U.S. – CANADA PLANNING

Global planning for wealth straddling U.S. – Canada border

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In today's global economy and mobile society, it is increasingly common for individuals to own assets internationally, for executives to have international assignments, and for families to have members who live abroad or are citizens of various countries.[1] One country that generates immense cross-border activity is our neighbor to the north, Canada. Consider these trends:

- Canada and the U.S. share the world's largest and most comprehensive trading relationship. Since the Canada-U.S. Free Trade Agreement[2] came into force in 1989, the two-way trade in goods and services between the countries has more than tripled.[3]
- During 2013, Canada and the U.S. exchanged an estimated $1.8 billion of goods and services per day — which is $1.2 million of goods and services every minute.[4] The U.S. is Canada's largest foreign investor and Canada is the third largest foreign investor in the U.S.[5]
- The Canada-U.S. border is the longest international border in the world. It is 5,525 miles long, and more than 300,000 people cross it daily.[6]

As personal advisors, estate planners see the impact of this cross-border activity in a variety of circumstances:

- California, Arizona, and Florida are host to many snowbirds, individuals escaping what can be cold Canadian winters. Florida alone is estimated to have 500,000 Canadian snowbirds who, in 2014, accounted for over 31% of all foreign investment of real estate in the state.[7]
- Canada is a thriving country on the business front and given the close trading relationship with the U.S., business owners, when looking to expand, will often have their first foray into the U.S. markets. In 2015, it is anticipated that more than 73% of Canadian exports of goods and services will be destined for the U.S.[8] In addition to the corporate tax planning that occurs, Canadian business owners often acquire residences in the U.S., and establish bank and investment management accounts.
- Canada has a highly educated, skilled workforce. Under NAFTA, Canadians who practice in certain professional occupations are granted "TN" Visas for U.S. work purposes that can be renewed without limit. Often, these individuals (with their family in tow) formally emigrate from Canada and become permanent residents of the U.S. (in other words, green card holders).
- The mobility factor is not limited to retirees or executives. Canada and the U.S. have witnessed an unprecedented number of their students crossing the border to attend post-secondary institutions in the other country. During the 2013-2014 academic year, an estimated 28,000 Canadian students attended U.S. post-secondary institutions.[9]
- In some situations, green card holders may decide to return home to their Canadian roots. For the year ending 12/31/2014, it is estimated that a record 3,415 individuals in the U.S. either renounced their citizenship or forfeited their green cards. This figure is up 14% from 2013, which was also a record year.[10] For Canadians and others alike, emigration from the U.S. carries with it certain tax consequences and reporting obligations.

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ISSUES FOR ADVISORS TO CONSIDER

Regardless of why an individual may find him or herself in the U.S., there are U.S. tax and estate planning issues for the Canadian individual and his or her U.S. advisors to consider. Failing to identify the critical differences between the Canadian and the U.S. tax systems, and failing to plan accordingly, can lead to unanticipated and unnecessary taxation and reporting requirements in each jurisdiction. Exhibit 1, "Comparison of Select Tax Attributes Between the U.S. and Canada," highlights some of the key differences between the Canadian and U.S. individual taxation systems. Those issues are discussed in more detail below.

Exhibit 1
Comparison of Select Tax Attributes Between the U.S. and Canada

	U.S.	Canada
Residence tests	Green card status, substantial presence test, or election.	General rules only – 183-day test or where an individual "customarily lives."
Income tax criteria	Citizenship and residency relevant.	Citizenship irrelevant; residence is determinative factor.
Estate tax	Yes; estates beyond exclusion amount subject to tax at 40%.	No estate tax but deemed disposition of property at death; resultant capital gains tax.
Gift tax	Yes; gifts beyond annual exclusion or lifetime exclusion amount subject to tax.	No gift tax but most transfers of property subject to deemed disposition rule and resultant capital gains tax; some protected transfers.
Generation-skipping transfer tax (GSTT)	Yes; distributions to skip person beyond exclusion amount subject to tax.	No GSST, but certain trust have a 21-year deemed disposition rule regarding property and, therefore resultant capital gains tax.
Capital gains tax	All capital gains included in income; preferential capital gain tax rates; $250,000 exclusion available for gain on "primary residence' ($500,000 per couple).	One-half of capital gains included in certain types of income; all gains from "principal residence" excluded; CDN$800,000 capital gain from sale of share of certain small businesses excluded.
2015 top combined federal and state (provincial) individual income tax rates	Top federal rate: 39.6% *Combined rates*: California- 52.9% + 3.8% net investment income tax New York- 48.42% + 3.8% net investment income tax	Top federal rate: 29% *Combined rates:* British Columbia- 45.8% Ontario- 49.53%

What is the individual's U.S. tax status?

