a residence, no withholding is required when the proceeds of sale are under USD$300,000, and a 10% rate applies for proceeds up to USD$1 million. In some cases, such as when the ultimate income tax liability is expected to be less than the withholding amount, you may apply to the IRS for a withholding certificate that would allow the purchaser to reduce or eliminate the amount withheld.

[4] To discourage speculation in the Canadian housing market, the government introduced anti-flipping rules for residential real estate (including rental properties) that came into effect Jan. 1, 2023, and were designed to “reduce speculative demand in the marketplace and help to cool excessive price growth.” The rules prevent you from claiming the principal residence exemption to shelter the capital gain realized on the sale of your home if you’ve owned it for less than 12 months, and they tax the gain on the sale of any residential real estate as 100 per cent taxable business income, subject to certain exemptions for life events such as death, disability, separation and work relocation.

[5] More details are available in the CIBC report Your US vacation property could be quite taxing.

[6] A married individual who leaves US situs assets, including US real estate, to a surviving spouse may claim a marital credit so that a worldwide estate up to USD$27.22 million may be sheltered from US estate tax. The *Tax Cuts and Jobs Act* that was enacted in December 2017 temporarily doubled the estate tax exemption (which is indexed to inflation annually) for years from 2018 and 2025. Unless steps are taken by US legislators before December 31, 2025, the doubled exemption is set to “sunset” after 2025, and go back to pre-TCJA levels, estimated to be approximately USD$7 million (inflation-adjusted estimate).

An example of taxes on a US vacation property upon death

Let's say you bought a US vacation home for USD$4 million when USD$1.00 equaled CAD$1.25 so you paid CAD$5 million. Suppose that when you die your home is worth USD$5 million and you have USD$20 million of other assets in Ontario, where you pay tax at the top marginal rate.

Based on the USD$5 million value of your US home and your worldwide estate of USD$25 million, the US estate tax on your vacation home would be about USD$868,000.[7] There would be no US tax on the USD$1 million capital gain that arose during your lifetime, either for you or your heirs, due to a step-up in cost basis upon death.

Suppose that when you die, the foreign exchange rate is still USD$1.00 equals CAD$1.25. In US dollars, there would be a capital gain of USD$1 million. For Canadian tax purposes, however, there would be a capital gain of CAD$1,250,000[8], which would result in about CAD$334,563[9] of tax. Although the PRE could be claimed to eliminate the capital gain, it would be better to claim a foreign tax credit based on the USD$868,000 (about CAD$1,085,000[10]) of US estate tax – this would eliminate Canadian taxes on your US home while preserving the PRE for another home. Since the foreign tax credit would completely eliminate Canadian taxes payable, the combined US and Canadian taxes owing on your US vacation property would be equal to the US estate tax of USD$868,000 (about CAD$1,085,000).

But what if there was a change in the exchange rate? Suppose that when you die, USD$1.00 equals CAD$1.00. For Canadian tax purposes, there would be no capital loss or capital gain[11], so there would be no tax payable in Canada on your US vacation property. No foreign tax credit could be claimed for the USD$868,000 (about CAD$1,085,000) of US estate tax that is payable. Since there would be no Canadian taxes payable, the combined US and Canadian taxes owing on your US vacation property would still be equal to the US estate tax, which would be USD$868,000 (about CAD$1,085,000).

Some estate planning strategies

Here are some estate planning strategies to consider:

- You may wish to gift some of your assets during your lifetime, to reduce the value of your worldwide estate that is used in US estate tax calculations. Note that gifting certain US assets may result in US gift tax or immediate tax in Canada on any accrued capital gains.
- You could purchase life insurance to cover any tax liability upon death. Note, however, that the value of the life insurance will generally be included in the value of your worldwide estate when calculating US estate tax. To mitigate this, you could consider having the life insurance proceeds flow into a life insurance trust.
- "Non-recourse" debt, which is secured only by the property and not your other assets, could be used to finance your US home. This would reduce the value of the property for US estate tax purposes. Practically, however, it may be difficult to find a lender offering this type of debt.
- You could consider holding your US vacation property indirectly, perhaps through a family trust or partnership, which may eliminate US estate tax. These are advanced strategies that should be discussed with Canadian and US tax and legal advisors.

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7 Calculated as gross estate tax of USD$1,945,800 − [USD$5 million ÷ (USD$5 million + USD$20 million) × the credit of USD$5,389,800]. It is assumed that you held no other US situs asset at the time of your death.

8 Calculated as (USD$5,000,000 × CAD$1.25) − (USD$4,000,000 × CAD$1.25).

9 Calculated as CAD$1,250,000 50% × 53.53%..

10 Calculated as USD$868,000 × CAD$1.25 ÷ USD$1.00.

11 Calculated as (USD$5,000,000 × CAD$1.00) − (USD$4,000,000 × CAD$1.25).

A final note

Finally, here are some general points to keep in mind when planning for the transfer of your US vacation property:

- Taxes may apply in both Canada and the US and may be substantial.
- You should consult with Canadian and US tax and legal advisers about taxes that could apply on your US vacation property, as well as any strategies that may help to reduce or eliminate taxes. It is best to undertake planning prior to the purchase of the property, since it can be difficult to do any planning after the purchase of the property without triggering taxes.
- Even with the best of planning, factors that are out of your control, including currency fluctuations and legislative changes, can affect the amount of taxes that you will pay.

Although this report has explored some of the primary Canadian and US tax considerations for transferring US real estate, it is not comprehensive. Since the issues are complex, you should consult with Canadian and US tax and legal advisers to determine the implications, and potential strategies for making ownership of your US vacation home a little less taxing.

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