

# Spotlight on Crossborder Tax

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## I. Resident Status

### A. United States

1. Citizen (taxed on worldwide income, gifts and estate, subject to foreign earned income and foreign tax credits)
  - a. Possession of dual nationality not a bar to taxation as a U.S. citizen.
  - b. Whether residence of a U.S. citizen is inside or outside the U.S. is meaningful to a determination of the source of interest he or she pays on indebtedness, of eligibility for exclusion of certain “foreign earned income”, of qualification for many bilateral treaty benefits and of qualification for benefits accorded residents of U.S. possessions (*e.g.*, the Virgin Islands).
2. Green card (taxed on worldwide income, subject to treaty)
  - a. Whether an individual maintains “permanent residence” in compliance with the requirements of U.S. immigration law is not

- germane to the determination of his or her tax residence if the green card has not been surrendered or revoked.
- b. Many immigration attorneys regard an election of treaty tie-breaker benefits by a green card holder to avoid U.S. tax residence as inconsistent with maintenance of “permanent residence” for immigration law purposes.
3. Substantial presence unless closer connection (taxed on worldwide income, subject to treaty)
    - a. Note exceptions for students and persons who become subject to a constraining medical condition after having entered the U.S.
    - b. Assertion of closer connection requires timely filing on Form 8840.
    - c. Substantial presence in a foreign jurisdiction or possession may not be invoked by a U.S. citizen to qualify for benefits - - here it is a “facts and circumstances” test.
  4. Treaty (resident tiebreaker rules, effect on taxation, reporting)
    - a. Interpretation of the meaning of certain treaty tiebreaker terms derived from OECD Model is not well developed (*e.g.*, the correct meaning of “habitual abode”).
    - b. Treaty tiebreaker has no relevance to determination of residence for state and city tax purposes.
    - c. Per the Canadian Department of Finance, a trust clearly resident in the U.S. under U.S. rules may not invoke treaty tiebreaker rules to avoid taxation in Canada under new deeming rules . . . a court test would seem inevitable.
    - d. A person invoking treaty tiebreaker benefits must take care to be in full compliance with the laws of his or her claimed jurisdiction of residence . . . fiscal authorities will share and compare.
  5. Estate and gift tax residence (domicile)

- a. Is visa status still the overriding determining factor? Recent jurisprudence renders this unclear.
  - b. Does declaration of “permanent residence” for immigration law purposes create merely a rebuttable presumption of domicile for transfer tax purposes? Some argue yes, but it is a dangerous gambit.
6. California (non-temporary presence)
- a. A “facts and circumstances” approach subject to a special rule for persons migrating to a foreign jurisdiction under a contract of employment (but take care the limitation regarding investment income).

B. Canada

- 1. Resident (taxed on worldwide income, subject to foreign tax credits)
- 2. Treaty (treaty tiebreaker rules, effect on taxation, 250(5), reporting)
- 3. Provincial resident
- 4. Taxation of residents
- 5. taxation of nonresidents

II. Relocation

A. From United States to Canada

- 1. United States
  - a. Expatriation (loss of U.S. citizenship)
    - i. Merely acquiring a new citizenship is not enough to effect loss of U.S. citizenship; one must obtain a certificate of loss of nationality from the State Department to terminate a U.S. citizenship for tax purposes unless the loss is precipitated by an oath of renunciation to a U.S. consular official.
    - ii. What implications a tax motivated renunciation of U.S. citizenship for the right to visit the U.S. in the future?

- iii. Note numerous legislative initiatives to replace the existing expatriate tax regime with a Canadian style general exit tax.
    - b. Expatriation (loss of resident alien status by a long-term resident, even if not estate and gift tax resident)
      - i. Expatriation tax rules affecting green card holders may render a treaty trader or treaty investor visa preferable.
      - ii. Compliance of departing long term residents with U.S. expatriation tax rules has been marginal and is the subject of Congressional scrutiny.
    - c. Expatriation (other cases)
    - d. Other issues
      - i. Except for spouses of U.S. citizens, it is not easy to re-acquire a green card once it has been surrendered; for a Canadian citizen, this might not be a material issue, but for the citizen of a country having a less stable political environment, loss of a green card may be a serious matter.
      - ii. Although Canada gives a new resident a “fresh start basis”, the U.S. citizen relocating to Canada might consider selective acceleration of recognition of gain for U.S. purposes in order to step up U.S. tax basis while long term capital gains rates remain low.
  - 2. Canada
    - a. Deemed acquisition of some assets
    - b. Taxation of other assets (pension, stock options and other equity arrangements)
- B. From Canada to United States
- 1. Canada
    - a. Departure tax
    - b. Other issues
  - 2. United States

