

# The TaxLetter®

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Your Guide to Tax-Saving Strategies

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## TAXSTRATEGY

### Americans in Canada

# U.S. Tax Issues

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The first 100 days are in the books for the Trump administration. While many of us north of the border feel insulated from the comings and goings on south of the border, U.S. tax rules may be a larger issue for many Canadians. This is because while Canada taxes you based on residency, the U.S. taxes you based on citizenship.

And considering that an estimated 1 million U.S. citizens live in Canada, chances are that many of you (or someone you know) might find this article of interest.

#### U.S. filing requirements

What does it mean then if you are a U.S. citizen living in Canada? Even though you duly

file your Canadian tax return and report all of your income, you are still required to file a U.S. tax return with the IRS and report all of your worldwide income (even if none of that income is earned in the U.S.). Happily, this does not mean that you're being taxed twice. The Canada-U.S. Tax Treaty provides relief against such double taxation by allowing you to claim a foreign tax credit on your U.S. tax return for the amount of taxes that you pay in Canada (or vice versa). Of course, the rules in the U.S. are different than those in Canada (including the tax rates) but the idea is still the same.

Some U.S. citizens living abroad may have kept up with their U.S. tax filing obligations; however, many others have not, and many of those people may not have even have known that there is such an obligation.

However, the IRS has become a lot more aggressive in making sure that non-resident U.S. citizens complied with this obligation. The 2011 "Offshore Voluntary Disclosure Initiative" (OVDI) was implemented to ensure that U.S. citizens become fully compliant with filing and reporting obligations.

As part of the OVDI, US citizens are required not only to comply with the filing requirements, but also various reporting obligations such as the Report of Foreign Bank and Financial Accounts ("FBAR") requirement. If you have more than \$10,000 in non-U.S. accounts, including those in a Canadian bank, investment, RRSP and RRIF accounts, you must file an FBAR return listing the details of each account (this is required if such an account has EVER hit the \$10,000 threshold, even if it has nothing in it today). The failure to comply could result in onerous fines and potential criminal persecution. A penalty alone may reach as high as 50 per cent of the highest amount held in an unreported account in a fiscal year.

So, if a U.S. citizen has been living and working in Canada for years, and even if he or she has filed U.S. tax returns as required, he or she could still be exposed to harsh penalties for failing to report a single bank account or even an RRSP account, held either directly or perhaps jointly with a spouse.

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And sadly, you can't hide behind the Canadian flag. The Canada-U.S. Tax Treaty provides the IRS with broad legal powers to collect income taxes and penalties due from U.S. citizens residing in Canada.

### RRSPs/RRIFs/TFSA's

The advantage of RRSPs, RRIFs and TFSA's is that any income or gains will be deferred until such time as you withdraw the funds; until then, your investments can grow tax-free in Canada. However, per the IRS, any income or gains earned inside these types of accounts will be taxable currently in the U.S., and not at the time of a withdrawal. Happily, the U.S.-Canada Tax Treaty offers some relief from this timing mismatch: a U.S. citizen can elect to defer recognition of the income and gains in the current U.S. tax return until such time as the income is withdrawn from their RRSP or RRIF. Such an election allows for the same timing on taxation in Canada and the United States.

### U.S. Estate Tax

If you are a U.S. citizen, you will be subject to a U.S. estate tax on your death based on the fair market value of all of your assets, regardless of whether you have lived in Canada (or elsewhere) for most of your life. The top rate of the estate tax is 40 per cent, with an exemption for

estates up to \$5.49 million (USD). Whether this exemption and rate will remain in place under the Trump administration is still yet to be determined. Trump has talked about repealing the U.S. estate tax entirely; however, based on his record to date, this is considered to be a red herring.

There are certain planning opportunities that you can take advantage of, especially by ensuring that you have a properly tax-planned will. If you are not a U.S. citizen, but your spouse is, you might think about ensuring that you don't leave all of your assets outright to your U.S. spouse. Otherwise, those assets will be subject to a U.S. estate tax on your spouse's death. The use of certain testamentary trusts in your will would be useful in shielding those assets from a U.S. estate tax. There are also certain credits available that offer some shelter from US estate tax. It would be worthwhile to speak to an estate-planning advisor who has experience with U.S.-estate tax planning to ensure that you make the most of these credits and testamentary trusts.

### U.S. Gift Tax

Giving in the U.S. can also land you in hot water. The U.S. taxes its citizens on gifts of all property at a rate equal to the estate tax rates. There are, however, annual gift-tax exclusions:

☞ You can gift as much as

you want to your spouse as long as that spouse is also a U.S. citizen; otherwise, the gift limit per year to a spouse that is not a U.S. citizen is \$149,000 USD per year (for 2017).

☞ \$14,000 USD per year to all other recipients. Note that you and your spouse can pool this so that you can together gift up to \$28,000 USD per year.

In addition, there is a lifetime gift tax exemption of \$5.49 million (USD) for U.S. citizens and residents (for 2017). This mirrors the exemption for the U.S. estate tax for 2017.

### Summary

The above is meant to be a general overview of certain U.S. tax issues affecting many Canadians with U.S. roots. This list is not meant to be exhaustive, otherwise this article may be the size of a textbook. Obviously, it would be important to ensure that you speak to your U.S. tax advisor to ensure that you are in compliance with the various IRS rules and that you don't trip into any other U.S. tax issues inadvertently. Your other choice, of course, may be to relinquish your U.S. citizenship. But be warned that this process is not as simple as one would hope. Not only is the red tape pretty thick, but if the value of your assets is over \$2,000,000 (USD) or your net income is over a certain amount, you could be hit with a departure tax in the United States. ☐