TAX BULLETIN

TAX CONSEQUENCES FOR U.S. CITIZENS AND OTHER U.S. PERSONS LIVING IN CANADA

September 2021

CONTENTS

Over the past several years, there has been increased media attention in Canada with respect to the U.S. income tax filing requirements that apply to all U.S. citizens who live outside of the U.S. These filing requirements can in some cases impose significant taxes, interest and penalties upon U.S. citizens residing in Canada.

Given the close economic and geographical relationship between Canada and the U.S., it is not uncommon to find U.S. citizens living in Canada. Some may be in Canada as the result of a temporary employment transfer, while others may be living here on a more permanent basis. As a U.S. citizen, you continue to have annual U.S. income tax filing obligations, even though you may be resident in Canada.

Note that many of these filing obligations also apply to U.S. green card holders, who are generally treated as U.S. residents for U.S. income tax purposes. We have referred to U.S. green card holders and U.S. citizens collectively as U.S. persons in this bulletin. This bulletin outlines various U.S. tax obligations of which U.S. persons living in Canada need to be aware. Unless otherwise stated, all figures are expressed in U.S. currency.

What's new?

On December 22, 2017, the U.S. passed the most far-reaching tax reform in the last thirty years, commonly referred to as the *Tax Cuts and Jobs Act* (TCJA). The TCJA includes significant changes to individual tax provisions. Most of these changes were effective starting on January 1, 2018 and are set to expire on December 31, 2025. All these changes affect U.S. persons. For information regarding these changes, you can view our recorded webinar on the subject, *Impacts of the U.S. Tax Reform on Canadian Individuals Subject to U.S. Tax.*

There have not been many additional changes since the December 22, 2017 announcement, as lawmakers have been busy drafting and finalizing regulations relating to tax reform under the TCJA.

Expectations were for 2020 to be a quieter year for taxpayers as major tax changes under the prior Tax Cuts and Job Act (TCJA) were generally to remain in place. However, it was a very tumultuous year, and the effects of COVID-19 are still being felt well into 2021. To provide help to taxpayers impacted by COVID-19, economic stimulus for taxpayers was provided in March 2020. The CARES Act (PL 116-136) was enacted, providing for a direct payment of $1,200 per individual, plus an extra $500 for each dependent under the age of 17. These payments are not considered taxable for U.S. or Canadian tax purposes.

A second round of economic stimulus for taxpayers was issued in December 2020 as part of the *Coronavirus Response and Relief Supplemental Appropriations Act* of 2021. Eligible individuals received $600 per individual, plus an extra $600 for each dependent under the age of 17.

Under the CARES Act, there were also some changes to charitable contribution limits. You can now qualify for an above-the-line charitable contribution of $300, even if you do not itemize your deductions on Schedule A. For those that do itemize their deductions, certain cash contributions are no longer subject to the 60% limit for cash contributions.

While there were no major changes to U.S. tax legislation in the 2020 tax year, this year may bring major changes to the U.S. tax law under the new Biden administration. During his presidential campaign, President Biden supported tax increases on the wealthy (individuals earning more than $400,000), which could result in increases in income taxes, estate taxes and gift taxes. For example, President Biden proposed increases to the top marginal income tax rates on ordinary income, long-term capital gains and qualified dividends. Numerous tax increase proposals made by the Democrats have been incorporated into draft legislation released to the public in September 2021, which they hope to pass into law before the end of 2021.

U.S. income tax filing requirements

Liability for U.S. income taxes payable by an individual is based on citizenship, as well as residence. As a U.S. person, you must file annual U.S. income tax returns regardless of where you live or how long you have been away from the U.S. For U.S. tax purposes, you must report your worldwide income from all sources. This does not change your obligation as a Canadian resident to file a Canadian tax return and to pay Canadian taxes. However, the potential for double taxation is relieved in two ways: income exclusions and tax credits.

