Taxation of Canadians in America

Faculty:
Dale Walters, CPA, PFS
David Levine, CPA (FL), CPA, CA (ON)
Art Werner J.D., M.S.

1717 Pennsylvania Avenue NW, Suite 1025
Washington, DC 20006 USA
Email: cpe@cpewarehouse.com

CPE Warehouse

David Levine, CPA (FL), CPA (ON)

David Levine is the Managing Partner of Cross Border Tax & Accounting LP, a tax firm that prepares U.S. and Canadian income tax returns for Canadians living, working or investing in the U.S. and Americans living, working or investing in Canada.

David Levine began working in the Accounting and Tax Services industry in 1980. He practiced as a Chartered Professional Accountant in Toronto, Canada for 20 years. He assisted his many clients with U.S. and Canadian cross-border tax concerns, before moving to Palm Beach County, Florida and experiencing first-hand the tax issues related to a move from Canada to the U.S.

David now specializes in international taxes to help clients get the best possible tax outcome. David is the co-author of the books *Taxation of Canadians in America: Are you at Risk?* and *Taxation of Americans in Canada: Are you at Risk?*

When he's not at work, David enjoys spending time with his family and traveling.

David can be reached at davidl@cbta.cpa or by calling his direct line at 561-257-0149.

Dale A. Walters, CPA, PFS

Dale is the Director of Canada-U.S. Tax Services at BeachFleischman, Arizona's largest locally owned CPA firm.

Dale is a licensed certified public accountant and has earned the personal financial specialist designation. Dale was one of the few people that earned the CERTIFIED FINANCIAL PLANNER™ designation in both the U.S. and Canada. Due to the fact he no longer provides financial planning services, Dale voluntarily relinquished his CFP® designations in 2022.

Dale has over forty years of experience in the financial industry and 28 years as a cross-border tax and planning specialist. He has been a frequent speaker on U.S.-Canada financial planning and tax related issues, and is the author of *Buying Real Estate in the US – The Concise Guide for Canadians* and is the co-author of *Taxation of Canadians in America: Are YOU at risk?* and *Taxation of Americans in Canada: Are YOU at risk?*

Having owned and run many businesses over many years, including KeatsConnelly, which was the largest Canada-U.S. wealth management firm in North America. Dale led KeatsConnelly to several significant awards including; Ethics, Volunteerism, Company Culture, Workplace Flexibility, being named Top CPA/financial planning firm in the U.S., all of which led to being named one of Arizona's Most Admired Companies in 2011, 2012 and 2013, as well as being named one of the "100 Top Arizona Businesses" in 2012. In 2016, Dale sold his shares of KeatsConnelly and shortly thereafter began working for BeachFleischman.

Dale is a former NCAA Division I collegiate wrestler, four-time World Heavyweight Karate Champion, fourth-degree black belt in Judo and a first-degree black belt in Krav Maga. Dale married Charlene, his college sweetheart, and they have been together for 46 years and married for 41 years. In their spare time, Dale and Charlene enjoy traveling the world.

Dale can be reached at dawalters@beachfleischman.com or by calling his direct line at 602-792-5961.

OBJECTIVES

- Discuss issues for U.S. nonresidents and commuters
- Identify issues that should be addressed before moving to the U.S.
- Recognize and make appropriate first-year income tax elections
- Overview of the Canadian Tax System
- Have a basic understanding of the Canada-U.S. Tax Treaty
- Understand how Canada taxes its nonresidents
- Have a basic understanding of Canadian Retirement Plans, Pensions and Social Security, and how these items should be reported for U.S. tax purposes
- Overview of non-resident and non-U.S. citizen estate tax
- Understand the issues of Green Card holders and U.S. citizens leaving the U.S., whether they keep or give up their status as Permanent Residents or Citizens
- Overview of the tax issues of Canadians owning U.S. real estate

Overview of the Canadian tax system

- **Part I Tax**
  - Residents of Canada (Individuals, Corporations and Trusts) file income tax returns and report "world" income
  - Nonresidents of Canada file income tax returns in Canada for Employment Income earned in Canada, Business income earned in Canada or the sale of Taxable Canadian Property (i.e., real estate in Canada)

