AMERICANS LIVING IN CANADA

SMILE, THE IRS IS WATCHING YOU

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A selection from certain chapters has been provided for preview to show you the style of the book and the type of information presented to readers.

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CHAPTER 1

US Citizenship

This book is intended to help Canadian residents who are also "US Persons" for the purposes of the Internal Revenue Code (IRC). It therefore makes sense to set out the rules on this basic point so readers can know how and whether all the issues addressed in this book affect them.

Many people are legitimately surprised to learn that they have US tax filing obligations. Maybe they moved to Canada as very young children; maybe they just worked in the US on a Green Card for a few years in their youth. Maybe they have never lived in the US at all, but their parents were from there. There are many ways in which the US tax rules can entangle unsuspecting Canadians. Let's look at the main ones.

Citizenship by Birth

The Fourteenth Amendment to the US Constitution guarantees that anyone born in the US gains citizenship automatically. This birthright was adopted in 1868 to grant citizenship to US-born former slaves after the American Civil War and has continued to have significance for millions of other "accidental Americans" ever since.

We have seen many cases over the years where the birthright to citizenship has caught people unaware. For example, a person from a rural Canadian town, whose mother had to cross the border to give birth because there was no Canadian hospital close enough to home is considered a US citizen with US tax filing obligations. In another case, a now-elderly client had moved to Canada with his parents when he was an infant. He never stopped to think that the US birthplace on his

Canadian passport could raise issues with the Internal Revenue Service (IRS) or Homeland Security.

However, the indisputable fact is that virtually every person alive today who was born in the US gained citizenship at birth. As such, unless some action has been taken to relinquish that status, those people remain US citizens whether or not they have ever lived there, applied for a social security number or passport, or filed tax returns.

Citizenship through Parentage

Some who were born in Canada may have inherited citizenship from American parents. However, these rules have changed quite a bit over the years, so determining whether a Canadian-born person is a US citizen depends on a combination of the following factors:

1. Whether one or both parents are US citizens;
2. Whether the parents were married;
3. The person's date of birth;
4. The length of time each of the US citizen parents lived in the US during their lives (there have been different rules for mothers and fathers); and
5. The length of time the person resided in the US after their birth in Canada.

There are many possible combinations of answers to these questions. Generally, if both of a person's parents are US citizens, that person will also be a US citizen *if at least one parent ever lived in the US at any time* prior to the person's birth.

If only one parent is a US citizen, US citizenship will be inherited if that US citizen parent lived in the US for a set period of time prior to the person's birth. The length of the parent's residency required to transmit US citizenship to a child depends on when the person was born. Since 1986, only five years of US residency have been required, two of which must have been after the parent was 14 years old. If the person was born prior to 1986, the US citizen parent must have lived in the US for at least ten years prior to the person's birth, and at least five of those years must have been after the parent was 14 years old.

There were periods when the rules depended on whether the parents were married or in the military. If in doubt, it is best to speak with a lawyer.

CHAPTER 6

FATCA – Not Just Another Layer of Paperwork

If the FBAR rules were not onerous enough already, Congress enacted the *Foreign Account Tax Compliance Act* (FATCA) in 2010 to enhance its oversight of US taxpayers with foreign accounts.

FATCA has two distinct components: a reporting obligation on US taxpayers that is somewhat similar to the FBAR rules and an obligation on Foreign Financial Institutions (FFIs) to enter into agreements with the Internal Revenue Service (IRS) to identify US account holders and disclose certain information. These rules are intended to combat offshore tax evasion.

US citizens living in Canada must file form 8938 as part of their US tax returns if the aggregate value of their specified foreign financial assets is greater than $200,000 on the last day of the year or greater than $300,000 at any time during the year.

The term "specified foreign assets" is broadly defined to include any financial account held with a FFI, as well as stocks or securities of non-US entities and interests in foreign entities (such as partnerships and trusts). Even financial instruments (including insurance) and contracts made with non-US persons are reportable under FATCA.

Filing Form 8938 & the FBAR form may be required.

It seems bizarre at first, but the FBAR and FATCA reporting obligations do not cancel each other out. Indeed, there is considerable overlap between these sets of reporting rules, and a given asset must often be reported on both an FBAR form and Form 8938.