For example, if you are a U.S. person residing outside the U.S., you may qualify for a foreign earned income exclusion (maximum $107,600 for the 2020 tax year and $108,700 for the 2021 tax year) in connection with your employment and/or self-employment income. In addition, you can claim a foreign tax credit against your U.S. tax liability for taxes you paid to Canada. In many cases, the credit will be enough to eliminate any U.S. income tax liability since Canadian tax rates are typically higher than U.S. tax rates.

While the American and Canadian tax systems are similar, there are differences between the two countries' income recognition rules and allowed deductions. Therefore, you may end up with a U.S. income tax liability, even if you take advantage of the foreign earned income exclusion and/or a foreign tax credit claim.

The determination of actual Canadian and U.S. foreign tax credits can be complex, depending on the type of income earned or exemptions claimed. Your BDO tax advisor can assist with these details when preparing your Canadian and U.S. income tax returns.

On March 23, 2010, the U.S. Government enacted the *Patient Protection and Affordable Care Act* (commonly called Obamacare). This legislation introduced a 3.8% net investment income tax (NIIT) which applies to unearned income. Unearned income includes interest, dividends, capital gains, annuities, royalties, rents, and passive pass-through income. The NIIT went into effect on January 1, 2013 and it applies to U.S. persons who have income above certain statutory thresholds. For married individuals filing jointly, the NIIT applies to the extent their modified adjusted gross income (MAGI) exceeds $250,000. For married individuals filing separately, the MAGI threshold is $125,000; and for single filers, the MAGI threshold is $200,000. If you are subject to the NIIT, you may have tax due in the U.S., as the Internal Revenue Service (IRS) has stated that it will not allow a foreign tax credit against this tax.

The *Patient Protection and Affordable Care Act* also introduced mandatory health coverage beginning in 2014. An exemption from the coverage requirement has been granted to U.S. persons living abroad who are not physically present in the U.S. for at least 330 days within a 12-month period. This exemption also extends to individuals who are bona fide residents of foreign countries for an entire taxable year. The TCJA has reduced the shared responsibility payment for individuals failing to maintain minimum essential health insurance coverage to zero for tax years beginning after December 31, 2018.

Filing deadlines

Normally, you must file your U.S. income tax return for a particular year no later than April 15 of the year following the year in question. However, there is an automatic extension of time to file to June 15 if you are outside the U.S. on April 15. For example, if you are a U.S. person and are a resident of Canada on the April 15, 2021 deadline, you have until June 15, 2021 to file your 2020 U.S. tax return.

It is important to note that despite the automatic 2-month extension to file your return, any amounts owing to the IRS are still due April 15, and may be subject to penalties and interest if paid after that date.

Penalties

If you don't file your income tax return by the due date, the IRS may impose a late filing penalty of 5% per month (up to 25% of the balance due). The IRS may also impose a late payment penalty of 0.5% per month (up to 25% of the balance due).

Other penalties may also be imposed, including criminal penalties.

Non-filers

There has been an ongoing campaign by the U.S. government to make sure that U.S. citizens living outside of the U.S. are aware not only of their filing obligations for income tax returns, but also for related information filings, which often have steep penalties for failure to comply. See the section *U.S. foreign reporting requirements* below.

As part of its offshore initiatives, in March 2010 the U.S. enacted the *Foreign Account Tax Compliance Act (FATCA)*, which requires non-U.S. financial institutions to report accounts held by U.S. persons to the IRS. Canada and the U.S. signed an intergovernmental agreement (IGA) on February 5, 2014. Under the IGA, Canadian financial institutions are reporting relevant information on accounts held by U.S. citizens to the Canada Revenue Agency (CRA), and the CRA is exchanging the information with the IRS through existing provisions in the *Canada - U.S. Income Tax Convention* ("the Treaty"). Registered accounts such as RRSPs, RRIFs, RESPs, and TFSAs are exempt from these reporting requirements.