Overview of the Canadian tax system

- **Part XIII Tax for Nonresidents**
  - Withholding on income paid to a nonresident, that is not employment income, business income or sale of Taxable Canadian Property
  - If proper withholding, as prescribed by Treaty, no income tax return is required
  - Default withholding tax rate is 25%, but may be modified by Treaty
  - Dividends and periodic pension payments require 15% withholding
  - Lump-sum pension payments (payments other than periodic) are at 25%
  - Canada Pension and Old Age Security are taxable only in country of residence
  - Arm's Length Interest Income has 0% withholding
  - Elective returns – §216 for income from a rental property in Canada; §216.1 for actors and entertainers; §217 return for reduction of withholding tax, but worldwide income needs to be very low

Overview of the Canadian tax system

- **Goods and Services Tax (GST)**
  - Sales taxes on goods and services
  - Federal GST tax is 5%
  - Harmonized Sales Tax (HST), is the GST, plus the provincial sales tax (PST)
  - Ontario and provinces east (except Quebec) have harmonized the provincial sales tax with the federal and charge the HST (for example Ontario HST is 13%, whereas Nova Scotia is 15%, Quebec is 5% GST and 9.975% TVQ)
  - Western provinces charge GST and their provincial sales tax (for example British Columbia charges 5% GST and 8% PST, and Alberta 5% GST and 0% PST)
  - When a seller remits GST/HST to Canada Revenue the amount remitted is the amount collected, less amounts of GST and PST paid out
  - GST/HST does not affect the income statement; registration required when taxable sales >$30,000
  - Exemptions for groceries, medical supplies and services, residential rents, sale of used homes

Clarifying Terms

- **Citizen** (Trivia – only the U.S. and Eritrea tax based on citizenship)
  - Birth
  - Naturalization
- From USCIS Website: "The U.S. does not formally recognize dual citizenship; however, it has not taken any stand against it, either legally or politically. Typically, no American will forfeit his or her citizenship, nor will the U.S. ask the person to give up citizenship of another country."
- **Alien**
  - Resident Alien – Green Card holders and non-citizens living in the U.S.
  - Nonresident Alien – Non-citizens not living in the U.S.

Green Card Issues

- The tax consequences of a green card are generally the same as citizenship, with some exceptions.
  - No unlimited marital deduction to a non-citizen spouse, however, the exemption is allowed. ($12,060,000 for 2022 and $12,920,000 for 2023)
  - Annual gifts to non-citizen spouse are limited to $164,000 per year for 2022 and $175,000 for 2023
  - If a **green card holder** for less than 8 out of last 15 years, then no expatriation tax. **Note** that year 1 could be as little as 31 days (per the substantial presence test discussed later), and year 8 could be as little as 1 day.

- If a green card holder for more than 8 out of last 15 years, the taxpayer is considered a "long-term resident"
- Long-term residents MUST expatriate to give up the green card and will be subject to the expatriation tax
- Expatriation tax is a tax on all previously untaxed income
- Form 8854, with a $767,000 exclusion
- Leaving the U.S. will not change their tax status. The green card must be surrendered using USCIS form I-407 – Abandonment of Lawful Permanent Resident Status.
- Immigration status will change if out of the country for more than six months

U.S. Nonresidents

- The first step is to determine residency/non-residency
- If you are not a U.S. citizen, you are considered a nonresident for tax purposes, unless you meet one of two tests:
  - Green Card Test
  - Substantial Presence Test
- A Green Card holder is officially called a Lawful Permanent Resident
  - Residency starts on the first day the person is physically present in the U.S. after having been granted the Green Card
  - Residency continues until formally surrendering the Green Card using USCIS form I-407

Substantial Presence Test

- You must be physically present in the U.S. at least:
- 31 days during the current tax year, **and**
- 183 days during the 3-year period that includes the current tax year and the two years immediately before, by counting:
  - All the days you were present in the current year, and
  - 1/3 of the days you were present in the 1st year before the current year, and
  - 1/6 of the days you were present in the 2nd year before the current year

Substantial Presence Test Examples

- 120 days every year for the past three years
  - Current tax year: 120 at 1 for 1 = 120
  - 1st proceeding year: 120 at 1 for 3 = 40
  - 2nd proceeding year: 120 at 1 for 6 = 20
  - Total days in the U.S. using the formula is 180 < 183 = Nonresident
- 122 days every year for the past three years
  - Current tax year: 122 at 1 for 1 = 122
  - 1st proceeding year: 122 at 1 for 3 = 41
  - 2nd proceeding year: 122 at 1 for 6 = 20
  - Total days in the U.S. using the formula is 183 ≥ 183 = Resident