The technical reason that these reporting regimes are not mutually exclusive is that they each have a statutory source in different parts of the US Code. The FBAR is authorized under the *Bank Secrecy Act*, while the FATCA is found in the Internal Revenue Code. That said, in practice, the IRS administers both regimes, and many critics have questioned whether the additional paperwork is likely to yield the intended benefits to the US government. Perhaps one day the two regimes will be combined to reduce the paperwork, but tax reform is a slow and unpredictable process in the US, so for now, both remain the law.

A more important aspect of the FATCA regime is likely the obligation imposed on FFIs. FATCA threatens to impose a 30% withholding tax on most US payments to FFIs unless they agree to identify to the IRS the names, addresses, taxpayer ID numbers, account numbers, account balances, and gross deposits and withdrawals on US taxpayer accounts. This is a lot of information that the FFI would be handing over to the IRS on your behalf.

On February 5, 2014, an intergovernmental agreement (IGA) between the governments of Canada and the US was announced, which relieves the Canadian banks from the threat of the FATCA withholding tax. The IGA requires that Canadian banks release the required information on US clients to the CRA (rather than the IRS). Then, consistent with the information sharing provisions of the Treaty, CRA will provide the information to the IRS, thereby avoiding the privacy issues under Canadian law (reassuring, isn't it?).

In the spirit of preventing international tax evasion, the IRS has agreed to provide similar types of information to CRA to ensure that Canadian taxpayers properly report and pay tax on US source income. This will have implications for all cross border investors.

Canadian Real Estate Investors

Canadians that purchased rental real estate after the US real estate bubble burst in 2008 would be wise to ensure their own accounting is up to date.

CHAPTER 15

Estate Tax – Calculating the Gross Estate

The starting point for calculating the US estate tax is to determine what is included in the decedent's "gross estate." The purpose here is to determine the total value of all the includible property.

Many assets are straightforward to appraise and to include in the gross estate. Real estate owned by the decedent, financial accounts and personal property are clearly includable. However, other assets that are not technically "owned" by the decedent may still be taxable in his or her estate, so a careful consideration of the rules is warranted.

s.2035 – Transfers made within Three Years of Death

Section 2035 operates to claw back into the gross estate any property that had been transferred within three years of death. This rule does not apply to sales at fair market value. For example, if a person made a gift of stock valued at $1 million to his or her children (perhaps as an estate tax prevention measure), but passed away two years later, that million, plus any gift tax paid on the transfer, would have to be declared as part of the gross estate of the decedent.

This section often causes problems when implementing life insurance trust structures (which will be discussed later).

Gift and Estate Tax Rates

Generally, since the gift and estate tax rates are now the same, there is little incentive to make gifts during life that would be taxable in any event. However, certain items without a cash value (such as term life insurance) can be gifted without tax, but are taxable in an estate (see below), creating incentives to transfer prior to death.

s.2036 – Transfers with a Retained Life Interest

Section 2036 is one of the most important rules to understand in order to prevent unexpected consequences in estate tax planning. Often, in an effort to exclude assets from one's estate, property will be transferred to another legal entity, such as a trust, partnership or corporation. Because these entities are legally separate from, and will survive the donor, the thought is that the assets will not form part of the donor's taxable estate on death.

However, in many cases, the donor may be unwilling to surrender control or use of the assets. This retained control is the undoing of such a plan, as it triggers the s.2036 retained interest rule and causes inclusion of the transferred assets in the estate of the deceased.

A common example can result from the transfer of real estate to a trust. If the original owner of the real estate was to be the trustee of the trust, or was permitted under the terms of the trust to use the property during his or her life, the property would be included.

This rule also may come into play for US citizens living in Canada who undertake a Canadian estate freeze. This topic is discussed in detail in Chapter 23. It can also be a factor in any estate plan that uses discretionary trusts.

s.2037 – Transfers Taking Effect at Death

Sometimes a question arises about whether an asset is includable in an estate even though the asset does not form part of the estate itself. For example, what if the designated beneficiary on a registered savings plan is automatically entitled to what is left in the account upon the death of the owner? It is not legally part of the estate. No estate administration is required by the executor, so it may be thought that these funds do not form part of the "gross estate" for estate tax purposes.

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David A. Altro is the managing partner at **Altro Levy llp,** which he founded in 1988 with offices in Montreal, Toronto, Calgary, Vancouver, Florida, Arizona and California. The industry leading law firm provides sophisticated cross border and domestic tax, estate planning and real estate legal services to high net worth individuals and corporations.

