U.S. Citizens Living in Canada

Income Tax Considerations

Many U.S. citizens have lived in Canada most of their lives and often think of themselves as Canadians. This may be true in terms of national pride and culture; however, their U.S. citizenship means they must fulfil their U.S. income tax filing requirements. U.S. citizenship is acquired by being born in the U.S. or being born to U.S. citizen parents, and often the tax implications of being a U.S. citizen are overlooked. The U.S. imposes income tax on the worldwide income of U.S. persons, including U.S. citizens, U.S. residents and Green Card holders, regardless of where they reside. As a result, U.S. persons have annual U.S. income tax filing and reporting requirements that exist regardless of where they call home, and how much time they spend in the U.S.

This publication provides a general overview of issues and considerations for U.S. citizens who are Canadian residents for income tax purposes. U.S. tax reform legislation passed in December 2017, and may impact the income tax filing and reporting requirement for U.S. citizens living in Canada and Green Card holders.

U.S. tax filing considerations

Overall income tax liability – Each year that a U.S. citizen resides in Canada they are required to file a U.S. individual income tax return (Form 1040) to report their worldwide income, in addition to their Canadian income tax filing requirements as a tax resident of Canada. Although income is reported in both Canada and the U.S., double taxation is generally mitigated through the use of foreign tax credits. The foreign tax credit mechanism allows for any Canadian income tax paid to reduce the amount of U.S. income tax otherwise payable, on the taxable income on both Canadian and U.S. income tax returns. The foreign tax credit results in the individual's ultimate tax liability being determined by the higher tax rate country. As such, while an individual's U.S. income tax liability may be reduced as a result of the recent U.S. tax reform legislation, the overall income tax burden for most U.S. citizens living in Canada will not likely be reduced.

U.S estate tax – U.S. tax reform increased the U.S. lifetime estate tax exclusion amount to US$11.18 million (from the previous 2018 inflation adjusted amount of US$5.6 million). While the increased exemption may eliminate (or reduce) U.S. estate tax exposure for many estates, it is important to note that the increased exclusion amount is only effective until the end of 2025. Therefore, any long-term U.S. estate tax planning should consider the potential lower (inflation adjusted amount of US$5 million) threshold.

FBAR reporting – In addition to filing an annual U.S. income tax return, there are other reporting requirements for U.S. citizens. One requirements is the Report of Foreign Bank and Financial Accounts ("FBAR"), FinCEN Form 114 (formerly Form TD F90-22.1), which must be filed if you have a financial interest (or signature authority) in one or more accounts in a foreign country, and the aggregate value of those accounts exceeds US$10,000.

While there are significant penalties (in addition to possible criminal prosecution) associated with the failure to file an individual U.S. income tax return and complying with the FBAR reporting requirements, the Internal Revenue Service ("IRS") has indicated that penalties may be waived if the failure to file the FBAR or U.S. individual income tax return is due to a reasonable cause.

Passive Foreign Investment Company ("PFIC") – U.S. citizens who are shareholders of a PFIC are required to file Form 8621 - Information Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund.

In general, a PFIC is a non-U.S. corporation that derives most of its gross income as passive income or that at least half of its assets produce passive income. In determining whether or not you have PFIC reporting requirements, it is important to note that a Canadian mutual fund would be classified as a corporation regardless of whether it is structured as a trust for Canadian income tax purposes. As such, if you hold units in a Canadian mutual fund, you may be subject to the PFIC reporting requirements. Other investment vehicles that may be considered as PFICs include Canadian Exchange-traded Funds ("ETFs"), and Canadian Real Estate Investment Trusts ("REITs").

Among other exceptions, the regulations exclude PFICs held in a Registered Retirement Savings Plan ("RRSP"), Registered Retirement Income Fund ("RRIF"), or Registered Pension Plan ("RPP") from the reporting requirements if, under the Canada/U.S. Income Tax Treaty (the "Treaty"), U.S. citizens elected to defer the U.S. income tax on the income earned in these plans until the funds are distributed. It is important to note that the IRS still requires Form 8621 be completed for Canadian mutual funds held in a Registered Education Savings Plan ("RESP") or Tax-Free Savings Account ("TFSA").

Reporting of specified foreign financial assets – U.S. citizens who have foreign accounts/assets with an aggregate value exceeding a specified amount are required to disclose certain information about these accounts on Form 8938, Statement of Specified Foreign Financial Assets. The IRS uses the information reported on this form to ensure the income attributable to these foreign assets/accounts is properly reported on the individual's U.S. income tax return.