Substantial Presence Exceptions

- Foreign government-related individuals
- Teachers or trainees under a J or Q visa
- Students under F, J, M or Q visas
- Professional athletes
- Individuals with medical conditions

Other Residency Comments

- Anyone physically present in the U.S. for 183+ days in any calendar year, is considered a resident and must file, unless they meet an exception
- Taxpayer may be able to argue, under the Treaty "Tie-breaker" rules, that they were not a resident of the U.S.
- Article IV of the U.S.-Canada Tax Treaty discusses residency and Paragraph 2 provides the "tie-breaker" rules
- Proceed through the questions until you have a clear answer. Once you have an answer, STOP, that is the person's residency
- **Must file Form 8833** – Treaty-Based Return Disclosure

Treaty Tie-breaker rules

If an individual is a resident of both Contracting States, their status shall be determined as follows:

(a) In which country is a permanent home available?

(b) In which country are the personal and economic relations closer (center of vital interests)?

(c) In which country is the habitual abode?

(d) In which country is the taxpayer a citizen?

(e) If the taxpayer is a citizen of both countries or of neither of them, competent authorities shall settle the question by mutual agreement

CANADIANS OWNING REAL ESTATE IN THE U.S.

Issues to consider

- How to own / take title to the property
- U.S. probate
- Potential U.S. nonresident estate tax
- Income taxes
- Other miscellaneous issues
- Canadian tax return filing

U.S. Probate

- Probate is the cost of settling the estate, such as attorney fees and court costs
- Only assets that pass via a will are subject to probate
- The cost can be as high as 4% in California
- Arizona and Florida do not regulate probate fees, but they must be "reasonable," typically 2% to 3%
- Arizona requires a <u>minimum</u> of 4 months to settle probate
- Florida – 5 to 6 months would be reasonable

U.S. Probate can be avoided

- Owning so that the property automatically passes to the other owner

  Examples: Joint Tenants with Rights of Survivorship

  Community Property with Rights of Survivorship

- Using a "will substitute"

  Example: Transfer on Death (aka, beneficiary deed)

  TOD for Real Property, Vehicles and Securities

  POD for Bank or Credit Union accounts

- Owning property in a trust so that the property passes via the terms of the trust

  Example: A Cross Border Trust

States that allow TOD / Beneficiary Deeds

Alaska	Indiana	Nevada	Utah
Arizona	Kansas	New Mexico	Virginia
Arkansas	Maine	North Dakota	Washington
California	Minnesota	Ohio	West Virginia
Colorado	Mississippi	Oklahoma	Wisconsin
District of Columbia	Missouri	Oregon	Wyoming
Hawaii	Montana	South Dakota	
Illinois	Nebraska	Texas	

Nonresident U.S. Estate Tax

General Rules

- $60,000 exemption for nonresident aliens, per person
- Unlimited marital deduction is not allowed for non-citizens
- U.S. taxable estate is net of U.S. debt ONLY if the debt is non-recourse

Canada-U.S. Tax Treaty

- Allows for pro-rata estate tax exemption
- Equal to the Applicable Exclusion Amount ($12,060,00 in 2022 and $12,920,000 for 2023), multiplied by the fraction of U.S. to worldwide assets, but not to exceed the amount of U.S. tax
- Taxpayer must report worldwide assets
- If married, the spouse gets double the exclusion amount in lieu of the marital deduction

Marital Credit (doubling of exemption) rules

Must meet all the rules

- Qualifying property passes to surviving "spouse," as defined by U.S. law, i.e., common law spouse does not count
- Decedent must have been a resident of Canada, or the U.S. or a citizen of the U.S.
- Survivor must have been a resident of Canada or the U.S.
- If both were U.S. residents at the date of death, the one must be a Canadian citizen
- Irrevocably waive rights to marital deduction

Ownership of U.S. Real Estate

There are several ways for Canadians to own U.S. real estate

- U.S. LLC
- U.S. LLP and LLLP
- U.S. Corporation
- U.S. Partnership
- Canadian Corporation
- Canadian Partnership
- Cross-border Trust
- Individually