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Mr. Altro earned his civil law degree, LL.L., from the University of Montreal in 1979, graduating on the Dean's List. He earned his Juris Doctor for Nova Southeastern University in 1984. In 1989, Mr. Altro returned to the University of Montreal to complete his Notarial Post-Graduate Studies. He received his B.A. in Honors Political Science from Concordia University in 1976.

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Jonah Spiegelman is a cross border tax and estate-planning attorney and founder of **J. Spiegelman & Co**., His practice is focused on assisting high net worth individuals and businesses to understand the complex interactions between the Canadian and US tax regimes, and developing solutions that ensure efficiency and compliance on both sides of the border.

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Jonah is a frequent contributor to **J. Spiegelman & Co**., publications, and is regularly invited to speak on these topics at seminars, workshops and conferences. He has been interviewed by media outlets including The Vancouver Sun and Advisor's Edge Magazine to provide expert advice on planning for cross border issues. Jonah is a graduate of the University of British Columbia where he received his J.D. Jonah also received an M.A. from the University of British Columbia and a B.Sc. from the University of Oregon. He has been called to the British Columbia Bar and both the Alberta and California Bars. Jonah gained considerable experience in governmental policy and regulation as counsel with the Federal Department of Justice prior to founding **J. Spiegelman & Co**., Jonah was a partner at **Altro Levy LLP.,** where he focused on assisting high net worth individuals and businesses to understand the complex interactions between the Canadian and US tax regimes, and developing solutions that ensure efficiency and compliance on both sides of the border.

There are well over a million US citizens residing in Canada. Additionally, there are many Canadian citizens who were born in the US, or who have lived and worked there and later returned to Canada. Over the last few years the US government has stepped up its pursuit of Americans residing abroad who are not tax compliant. AMERICANS LIVING IN CANADA – SMILE, THE IRS IS WATCHING YOU, provides a detailed review of the tax compliance requirements, consequences and opportunities & pitfalls for US persons living in Canada.

AMERICANS LIVING IN CANADA – SMILE, THE IRS IS WATCHING YOU addresses many issues that may be affecting you or your clients. The book has four sections:

- Dual Status Taxpayers
- Income Tax Compliance
- Living and Dying with US Transfer Taxes
- Trust and Estate Planning for Americans in Canada

About the Authors

David A. Altro is the managing partner at ALTRO LEVY LLP, a multi-jurisdictional law firm with offices in Montreal, Toronto, Calgary, Vancouver, Fort Lauderdale/Hollywood, Sarasota, Naples, Phoenix and Palm Springs. He is also the author of the book *Owning US Property the Canadian Way, Third Edition.* David is a Florida Attorney, Quebec Notary and Canadian Legal Advisor who has been practicing law for over 30 years in Canada and the US and specializes in cross border tax, estate planning and real estate for high net worth individuals.

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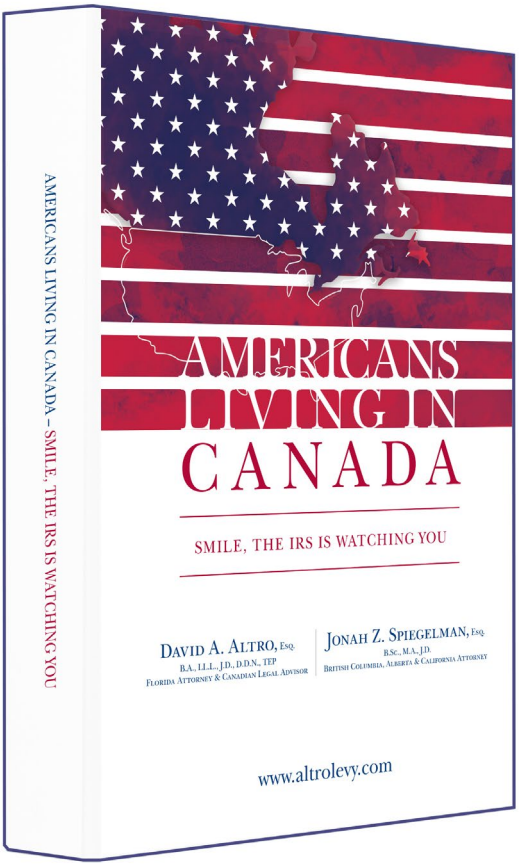

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