

TOP 5 CROSS-BORDER TAX ISSUES

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ABOUT MAX REED



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Max solves US tax problems for Canadians including:

- Adding corporations on the UX tax implications of cross-border transactions and initial public offerings;
- Helping citizens in Canada deal with US tax issues including renouncing their US citizenship; and
- Advising Canadian investment funds on investments into the United States and receiving investments from US taxpayers.

Max is the co-author (with Dick Pound of Stikeman Elliot) of A Tax Guide for American Citizens in Canada, as well as over 20 technical and plain language articles on a wide range of cross-border tax topics. Recognized for his expertise, Max is often invited to speak at conferences and seminars for tax professionals and the general public. He was invited to testify before the Canadian House of Commons Finance Committee on the impact of US tax law on Canadians.

Prior to joining SKL, Max worked at White & Case LLP, an international law firm in new York City where he provided US tax advice to individuals, corporations, and foreign states.

He holds a BA and two law degrees from McGill University, where he won several academic and leadership awards and is admitted to the bars of BC and New York.

TODAY'S AGENDA

- Which Canadian Individuals Are US Taxpayers
- Renouncing US citizenship for US citizens in Canada
- US Estate Tax For Canadians
- Corporations doing business in the US
- Top 10 cross-border tax traps
- Conclusions
- Further reading

WHO IS A US TAXPAYER

WHO HAS TO FILE US TAXES

- Canada imposes income taxes based on residency
- US imposes income taxes based on immigration status (i.e. citizenship; Green card) and residency
- US taxpayers abroad subject to international sections of US tax code
 - Complex filing requirements;
 - Punitive tax rules;
- Frustrate even simple planning
- Always ask if client is US Person

WHO HAS TO FILE US TAXES

- A “US Person” has to file US tax returns
- A “US Person” defined as:
 - US citizen
 - US Greencard holder
 - US resident
- Obligation has existed for over 100 years
- FATCA makes it much harder to ignore this obligation

US CITIZENS

- Born in the US = US citizen
- US passport = US citizen
- Born abroad to US citizen parents = may be a US citizen
 - Depends on how long parents lived in US
- More information

US GREENCARD HOLDER

- US Greencard requires US tax return filing
- Even if Greencard is expired → tax obligation may still exist if Greencard not surrendered properly
- Must give up Greencard by filing Form I-407

US RESIDENT (SNOWBIRDS)

- > 183 tax days = US tax resident
- Counted as follows:
 - Current year – 1 day in US = 1 tax day
 - Last year – 1 day in US = 1/3 tax day
 - Two years ago – 1 day in US = 1/6 tax day
- Golden rule: spend no more than 120 days/year in US and likely never have any problems
- If status met, can terminate US tax residency by filing appropriate forms on a timely basis

RENOUNCING US CITIZENSHIP

RENOUNCING US CITIZENSHIP

- An increasingly popular solution
- Weigh tax and compliance cost against value of citizenship
- Consider tax and immigration aspect if wish to renounce
- Renunciation in a prior year (“relinquishment”) of US citizenship possible but complex

RENUNCIATION: TAX CONSIDERATIONS

- No changes to renunciation law in TCJA
- No capital gains tax upon renunciation if:
 - 5 years of returns done perfectly (a review is worthwhile)
 - Less than USD \$ 2 million net worth
 - Less than USD \$ \$165,000 in average annual tax liability
- If born a dual citizen and live in Canada, no exit tax as long as returns done properly
- Pre-expatriation gifting – transfer to non-US spouse prior to renunciation
 - No tax (provided below gift and estate tax exemption)
 - Tax deferred in Canada

RENUNCIATION FOR HNW CLIENTS

- Renunciation viable solution for high net worth clients
- Dual citizen from birth exception: net worth test not applicable
- Increase in US estate tax exemption means higher pre-expatriation gifts
- Client willing to make gifts to spouse can renounce tax free even if net worth is USD **\$13 million**
- Planning possible to get Canadian tax benefit for US exit tax

IMMIGRATION ASPECTS OF RENOUNCING

- Under current law basically zero risk at US border
- Reed Amendment – 1996 law can prevent entry to US
 - No regulations
 - Bureaucratically cumbersome
 - Only applied twice in last 20 years
 - Easy to advance non-tax avoidance purpose

BUYING US REAL ESTATE

TAX CONSIDERATIONS

- US estate tax applies to stocks in US corporations, US real property, and US debt obligations
- Issues to consider for real property purchase:
 - US estate tax
 - Income/capital gains rates
 - Probate/estate planning (state specific)