The purpose of FATCA is to identify U.S. citizens, particularly those living outside the U.S., who are non-compliant, and who have significant assets in non-U.S. accounts. It is therefore expected that the IRS will follow up on reported non-compliant U.S. citizens to request tax returns and to assess taxes, interest and penalties accordingly.

Under the Treaty, the IRS can solicit the assistance of the CRA in collecting unpaid taxes from U.S. persons residing in Canada that the IRS has established to have been due in the last 10 years. However, the CRA has stated that this provision does not include the collection of penalties related to Foreign Bank and Financial Accounts (FBAR) information reporting (discussed on page 5). In addition, the CRA has stated that it will not help collect any debts owing to the IRS by individuals who were Canadian citizens when the debts arose, even if they were also U.S. citizens.

U.S. persons living in Canada who are non-compliant and want to become up-to-date with respect to their U.S. tax filing obligations have various options available to them.

In July 2014, the IRS unveiled the current version of the Streamlined Foreign Offshore Procedures (SFOP) for taxpayers residing outside the U.S.

The procedures require the filing of original or amended income tax returns for the previous three years and FBAR information reporting for the previous six years. Taxpayers accepted into the program do not owe failure-to-file or failure-to-pay penalties, nor the civil penalties or criminal charges associated various late-filed information reporting forms. However, interest would still apply on any tax owing.

To qualify for these procedures, taxpayers must make a certification (via Form 14653) that failure to comply resulted from non-willful conduct and provide additional narrative commentary regarding the circumstances behind their past reporting delinquency. Furthermore, taxpayers must meet a defined test of non-residency by being physically outside the U.S. for at least 330 full days during at least one of the three primary years of the submission.

For more information regarding the SFOP, see our Tax Alert, *IRS announces relief procedures for certain former U.S. citizens* (October 8, 2019)

There are less rigorous amnesty procedures available for taxpayers in situations where income from foreign assets has been duly reported, but foreign information disclosures have been unintentionally omitted. Penalties are generally waived as long as reasonable cause for the failure to file can be established to the satisfaction of the IRS.

The 2012 Offshore Voluntary Disclosure Program (OVDP) was closed effective September 28, 2018. This program was designed for those who were willfully noncompliant with the filing obligations, and therefore did not qualify for the SFOP or other similar amnesty programs. In the absence of the OVDP, such U.S. persons should still make efforts to become compliant and disclose foreign accounts under the IRS' general voluntary disclosure procedures, rather than risk detection by the IRS and possible criminal prosecution.

Contact your BDO advisor for assistance with filing your U.S. income tax returns.

U.S. foreign reporting requirements

In addition to being subject to U.S. income tax on worldwide income, U.S. persons are subject to various U.S. foreign reporting requirements as discussed below. Non-compliance may result in penalties. Furthermore, in some cases, if a return is filed but the required disclosures are not filed, the statute of limitations for a return filed for that year will not expire.

Report of Foreign Bank and Financial Accounts (FBAR)

Any U.S. person who has a financial interest in (or signature authority over) any financial account in a foreign country may be required to file FinCEN Form 114, *Report of Foreign Bank and Financial Accounts* (FBAR). This form was formerly known as Form TD F 90-22.1 and is required if the aggregate value of these accounts exceeds $10,000 at any time during the calendar year.

If you fail to file an FBAR, in the absence of "reasonable cause" for doing so, you may be subject to a civil penalty for either non-willful or willful noncompliance. Non-willful violations are subject to a penalty of up to $10,000 per violation. Civil penalties for willful violations can be up to the greater of $100,000 or 50% of the total balance of the foreign account.

The due date of the FBAR is April 15 of the subsequent year (April 15, 2021 for 2020 filings). However, FinCEN has granted a permanent automatic extension of the filing deadline to October 15 (October 15, 2021 for 2020 filings) without a need for taxpayers to formally request an extension.