A single U.S. citizen/U.S. resident living abroad would be required to complete Form 8938 if they have specified foreign assets with a value exceeding US$200,000 at the end of the year, or US$300,000 at any time during the year. Specified foreign assets can include, but are not limited to, bank accounts, RRSPs, stocks, pensions/annuities, partnerships, trusts, debt instruments, mutual funds and insurance contracts. Form 8938 must be attached to the individual's U.S. income tax return. This disclosure requirement is in addition to FBAR reporting previously discussed.

Options for U.S. citizens who have not filed U.S. income tax returns

Recognizing that many U.S. citizens may have not complied with their U.S. income tax filing and reporting requirements, the IRS has implemented streamlined filing procedures that provides relief from penalties for U.S. citizens living in Canada who have been unaware of their U.S. income tax filing obligations.

Taxpayers who wish to become compliant through the streamlined procedures must certify that their failure to comply with U.S. income tax and information reporting requirements was "non-willful" and a result of a good faith misunderstanding of the requirements.

Although the streamlined procedures will not protect those who may be subject to criminal prosecution (i.e., those who knowingly have not been in compliance), the process provides some relief for individuals who were not previously aware of their U.S. tax filing and reporting obligations. It should also be noted that the Offshore Voluntary Disclosure Program ("OVDP"), which offers another means for U.S. tax filers to become compliant, will not be available to individuals who make a submission under the streamlined procedures. Please note that the OVDP will no longer be available after September 28, 2018. As such, it is important to consult with a cross-border tax professional to determine the best course of action for your circumstances.

Registered plan considerations

Many Canadians may have investments in registered plans such as TFSAs, RESPs, RRSPs and RRIFs. However, a Canadian resident who is a U.S. citizen has additional income tax considerations associated with these savings vehicles.

TFSA – Although the income earned in a TFSA is tax-free for Canadian tax purposes, the income earned is taxable for U.S. income tax purposes. Therefore, it is not always a recommended investment vehicle for a U.S. citizen.

However, the TFSA may be a beneficial savings vehicle for U.S. citizens residing in Canada if the individual has foreign (such as Canadian) taxes payable on other non-U.S. investment income (held outside of a TFSA), as the foreign taxes payable on the other non-U.S. investment income may be applied to offset some of the U.S. income tax attributable to the TFSA income.

RESP – Similar to the TFSA, the income earned in an RESP is taxable for U.S. income tax purposes. As such, if either the subscriber and/or the beneficiary of an RESP is a U.S. citizen, the U.S. tax filing and reporting obligations associated with an RESP should be considered to determine the feasibility of establishing (or maintaining) the RESP.

Both TFSAs and RESPs may be considered foreign trusts for U.S. income tax purposes and would require additional annual reporting requirements such as a Form 3520 (Annual Return to Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts), and Form 3520A (Annual Information Return of Foreign Trust with a U.S. Owner). Completion of Form 8621 (previously discussed in this publication) may also be required if the TFSA or RESP holds a Canadian mutual fund.

RRSP/RRIF – Although RRSP/RRIF income grows tax-free for Canadian income tax purposes, the annual income earned in an RRSP/RRIF is considered to be taxable income for U.S. income tax purposes. However, in order to mitigate any double taxation, the Treaty provides an automatic election for eligible individuals to defer the income for U.S. federal income tax

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purposes until the funds are withdrawn. Because of this, the timing of the taxation becomes the same for both countries and foreign tax credits can be used to minimize any double taxation. In previous years, an election to defer the income was made by filing Form 8891 with your U.S. individual income tax return. However, this procedure changed in October 2014. It is important to note that the automatic election to defer the income only applies to "eligible taxpayers." Very broadly, "eligible taxpayers" are U.S. citizens (or U.S. residents) who have complied with their U.S. federal income tax filing obligations every year. If you are not an eligible individual, the automatic deferral election would not apply in your situation. As such, you will likely have to follow different procedures to make an election to defer the accrued income in your RRSP/RRIF.

Transfer of a U.S. retirement plan to an RRSP – If you are a U.S. citizen (or former U.S. resident) who has previously worked in the U.S., you may want to transfer your U.S. retirement plan, such as a 401(k)/IRA, into your RRSP. In general, it is possible for a Canadian resident to transfer a lump sum from a U.S. pension plan into an RRSP if you are under the age of 71. The lump sum transfer of a U.S. retirement pension plan into an RRSP would not affect your RRSP contribution room. However, there are potential U.S. tax consequences on this transfer, namely:

1. A 10% early withdrawal penalty if you are under 59½ years of age; and
2. U.S. withholding tax on the withdrawal.

As a U.S. citizen, you are required to report the transfer on your U.S. income tax return and your Canadian income tax return. However, you will likely be able to claim a deduction for Canadian tax purposes for some, or the entire amount that you transfer into your RRSP. In addition, you may be able to reduce your Canadian income tax payable by claiming a foreign tax credit for any U.S. taxes payable on the 401(k)/IRA transfer. It is very important to estimate your Canadian and U.S. income tax liabilities before you make a transfer from your U.S. retirement plan in order to determine whether or not the transfer is feasible in your particular circumstances.

