Look before you leap

Taxing issues of owning U.S. property

When Canadians think about another long Canadian winter, the anticipation of an annual sojourn to the sunny south is especially appealing. For many, purchasing a second residence in the United States is an attractive alternative.

However, significant tax planning, financial planning and estate planning implications accompany the purchase of foreign property. It's important to do your research first, so you know what to expect and how to prepare. Here's a review of the key issues.

Financing the deal

When you purchased your principal residence in Canada, chances are you took out a mortgage for a good portion of the total value. You might want to do the same with your U.S. property.

Canadian based lenders cannot accept a mortgage on a U.S. property. You may need to consider other sources of financing.

You may be able to borrow in the U.S. at a lower rate than Canada. While lower interest rates are appealing, remember that foreign exchange fluctuations ultimately may make your U.S. debt more expensive to service.

A non-recourse mortgage may be your best option since this type of mortgage may reduce your exposure to U.S. Estate Tax.

Ownership options

There are many options to ownership that may reduce the estate tax liability. Generally, assets can be owned personally, in a partnership or through a trust.

Keep in mind that there are many factors you need to consider in order to determine what option is right for you. You should consult with your Investors Group Consultant who will work with your lawyer and accountant to ensure you maximize your tax reductions.

After the purchase

Once you've decided on the property you want and have arranged appropriate financing, more decisions await.

- Will you rent out the property? Canadian residents are taxable in Canada on their world wide income. Therefore, any net rental income from your U.S. property will be taxable to you in Canada.

  In addition, you will be taxed in the U.S. on the rental income (foreign tax credits can be claimed when filing your Canadian tax return, to avoid double taxation). Depreciation is mandatory for U.S. tax purposes, so the U.S. and Canadian returns should be done in conjunction with one another to ensure the full potential of foreign tax credits is achieved.

  U.S. tax must be withheld by the U.S. renter unless you elect to use the net rental income method.

- If so, for how long? If you rent out your U.S. property for more time than you use it yourself, and if it costs more than $100,000, you must also file an annual information return in Canada along with your Canadian tax return (Form T1135).

Upon disposition

When you sell your U.S. property, any capital gains will be included in your income for Canadian tax purposes. As well, a U.S. federal return and possibly a state return will be required to report the gain. Canada will usually allow a foreign tax credit for U.S. tax paid.

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A deemed disposition for Canadian tax purposes will also take place upon death. The U.S. may levy federal and state estate tax, depending on the value of the property and the size of your estate. Only U.S. estate tax may be eligible for a foreign tax credit to offset any Canadian capital gains tax on the deemed disposition.

Buying real property is always a major life decision, and often represents a major expenditure. When that property is in another country, there are additional tax and estate planning implications to consider.

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(10/2008) MP1014