Foreign financial asset reporting

U.S. persons who have an interest in certain specified foreign financial assets are required to report these assets on Form 8938, *Statement of Specified Foreign Financial Assets* if the total value of these assets exceeds certain thresholds. For individuals living outside of the U.S., the threshold is $200,000 at the end of the year, or $300,000 at any time during the year. For taxpayers filing a joint return, these thresholds are doubled to $400,000 and $600,000 respectively. Note that the thresholds for U.S. persons living in the U.S. are lower than for those living outside of the U.S.

Failure to file Form 8938 could result in a $10,000 penalty, with an additional penalty up to $50,000 for continuing failure to file after receiving notification from the IRS.

This form is required in addition to the FBAR reporting described above. Unlike the FBAR, this form is filed as a part of your income tax return.

Foreign trusts

If you contributed to, loaned money to, or are the beneficiary of, a non-U.S. trust, you may be subject to U.S. foreign reporting requirements associated with foreign trusts.

There are two types of foreign trusts under U.S. tax rules:

- Foreign grantor trusts
- Foreign nongrantor trusts

If a foreign trust is considered a grantor trust, it is effectively disregarded for U.S. income tax purposes, and the trust's income is taxable in the hands of the person considered to be the trust's owner (i.e. the grantor).

If a foreign trust is considered a nongrantor trust, its income is taxable to its U.S. beneficiaries. If the trust's income is not distributed to beneficiaries in the year earned, the beneficiaries may be subject to a punitive "throwback tax" on the eventual distribution of the accumulated income. The throwback tax is designed to tax the income as if it was hypothetically distributed in the year it was earned.

Foreign grantor trusts and/or their U.S. owners are required to file the following two foreign reporting forms annually:

- Form 3520-A, *Annual Information Return of Foreign Trust With a U.S. Owner*, and
- Form 3520, *Annual Return to Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts*.

The above forms are filed separately from the taxpayer's individual income tax return.
Form 3520-A is due March 15 (a 6-month extension is available by filing an extension request by the due date). Form 3520 is due the same day as the taxpayer's individual income tax return, including extensions.

If you fail to comply with the above foreign reporting requirements, you may face the following penalties:

- If you don't file form 3520-A, or if you file it late, a penalty equal to the greater of $10,000 or 5% of the gross value of the portion of the trust you are deemed to own,
- If you don't file form 3520, or if you file it late, a penalty equal to the greater of $10,000, 35% of the annual contributions to the plan, 35% of the gross distribution received, or 5% of the gross value of the portion of the trust that you are deemed to own.

Registered Retirement Savings Plans (RRSPs) and Registered Retirement Income Funds (RRIFs)

If you own a Canadian RRSP or RRIF, an automatic election is available to under the Treaty to defer recognition of the income and gains realized in these plans for U.S. tax purposes until such time that the income is withdrawn from your RRSP or RRIF. This means that the timing of the taxation of the RRSP or RRIF income will be the same for both Canadian and U.S. tax purposes.

Since no U.S. tax deduction is available for contributions to RRSPs, the withdrawal of these contributions is not subject to U.S. tax, and generally only the growth in value (if any) of the RRSP or RRIF is taxed upon withdrawal.

The automatic election to defer current taxation of income earned is also available to Registered Pension Plan and Deferred Profit-Sharing Plan holders. However, the U.S. reporting requirements for these types of plans are different from those for RRSPs or RRIFs. Please contact your BDO advisor for assistance with making the proper disclosure in connection with your Canadian retirement plans.

Registered Education Savings Plans (RESPs)

U.S. persons living in Canada can invest in RESPs but doing so may have negative consequences for U.S. income tax purposes. The main disadvantage is that U.S. persons cannot elect to defer the U.S. taxation of income earned in an RESP. That is, the tax relief available for RRSPs and RRIFs is not available to contributors or beneficiaries of RESPs.

Since an RESP is generally considered to be a foreign trust for U.S. tax purposes, U.S. persons who invest in them are subject to the U.S. reporting requirements for foreign trusts.

