BY JAMIE GOLOMBEK

Expatriated Citizens

Costs and filing obligations can be prohibitive

U.S. citizens living in Canada face an enormous tax-filing burden. Not only do they have to file Canadian (and possibly Quebec) tax returns, but they also must contend with U.S. tax-filing requirements as the U.S. is one of the few countries in the world that taxes based on citizenship, as opposed to residency.

U.S. TAX COMPLIANCE BURDEN

What's particularly challenging is the enormous cost of U.S. tax compliance, which goes well beyond simply filing a 1040 U.S. federal income tax return. For example, all foreign financial accounts including a bank account, brokerage account, mutual fund, trust, or other type of foreign financial account over $10,000 must be disclosed annually to the U.S. Department of Treasury by electronically filing a Financial Crimes Enforcement Network (FinCEN) Form 114, *Report of Foreign Bank and Financial Accounts* (FBAR). If the value of those accounts (and other specified foreign financial assets) exceeds $200,000 on the last day of the tax year, or $300,000 at any time during the tax year, those assets must, with some exceptions, also be reported on Form 8938, *Statement of Specified Foreign Financial Assets*, which is filed with the 1040 income tax return.

Furthermore, if the U.S. citizen holds a TFSA, RESP, or RDSP, these accounts are not recognized as tax preferred by the U.S. and the income from these must be reported annually on a U.S. return. Most U.S. tax professionals consider these Canadian plans to be foreign grantor trusts from a U.S. tax perspective and thus also subject them to onerous and costly information return filings (Forms 3520, *Annual Return To Report Transactions With Foreign Trusts,* and Form 3520A, Form 3520–A, *Annual Information Return of Foreign Trust With a U.S. Owner).*

And to make matters worse, U.S. citizens are generally cautioned to avoid purchasing Canadian mutual funds as they are considered to be Passive Foreign Investment Corporations ("PFICs") under U.S. tax law and must be extensively disclosed on Form 8621, *Information Return by a Shareholder of a Passive Foreign Investment Company.*

While most dual citizens find that at the end of the day, no U.S. tax is owing as a result of these filings, as a result of fully offsetting foreign tax credits for the taxes paid in Canada, the compliance burden and costs of filing are prohibitive, easily running into the thousands of dollars for a Canadian-resident U.S. citizen who holds multiple foreign accounts and some mutual funds.

As a result, many U.S. citizens who reside outside of the U.S. and have no intention of ever living in the U.S. in the future have begun to explore the process of renouncing their U.S. citizenship. Since the U.S. publishes the names, online, of all U.S. citizens who have expatriated, we can see that the numbers have increased exponentially in the last number of years, up from 231 people in 2008 to 3,415 in 2014!

Renunciation of U.S. Nationality

So, if your Canadian-resident U.S. citizen client has had enough of the compliance burden, he or she may be tempted to renounce their U.S. citizenship. The first thing to keep in mind is that you can't simply do it by mail. Under the U.S. *Immigration and Nationality Act,* you must make a "formal renunciation of nationality before a diplomatic or consular officer of the United States in a foreign state." In other words, your client must appear, in person, before a U.S. consular or diplomatic officer in a foreign country (normally at a U.S. Embassy or Consulate) and sign an oath of renunciation.

At the U.S. Embassy and consulates in Canada, the increased volume of loss of nationality cases has resulted in wait times to get an appointment ranging from as few as two months to as high as 10 months. And, it is now more costly than ever to renounce. In September 2014, the U.S. Department of State quadrupled the application processing fee for renunciation from $450 to $2,350. But perhaps the bigger cost for high net worth U.S. citizen clients could be the potentially costly "exit tax."

U.S. Exit Tax

If your client hasn't complied with all U.S. federal tax obligations for the five years preceding the date of expatriation, had average annual net income tax for the five years ending before the date of expatriation of more than US$160,000, or their net worth was over US$2 million on the date of expatriation, the individual is considered to be a "covered expatriate."

The U.S. tax code imposes a mark-to-market system, bolstered by an acceleration into income of certain deferred income items, which generally means that all the property of a covered expatriate is deemed to be sold at its fair market value on the day before the expatriation date. Any capital gain arising from this deemed sale above an exclusion amount (US$690,000 in 2015) is immediately taxable. A taxpayer can elect to defer payment of this tax until the property is sold, however interest will apply on the tax owing and security must be provided to the IRS.

One piece of good news: if your Canadian client acquired dual citizenship at birth (perhaps by being born to a U.S. citizen parent living in Canada), and continues to be a resident of Canada and has not resided in the U.S. for more than 10 of the past 15 years, then he or she is exempt from the exit tax. F

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