

Lessons from a cross-border tax expert



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By
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The U.S. is the only developed country that taxes its citizens regardless of where they live in the world. Whether you agree with this policy or not, those are the facts.

I am married to a patriotic American and even though our children were born in Toronto, they automatically became dual citizens at birth, with all the privileges and headaches that go with the territory. To learn more about the cost of maintaining U.S. citizenship, I talked to Bryant Andrus, vice-president of Canadian operations at KeatsConnelly, the largest cross-border wealth management firm in North America.

Andrus began by saying that with the right planning, the cost of an American maintaining their citizenship can be minimal, and U.S. citizens can enjoy the majority of the same benefits that Canadian citizens enjoy from a tax perspective with additional benefits. These include the elimination of the U.S.-Canada border for travel purposes, cross-border living and retirement, employment, and the opportunity to vote (if one desires to get involved in crazy U.S. politics).

Most people get into trouble if they do not have an advisor that understands the Canadian tax and investment system, the U.S. tax and investment system, and more importantly, how to optimize their situation using both systems.

Anyone who has read the newspapers and professional periodicals over the past several years is familiar with stories of people threatened

with jail time if they're not in compliance with the IRS. What Andrus emphasizes is "what we haven't heard as much in the media is that the IRS is looking for those people who are wilfully evading the U.S. tax system and the IRS is not looking to throw someone in jail who was simply ignorant of the law; the IRS wants everyone to come into compliance."

To demonstrate, the IRS has created a streamlined version of the voluntary disclosure program that fits the situation of many Canadians who have simply been ignorant of the law.

"This new streamlined process only requires three years of previous tax returns to be filed and six years of disclosing bank/investment accounts held outside the U.S. This is much better than the six years of tax returns and eight years of foreign bank account disclosures previously required," Andrus says.

He has found Canadians get into the most trouble when they employ sophisticated tax strategies to reduce their Canadian income tax, or when they are investing in certain type of products/accounts that are not covered by the U.S.-Canada Income Tax treaty, e.g. TSFA, RESP, Flow Through Shares, etc. When examining these strategies through the lens of the Canadian tax system, they may work just fine, but in the eyes of the IRS they are disallowed or taxed punitively. Much of the time, dual citizens are reliant on advisors to recommend different solutions for their needs and these advisors may not understand the U.S. tax implications of their recommendations.

When dealing with a cross-border tax advisor and the client's current Canadian tax advisors, there needs to be a free flow of information about the client situation so that the "right hand" knows what the "left hand" is doing. Things like owning companies that are structured as Ltd. or Inc., stock options, corporate-class mutual funds, mutual funds or ETFs in general, RESPs, and TSFAs are a few prob-

lematic areas are often seen for U.S. citizens, even though these are common among Canadians because the *Income Tax Act* encourages the above mentioned accounts/structures.

"For every obstacle or issue a U.S. citizen encounters there are solutions to either minimize the negative tax effects or eliminate the issues altogether. It just takes the right planning and execution to harmonize the two tax structures. The biggest, most important factor here is ensuring that the advisor who is advising you in the cross-border arena is qualified to do so," says Andrus.

He used two quick examples to illustrate. First, an RESP established by parents to save money, tax-efficiently, for their child's education, does not have preferential tax treatment from the IRS and thus provides no deferral of income on the U.S. return. Additionally, an RESP is considered a foreign trust and the U.S. citizen is required to file a 3520 and/or 3520A in the U.S. These two forms are quite costly (from an accounting perspective) and can easily increase the accounting costs or the cost of filing a U.S. tax return by 25 per cent or more. As a U.S. citizen, depending on your situation, you maybe be able to open up a U.S. 529 plan which will allow all of your contributions to grow tax-free as long as the distributions are used to pay for college — anywhere in the world at a qualifying institution.

How you own this 529 plan is important. The cost to maintain a 529 plan tax-free on either side of the border can be less than the filing requirements of owning a RESP. When combined with the fact that there is no tax on either side of the border it's a win-win (lifetime contribution limits to a 529 plan can be as high as \$300,000, versus only \$50,000 for RESP).

Second, every person should desire to have an optimized investment portfolio that gives them the maximum probability of success in reaching their goals and objectives. Research shows that individuals

cannot control the markets' ups and down. However, there are a couple of factors that have a direct correlation with the probability of success of our portfolio that we can control or influence: fees and taxes. Corporate-class mutual funds, dividends from Canadian companies, etc. have preferential tax treatment in Canada. However, the U.S. does not always recognize the preferential tax treatment given by Canada to certain investments.

Further, the IRS wants to know more about pooled investments products, so there are additional forms that must be filed or it can result in more punitive taxes. Having a portfolio manager that is also trained in cross-border tax issues to the extent the tax issues affect the investment portfolio can reduce the overall tax burden and optimize the client's cross-border portfolio to

maximize the probability of success.

By understanding the cross-border tax situation CAs, CFPs, CFAs, CPAs, attorneys and other cross-border advisors can optimize U.S. citizens' financial situation, so that the burdens of maintaining one's U.S. citizenship while living outside the United States and in Canada are reduced to a manageable level.

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Worry timing now too quick

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think we will have a hard time getting ready."

Golden said "when we set the effective date, we set it well in advance and wanted to ensure that stakeholders had sufficient time to understand the scope of changes and to implement the changes. We look forward to understanding the questions to come, and to educating our stakeholders to ensure a smooth transition. But, right now, those are the effective dates."

Mackintosh added that "there is always a balance between giving people plenty of time and getting something done."

In early June, the two boards

announced a joint transition resource group to inform of potential problems around the new standards' usage. Members include financial statement preparers, auditors and users from a wide spectrum of industries, geographical locations and public and private companies, including Brooks as the Canadian member. The group's first meeting is this month, and the group will remain in place until the standard's application date.

Mackintosh said the work of the transition resource group will be mainly educational. "It is not a decision-making body. It will be a body that listens to problems that people have and, hopefully, point

them in the right direction for finding an answer."

As the first such joint action between IASB and FASB, Mackintosh said "it is important to not only have a merged standard but that we also keep our practices merged. If we have separate interpretations going forward, we will no longer be merged."

Mezon said: "There is a tendency in the U.S. to issue interpretive guidance, and for the IASB not to. How will this play out in the long run, and will we be able to stay with a converged standard? It will be absolutely interesting to follow the implementation process of this standard and see what happens."

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