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The U.S. TAXFACTS

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

This edition of the U.S. TAXFACTS will discuss a few of the issues that Canadian professionals may come across while assisting their clients during the 2017 busy season.

US REAL ESTATE

If you have clients who have, or are thinking about purchasing property in some of the warmer climates to the south, it's important that they are aware that there may be tax implications attached to that new vacation/rental property.

INCOME FROM US PROPERTY

Whether it's from the rental of property, or the ultimate sale of the property, any income derived from US property is a taxable event that will require US federal and in most cases state tax returns be filed.

Many clients are purchasing US properties with the intention of renting them out now and enjoying them as their second home later in retirement. Most clients are alarmed to learn that they may incur a tax liability when they convert the rental property to a personal use property.

Clients may also be in for a shock when they learn that interest paid on their Canadian mortgage credit lines is not deductible on their US tax return even though this debt was incurred to purchase the US property. This can result in a current tax liability in the US with no credit available in Canada. Bottom line is, don't let your clients make such a significant purchase without gathering the facts first.

CHANGING TITLE ON US VACATION HOME

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

What the lawyer does not consider is whether a gift to the child has occurred when they are put on title. *It is important to keep in mind that the US taxes gifts*. 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% on the value being gifted in excess of US$14,000. A non US citizen is not eligible for the lifetime gift tax exemption available to US citizens nor does the Treaty apply to reduce gift taxes.

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.

UNEXPECTED US ESTATE TAXES

As the aging population moves forward, tax practitioners are dealing with Estates much more frequently. It is very important that US Estate taxes be planned for when you have elderly clients with children residing in the US or who are US citizens. We have had situations where US residents inherit wealth from Canadian parents only to pass away themselves leaving a significant portion (i.e. up to 40%) of the parents' wealth to the US government.

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Similar to gift taxes, many Canadian residents, or their executors, are surprised to discover that US estate taxes can apply to a Canadian resident non-US citizen if that Canadian dies holding more than $60,000 of US situs property.

US situs property can include the obvious, such as US real estate, but will also include the less obvious assets such as US shares in a Canadian brokerage account or RRSP.

A properly structured estate plan can eliminate or significantly reduce exposure to US estate taxes.

US CITIZENS

Some issues to be aware of when one of your clients is, or might be, a US citizen.

U,S. Citizen Non-Filer Update

We've said this before, but it bears repeating: If an individual was born in the United States, they are a US citizen. It doesn't matter if they moved to Canada at two months old sixty years ago, or moved to Canada just last week. Unless the individual has taken steps to renounce their citizenship, they remain a US citizen. A US citizen is obligated to file a US income tax return annually reporting worldwide income. 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 are not current with their US tax obligations, the IRS program, called the Streamlined Foreign Offshore Procedure, 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 three years of past due tax returns and six years of Foreign Bank Account Reporting (FBAR) forms. No penalties will be assessed for the late filing of the tax returns and information forms. This program has been extremely popular for US citizens residing in Canada. When presented with a US citizen non filer, it is 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 potentially at their peak, 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 up to 20%.

There may be planning opportunities to get away from this tax but only if a plan is put in place before the property is sold.

W8 or W9 Forms, a trap for the unwary?

When the US Foreign Asset Tax Compliance Act (FATCA) became law in July of 2014, there was concern as to how Canadian banks would acquire the information required by the law from Canadian account holders.

The answer is the W-8BEN form and its cousin, the W-9 form. When opening a new account with a major Canadian bank, the bank is now required to inquire as to whether or not the account holder is a US citizen. If the account holder answers in the negative, they are asked to complete a W8-BEN form to confirm their foreign status, which the bank then keeps on record. Where however the account holder answers in the affirmative, they are asked to complete a W-9 form so that the bank has a record of their US status and US Social Security Number (SSN).

A non-answer is not permitted, as the bank must collect this information to avoid having significant tax withheld on the bank's US source income.

The request for the taxpayer's SSN can cause problems for a US citizen who is not up to date with their taxes as the information collected by the bank ultimately ends up in the hands of the IRS.

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 within this edition of the US TAXFACTS