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TAX BULLETIN

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

March 2018

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Over the past few 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 result in significant tax, interest and penalties being imposed 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" or "TCJA". This Act includes significant changes to individual tax provisions. Most of these are effective starting January 1, 2018 and are set to expire on December 31, 2025. All these changes affect U.S. citizens or U.S. permanent residents. There are also significant changes to the U.S. Estate Tax.

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.

If you are a U.S. person residing outside the U.S., you may qualify for a foreign earned income exclusion (maximum $102,100 for the 2017 tax year and $104,100

for the 2018 tax year) in connection with your employment and/or self-employment income. In addition, you can claim a 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 coverage exemption is required to be reported on Form 8965, *Health Coverage Exemptions*. Taxpayers who do not comply with this mandate will be assessed a penalty (excise tax) on their 2017 tax return.

Please note the TCJA has reduced the shared responsibility payment for individuals failing to maintain minimum essential health insurance coverage to $0 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 (April 17, 2018 for the 2017 tax year). 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 17, 2018 deadline, you have until June 15, 2018 to file your 2017 U.S. tax return.

Penalties

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

Other penalties may also be imposed, including criminal penalties.

Non-filers

There has been a recent 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. Please 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). RRSP, RRIF, RESP, and TFSA accounts are exempt from these reporting requirements. FATCA reporting commenced effective July 1, 2014, and the first FATCA reporting to the CRA for the 2014 tax year was due on May 1, 2015. FATCA reporting to the CRA for the 2015 tax year was due May 1, 2016 and included additional disclosure items beyond what was included in the reporting for the 2014 tax year. As part of its first submission to the IRS in September 2015, the CRA submitted information for approximately 155,000 accounts (315,000 accounts in September 2016).

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 which 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 the Report of Foreign Bank and Financial Accounts (FBAR, discussed below). 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 be up-to-date on filing their U.S. tax returns have various options available to them.

On June 26, 2012, the IRS announced a program of streamlined filing compliance procedures for noncompliant U.S. taxpayers who have resided outside of the U.S. since January 1, 2009, have not filed any U.S. returns for 2009 and onwards, and who presented a low level of compliance risk. The IRS was assessing the level of compliance risk based on information provided on the returns filed and based on additional information provided in response to a questionnaire required as part of the procedures. Taxpayers accepted into the program did not owe failure-to-file or failure-to-pay penalties, nor the civil penalties or criminal charges for late-filed FBAR forms. The procedures required the filing of the previous three years' tax returns and the previous six years' FBARs.

In July 2014, the streamlined filing procedures as explained above were expanded and modified to accommodate a broader group of U.S. taxpayers. The program has been divided into two categories:

- Streamlined Foreign Offshore Procedures (SFOP) for taxpayers residing outside the U.S.
- Streamlined Domestic Offshore Procedures (SDOP) for taxpayers residing in the U.S.

These programs are similar to the program announced in June 2012. However, the IRS is no longer assessing the level of compliance risk, but is instead looking for confirmation that failure to comply resulted from non-willful conduct. In order to be eligible for the SFOP, a taxpayer must meet a defined test of non-residency. The main difference between qualifying under the SFOP rather than the SDOP is that the SDOP carries a 5% miscellaneous offshore penalty based on the value of foreign assets.

In January 2016 and in June 2016, the IRS revised the certification Forms 14653 and 14654 which are part of the submission under the SFOP and SDOP, respectively. These certification forms are used to document the taxpayer's representations of eligibility for the procedures, and now require additional narrative commentary to explain matters such as reasons for not filing on a timely basis, and reasons for existence of foreign accounts.

For more information regarding the SFOP and SDOP, please see our Tax Alert, *IRS Announces Revised Catch Up Procedures for U.S. Non-Filers* (July 16, 2014)

U.S. persons who don't qualify for either of the streamlined compliance procedures programs may consider filing under the 2012 Offshore Voluntary

Disclosure Program (OVDP). The 2012 OVDP has a higher penalty rate than the previous program but offers clear benefits to encourage taxpayers to disclose foreign accounts now 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 a 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.

Starting with the 2016 FBARs, the due date of the filings is April 15 of the subsequent year (April 17, 2018 for 2017 filings). However, FinCEN has granted a permanent automatic extension of the filing deadline to October 15 (October 15, 2018 for 2017 filings) without a need for taxpayers to actually 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 Foreign 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 $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.

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 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 non-grantor 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.