There are 5 factors/goals to consider when choosing the proper entity

- Income Taxes
- Estate Taxes
- Probate Fees
- Asset Protection
- Costs/Simplicity

Seldom, can you achieve every goal

Hybrid Entities

- LLC, LLP and LLLP are all taxed as corporations in Canada
- No tax in Canada until money is repatriated. The repatriated money is considered a dividend in the year paid/received in Canada.
- These hybrid entities will be taxed as flow-throughs (unless the LLC elections to be taxed as a corporation) and taxed on a current basis
- This timing difference will result in double tax
- **Do not use any of these entities**

Partnerships

- Potentially a good choice
- Issues are
  - 30% nonresident withholding (Branch Profits Tax) when money is repatriated
  - If held in a Canadian partnership, it is unclear whether the U.S. assets would be subject to nonresident estate tax (unlike a Canadian corporation)
  - Only one partner of a death of one, when two partners
  - Two-tiered partnership may avoid estate tax
  - Two-tiered partnership the most expensive
- No double tax

Corporations

- Potentially a good choice
- Issues are
  - Double tax
  - Flat tax – no benefit for capital gains
- Benefits are
  - Canadian corporation will avoid U.S. nonresident estate tax
  - In a parent-sub situation, the dividend to the parent is subject to a 5% withholding tax
  - Less expensive than the two-tiered partnership structure

Other issues

- Depreciation differences
- Net income election can be made on the first return or by using IRS form W-8ECI - Certificate of Foreign Person's Claim That Income Is Effectively Connected With the Conduct of a Trade or Business in the United States
- Form 1040NR is due June 15
- Canadians do not have the option to defer gain, via something like §1031
- Installment sales in Canada are limited to five years
- Department of Commerce filing requirements

Canadian tax return filing for rental of U.S. property

- Canadian tax return is due April 30 – no extensions allowed in Canada unless the taxpayer or partner is self-employed in which case the due date is June 15
- Difference in U.S. depreciation vs Canadian depreciation for income tax purposes which is called Capital Cost Allowance and is set for buildings, houses, condos based on a 4% declining balance
- Income tax paid to the U.S. becomes a foreign tax credit on the Canadian return
- Canadians must report on form T1135, Foreign Income Verification Statement their cost of the foreign rental property and gross rentals per year in addition to reporting the income in the tax return (similar to U.S. form 8938)
- Rental income and expenses reported on 1040NR would need to be converted to Canadian currency using the average exchange rate for the year as set by the Bank of Canada

Canadian tax filing for rental of Canadian Property by a Nonresident

- Withholding tax of 25% on gross rents-no further tax return required, OR
- File a “Section 216 return” – Per Section 216 of the Canadian ITA
- Requires a Canadian resident to act as agent and remit 25% of net rents, instead of gross rents
- Requires filing form NR6 in advance of first rental payment to report the estimated net rental income for year and report the Canadian resident agent – approved by Canada Revenue Agency (CRA)
- Section 216 return due June 30; if not filed by June 30, all expenses disallowed

Sale of Canadian Property by a Nonresident

- Requires a Request for a Certificate of Compliance by CRA
- Request is done using form T2062 and must be filed within 10 days of closing. It provides an estimate of the capital gain.
- CRA takes on average 4-6 months to approve a Certificate of Compliance
- If the property closes prior to receiving the Certificate of compliance, the attorney needs to withhold 25% of the selling price and retain in Trust account
- Canada Revenue will contact the attorney once they have completed their due diligence on the T2062 and will request 25% of the estimated gain
- Once Canada Revenue has received the funds, they will issue the Certificate and the attorney can refund to the client the balance in their Trust account
- Must file a nonresident tax return to report the sale and claim costs of disposition (i.e., Real Estate commissions, legal fees)

Department of Commerce

- The required forms are survey forms to determine foreign investment into the U.S.
- Penalty for not filing is $10,000 per property
- When a “Foreign Person” invests in a business enterprise (which includes rental operations) there are Department of Commerce forms that must be filed
- What needs to be completed is determined mainly by the value of the assets or the income of the business
- In the case of land, the number of acres is a determining factor

Department of Commerce

A "Foreign Person" is defined as anyone that is a resident outside the U.S. and is subject to the jurisdiction of another country

U.S. citizens and Green Card holders will have to complete these forms if they reside outside of the U.S.