Capital gains considerations

While favourable U.S. income tax rates apply for long-term capital gains (i.e., gains attributable to assets held for more than one year), the capital gain exemptions that are applicable for Canadian income tax purposes do not apply for U.S. income tax purposes. For example, if you are a U.S. citizen who sells an asset that is eligible for the lifetime CDN$800,000 capital gains exemption (i.e., the sale of shares of a qualifying small business corporation) for Canadian income tax purposes, you should be aware that the gain must be reported for U.S. income tax purposes and is subject to U.S. income tax. Similarly, while the Principal Residence Exemption applies for Canadian income tax purposes, there is no similar principal residence exemption for U.S. income tax purposes. However, there may be a US$250,000 capital gain exclusion available on the sale of a principal residence for U.S. income tax purposes if certain criteria are met.

Other planning considerations

Many Canadian residents undertake some tax and estate planning that commonly results in individuals becoming shareholders of private Canadian corporations or beneficiaries of trusts resident in Canada. If you, and/or a family member such as a spouse, child or grandchild, is a U.S. person (i.e., U.S. citizen, U.S. resident or Green Card holder), U.S. income tax implications should be considered in conjunction with Canadian income tax considerations. Some possible U.S. tax and estate planning considerations include:

Controlled Foreign Corporations ("CFC") – Broadly defined, a foreign (non-U.S.) corporation is a CFC for U.S. income tax purposes if more than half of the corporation is owned by one or more U.S. citizens. Recently passed U.S. tax reform legislation imposes a one-time mandatory repatriation tax (also referred to as a toll charge) that may be applicable to U.S. shareholders of a CFC. While the mechanics of this mandatory repatriation tax is beyond the scope of this publication, the tax is based on post-1986 accumulated active business profits. Individuals subject to this one-time tax may elect to pay the tax over an eight-year period. While the first installment payment was due April 17, 2018, the U.S Treasury Department and the IRS extended the due date to June 15, 2018 for U.S citizens living outside the U.S.

As a U.S. citizen who holds shares in a CFC, you may have been required to include your share of the company's income in your annual U.S. individual income tax return, even if that income was not distributed to you. Often referred to as "Subpart F" income, it generally includes passive income such as interest, dividends and capital gains realized by the corporation. As of tax year 2018, U.S. tax reform introduces a new category of taxable income – Global Intangible Low-Taxed Income ("GILTI") – that individuals may need to include on their U.S. individual income tax return. GILTI income generally consists of active profits retained in the company and is subject to U.S. income tax in a similar manner as Subpart F income. In addition, there is an annual U.S. reporting requirement to disclose information about your corporation.

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Passive Foreign Investment Company ("PFIC") – As discussed earlier, a PFIC is a non-U.S. corporation that derives most of its gross taxable income as passive income (i.e., dividends, interest, rent) or at least half of its assets produce passive income. As such, many Canadian holding companies are considered PFICs. Distributions received by a U.S. citizen from a PFIC are subject to a special set of tax rules which may cause an interest component to be added to the income tax associated with the distributions. In addition, it can be difficult to obtain the information needed to fulfill PFIC reporting requirements.

Dividends paid out of the Capital Dividend Account – While dividends paid out of a corporation's Capital Dividend Account are not subject to Canadian income tax when received by Canadian residents, the dividends received by a U.S. citizen resident in Canada would be subject to U.S. income tax.

Foreign (non-U.S.) trusts – If you are a U.S. citizen who is a beneficiary of a foreign trust, you may be required to report the distributions in your U.S. income tax return for the year, even if the trust has been subject to Canadian income tax. In addition, if any of that distribution is from income that has been accumulating in the trust, there may be an interest component to the U.S. tax associated with the distribution. In some circumstances, where there has been an accumulation of income, distributions of trust capital (which is not taxable for Canadian income tax purposes) may be included as taxable income for U.S. income tax purposes. U.S. beneficiaries of a foreign trust must also comply with annual reporting requirements.

U.S. estate tax – As a U.S. citizen, the value of your worldwide assets at the time of your death (in excess of any unused lifetime exclusion amount applicable for that year) is subject to U.S. estate tax regardless of where you reside. The exclusion amount for U.S. estate tax purposes is US$11.18 million for 2018. Since the American Taxpayer Relief Act of 2012 made permanent the existence of U.S. estate tax, estate planning strategies for Canadian tax purposes (including any terms included in trust agreements), should be implemented with the additional goal to minimize the inclusion of any assets into your estate for U.S. estate tax purposes. For example, you may want to be mindful of the fact that life insurance proceeds will be included in the value of a U.S. citizen's estate unless there has been estate planning, such as the use of an Irrevocable Life Insurance Trust ("ILIT"), or having a non-U.S. citizen family member(s) own the insurance policy.