ESTATE TAX CHANGES

- Under prior law, US federal estate tax exemption was USD \$5.49 million per person (2017 amount)
- With TCJA until 2025, 2020 US federal estate tax exemption is USD \$11.58 million per US citizen
- Treaty allows Canadian resident similar benefit:
$$\frac{\text{US assets}}{\text{worldwide assets}} \times (\text{US } \$11.58 \text{ million})$$
- Enhanced credit for property that passes to Canadian resident spouse
- No tax exposure if:
 - Total estate < USD \$11.58 million and
 - Form 706-NA filed at the proper time

State estate tax

- Note that US state estate tax is different than the federal level;
- WA → \$ 2 million exemption;
- Oregon → \$ 1 million;
- May/may not follow the Treaty exemption

State estate tax

- Connecticut – \$3,600,000
- District of Columbia – \$11,400,000
- Hawaii – \$11,400,000
- Illinois – \$4,000,000
- Oregon – \$1,000,000
- Maine – \$11,400,000
- Maryland – \$11,400,000
- Massachusetts – \$1,000,000
- Minnesota – \$2,700,000
- New York – \$11,400,000
- Rhode Island – \$1,561,719
- Vermont – \$2,750,000
- Washington – \$2,193,00

Relying on Treaty exemption

- Relying on estate tax exemption is generally fine
- However, note that estate has to file Form 706-NA to claim treaty benefits
- 706-NA requires valuation under US tax principles of all assets held by the estate
- So if complex financial picture in Canada, even if no estate tax owing, cost of 706-NA on death may exceed cost of using estate blocking structure

Restructuring US real estate

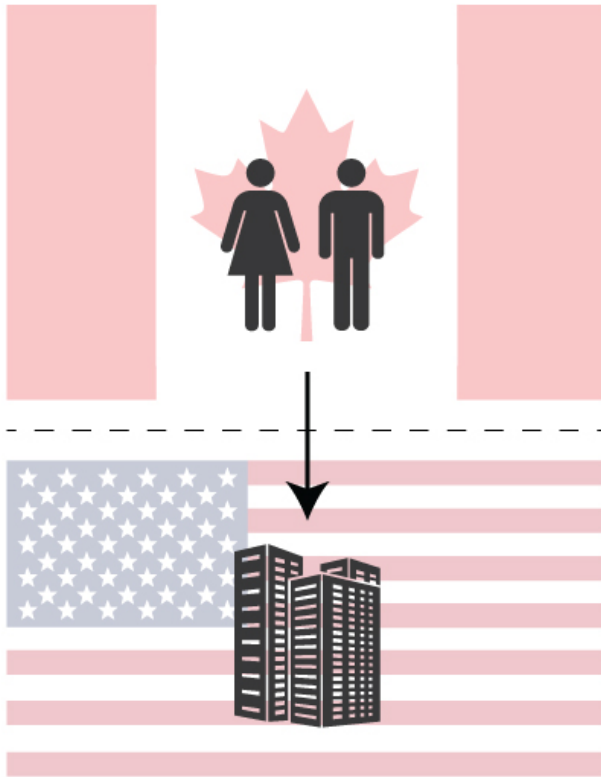
- Restructuring to avoid US federal estate tax/state estate tax:
- Transfer US real estate to Canadian LP/LLP → tax neutral
- Sell to specially designed trust – may trigger capital gain
- Roll into Hybrid LP → complicated, but can be done on tax neutral basis

LOWER CORPORATE TAX RATE

Country	Business Income	Capital gain	Max possible rate including state rate
Canada	26%	24%	27%
US	21%	21%	29%

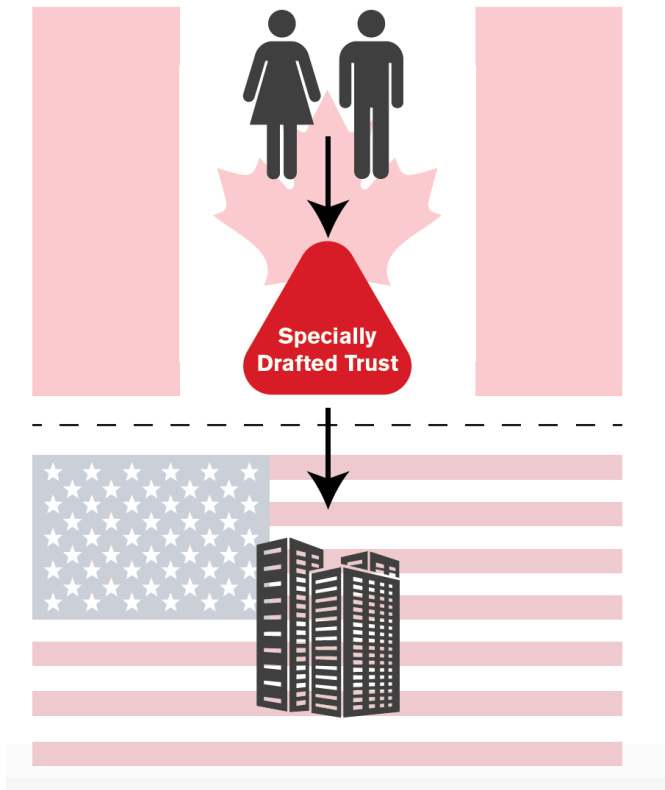
- Corporate tax rates essentially the same between 2 countries