NOTE that personal use real estate does not need to be reported

Department of Commerce Forms

BE-605

series is completed quarterly to report transactions with the foreign parent (when ***foreign entity*** such as a Canadian corporation is the buyer).

BE-15

series are to report annually the overall operations (when ***individual*** buys).

Canadian residents renting U.S. Real Property

- Default withholding of 30% of gross rents
- Can elect to treat the rental income as Effectively Connected Income by completing form W-8ECI and providing it to the withholding agent (i.e., property rental company or tenant)
- By providing the W-8ECI, the withholding agent does not have to withhold 30%; the foreign person would have to file 1040NR to report the rental income and expenses
- The foreign person would need an ITIN in order to complete the W-ECI
- The ITIN can be obtained in advance for completion of the W-8ECI as it meets one of the exceptions to obtain an ITIN in advance of filing a tax return

Canadian residents Sale of U.S. Real Property

- FIRPTA withholding on sale U.S. Real Property Interests by foreign sellers
- If the sale price is ≤ $300,000 and the buyer plans to use the property as a personal residence, then 0% withholding (Buyer must sign a Declaration of Intent to reside) otherwise the withholding is 15%
- If the sale price is $300,001 - $1,000,000 the withholding is 10% if the Buyer signs a Declaration of Intent to reside, otherwise the withholding is 15%
- Sale price more then $1,000,000, then 15% withholding
- Sale is also reported to Canada and is allowed a foreign tax credit for taxes paid to the U.S.

Canadian residents Sale of U.S. Real Property

- The purchaser is the withholding agent and must submit the withholding along with forms 8288 and 8288-A within 20 days of closing to the FIRPTA unit at the Ogden, UT tax center. IRS will stamp 8288-A and return to foreign seller to file with their tax return.
- There is a procedure for reduced withholding by filing 8288-B prior to closing – the IRS takes a long time, and the withholding remains in Trust
- Form 1040NR and applicable state return is required to be filed and must include IRS stamped copy of 8288-A

Commuters

- Commuters are people that commute to the U.S. for regular or seasonal work
- Only available to residents of Canada and Mexico
- USCIS will issue commuters a Permanent Resident Card
- Not subject to the residency rules

Students

- Per the Tax Treaty, students are treated as residents in their country of origin
- F-1 or J-1 are typical student visas - status changes when visa changes
- A student working in the U.S. will need to file a 1040NR return for any employment income in the U.S. and will also have to report this income in Canada and claim any tax paid in the U.S. as a foreign tax credit in Canada
- Canadian students should provide to the registrar of their U.S school, Canada Revenue form TL11A, for completion to claim tuition as a Canadian deduction, which can be for the current year or carried forward
- Canadian students employed in the U.S. should have no FICA deductions

Before leaving Canada

Two main themes:

- Prepare for Canadian Exit Tax*
- Prepare for U.S. Tax*

*Unless otherwise noted, we assume taxpayers are not U.S. citizens or Green Card holders.

Prepare for Canadian Exit Tax

- Canadian tax system is based on residency; part year return in year of exit
- Exit tax, specialized returns for nonresidents, e.g., Section 216, 216.1 and 217
- When a taxpayer ceases to be a Canadian resident, Canada imposes a tax on previously untaxed capital gain income, imposed on their final income tax return
- Limited exceptions:
  - Canadian Real Property
  - Canadian Registered (Qualified) Assets
  - 60-month rule
- The goal of planning is to reduce the Canadian gain, for tax purposes

Prepare for U.S. Tax

- Consider eliminating assets that require onerous U.S. reporting, with no benefit. Examples include Tax-Free Savings Accounts (TFSA), PFICs and Registered Education Savings Plan (RESP)
- Consider combining accounts to reduce FBAR and FATCA reporting
- Consider entity reorganization
- Consider estate reducing strategies to avoid U.S. estate and gift tax
- Consider equalizing estate
- Determine FMV of assets on last day of Canadian residency

First Year in the U.S.

