

Focus TAX LAW

Beware long arm of Uncle Sam if fleeing to Canada



Peter Merrick

A lot of Americans started looking at their option to moving north after the election of Donald Trump. However, before packing their suitcases, these people should know that moving to Canada may distance them from Trump, but not from Uncle Sam. Veronika Chang, with Morris Kepes Winters LLP in

Toronto, is a tax specialist with extensive experience working in the United States, especially in the areas of the *Canada/U.S. Income Tax Convention* and the Internal Revenue Service. I asked her what the tax pitfalls of this move north might mean.

Chang first explained that under the Internal Revenue Code, the United States taxes “U.S. persons” on their worldwide income and such a person is defined as one who is: an American citizen, a resident, or a U.S. partnership, a U.S. corporation, or a U.S. estate and trust. So, a U.S. citizen is subject to U.S. tax, and it doesn’t

matter if they reside in Canada or south of the border.

Our conversation moved to the example of American actress Lena Dunham, who said she would leave for Canada if Trump won. If she does move to Canada, she must become aware that she will need to continue to file annual income tax returns in the U.S., and if she becomes a resident of Canada, she also needs to file Canadian returns and pay Canadian taxes. “Lena won’t be double-taxed because she can claim a foreign tax credit for taxes paid in Canada on her U.S. return. But she must endure the pain of double filing,” said Chang.

What should Dunham know if she wants to buy a house in Canada? Assuming she comes and remains a Canadian resident, Chang explained that Dunham must worry about the capital gains tax upon sale. Unlike Canada, the U.S. limits the capital gains exemption to US\$250,000 per person; any gain over US\$250,000 and you have to pay Uncle Sam.

What if Dunham uses a Canadian entity or a Canadian trust to buy that house?

“Well, Uncle Sam tends to dislike Americans using a non-U.S. structure as an investment vehicle, so Lena would then have to file additional tax forms to disclose her interest in the Canadian structure,” said Chang.

And what if Dunham should die in Canada? Chang explained that Americans are subject to the U.S. estate tax on their worldwide assets. This tax applies only to those whose worldwide gross assets exceed the exemption for U.S. estate tax, which is US\$5.45 million. So, if Dunham dies here in Canada and her worldwide assets are above the exemption limit, she is subject to the estate tax.

One of Trump’s campaign promises was that he would repeal the current estate tax regime and, instead, institute a capital gains tax regime. These details still remain to be seen, but he is basically proposing a death tax similar to the one currently imposed in Canada. This can mean one of two things, Chang explained.

First, as in Canada, the deceased is deemed to have sold all his or her worldly belongings at the time of death and pay the tax on the gain. Second, in the U.S. one’s inherited assets get stepped-up basis which means the inherited assets get a new basis equal to their fair market value. The example that Chang used was this: imagine Grandpa dies and leaves his house worth \$1 million, which he had purchased for \$100,000. Whoever inherits the



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US\$10 million. Whether he means that much per person or per couple isn’t clear. In any case, his plan nonetheless replaces the estate tax with capital gains tax.

“In certain cases, the U.S.-Canada Treaty provides a U.S. estate tax credit for Canadian capital gains tax at death,” said Chang. “Under Trump’s plan there is no longer a U.S. estate tax. Whether or not the treaty will apply, we just don’t know.”

My next question was, what if you are Canadian who now lives in the U.S. and want to return to Canada? I found out that if you are not an American citizen or have not held a green card for more than eight years, no problem. You can depart the U.S., hand in your green card, and end your relationship with Uncle Sam. This is provided you don’t keep any U.S. properties.

But if you are a naturalized U.S. citizen, have been the proud owner of a green card for eight years or more, or hold on to it (i.e., move to Canada without properly turning in your green card), then you are in the same boat as Dunham. If you held a green card for at least eight of the past 15 years, you are considered a long-term resident and are basically treated the same as any American citizen, except that you don’t have the right to vote.

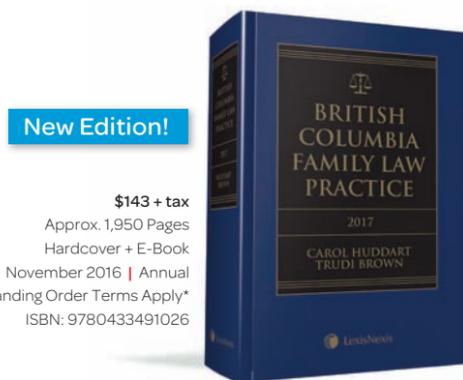
My final question to Chang was this: If you want to renounce your U.S. citizenship or long-term residency, what should you be mindful of? Unfortunately, her answer was: “You will still have to deal with the U.S. exit tax. This is another tax based on capital gains which applies to those with assets over US\$2 million.”

So far, the exit tax has not been on Trump’s radar. But then again, who knows what the future will bring?

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