Tax and Estate Planning Issues for Canadian Citizens and Residents residing in the U.S. and Dual U.S.- Canadian Citizens

This outline was prepared in advance of the workshop Ms. Yegorova gave on September 23, 2009 to a community of Canadians residing in Portland, Oregon as part of the series of Maple Leaf Forums organized by the Canada America Society of Oregon.

The following material is presented for discussion purposes only, and is not intended, nor may it be used, as definitive advice for any specific situation.

In accordance with Treasury Regulations Circular 230, we inform you that any tax advice contained in this communication was not intended or written to be used, and cannot be used, for the purpose of (i) avoiding tax-related penalties under the Internal Revenue Code or (ii) promoting, marketing or recommending to another party any tax-related matter addressed herein.

I. Background:
   a. U.S. taxes U.S. citizens and residents on worldwide income;
   b. Canada taxes Canadian residents on worldwide income; and
   c. Potential double taxation is ameliorated (to a certain degree) through foreign tax credit system and/or bilateral tax treaties.

II. Real Property Acquisition/ Disposition
   a. In considering acquisition of real property in Canada or United States, several factors should be considered:
      i. Whether you prefer to receive income on a regular basis or want income to accumulate;
      ii. What are the income tax considerations in your country of residence?
      iii. Are there any tax treaty provisions affecting the decision?
   b. Canada:
      i. Canadian taxpayer is exempt from any tax on any gain realized on the disposition of the taxpayer’s principal residence, but not on any other residences that the
taxpayer may own; and
ii. A U.S. resident (non-Canadian resident) who owns
Canadian real estate is liable for Canadian tax at the
rate of 25% of gross rental income. In the alternative,
an election may be made to pay tax at normal Canadian
tax rates on their net income from real estate in Canada.
Upon the sale of the Canadian real property, the U.S.
resident will be subject to Canadian tax at a normal
rate.

c. United States:
i. If a Canadian citizen (non-U.S. resident) purchases a
second home in the U.S., it will be subject to U.S. estate
tax. Planning possibilities may exist if the home is
instead purchased by a foreign corporation owned by a
nonresident alien.
ii. U.S. taxpayer is entitled to a $250,000 ($500,000
for married couples) exclusion from gain on the
disposition of the primary residence.

III. Estate Planning Issues
a. Should you have a situs will? (i.e., separate will for your
foreign property)
i. When multiple wills make sense;
ii. When one will makes sense;
b. Should you have a revocable trust?
i. Transfer of Canadian property into a revocable trust
may be deemed disposition of the property for income
tax purposes.
c. Is your U.S. will valid in Canada (and vice versa)?
i. Yes, if the executed will is an “international will.” For
requirements of an international will, see Appendix B.

IV. U.S. and Canadian Gift Tax Issues
a. United States:
i. A U.S. resident is entitled to an unlimited marital
deduction for transfers of property to his or her spouse,
provided the spouse is a U.S. citizen. If the spouse
is not a citizen, the gifts to the spouse during life are
eligible for a special spousal annual exclusion ($120,000
in 2006), but otherwise, are not deductible; and
b. Canada:
i. If Taxpayer A gifts the property to Taxpayer B,
Taxpayer A is deemed to have received proceeds of
disposition equal to the then-fair market value of the
property. Receipt of the gift by Taxpayer B is not
taxable but the cost of the property is deemed to be its
FMV at the time it was acquired. As a result, taxpayer
will be liable for tax on the capital gain arising of any
subsequent disposition of the property for proceeds
greater than the deemed cost; and
ii. Tax free rollovers during life to the spouse, common law partner, or a trust for the benefit of the trust or the common law partner are allowed. For transfers during life, both spouses must be residents of Canada.

