Collins Barrow

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US TAX ALERT

INCOME TAX CONSIDERATIONS WHEN MOVING TO THE UNITED STATES

Jason J. Melo, CPA, CA, CFP, CPA (licensed in Illinois, USA), is a tax partner in the Leamington office of Collins Barrow

From time to time, many Canadians find themselves considering a permanent move to the United States. Whether it is a business executive seizing an extraordinary career opportunity or a retired entrepreneur simply in search of warmer climates, it is important to understand the tax implications that may result.

Residence

The determination of an individual's residence is a critical step for both Canadian and U.S. tax purposes with many factors to consider. The term "residence" is not defined in the Canadian *Income Tax Act* so the analysis typically requires reviewing jurisprudence, tax treaties and various interpretations provided by the Canada Revenue Agency (CRA). Generally, residence is determined on the basis of primary ties in Canada, including the location of a permanent home and the location of a spouse and other family members. Secondary ties will also be considered, including the extent of personal property (e.g., furniture, automobiles, etc.) located in Canada and social and economic interests remaining in Canada. Form NR73 – Determination of Residency Status (Leaving Canada) can be used as a guide in this regard.

Though a comprehensive residency analysis is beyond the scope of this article, it is important to understand that the determination of an individual's country of residence for tax purposes has significant tax consequences and ultimately determines the nature and extent of the tax burden the individual will have in each country.

The discussions below assume that an individual has ceased to be a resident of Canada and has permanently established residence in the U.S.

Canadian deemed disposition on departure

An individual who emigrates from Canada generally will be deemed to have disposed of all property owned at fair market value immediately prior to emigrating. This deemed disposition can result in large unexpected capital gains. Any resulting tax is due by April 30 of the year following the year of departure.

Certain property is excepted from this rule, including:

- Canadian real estate;
- capital property or inventory that is used in a business in Canada;
- certain stock options;
- RRSPs, RRIFs and various other pension plans;
- life insurance policies in Canada; and
- property owned when an individual last became a resident of Canada provided the individual was a resident of Canada for five years or less during the 10 years preceding emigration.

The above types of property generally are excepted as they will continue to be subject to Canadian income tax in one form or another (i.e., upon sale or gift, or will be subject to Canadian withholding tax when amounts are distributed).

If capital gains are triggered on the deemed disposition, individuals have the option to defer payment of the resulting tax by posting acceptable security with the CRA and filing the applicable election form. The additional tax may be deferred until the asset is sold, the taxpayer dies, or the taxpayer re-establishes Canadian residency. Acceptable security includes a bank letter of guarantee, a letter of credit, or a Government of Canada bond. Other types of security like shares of public or private corporations or valuable personal property might also be acceptable, though approval by the CRA is required. Security is deemed to be posted on any tax arising on the first $100,000 of capital gains – in other words, no physical security is required when the total gains do not exceed $100,000.

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Additional forms may also be required with the personal tax return for the year of departure, including Form T1161 – List of Properties by an Emigrant of Canada, and Form T1243 – Deemed Disposition of Property by an Emigrant of Canada. Significant penalties may be imposed for non-filing.

Canadian-controlled private corporations (CCPCs)

If an individual owns or controls a CCPC prior to emigration, not only will they be deemed to dispose of the shares at fair market value, potentially resulting in considerable tax, other negative consequences will arise. For example, the corporation will no longer qualify as a CCPC, resulting in lost access to preferential Canadian corporate tax rates and other valuable tax benefits. The company might also be considered a "controlled foreign corporation" or a "passive foreign investment company" for U.S. tax purposes. Either of these classifications can result in significant adverse U.S. tax consequences.

U.S. tax compliance

A resident for U.S. tax purposes must file a U.S. individual income tax return annually, Form 1040 – U.S. Individual Income Tax Return. Should the individual maintain interests in Canadian RRSPs or other tax-deferred Canadian investment vehicles, additional and potentially complex forms must be included in the U.S. personal tax filing. If shareholdings in a private Canadian corporation are maintained, they will add another element of complexity and cost to the annual return.

Conclusion

Any individual considering a permanent relocation to the U.S. should evaluate the financial and tax consequences of the move. Often, the resulting situation becomes increasingly complex and the impending tax and compliance costs play a large role in the ultimate decision. Many tax planning and optimization strategies are available to reduce or eliminate these tax matters, but it is critical that this planning be implemented *prior to* a change in residence.

Contact your local Collins Barrow advisor for additional comments and to discuss planning opportunities if you are considering a move to the United States.

STREAMLINED AND OVDP UPDATE

Matthew Wilson, CPA (licensed in Ohio, USA), MTAX, MBA, is a partner in the Toronto office of Collins Barrow

U.S. persons looking to catch up on required U.S. income tax filings may now be able to take advantage of an updated set of "taxpayer friendly" rules introduced in June 2014: the Streamlined Filing Compliance Procedures (Streamlined Program), and the Offshore Voluntary Disclosure Program (OVDP). These programs are integral parts of the ongoing Internal Revenue Service (IRS) initiative to encourage U.S. taxpayers, particularly those located outside the U.S., to become compliant.