Recent IRS Revenue Procedure 2020-17 released in March 2020 effectively eliminated the Form 3520 and 3520-A filing requirements for RESPs for all past and future years, provided that certain criteria are met.

Contributor is a U.S. person

Where the contributor to the plan is a U.S. person, the annual income earned within the plan (excluding unrealized capital gains but including Canadian Education Savings Grants) is taxable to the contributor parent for U.S. tax purposes. There are no income tax consequences upon withdrawal of the funds if the proper reporting is followed. However, there is an element of double taxation. As noted, for U.S. tax purposes, the plan income will be taxable to the contributor parent, but for Canadian tax purposes, the income earned in the plan will generally be taxable in the hands of the child when he or she withdraws funds to pay for university or college.

Contributor is not a U.S. person

Where the contributor to the plan is not a U.S. person, the income earned within the plan is not taxable in the U.S. to any party when earned nor when distributed.

If you are considering contributing to an RESP for your child in order to take advantage of the Canada Education Savings Grant, you may consider if a non-U.S. person, such as your spouse or a grandparent, is eligible to contribute to the plan, thereby avoiding any U.S. issues.

Beneficiary is a U.S. person

Where the beneficiary of the RESP is a U.S. person, any distribution of income or principal from an RESP will not be included in the beneficiary's income for U.S. income tax purposes.

Tax Free Savings Accounts (TFSAs)

Since their introduction in 2009, TFSAs have become a very popular tax-free investment vehicle in Canada. There are three types of TFSA accounts:

- Deposit accounts
- Annuity contracts or arrangements
- Trust arrangements

Similar to RESPs, U.S. persons investing in TFSAs cannot elect to defer the taxation of income earned inside the plan. The plan's income is taxable to the plan owner for U.S. tax purposes, even though there is no tax to pay on this income for Canadian tax purposes.

In addition, if you invest in a TFSA structured as a trust arrangement, you will generally be required to file Forms 3520 and 3520-A (see the Foreign grantor trust section of this bulletin, above).

Foreign corporations

If a U.S. person invests in a closely held foreign corporation (such as a Canadian private corporation owned by a U.S. person living in Canada) or in a widely held foreign corporation that earns the majority of its income from passive sources (such as stocks, bonds or mutual funds), the reporting and disclosure requirements for U.S. tax purposes can be complex. In addition, these investments may be subject to punitive U.S. tax regimes designed to prevent tax deferrals.

A potential tax deferral exists if the U.S. person is not taxed on corporate earnings until actual distributions are made to the U.S. person by the foreign corporation. To prevent this deferral benefit on certain types of income, the U.S. has put anti-deferral regimes in place.

Two classes of foreign corporations associated with anti-deferral regimes are:

- controlled foreign corporations (CFCs), and
- passive foreign investment companies (PFICs).

Controlled foreign corporations (CFCs)

A non-U.S. corporation is considered to be a CFC if more than 50% of the total combined voting power or the total value of its stock is owned directly, indirectly, or constructively by U.S. shareholders on any day during the CFC's tax year. For certain purposes, shares owned by close family members can be considered to be owned by the U.S. person.

If you own (directly, indirectly or constructively) 10% or more of the shares (measured in votes or value) of a corporation that meets the definition of a CFC, you may be required to include a portion of the passive income of the corporation in your taxable income in the year the income is earned by the corporation. This applies even though you may not have received an actual distribution from the corporation related to that passive income. This treatment can result in differences in the timing of income tax in the U.S. and in Canada and can therefore result in double taxation.

Even if the CFC does not earn passive income, you may be required to report undistributed corporate income in your taxable income if the CFC invests in U.S. property, such as stock of U.S. corporations or loans to U.S. persons.

In addition, you are required to file Form 5471, *Information Return of U.S. Persons with Respect to Certain Foreign Corporations*. The form is due when the U.S. person's income tax return is due, including extensions. If the form is not filed on time, the IRS may impose a $10,000 penalty.