V. Taxes on Death  
   a. United States:
      i. U.S. citizen’s or domiciliary’s
d world wide estate is subject to U.S. estate tax. If the estate includes property located in a foreign country, the decedent’s estate tax return will include that property;
      ii. U.S. taxes non-domiciliaries on real property located in the U.S., stocks and bonds issued by a U.S. corporation, and funds in bank accounts located in the United States; and
      iii. Federal threshold for estate tax- $2 million (2008) & $3.5 million (2009). State threshold for estate tax may be less than federal (e.g., Oregon).
   b. Canada:
      i. Deems the death of a person to be a disposition of appreciated property for income tax purposes. The person inheriting the property is deemed to acquire it at its FMV;
      ii. A Canadian resident will be entitled to a foreign tax credit for estate taxes paid in U.S.;
      iii. Tax-free rollover of property (no capital gains on the disposition) upon death is allowed for transfers to a spouse, common law partner, or a trust for the benefit of the spouse or a common law partner. To qualify:
         1. The taxpayer must reside in Canada immediately before his or her death;
         2. If the property is transferred to a trust, the trust must be created by the transferor’s will;
         3. It must be possible to establish, within 36 months after the death of the taxpayer that the property has become vested in the spouse; and
         4. The spouse must be resident in Canada immediately before the death. For a trust created for a spouse or common law partner, the trust must be resident in Canada immediately after the property vested in it.

VI. Registered Pension Plans  
   a. Four most common types of registered Canadian retirement plans:
      i. Defined Benefit Pension Plans;
      ii. Defined Contribution Registered Pension Plans;
      iii. Registered Retirement Savings Plans; and
      iv. Deferred Profit Sharing Plans.
   b. With all four plans, employer and employee contributions are deductible and investment earnings inside the plans are not taxed.

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1 Domiciliary is defined as the person who moved to the United States with no intention to leave.
c. Registered Pensions (Registered Retirement Savings Plans (RRSP) and Registered Retirement Income Funds (RRIF):

   i. As a general matter, in considering registered pension plans in the U.S. and Canada, pensions that are tax-free in one country will be tax-free in the other country;

   ii. Citizen/resident of one country with interest in a retirement trust in another country may elect to defer tax on investment returns until distributed. (Treaty, Article XVIII, Par. 7). (Sample of an election to defer that should be attached to the taxpayer’s tax return for the year is included as Appendix A of this outline);

   iii. If the election is not made, the RRSP income is currently taxable to the citizen because RRSP does not qualify for any special tax deferral in the United States. 


iv. Contributions:

   1. Currently, contributions made to a plan in home country are not deductible in the host country;

   2. The Fifth Protocol to the Tax Treaty will change that rule to provide that for individuals on an international assignment not exceeding 60 months, the individual will be able to deduct for purposes of calculating their host country income tax, contributions to their home country’s qualifying retirement plans;

      a. In Canada, the amount of contributions to U.S. qualifying retirement plans allowed as a deduction cannot exceed the individual’s deduction limit for contributions to the RRSP after taking into account contributions already made to the plan; and

      b. In U.S., the amount of contributions to Canadian qualifying retirement plans otherwise allowed as a deduction cannot exceed the deduction allowable for a generally corresponding pension or retirement plan in the U.S.

v. Distributions:

   1. Both U.S. and Canada may tax: for a U.S. resident/citizen receiving benefits from an RRSP, the benefits may be taxed in the U.S. unless the amount would be excluded from taxable income in Canada if it were paid to Canadian resident.

   2. Residence country (US) taxes under its domestic law (but a foreign tax credit paid in Canada may be used to offset this tax);

   3. Source country (Canada) taxes, rate is limited to 15% in case of periodic distributions. Treaty,
Article XVIII, Par. 2a.; and
4. Where Canada is a residence country, U.S. may tax its citizens and green card holders fully without regard to the Treaty (Art. XXIX(2)).

vi. Rollovers between U.S. and Canadian plans: not possible on a pre-tax basis. But, a beneficiary of an RRSP may roll over the entire amount into a RRIF, and the roll-over will be tax-free for U.S. tax purposes.

VII. Totalization Agreements for Social Security/Canada Pension Plan

a. Purpose for totalization agreements is to preclude double coverage and double taxation under the social security systems and to provide benefits to the employees for periods of service that would normally be insufficient to secure any retirement benefits for the employees incurring the payroll tax liability;

b. If employment in the U.S. is under five years, the taxpayer can continue being covered by the Canadian system, and not have to contribute to the social security system in the United States;

c. U.S. worker employed in Canada will be covered by U.S. Social Security only if the employer is a U.S. company or a foreign affiliate of a U.S. employer;

d. Canadian worker employed in U.S. will be covered by Canada Pension Plan only if the employer is a Canadian company or a foreign affiliate of the Canadian company;