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

If you own a Canadian RRSP or RRIF, the default treatment under U.S. domestic law is that income and gains earned inside your RRSP or RRIF are included in your taxable income for U.S. tax purposes in the year they are earned, rather than when this income is withdrawn from the plan (which is when the income is taxed for Canadian tax purposes). However, there is relief under the Treaty, which allows a U.S. person to elect to defer recognition of the income and gains in these plans for U.S. tax purposes until such time as the income is withdrawn from their RRSP or RRIF. Since October 27, 2014, a U.S. citizen or resident alien automatically qualifies for tax deferral if they hold an interest in an RRSP or RRIF. This means that the timing of the taxation of the accrued RRSP or RRIF income will be the same for both Canadian and U.S. tax purposes.

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.

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.

The contributing parent is 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 plan 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 plan that you are deemed to own.

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, unless the beneficiary is a U.S. person and does not obtain proper U.S. tax documentation relating to the plan.

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 these 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 be included in the beneficiary's income unless the beneficiary obtains a statement from the trustee showing that the income is not taxable in the beneficiary's hands. When the beneficiary is taxable, the throwback tax mentioned above may apply.

If your child is a U.S. citizen or resident, they are required to file Form 3520 in any year they receive a distribution from an RESP. If your child does not file Form 3520, they could be subject to a penalty equal to the greater of $10,000 or 35% of the distributions from the plan.

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 be required to file Forms 3520 and 3520-A (see the RESP 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 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, and 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.

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.

What's new?

The TCJA imposes a mandatory one-time tax known as a 'transition tax' on U.S. shareholders that own 10 percent or more of the shares of a CFC. The transition tax is imposed on the untaxed foreign earnings and profits of the CFC. This provision is effective for the 2017 tax year for calendar year CFCs and is also applicable to the fiscal year of CFCs which includes Dec 31, 2017.

The new tax bill also provides for the global intangible low-taxed income tax, which is being referred to as the GILTI tax. The GILTI tax is a tax on a U.S. shareholder's share of its CFC's global intangible low-taxed income and is effective for CFC fiscal years beginning in 2018.

In addition, there are 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 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 below).

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 to 50% from 85%.

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. non-citizen domiciled in the U.S.), U.S. estate tax will apply on your death to the fair market value of your worldwide estate, not just on those assets situated in the U.S.

On January 1, 2013, President Obama signed into law the *American Taxpayer Relief Act* (ATRA). ATRA permanently raised the maximum federal estate tax rate to 40%, with an effective exemption for estates valued less than $5,000,000. The exclusion threshold is indexed annually for inflation. The exclusion is $5,490,000 for 2017). Under TCJA, the basic exclusion amount for 2018 increases to $10,000,000 (subject to annual inflation adjustment) but only until December 31, 2025.

There is 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 re-title 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.

It should be noted that 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 the property is inherited by their spouse. 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.

Contact your BDO advisor for more information on how the U.S. estate tax could impact 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 $14,000 per donee ($15,000 for the 2018 tax year)
- An unlimited marital deduction for gifts made to a U.S. citizen spouse
- An annual exemption of $149,000 in 2017 ($152,000 for 2018)for gifts made to a non-citizen spouse.

The taxpayer may use his or her lifetime gift tax exemptions to offset any taxable gifts (after the above exclusions and deductions) made during the year. For 2017, the lifetime exemption is $5,490,000, which is the same as the federal estate tax exemption. As noted above, for 2018, the

lifetime exemption was increased to $10,000,000 (subject to annual inflation adjustment) but only until December 31, 2025. Gifts in excess of the lifetime exemption are subject to 40% tax.

Note that 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 a 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

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 you filed as a non-resident of the U.S. due to being a resident of another country under a treaty.

The exit tax applies if you meet one of the following conditions:

- Your average annual net income tax liability for the five tax years preceding the date you relinquish your citizenship exceeds $162,000 for 2017,
- 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 federal tax obligations for the prior five tax years.

In limited circumstances, certain dual citizens and certain minors may qualify for an outright exemption from the exit tax.

If you are subject to this 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 2017 is $699,000. 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 tax 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 (a taxpayer subject to exit tax) makes a gift or a bequest to a U.S. person, the recipient could be subject to section 2801 tax at the 40% rate. The tax applies to covered gifts and bequests received since June 17, 2008, however 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. It's to your advantage to maintain yourself in good standing for future dealings with the U.S. authorities, particularly if you plan to return to the U.S. one day.

Don't 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. Your BDO advisor is ready to help.

The information in this publication is current as of March 1, 2018.

This publication has been carefully prepared, but it has been written in general terms and should be seen as broad guidance only. The publication cannot be relied upon to cover specific situations and you should not act, or refrain from acting, upon the information contained therein without obtaining specific professional advice. Please contact BDO Canada LLP to discuss these matters in the context of your particular circumstances. BDO Canada LLP, its partners, employees and agents do not accept or assume any liability or duty of care for any loss arising from any action taken or not taken by anyone in reliance on the information in this publication or for any decision based on it.

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