The updated changes include an expansion of the Streamlined Program, originally introduced in 2012, and important modifications to the 2012 OVDP. In conjunction with these programs, the IRS continues its ongoing effort to combat what it considers the "misuse" of foreign assets, including the implementation of the Foreign Account Tax Compliance Act (FATCA), which took effect on July 1, 2014. FATCA is intended to encourage foreign financial institutions to provide reporting to the IRS on their U.S. account holders, thus assisting with the investigation and identification of U.S. taxpayers that may be avoiding tax filing, reporting and payment obligations.

Streamlined Program

The Streamlined Program was originally introduced to help U.S. citizens residing outside the United States who had not kept up with their U.S. tax filings, or had never filed U.S. tax returns, to become compliant with their U.S. personal tax and other filing requirements without facing penalties or additional enforcement

action. The program originally was available only to non-resident non-filers; it subjected the taxpayer to different degrees of review based on the amount of tax owing (i.e., less than $1,500 resulted in being classified as a "low-risk" taxpayer) and the taxpayer's responses to a "risk" questionnaire. Generally speaking, the classification as a low-risk taxpayer meant that the submission would be subject to minimal review by the IRS.

Neither the initial version nor the recently updated version of the Streamlined Program provides protection from criminal penalties, though both do provide for civil penalty protection. The program requires individuals to file the most recent three years of income tax returns and related tax information forms, as well as six years of the Foreign Bank and Financial Account Report (FBAR) form.

The expanded Streamlined Program is now available to a wider group of U.S. taxpayers living outside the country and, for the first time, to certain U.S. taxpayers residing in the United States. The general framework is essentially the same: three years of prior year income tax returns, six years of FBAR forms, etc. However, some of the conditions and procedures have been modified, including:

- eliminating the requirement that the taxpayer have $1,500 or less of unpaid tax per year in order to be considered "low risk";
- eliminating the required risk questionnaire; and
- requiring the taxpayer to certify that previous failures to comply were due to non-wilful conduct. Such certification is provided on a new form introduced by the IRS for the Streamlined Program.

For eligible U.S. taxpayers residing outside the United States, all penalties will be waived. For eligible U.S. taxpayers residing in the United States, the only penalty will be a miscellaneous offshore penalty equal to five per cent of the foreign financial assets that gave rise to the tax compliance issue.

OVDP

Under the OVDP, participating taxpayers were afforded certain protections from potential criminal and civil penalties, while the Streamlined Program provided protection only for civil penalties. However, the OVDP has much more significant administrative and cost requirements. Under the previous and continuing OVDP, taxpayers generally are required to file eight years of prior period tax returns and eight years of all information reporting forms, including the FBAR. In addition, though civil penalty rates had been potentially lower than they were without use of the program, typically assessed on the highest aggregate balance in a taxpayer's foreign bank accounts, they were not completely waived like they can be for non-resident U.S. filers under the Streamlined Program.

The new changes make significant modifications to the OVDP, including:

- requiring additional information from taxpayers applying to the program;
- eliminating the existing reduced penalty percentage for certain non-wilful taxpayers in light of the expansion of the streamlined procedures;
- requiring taxpayers to submit all account statements and pay the offshore penalty at the time of the OVDP application;
- enabling taxpayers to submit the voluminous records electronically rather than on paper; and
- increasing the offshore penalty percentage from 27.5 per cent to 50 per cent if, before the taxpayer's OVDP pre-clearance is submitted, it becomes evident that a financial institution where the taxpayer holds an account or another party facilitating the taxpayer's offshore arrangement is under investigation by the IRS or the Department of Justice.

Under the Streamlined Program, there is a requirement to state that the reason for past non-compliance was not "wilful." While most taxpayers affected by these rules believe that their non-compliance was not wilful, the issue may become whether or not the IRS agrees. Thus, taxpayers should be cautious when certifying such so as to avoid a destructive and lengthy criminal investigation by the IRS.

Factoring in the impact of the FATCA legislation – procedures to facilitate reporting to the IRS are already well under way – and the continuing attention that the IRS and other U.S. authorities are devoting to the matter of non-compliance, there are many reasons to become compliant now, before these programs are modified in an unhelpful way or even worse, disbanded. If you are a U.S. taxpayer, contact a Collins Barrow advisor to discuss your compliance requirements and find out how the Streamlined Program and the OVDP might help you.

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Collins Barrow periodically publishes *U.S. Tax Alert* for its clients and associates. It is designed to highlight and summarize the continually changing tax and business scene across Canada. While *U.S. Tax Alert* suggests general planning ideas, we recommend professional advice always be sought before taking specific planning steps.

info@collinsbarrow.com

Editor:
Michael R. Hayward, CPA, CA, CPA (licensed in Illinois, USA)
mihayward@collinsbarrow.com
613.768.7569