e. To be exempt from coverage, employer will obtain a certificate of coverage from the country that will continue to cover the employee. The certificate needs to remain on file with the employer. If the individual is self-employed, the individual will obtain the certificate and attach a copy of the certificate to his or her tax return for each year as proof of exemption; and

f. Taxation of Social Security Benefits:
   i. Both countries agree not to tax social security benefits they pay to residents of the other country, subject to the following:
      1. State of residence must exempt from taxation one half of the total amount of benefits paid.
      2. Benefits under the U.S. Social Security system paid to a resident of Canada shall be taxable in Canada as though it were a benefit under the CPP, except that 15% of the amount of benefit shall be exempt.
      3. The United States exempts only those Canadian residents who are not United States citizens; United States citizens will continue to be taxable to the extent provided under United States law.

VIII. Reporting compliance in the United States

a. FBAR
   i. U.S. taxpayer (resident or citizen) must report financial accounts in a foreign country in which she has an
interest or over which she has signatory authority
on Form TD 90.22-1 if the value of the assets in the
financial account exceeds $10,000;

ii. Definition of a financial account is broad, and includes
bank, securities, and any other financial instruments
accounts; and

iii. Failure to file Form 90.22-1 may result in penalties of
up to $250,000, and/or imprisonment up to five years.

b. **Beneficiaries of Foreign Trusts**
   i. If you are a beneficiary of a foreign trust, and you
   receive a distribution, you must file Form 3520; and

   ii. If you receive an excess of $100,000 in cumulative gifts
   from various foreign persons during the year, you need
to disclose it on Form 3520.

c. **Controlling interest in a Foreign Corporation**
   i. U.S. persons must report to the IRS control of (more
   than 50%), transfers of property to, and transfers
   of ownership interests in foreign corporations and
   partnerships.

IX. **Treaty Update:** The Fifth Protocol to the U.S.-Canada Tax Treaty,
once ratified by the U.S. Senate, will affect cross-border business
transactions. Here are some of the highlights pertaining to
individuals:

a. Withholding tax on interest paid between Canadian and U.S.
   residents that are not related is eliminated. Withholding tax
   on interest paid between related persons is reduced to 7% (first
   year), 4% (second year), and subsequently eliminated;

b. U.S. resident members of LLCs may now claim benefits of the
   Treaty. CRA will now look through the entity to the persons
   who are members of the entity (LLC) to determine if they
   qualify for Treaty benefits; and

c. Protocol addresses the treatment of contributions in qualifying
   retirement plans. In short term (up to five years) cross-
   border employment situations, individuals may deduct, for
   host country tax purposes, the contributions they make to a
   qualifying retirement plan of a home country.

X. **Some Planning Techniques**

a. Because of the potential inadvertent gifts on the withdrawal
   of funds from a joint account between spouses where one of
   the spouses is not a U.S. citizen, it may be desirable to have
   separate bank accounts;

b. Surviving spouse will be treated as a U.S. citizen at the date
   of the decedent’s death if the surviving spouse becomes a
   U.S. citizen before the date the U.S. estate tax return is filed.
   Otherwise, a QDOT election needs to be made on the estate tax
   return; and

c. Because stock of a foreign corporation is not subject to
   U.S. estate tax, holding U.S. situs assets through a foreign
corporation is a tax planning opportunity.
Appendix A-
Sample Attachment to US Tax Return Claiming Tax Relief under the Treaty

I, ___________[ name, Social Security number], in accordance with Revenue Procedure 2002-23, hereby claim the benefit of Article XVIII(7) of the U.S.-Canada Income Tax Convention with respect to the pension, retirement or employee benefit plan identified below for ___________[year].

Name of plan trustee:

Plan account number:

Plan balance at beginning of ___________[ year]

____________________[ Signature]

Appendix B
Requirements of an International Will

An international will must meet the following requirements:

1. The will must be in writing (whether typed or handwritten), and in any language;
2. The testator must sign and acknowledge the will in the presence of two witnesses and a person “authorized to act in connection with an international will” (usually a lawyer) that the will is the testator’s will and that he or she knows the contents of the will;
3. Witnesses and the authorized person must sign the will in the presence of the testator;
4. All signatures must be at the end of the will; each page must be signed by testator and each page must be numbered;
5. Will must be dated at the end of the document by an authorized person; and
6. Authorized person (in the U.S., attorneys) must attach a certificate to the will that provides that the procedures for the execution of an international will have been complied with.