Transition tax and GILTI

The TCJA imposed a mandatory one-time tax known as a "transition tax" on U.S. shareholders that owned 10% or more of the shares of a CFC. The transition tax was imposed on the untaxed foreign earnings and profits of the CFC, particularly including undistributed profits from active business not already taxed under the aforementioned rules. The effective tax rate on this income was as high as 17.5%. For U.S. persons, this provision was generally effective for the 2017 tax year, regardless of the fiscal year end of the CFC.

The TCJA also provides for an annual tax on a U.S. shareholder's share of global intangible low-taxed income (GILTI). GILTI is very generally the CFC's after-tax business profits in excess of a 10% baseline return on depreciable assets. The GILTI rules are generally effective for 2018 and subsequent years.

For more information regarding GILTI, please see our Tax Alert, *New U.S. Tax on U.S. Citizens Owning Canadian Private Companies* (December 17, 2018).

In addition, there were some changes to the definition of U.S. shareholder and constructive ownership rules for U.S. corporations.

Passive foreign investment companies (PFICs)

Generally speaking, a non-U.S. corporation is considered to be a PFIC if more than 75% of its income is "passive" income, or 50% or more of the corporation's assets generate "passive" income. Passive income generally includes interest, dividends, capital gains and rents.

For U.S. tax purposes, Canadian mutual fund trusts may be considered to be corporations. Therefore, if you own an interest in a mutual fund trust, you may be subject to the PFIC rules.

In addition to mutual fund corporations and trusts, some privately and publicly owned companies may also be subject to the PFIC rules if they are not considered CFCs (discussed above).

If you directly or indirectly own a PFIC, any distributions received from the PFIC and any gain realized on the sale of the PFIC could be subject to a very punitive deferred tax regime. Under this regime, income received is allocated to each year of ownership and taxed at the highest marginal tax rate applicable to each year. Moreover, interest charges are added to the deferred tax.

You may be able to make certain elections which would allow you to avoid the default PFIC deferred tax regime.

If you have an interest in a PFIC, you are required to file Form 8621, *Information Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund*, along with your U.S. income tax return.

Canadian tax planning

Some Canadian estate planning for U.S. persons can put you squarely into the CFC and/or PFIC anti-deferral tax regimes. For example, although shares of an operating company may not be subject to particularly adverse U.S. tax consequences, the use of a Canadian holding company can create passive asset holdings and significant tax issues.

When U.S. persons are involved in Canadian "estate freeze" transactions, transfers of shares that are tax-deferred transactions for Canadian purposes may give rise to immediate U.S. income tax. Furthermore, new shares subscribed for by family members for nominal value may give rise to gift tax issues (discussed on page 8).

The rules regarding U.S. persons investing in CFCs and PFICs are very complex. If you think that you may have an interest in one of these types of investments, please consult with your BDO advisor.

Foreign partnerships

If you invest in a non-U.S. partnership, you may be required to file Form 8865, *Return of U.S. Persons With Respect to Certain Foreign Partnerships*. You will generally be required to file this form if you own 10% or more of a partnership that is controlled by U.S. persons, each of whom owns at least a 10% interest. In addition, you will be required to file the form in any year you invest more than $100,000 in a foreign partnership.

This form is due when the U.S. person's income tax return is due, including extensions. If the form is not filed on time, the IRS may impose a $10,000 penalty.

U.S. Social Security

If you receive U.S. Social Security payments, you will effectively include only 85% of the payments on your Canadian income tax return. However, you will not be subject to tax on this income in the U.S., as you will be able to claim that the income is treaty-exempt from U.S. tax on your U.S. income tax return.

For Canadian residents (and their spouses or common-law partners eligible to receive survivor benefits) who have been in receipt of U.S. Social Security benefits since before January 1, 1996, the inclusion rate is reduced from 85% to 50%.

