

Cross-border living a taxing issue



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By
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I recently was at an Estate Planning Council of Toronto meeting and sitting next to me was Mindi Banach, an American citizen who is also a lawyer at Morris Kepes Winters, one of the largest boutique tax law firms in Canada. Banach's practice focuses specifically on U.S.-Canada cross-border tax issues.

What intrigued me most about our conversation was not only did Banach provide legal assistance to Canadians living, working and investing in the U.S., but that she was applying her own cross-border tax planning advice to herself and her family as an American living and working in Canada.

Our conversation quickly turned towards the direction of the "weird" stuff most Canadians are unaware of when it comes to cross-border issues. As I listened, all I could think about was my own situation as a Canadian married to an American, and all the headaches and cross-border issues involved in our family financial and tax planning.

As a U.S. citizen living in Canada, Banach has personally found that unless a tax practitioner or financial advisor has some sort

of connection or personal interest in cross-border issues, most professionals are just not aware or even interested in dealing with any of the complexities that arise — and when a Canadian advisor is aware that there are U.S. tax issues, they have no idea whom to send an American to for advice.

When Banach first moved to Canada, she asked a financial advisor at a large wealth and practice management firm what he advises U.S. persons like her. To her surprise, the advisor, who held himself out to being a planning expert, basically threw his hands in the air and said, "This is what we do from a Canadian perspective, but I can't advise you on any U.S. matters, you need to speak to someone else" — without having any "someone else" to recommend.

Another personal example of Banach's journey came when she first arrived, and a bank manager recommend and then set up a Tax Free Savings Account (TFSA) for her. The manager told Banach that the TFSA was good and sound financial planning for everyone living in Canada over

the age of 18.

The bank manager knew Banach was an U.S. citizen and yet did not mention that, as an American, she should first seek out the advice of a U.S./Canadian advisor. If she'd spoken to an expert at the time, she would have been told of the potentially negative U.S. tax consequences for American citizens who own TFSA accounts. Specifically, she would have been told that although there is great uncertainty regarding how the IRS taxes a TFSA, the majority of tax practitioners take a conservative position that a TFSA account is not covered under the Canada-U.S. cross-border tax treaty, and although tax-free in Canada, as an American she would be taxed on it by the IRS. Additionally, she would have been told that the cost required to properly report and file a TFSA account with the IRS could be high, thus defeating the main, money-saving purpose behind owning a TFSA account in the first place.

Having been in Canada for several years and become an expert on cross-border tax issues,

Banach is now fully aware of the potentially negative U.S. tax consequences Americans face if they own a TFSA account. She also knows from personal experience that she will never make any investment decisions without first looking into the cross-border tax issues that may arise from such decisions, and advises all her U.S. clients living in Canada to do the same.

From Banach's firsthand experience, she believes there is a lack of awareness in Canada about U.S. tax issues faced by Americans living in Canada. Public accountants and financial advisors do not need to know what the solutions are to every cross-border issue that may arise. But what a client should expect from these experts who hold themselves out as trusted advisors is to at least answer two very important questions:

- Are there any possibilities that there could be a U.S. person involved either now or in the future? This question is not as easy as you may think. Sometimes people are not even aware they are a U.S. person for tax purposes;

- Are there any U.S. tax issues that may arise as a result of whatever arrangement, structure, etc. that a Canadian public accountant, lawyer or financial advisor is proposing for their client?

Banach was not putting all the blame for setting up her TFSA account on the bank manager. She recognizes that she could not have expected him to know everything about how Canadian investments are taxed in the U.S. However, she

would have appreciated at least some advice that perhaps she should look into the investment further from a U.S. tax perspective.

Cross-border tax planning is definitely complex, but what frustrates many Americans who have chosen to reside in Canada, and Canadians who live or invest in the United States, is the lack of awareness that there could be issues, and the lack of guidance available to them as to where to turn once an issue is spotted.

Banach is one of the lucky ones; she has become her own expert in the cross-border arena. What she aims to do now is to get the word out to others that there are some serious everyday tax-planning issues that need to be addressed in the area of cross-border planning.

"Think that if this happened to me (and I'm a U.S. tax attorney), just imagine how many other U.S. persons living in Canada that this can happen to and does happen to," she said. "I am literally my own client because I am going through issues that arise in the cross-border context by living through them myself."

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Capital hedge means capital account home: court

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tightly controlled as the CRA seems to think it is."

The government acknowledged the changing landscape in its appearance before the court.

"In this case, the Crown conceded that the taxpayer could establish a link between its currency-hedging contracts and its investment in a foreign subsidiary, but argued that for tax purposes the taxpayer could only make the necessary link if it established that it directly held, and was likely to sell, the subsidiary," said Woodyard.

The court disagreed with the minister of national revenue. What is important, it concluded, is to identify the risk to which the transaction is related and whether the related item is capital or income in nature.

"I am therefore prepared to accept the appellant's proposition that, if it is found that the derivative was used to hedge a capital investment, any gain derived from



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the derivative will be on capital account," Justice Lamarre said.

In part, the CRA's position is linked to its efforts to dissuade speculation. Over the long term, as interest rates fluctuate, gains and losses even out when swaps are used. However, in the short term, companies could opt out of

a swap at a point favourable to them financially.

"Taxpayers choosing wins or losses can be perceived as gaming the system," noted Tobin.

Speculation was not an issue in the Weston case, the court determined. Justice Lamarre pointed out that the company had entered into swaps lasting usually for 10 to 15 years, thereby incurring transaction costs associated with long-term swaps.

"Although the swaps were terminated early, the circumstances leading to the termination were linked to an evaluation of business risk and not speculation on the exchange rate," she stated.

The court clearly accepted the notion that the level of expense and high transaction costs associated with these swaps are fundamentally inconsistent with speculating in the currency market, noting that if currency speculation were the taxpayer's ultimate purpose there were other, more efficient methods at its disposal.

"These comments may provide



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a measure of clarity and certainty to other taxpayers considering in engaging in long-term currency swaps as a means of mitigating their exposure, shoring up their debt to equity ratios, and preserving their credit ratings in these increasingly volatile times," said Woodyard.

The decision is noteworthy and breaks new legal ground, noted Mirandola.

"The judge herself pointed out that this is the first time this issue has been brought before the courts."

The national tax agency is not appealing the decision, but a spokesperson said it is considering the court's findings moving forward.

"The CRA is reviewing the decision to determine its impact on the CRA's published position on the treatment of cross-currency basis swap contracts," spokesperson Magali Deussing said in an e-mail.

CFOs, accountants, and their clients should also take the time to review the decision.

"Taxpayers need to assess existing agreements," said Tobin noting that, "Sophisticated clients are looking very carefully at what they have been hedging and whether this has been on capital or income. There will be some navel-gazing."