- a. Historical costs (asset basis)
  - i. The United States grants no “fresh start” basis to an arriving alien resident, but for persons departing a jurisdiction other than one such as Canada (which imposes a general exit tax on the basis of a deemed mark-to market) there are several legitimate ways to accelerate recognition and step up basis in advance of acquisition of U.S. residence.
- b. Pending treaty amendment, announced 2000 but not finalized
  - i. As from August 1984, a Canadian moving to the United States has been permitted to make a treaty election to have his deemed disposition as a matter of Canadian tax law treated as an actual disposition with a consequent step up in basis (absent the treaty election, the U.S. would not regard a deemed disposition as an actual disposition for basis step up purposes).
  - ii. An announcement regarding further changes to the election provision has been pending since 2000 -- rules governing the election procedure under the Australia - U.S. Income Tax Treaty enacted by protocol as of May 12, 2003 might provide hints regarding the U.S. position (Australia, like Canada, has a general exit tax regime).
- c. Pre-immigration transactions
  - i. Funding of an irrevocable foreign trust by an intending U.S. residents within five years of moving to the United States may result in severe tax complications for the new U.S. resident, but pending modifications to Canada’s rules regarding the taxation of trusts suggests different but equally significant tax problems on the Canadian side.

C. Year of relocation issues

1. Planning
    - a. Pre-relocation asset reorganizations (RRSP, corporations)
    - b. Timing of move
    - c. Timing of income and expenses
    - d. Gifts
  2. Compliance
    - a. Joint returns
    - b. Form 8833
    - c. RRSP election
- D. Return to U.S.
1. Temporary absence rule
    - a. “Round trip” planning is discouraged by a 3-year provision which imposes U.S. tax on profits derived from U.S. situs assets during the temporary break as if the individual had remained resident in the U.S. throughout.

### III. Post-Relocation Issues

- A. Canadian assets held by U.S. resident
  1. real estate, partnerships, corporations, RRSPs, trusts, life insurance, bank accounts
  2. 216 return, Forms 8865, 5471, 3520, 3520A and 90-22, Notice 2003-75)
- B. U.S. assets held by Canadian resident
  1. partnerships, corporations, LLCs, trusts, life insurance
  2. foreign reporting rules, LLC issues, FAPI
- C. Wills and estate planning (marital deduction, QDOT, community property)
  1. Domicile is the determining factor for probate and trust law and family law purposes; but domicile for such purposes is determined by state law; domiciliary status for federal transfer tax purposes (whether or not there exists a bilateral tax treaty) is irrelevant to the determination; non-

immigrant visa status does not preclude acquisition of domicile for state law purposes.

2. Establishment of domicile within the United States as a matter of state law is unlikely to adversely impact an existing will on account of differences in the formality of execution, but acquisition of domicile in a state such as California will give rise to quasi-community rights (relevant in the event of divorce or death) in respect of all property acquired by the labors of either spouse during the marriage and full community rights will attach to any property produced by the labors of either spouse after establishment of California domicile.
3. Marital property contracts are recognized and given force and effect by American state courts; so called “prenups” are more common, but “postnups” are also permitted subject to a heightened element of fiduciary duty between existing spouses.
4. Carefully consider the potential complications inherent in the estate plan for spouses who are domiciled in the United States for probate and marital property purposes, but who remain domiciled abroad as a matter of statutory tax law or tax treaty law.
5. Carefully review existing universal or whole life insurance policies to insure they are compliant with IRC § 7702 -- if not, they may be treated as the functional equivalent of a foreign personal holding company.
6. Create new health powers and living wills which comply with the law of the new state of residence -- failure to do so may put a spouse or parent or child in an excruciatingly difficult position in the event of unanticipated medical emergency.
7. Bear in mind that gifts to a non-citizen spouse do not qualify for the marital deduction, and that inadvertent transfers between spouses attributable to casual use of joint accounts or uninformed elections with respect to real property title may have very adverse gift tax consequences if the donor has acquired U.S. domicile for federal transfer tax purposes.

IV. Business issues

A. Expanding from Canada to U.S.

1. What it means to be engaged in a trade or business through a permanent establishment and what it means to have effectively connected income.
2. Qualification to do business in a particular state.
3. Engaging in a course of conduct within the United States for jurisdictional purposes.

B. Expanding from U.S. to Canada

V. Common Traps and Issues

A. Living trusts

B. Crossborder enforcement

C. Resident in a state without being resident in the U.S.

D. RRSP reporting

E. Foreign bank account reporting

F. Paying foreign obligations (Housden 1992 TC Canadian citizen resident alien who pays Canadian bank interest and Canadian ex-spouse alimony must withhold, even if paid from Canadian currency from Canadian bank account)

*This article should not be construed as legal advice or opinion, since legal opinions are only given to clients in response to inquiries involving specific facts.*