U.S. estate tax

U.S. income tax is not the only tax concern for U.S. persons residing in Canada. If you are a U.S. citizen (or a U.S. noncitizen domiciled in the U.S.), U.S. estate tax will apply on your death. This tax will generally be equal to 40% of the fair market value of your *worldwide* estate in excess of the exclusion amount applicable at that time, and is not just based on your estate assets situated in the U.S.

Under the TCJA, the exclusion amount increased from $5,000,000 to $10,000,000 (subject to annual inflation adjustments from 2010 onwards), but is scheduled to revert to pre-TCJA levels in 2026, absent further legislative action. The indexed exemption amount for 2020 was $11,580,000 ($11,700,000 for 2021).

There was no change to the portability election enacted in 2010. This election allows estates of married taxpayers to pass along the unused part of their exclusion amounts to their surviving U.S. citizen spouse. This provision eliminates the need for spouses to retitle property and create trusts solely to take full advantage of each spouse's exclusion amount. There is also an unlimited marital deduction for bequests to a U.S. citizen spouse.

Where only one spouse is a U.S. citizen, the estate tax rules work differently than when both spouses are U.S. citizens. For example, where the decedent spouse is a U.S. citizen, but the surviving spouse is not, the unlimited marital deduction does not apply. This means that an estate tax liability can arise on the death of the U.S. citizen spouse, even where all of their assets pass to the surviving spouse.

However, there are planning methods to help mixed-citizenship couples minimize their combined estate tax liabilities. For example, the Treaty may apply to enhance the exemption available for transfers to surviving Canadian spouses via a special marital credit. If this marital credit is not sufficient, a qualified domestic trust (QDOT) can be used to defer estate tax.

Unlike the U.S., Canada does not have an estate tax. However, when Canadian residents die, they are deemed to dispose of all of their property, including retirement accounts, at fair market value, unless their spouse inherits the property. Fortunately, any U.S. estate tax that has to be paid on death may be eligible as a credit against Canadian income tax in the year of death on U.S. source income. Similarly, some Canadian income taxes resulting from death may be eligible as a credit against U.S. estate tax.

Note that during his presidential campaign President Biden proposed the return of the estate tax and exemption and rate to 2009 levels, which would result in and estate tax exemption of $3.5 million, and the highest marginal tax rate of 45%. He also proposed the elimination of the basis step-up at death. Draft legislation released to the public in September 2021 contemplates accelerating the return of the estate tax exemption to pre-TCJA levels in 2022.

Contact your BDO advisor for more information on how the U.S. estate tax could affect you.

U.S. gift tax

U.S. citizens and green card holders who are domiciled in the U.S. are subject to gift tax on the direct or indirect transfers of property by gift. The gift tax is imposed on the provider of the gift rather than the recipient and applies to the extent that the value of the property transferred exceeds allowable exclusions and deductions. The following exclusions and deductions are available to a U.S. taxpayer making a gift:

- an annual exemption of $15,000 per donee in 2020 ($15,000 for 2021),
- an unlimited marital deduction for gifts made to a U.S. citizen spouse, and
- an annual exemption of $157,000 in 2020 ($159,000 for 2021) for gifts made to a non-citizen spouse.

The taxpayer may use his or her lifetime gift tax exemption to offset any taxable gifts (after the above exclusions and deductions) made during the year. Under current legislation, the lifetime gift tax exemption is harmonized with the estate tax exclusion amount, i.e. $11,580,000 for 2020 ($11,700,000 for 2021). Gifts in excess of the lifetime exemption are subject to 40% tax.

The gift and estate tax systems are integrated. If you use some portion of your lifetime gift tax exemption, this will result in a corresponding reduction in your estate tax exemption.

While recipients of gifts are not subject to gift tax, if during a tax year you received a gift from a U.S. nonresident alien or a foreign estate valued in excess of $100,000, you are required to file Form 3520, *Annual Return to Report Transactions with Foreign Trusts and Receipts of Certain Foreign Gifts*. If you fail to report the foreign gift, you may be subject to a penalty equal to 5% of the amount of such gift for each month the return is outstanding, to a maximum of 25%.