U.S. gift tax – As part of the U.S. transfer tax regime (which includes U.S. estate tax), U.S. taxpayers are also subject to gift tax on the lifetime transfer of assets. Accordingly, gift tax should also be a consideration when implementing any estate or tax planning strategies. Since U.S. gift tax is generally tied to U.S. estate tax, the gift tax lifetime exclusion amount for U.S. citizens is the same as the exclusion amounts applicable for U.S. estate tax purposes (US$11.18 million for 2018).

Any use of the lifetime exemption amount towards gift tax will have a corresponding decrease in the exemption amount available for U.S. estate tax. In addition to the lifetime gift tax exclusion, U.S. citizens can give US$15,000 (annually per recipient) and up to US$152,000 to a non-U.S. citizen/non-U.S. resident spouse without being subject to gift tax. Both of these amounts are indexed annually.

Generation Skipping Tax ("GST") – GST is imposed in addition to estate or gift tax when there is a transfer of assets to a recipient that is more than one generation removed from the transferor. For example, a gift from a grandparent to a grandchild may be subject to the GST. The purpose of the GST is to ensure that estate or gift tax is not avoided by skipping one generation level. The rates and exclusion amounts for the GST are the same as the rates and exclusion amounts for estate and gift tax (US$11.18 million for 2018).

Implications of rescinding your U.S. citizenship

Given the numerous U.S. income tax and information reporting requirements imposed on U.S. citizens, especially those who have financial assets located outside of the U.S., many U.S. citizens living in Canada have considered rescinding their U.S. citizenship. However, in rescinding your U.S. citizenship, you may be subject to considerable U.S. income tax upon expatriation. In addition, gift tax may be imposed on the recipient of a gift from an expatriate. Unless you qualify for a specific exception to the rules, the "exit tax" provisions are imposed on expatriating individuals who meet any one of the following criteria:

1. Have a net worth over $2 million on the date of expatriation;
2. Average U.S. income tax liability for the five years preceding the date of expatriation exceeds a certain amount that is indexed to inflation (US$165,000 for 2018); or
3. Have not complied with all U.S. federal tax obligations for the five years preceding the expatriation date.

Individuals, who are dual citizens at birth and meet certain additional criteria, may be exempt from these "exit tax" provisions.

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Even if the exit tax does not apply in your circumstances, you should seek the advice of a U.S. immigration attorney to understand any issues that may arise if you decide to work or visit the U.S. after rescinding your U.S. citizenship.

Long-term capital gain and dividend rates[1]

The top rate for long-term capital gains (defined as capital gains from the sale of assets that were held for greater than one year), and qualified dividends is:

For married taxpayers filing jointly:

- 0% for joint incomes up to $77,199;
- 15% for joint incomes from $77,200 to $478,999; and
- 20% for joint incomes over $479,000

For single taxpayers:

- 0% for incomes up to $38,599;
- 15% for incomes from $38,600 to $425,799; and
- 20% for incomes over $425,800.

Appendix A – 2018 U.S. Income Tax Rates

Single Tax Filer Taxable Income Range	Married Taxpayers Filing Jointly (MFJ) Tax able Income Range	Ordinary Income Tax Rates[1]
$0 – $9,525	$0 – $19,050	10%
$9,526 – $38,700	$19,051 – $77,400	12%
$38,701 – $82,500	$77,401 – $165,000	22%
$82,501 – $157,500	$165,001 – $315,000	24%
$157,501 – $200,000	$315,001 – $400,000	32%
$200,001 – $500,000	$400,001 – $600,000	35%
Over $500,000	Over $600,000	37%

For more information about the U.S. income tax considerations discussed in this publication, please speak with your BMO financial professional for an introduction to a qualified cross-border tax professional.

[1] Higher income taxpayers (individuals with Modified Adjusted Gross Income over $200,000 for single individuals and $250,000 for married taxpayers) must also pay 3.8% additional tax on net investment income to the extent the threshold income amount is exceeded. Thus the capital gains and dividend tax rate will be 18.8% or 23.8% to the extent the 3.8% surtax on net investment income applies to capital gain and dividend income.

The information presented in this publication is neither a comprehensive review of the subject matter covered, nor a substitute for specific professional advice. Because of the complexity and evolving nature of cross-border taxation, and the potential for significant penalties, consultation with a cross-border tax specialist is recommended to review the applicable U.S. and Canadian tax consequences and to co-ordinate the tax implications in both jurisdictions.

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ID0373 (04/18)