- Default filing status is “Dual Status”
  - Couples must file as MFS
- Consider First Year Residency Elections
  - §6013(g) – election to treat NRA spouse as a resident
  - §6013(h) – election to file jointly
  - §7701(b)(4) - election for an NRA that becomes a resident of the U.S. after the middle of the year (<183 days), and does not hold a green card
- Step-up Basis of assets for U.S. tax purposes, per Article XII, paragraph 7 of the Canada-US Tax Treaty

The Treaty

- Treaties can be used to improve the taxpayer's situation, but not to their detriment
- Permanent Establishment
- Withholding Rates
  - Interest – 0% if arm's length interest rate
  - Dividends – 5% or 15%
  - Pensions – 15% for periodic, and statutory rate for lump-sum payments
- Capital Gain – Taxable only in country of residence
- Social Security – Taxable only in the country of residence and taxed exactly like U.S. Social Security
- Savings Clause – Article XXIX

Canadian Registered Plans

- Canadian Registered Plans are similar to Qualified Plans in the U.S.
- Some common retirement plan types:
  - Registered Retirement Savings Plan (RRSP)
  - Registered Retirement Income Fund (RRIF)
  - Locked-In Retirement Account (LIRA)
- Think of an RRSP as an IRA in accumulation phase and an RRIF as an IRA in required minimum distribution phase
- LIRA is an RRSP that generally cannot be withdrawn until age 55
- The rules for Canadian nonresidents differ from those of residents

Canadian Registered Plans Continued

- As nonresidents, there are no penalties for early withdrawal of funds from an RRSP or RRIF
- Withdrawals are subject to Canadian withholding tax of 15% for periodic withdrawals or 25% for lump-sum withdrawals
- All withdrawals from an RRSP are considered lump-sum withdrawals
- Withdrawals from an RRIF can be either periodic or a lump-sum
- A periodic withdrawal is defined as, the greater of twice the required minimum distribution or 10 percent of the fair market value of the RRIF at the beginning of the year

Canadian Registered Plans Continued

- Plans have basis from a U.S. perspective
  - For taxpayers that were not U.S. citizens during the contribution phase, the U.S. basis equals FMV, less unrealized appreciation, on date the person became a U.S. taxpayer
  - For taxpayers that were U.S. citizens during the contribution phase, the U.S. equals the value of the total taxpayer contributions
- Taxed according to IRC §72
- Mutual Funds and ETFs held in a Canadian Registered Plan are exempt from Personal Foreign Investment Company (PFIC) reporting

Canadian Registered Plans Continued

- Plans must be reported under FBAR (form 114) and FATCA (form 8938) rules, but there they are not considered foreign trusts and are not required to file form 3520-A
- RRSP/RRIF income is deferred on a federal level per the Treaty, but it may be taxable in some states – Currently, only California does not allow deferral
- Rev. Proc. 2020-17 exempts RESPs from foreign trust reporting, but not TFSAs
  - Registered Education Savings Plans (RESP) – Similar to 529 Plans
  - Tax Free Savings Account (TFSA) – Similar to Roth IRAs

Pensions

- For Treaty purposes, think of pensions as only defined benefit plans
- Typically, defined contribution plans would be registered type plans like RRSPs
- Pensions have 15% nonresident withholding applied
- All Canadian nonresident withholding is the final tax. A tax return is not required, but in some very limited circumstances it might make sense to file.

Social Security

- Canada's version of Social Security is provided in two parts:
  - Canada Pension Plan (CPP), or Quebec Pension Plan (QPP), and
  - Old Age Security (OAS)
- CPP/QPP are similar to Social Security. OAS is a payment based on residency (no work required).
- Per the Treaty, CPP, QPP and OAS is be taxed exactly like U.S. Social Security – Enter it as you would Social Security
- In states that follow the Fed and do not tax Social Security, CPP (QPP) and OAS will also be state tax free
- When a Treaty benefit is taken, it must be disclosed on Form 8833

Social Security

- In addition to a Tax Treaty, there is a Treaty on Social Security, aka Totalization Agreement. Key items are:
  - **Certificate of Coverage** – serves as proof of exemption from Social Security taxes on the same earnings in the other country. A Canadian on a 2-year assignment to their U.S. division may not want to pay U.S. Social Security for two years.
  - **Windfall Elimination Provision (WEP)** – Designed for taxpayers that participate in more than one social security system, to prevent them from double dipping.