If you are planning to gift a property or you have received a gift from a foreign person, you should discuss the consequences with your BDO advisor.

Giving up U.S. citizenship or green card

Given the onerous reporting requirements the U.S. imposes on its citizens regardless of where they reside, some U.S. citizens living permanently in Canada may wonder whether it is advantageous (for tax purposes) to renounce or relinquish their U.S. citizenship.

Unfortunately, there are rules in place which allow the IRS to levy an "exit tax" on U.S. citizens who expatriate and on long-term residents who give up their green card. There have been different regimes in place since the rules were first introduced, and the most recent law applies to expatriations after June 16, 2008. A long term resident is a green card holder who has held their green card for parts of at least eight of the last 15 years), not including years where one filed as a non-resident of the U.S. due to being a resident of another country under a treaty.

The exit tax applies to expatriating U.S. citizens and long-term residents who are considered “covered expatriates” by virtue of meeting one of the following conditions:

- Your average annual net income tax liability for the last five tax years preceding your expatriation year exceeds $171,000 for 2020 ($172,000 for 2021),
- Your net worth at the date you relinquish your citizenship exceeds $2,000,000, or

- You fail to certify that you have complied with all of your federal tax obligations for the last five tax years preceding your expatriation year.

In limited circumstances, certain dual citizens and certain minors may qualify for an outright exemption from covered expatriate status, as long as they comply with their U.S. tax filing obligations for the last five years prior to their expatriation year.

On September 6, 2019, the IRS announced Relief Procedures for Certain Former Citizens. Under this program, the IRS is providing an alternative means for satisfying the tax compliance obligations of citizens who expatriate after March 18, 2010, provided that they meet defined criteria. Please see our Tax Alert, *IRS Announces Relief Procedures for Certain Former U.S. Citizens* (October 8, 2019) for details related to this program.

If you are a covered expatriate subject to exit tax, for U.S. income tax purposes you will be deemed to have sold your worldwide assets at fair market value (subject to certain exceptions noted below) on the day before your expatriation date. Any net gain on the deemed sale is taxable to the extent it exceeds a certain threshold. The threshold was set at $600,000 in 2008, and is indexed for inflation. The threshold amount for 2020 is $737,000 ($744,000 for 2021). If there is any "mark-to-market" tax due, then it may be possible to make an election to defer the payment of the tax, with interest.

The mark-to-market tax does not apply to the following items:

- eligible deferred compensation,
- ineligible deferred compensation, and
- specified tax deferred accounts.

An expatriate is required to treat ineligible deferred compensation accounts (mostly pension plans) and specified tax deferred accounts (including IRAs) as being entirely distributed to them on the day before the date of the expatriation. There is no election to defer tax on these amounts.

If steps are taken to make an item of deferred compensation "eligible", the amount will not be taxable at the time of expatriation. However, 30% tax must be withheld by the payor on any subsequent payments, because one condition for deferring tax on the item is that the expatriate may not claim Treaty benefits with respect to withholding on the eventual payment of the item.

In addition to exit tax at the time of expatriation, if a covered expatriate makes a gift or a bequest to a U.S. person, the recipient is subject to 40% tax on the value of the gift. The tax applies to covered gifts and bequests received since June 17, 2008, but the collection of the tax has been suspended until relevant regulations are finalized.

If you are considering renouncing or relinquishing your U.S. citizenship or surrendering your green card, you should discuss the U.S. income tax consequences with your BDO advisor.

Summary

We strongly encourage all U.S. persons to comply with IRS filing requirements. It is important to remember that although you are a Canadian resident, as a U.S. citizen or green card holder, you continue to have U.S. tax obligations.

Do not allow yourself to be exposed to U.S. tax, penalties and interest — ensure that all of your U.S. tax filing requirements are satisfied on a timely basis.

If you have questions regarding how the U.S. personal income tax rules might affect you, please contact our U.S. Tax Practice Leaders in Canada:

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