KOTLER VAN DEN BRINK & COMPANY
U.S. & CROSS-BORDER TAX CONSULTANTS

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The U.S. TAXFACTS

Kotler van den Brink & Company has been providing U.S. and cross-border (Canada-U.S.) tax consulting and compliance services to accounting and legal professionals since 1988.

TOPIC: CURRENT EVENTS - INDIVIDUALS

This edition of the U.S. TAXFACTS will discuss issues that we are regularly seeing with respect to individual clients who are either US citizens, or receiving income from US sources. Future editions of the U.S. TAXFACTS will address corporate tax issues.

ACCIDENTAL AMERICANS

If an individual was born in the United States, they are a US citizen. It does not matter if they moved to Canada at two years old, or if that was sixty years ago. A US citizen is obligated to file a US tax return and report worldwide income on this return. In many cases the foreign tax credit for Canadian taxes paid reduces the US tax liability to zero; However, the IRS can apply substantial penalties for the late filing of certain international tax forms that need to be filed with the tax return.

For those individuals living in Canada who have not filed the necessary US tax returns, the IRS has created a program called the Streamlined Foreign Offshore Procedure which allows non-filers to voluntarily come forward and become compliant with US tax law. If a US citizen satisfies the eligibility requirements for this program, they will be required to file 3 past due tax returns and 6 years of Foreign Bank Account Reporting (FBAR) forms. No penalties will be assessed for the late filing of the tax returns and informational forms. This program has been extremely popular for US citizens living in Canada. However, we have recently seen many cases where US citizens living in Canada do not qualify for the program as they are present in the US more than 35 days per year (e.g. snowbirds or even individuals living close to the border who cross the border often to get gas). When presented with a US citizen non filer, it is very important to obtain all the facts before submitting tax forms to the IRS as an incorrect, or incomplete, submission can result in significant penalties.

SALE OF PRINCIPAL RESIDENCE

With housing prices on the lower mainland continuing to climb, many people are looking to cash in. While the sale of a principal residence is generally tax free in Canada, a US citizen is only provided US$250,000 of tax free gain on the sale of a principal residence, with any remaining gain being taxed at capital gains rates.

There may be planning opportunities to get away from this tax such as gifting the property to a non US citizen spouse, but only if put in place before the property is sold.

CANADIAN MUTUAL FUNDS - PFIC

The US Passive Foreign Investment Company ("PFIC") rules continue to be a problem for US citizens living in Canada, especially with respect to their mutual fund investments. The draconian PFIC rules work to significantly increase the US taxes payable on income and capital gains from mutual fund investments - we have seen rates as high as 70%.

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Many Canadian mutual fund companies have recognized this problem and are providing Qualified Electing Fund ("QEF") statements to investors and advising them that this QEF statement will solve all their PFIC related problems. Unfortunately this is not the case.

While making a QEF election does help eliminate some of the more punitive elements of PFIC taxation, there are two rather large caveats:

1. The QEF election must be made in the first year the fund is held, or it simply delays the problem as the PFIC rules will apply if a gain is realized on the sale of the fund, and

2. The income recognized under QEF can be markedly different than the income on the Canadian return. This causes timing issues and poor foreign tax credit integration, that can ultimately lead to double tax.

Based on these issues and a few other issues beyond the scope of this article, our recommendation to US citizen clients is to not own Canadian mutual funds and to invest in non PFIC investments. The good news is that many investment advisors are now aware of the PFIC rules and can create PFIC compliant portfolios.

CANADIAN PRIVATE COMPANIES - PFICS

A mutual fund is not the only way to run afoul of the very unfriendly PFIC rules. A PFIC is any foreign corporation where either more than 75% of the corporation's income is passive, or more than 50% of the corporation's assets are held for the production of passive income.

We often see US citizens with a minority interest in a family corporation where cash or other investments are far and away the largest asset on the balance sheet. Unfortunately these corporations are PFICs and income or capital gains realized by the shareholder can be taxed at very punitive tax rates. This can come as a surprise to those who created the structure in the first place to split income amongst family members to reduce Canadian taxes.

FIRPTA WITHHOLDING

The sale of US real property by a non-resident of the US has always required withholding on gross sale proceeds unless certain limited exceptions have been met. Two recent changes - one administrative and the other legislative has made this more of a headache for the Canadian resident.

Legislative: The signing of the PATH act in December of 2015 raised the FIRPTA withholding rate on gross proceeds for most sales from 10% to 15%.

Administrative: In 2015 the IRS instituted an administrative review on refunds requested by non-residents. This "matching" program has effectively delayed the processing on any return which is claiming a refund of withheld tax by up to 12 months. This delay in issuing refunds has been very frustrating to those who have followed all the rules and filed tax returns only to have the IRS delay refunds for no apparent reason.

GIFT OF US VACATION HOME

We are seeing many situations lately of Canadian residents putting their children on title to their US real estate. The reason given most often for doing this is that a US lawyer has advised them that probate tax will be reduced or eliminated.

What the US lawyer does not consider is whether a gift to the children has occurred when they are put on title. Generally speaking, the IRS would consider the transfer of title to be a gift which would be taxable in the US at rates of up to 40% of the value being gifted to the extent the gift exceeds $14,000.

There are situations where the IRS would not consider the change of title to be a gift but it is important that planning be undertaken to ensure that the intention of the parties involved is very clear.

Please remember, the information presented is general in nature and does not constitute professional advice. It is recommended that accounting, legal or other professional advice should be sought before acting upon any of the information contained.