U.S. Estate and Gift Tax

Treaty Article XXIXB – Taxes Imposed by Reason of Death

Paragraph 2. A non-U.S. citizen who was a resident of Canada at the time of the individual's death shall be allowed a unified credit equal to **the greater of $60,000 or**

$$\frac{U.S. assets}{World\ assets}\ X\ Unified\ Credit$$

The credit is reduced for previously allowed credits (for gifts)

The credit is only allowed only if all information necessary for the verification and computation of the credit is provided, i.e., taxpayer reports worldwide assets

Because Canada does not have an estate tax, there is not a separate Estate Tax Treaty, like many other countries. Canada’s death tax is a final income tax imposed on all previously untaxed income.

- Residents of the U.S. are allowed the full unified credit of $12,060,000 for 2022 and $12,920,000 for 2023
- The unlimited marital deduction is limited to transfers to U.S. citizen spouses
- To defer the estate tax a Qualified Domestic Trust (QDOT) can be established
- Lifetime transfers to non-citizen spouses are limited to $164,000 per year for 2022 and $175,000 for 2023
- Be careful of unintended gifts
    - An example is cashing out an RRSP and placing the proceeds into a jointly owned home or bank account*

*A gift occurs on formation when purchasing a home, but as money is used in a joint bank account.

- Qualified Domestic Trust (QDOT)
- Touted as allowing the unlimited marital deduction for non-U.S. citizen, however the QDOT is only deferral mechanism
- The non-citizen spouse must pay estate tax when
  - Receiving corpus
  - At death
- The ultimate estate tax is based on the laws at the date of death

To legally be a QDOT, a trust must be a U.S. trust that meets the following requirements:

- It must be structured as a power of appointment trust, a qualified terminable interest property trust, a qualified charitable remainder trust, or an estate trust. This rule does not apply if the surviving spouse irrevocably assigns the property to a QDOT in a timely manner and, under such a trust, the surviving spouse need not even be a beneficiary of the QDOT;
- Require at least one trustee to be a U.S. citizen, or a U.S. corporation;
- Allow the trustee the right to withhold any distributions from the trust, except distributions of income; and
- One of the trustees must be a U.S. bank if the property transferred to the QDOT exceeds $2 million (ignoring any indebtedness on the property). If the trustee is not a bank, then the trustee must post a bond with the IRS equal to 65% of the fair market value of the property transferred to the trust, or the trustee must furnish the IRS with a letter of credit of 65% of the fair market value of the property transferred to the trust. If the property transferred to the QDOT is less than $2 million, then no more than 35% of the trust property (determined annually on the last day of the trust's tax year) can consist of foreign real property. If it does, then the rules applying to a QDOT greater than $2 million will apply.
- The executor of the deceased spouse must make a timely QDOT election on the estate tax return for the decedent.

Leaving the U.S.

- IRC Sec. 877 provides that an expatriation tax applies to U.S. citizens that have renounced their citizenship and long-term residents who have ended their residency if one of the principal purposes is tax avoidance.
- Long-term residents are defined as a lawful permanent resident (Green Card holder) of the US for at least 8 of the last 15 years prior to expatriation
- Tax avoidance is assumed if:

1. Average net income tax for the last five years is more than $178,000 (for 2022 and $190,000 for 2023), **or**
2. Net worth on the date of expatriation is $2,000,000 (not indexed) or more

- Relinquishment of citizenship or termination of green card status will not be effective until such person:
  1. Gives notice to the Secretary of State of Homeland Security, and
  2. Provides a statement in accordance with section 6039G (Form 8854)
- The expatriate tax is a tax on all previously untaxed income, less an exemption of $767,000 for 2022 and $821,000 for 2023

In addition to the tax, citizens that give up their citizenship may be concerned with the Reed Amendment. This is an amendment to The Illegal Immigration Reform and Immigrant Responsibility Act of 1996. 8 U.S.C. §1182(a)(10)(E) reads as follows: "Former citizens who renounced citizenship to avoid taxation. Any alien who is a former citizen of the US who officially renounces US citizenship and who is determined by the Attorney General to have renounced US citizenship for the purpose of avoiding taxation by the US is inadmissible."

If imposed, the Reed Amendment would prohibit the former citizen from ever entering the country again. This could be of significant concern if the taxpayer still had family living in the US. To date the Reed Amendment has never been imposed.

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CPE Warehouse

1717 Pennsylvania Avenue NW Suite 1025,
Washington, DC 20006 USA

cpe@cpewarehouse.com