Direct Ownership



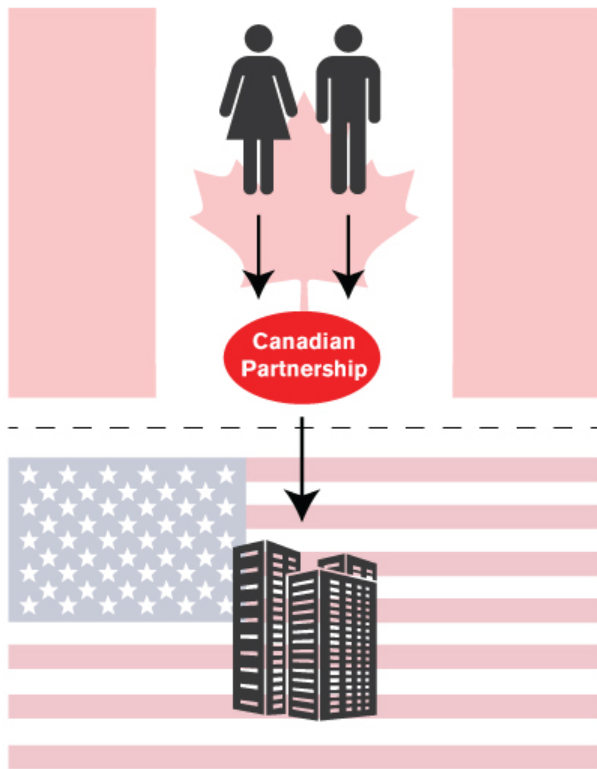
Rental Income	49.80%
Capital Gains	24.9%
Obligation to File US Returns?	YES
Estate Tax Exposure?	YES

Specially Drafted Trust



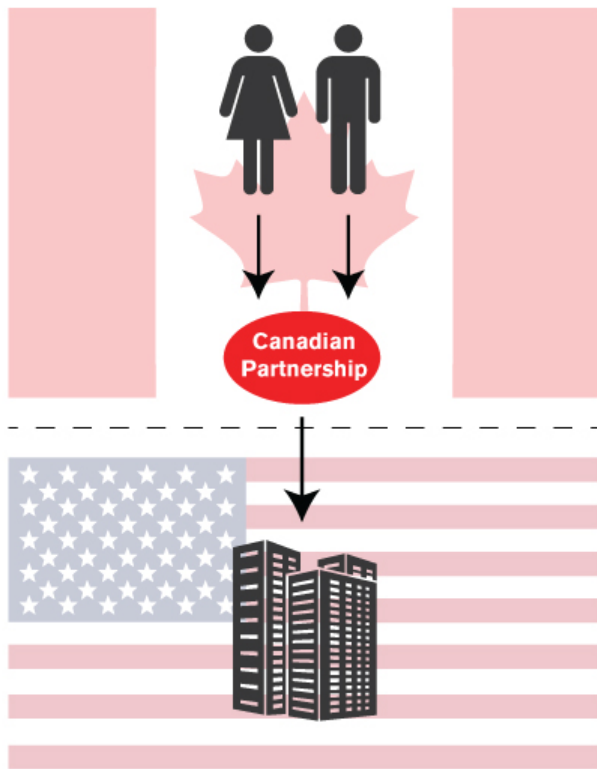
Rental Income	49.80%
Capital Gains	24.9%
Obligation to File US Returns?	YES
Estate Tax Exposure?	NO

Canadian Partnership



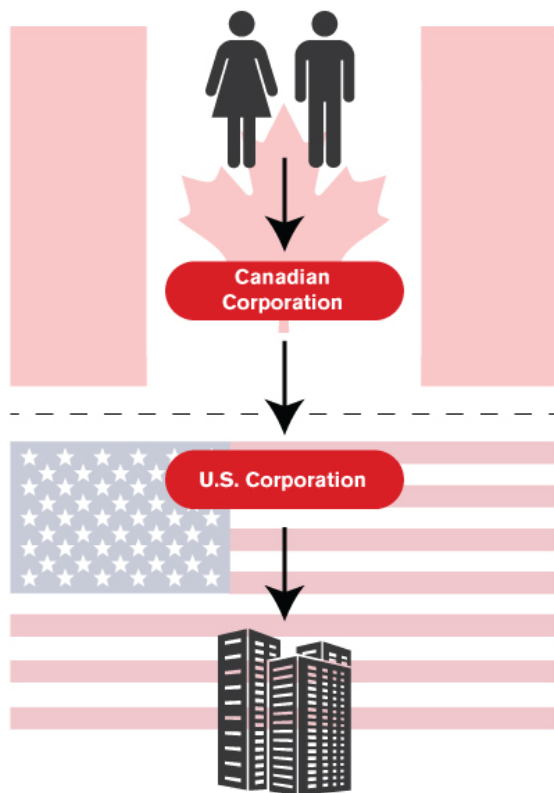
Rental Income	49.80%
Capital Gains	24.9%
Obligation to File US Returns?	YES
Estate Tax Exposure?	POSSIBLE BUT UNLIKELY

