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Your Guide to Tax-Saving Strategies

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TAXSTRATEGY

Residency

Canada or U.S.?

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The first 100 days are in the books for the Biden administration. Many of us north of the border feel insulated from the comings and goings on in the U.S.; however, the 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 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 US tax return with the IRS and report all of your

worldwide income (even if none of that income arises in the U.S.). Happily, this does not mean that you're being taxed twice. The Canada-U.S. Tax Treaty provides relief against any double taxation by allowing you to claim a foreign tax credit in 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 known that there was such an obligation. However, the IRS has been known to be quite aggressive in making sure that non-resident U.S. citizens complied with this obligation. The 2011 "Offshore Voluntary Disclosure Initiative" (OVDI) was implemented to help the IRS ensure that U.S. citizens become fully compliant with filing and

reporting obligations.

As part of the OVDI, not only are U.S. citizens required to comply with the filing requirements, there are 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 Canadian bank, investment, RRSP and RRIF accounts, you must file an FBAR return listing the details of each account (and this is required if such an account has EVER hit the \$10,000 threshold, even if it has nothing in it now). 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 US 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. And sadly, you can't hide behind the Canadian flag. The Canada-US. 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/TSFAs

And not all things are treated equally on both sides of the border. In Canada, the advantage of

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RRSPs, RRIFs and TSFAs 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. Thankfully, the U.S.-Canada Tax Treaty offers some relief to this timing mismatch: a U.S. citizen can elect to defer the 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. The result is that this election allows for the same timing on taxation in Canada and the U.S.

U.S. Estate Tax

If you are a U.S. citizen, you will be subject to U.S. estate tax on your death on the fair market value of all of your assets, again regardless if you have lived in Canada (or elsewhere) for most of your life. The top rate of estate tax is 40 per cent, with an exemption for estates up to \$11.7 million (USD) for 2021 (and for married couples, this threshold is doubled, so they can, together, shelter assets having a fair market value of up to \$23.4 million (for 2021). For the majority of US citizens, this may never be relevant since the exemption is quite high; however the exemption threshold has been the subject of many changes over the years (it was less

than half of that amount under the Obama administration). Note: the U.S. estate tax is not triggered when you leave assets to your surviving spouse (as long as that spouse is also a U.S. citizen).

There are certain planning opportunities that you can take advantage of, including by ensuring that you have a properly tax-planned will. If you are not a U.S. citizen, but your spouse is, thought may be given to ensuring you don't leave all of your assets outright to your U.S. spouse, otherwise those assets will all of a sudden be subject to 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 U.S. estate tax. There are also certain credits available to offer some shelter from U.S. 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

\$159,000 USD per year (for 2021).

- \$15,000 USD per year (for 2021) to all other recipients. Note – you and your spouse can pool this so that you can together gift up to \$30,000 USD per year; moreover, the exclusion is per person which means that you can give \$15,000 USD to your sister, another \$15,000 USD to your brother and so on in the same year. Whether you want to do so, however, is another matter. In addition, there is a lifetime gift tax exemption of \$11.7 million (USD) for U.S. citizens and residents (for 2021). This mirrors the exemption for US estate tax.

Summary

The above is meant as 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 you speak to your US 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 U.S. citizenship. But be warned that this process is not as simple as you 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 US. □