Hybrid Partnership



Rental Income	49.80%
Capital Gains	24.9%
Obligation to File US Returns?	YES
Estate Tax Exposure?	NO

Stacked Corporations



Rental Income	~52% (assuming fully distributed to shareholders)
Capital Gains	~52% (assuming fully distributed to shareholders)
Obligation to File US Returns?	YES
Estate Tax Exposure?	NO

CONCLUSIONS

- Perfect estate tax protection now easily available
- Hybrid partnership provides for best integrated rate for real estate investments
- Subject to FAPI, stacked corporations may allow for cheaper reinvestments of profits due to lower US corporate tax rate
- No US tax penalty for use of holding company to buy personal use US real estate
 - Canadian shareholder benefit rules require attention

DOING BUSINESS IN THE US

US Corporate Tax Exposure

- Three types of exposure
 - US federal income tax – PE or no PE? Form 1120-F?
 - US state income tax – Nexus? State filings?
 - US state sales tax - 10,000 different taxing regimes
- 50 states = 50 sets of rules
- Forms required even if no tax owing
- Common mistakes:
 - Assume no US presence = no forms
 - Assume no US PE = no state tax

US Federal Tax Exposure

- US domestic rule – CanCo taxable if engaged in business in US – low threshold
- Canadian resident corporations not US taxable unless they have permanent establishment (PE)
- PE = fixed place of business (i.e. office)
- Provision of services caught by new “agency PE rules”
- To take advantage of Treaty CanCO **must** file Form 1120-F annually
- Take away – make sure Form 1120-F filed

US STATE INCOME TAX

- 50 states have 50 sets of rules
- States are not obliged to follow Canada-US Treaty
- So they don't -- California, New York, Oregon etc.
- Nexus can be triggered even if no physical presence
- States are aggressive
- **Take away – consider state tax issues even if no US PE**

US STATE SALES TAX

- There are 10,000 different sales tax jurisdictions in the United States
- After the Wayfair case, states are allowed to tax without a physical presence
- California – if you make \$500,000 of sales into California you have a sales tax obligation there (even if only online)

COMMON CROSS-BORDER TAX TRAPS

CROSS-BORDER TAX TRAPS

1. Canadian receiving distribution from US revocable trust (capital gains exposure in Canada – more [here](#))
2. Canadian resident owning US LLC/LLP/LLLP (double tax risk as CRA considers them corporations)
3. Canadian gifting US real estate (US gift tax will apply)
4. Canadian owning US real estate in joint tenancy (double US estate tax exposure)
5. Trust on one side of the border; beneficiary the other

CROSS-BORDER TAX TRAPS

6. 401K → RRSP rollover (not automatically tax deferred rollover; needs accountant)
7. Assets in multiple places (see next slide)
8. US citizen in Canada ignoring US tax filing obligations (window to catch up may be closing)
9. US taxpayer invests in Canadian pooled funds without proper advice
10. US taxpayer sells principle residence (US capital gains exemption only \$250,000)

ASSETS IN MULTIPLE PLACES

- Each state/province has its own rules on whether a will is valid
- A will in one country may not work in the other country
- Scenario:
 - James lives in BC but has a Florida condo
 - His BC will leaves condo to son, not spouse
 - BC will may not work in Florida
 - Florida default laws may require condo to go to spouse
- Solution:
 - A will in each jurisdiction you have assets
 - International will
 - Use a trust

ASSETS IN MULTIPLE PLACES

Client friendly pieces:

- Renouncing US citizenship → <http://www.skltax.com/renouncing-us-citizenship-after-us-tax-reform/>
- Inheriting money from the US → <https://skltax.com/the-tax-consequences-of-inheriting-money-from-the-u-s/>
- Buying US real estate → <http://www.skltax.com/us-estate-tax-exposure-canadians-us-tax-reform/>

FURTHER READING

Client friendly pieces:

- Renouncing US citizenship → Tax issues when Canadians have US executors → <https://skltax.com/tax-issues-when-canadians-have-u-s-executors/>
- Estate planning for Canadians with US real estate → <https://skltax.com/estate-planning-for-canadians-with-us-real-estate/>

QUESTIONS?

THANK YOU!