One of the foremost considerations when dealing with a Canadian individual is his or her status from a U.S. tax perspective. Residence, domicile, and citizenship each play a role in determining

the proper application of U.S. income tax and U.S. estate, gift, and generation-skipping transfer taxes (referred to collectively as the "transfer tax"). The U.S. income and transfer tax regimes apply differently to foreign individuals, (considered to be those who are neither U.S. citizens, U.S. residents for income tax purposes, nor U.S. domiciled for transfer tax purposes), than they do to U.S. persons.

For U.S. income tax purposes, U.S. persons are defined under the U.S. Internal Revenue Code ("Code") Section 7701(a)(30) to include individual U.S. citizens, U.S. residents, U.S. corporations, U.S. partnerships, and U.S. estates and trusts. For U.S. transfer tax purposes, domicile is the relevant test.[11]

Inadvertently triggering U.S. residence and domicile for a Canadian individual can lead to:

- Liability for U.S. income tax on worldwide income (in conjunction with potential liability for Canadian income tax on worldwide income, but with certain treaty relief).
- Liability for U.S. estate tax on worldwide assets.
- Liability for Canadian departure tax if the Canadian individual is found to have ceased Canadian residency.
- Mandatory U.S. foreign reporting requirements.
- Loss of often-coveted access to the Canadian healthcare system.
- Loss of preferential tuition rates at Canadian post-secondary institutions.

The Convention Between Canada and the United States of America with Respect to Taxes on Income and Capital Gains[12] (the "Canada-U.S. Tax Treaty") provides relief in some situations where the Code and the Canadian Income Tax Act[13] (the "Canadian Tax Act") conflict.

What U.S. income tax issues must be considered?

Canadian individuals who satisfy the test for U.S. residency are, like U.S. citizens, subject to U.S. income tax on their worldwide income. By contrast, Canadian individuals who are considered non-U.S. residents are subject to U.S. income tax on only U.S.-source income. An individual is considered a U.S. resident if he or she meets any of these three tests:

1. Is a lawful, permanent resident of the U.S. at any time during the year (a green card holder).
2. Meets the "substantial presence" test under Section 7701(b)(3).
3. Has made an election to be taxed as a resident alien.[14]

An individual has a substantial presence in the U.S. if he or she satisfies the 183-day physical presence test for the current year or if the individual is physically present for at least 31 days in the current year and exceeds the 183-day limit of the "weighted average test," for the current year plus the two immediately preceding years. This weighted average test involves adding (1) the number of days the individual was in the U.S. during the current year, (2) 1/3 of the number of days the individual was in the U.S. in the first preceding year, and (3) 1/6 of the number of days the individual was in the U.S. in the second preceding year.

Although the substantial presence test is formula based and seemingly straight forward, complications can arise when the Canadian residency rules are also considered. Note that even where an individual meets the substantial presence test, as discussed further below, he or she may be able to claim a "closer connection" with another country.

Unlike the U.S. system of income taxation which is based on citizenship and residency, the Canadian system of income taxation is based on the sole concept of residency; citizenship is irrelevant. Canadian residents are subject to Canadian income tax on their worldwide income, but

residence for Canadian purposes is not defined in the Canadian Tax Act. Rather, Canadian residence is deemed to be a question of fact. Generally, an individual who spends more than 183 days in any year in Canada is considered to be a resident, as is an individual who does not meet this 183-day requirement but rather, is found to customarily live in Canada.[15]

The integration of the Canadian and U.S. income tax systems can create an outcome where an individual is considered to be a resident in each jurisdiction and therefore, subject to the income tax and tax filing requirements in each jurisdiction.

Example 1. A Canadian snowbird spends four months (i.e., 120 days) per year, for three consecutive years, at his U.S. residence and the remainder of the year (i.e., eight months or 245 days) in Canada. He will not satisfy the U.S. substantial presence test and, therefore, will not be a considered a resident of the U.S.

Example 2. The facts are the same as in the Example 1, except the individual extends his stay in the U.S. by four days in the current year. Thus, he will trigger U.S. residence for the current year, in addition to being considered a Canadian resident. The computations for analyzing these two scenarios are shown in Exhibit 2.

Exhibit 2
Substantial Presence Test

	Example 1: Days in the U.S.	Example 2: Days in the U.S.	Applicable Factor Under the Code*	Example 1: Weighted Average	Example 2: Weighted Average
Current year	120	124	1	120	124
Last year	120	120	1/3	40	40
Two years ago	120	120	1/6	20	20
Weighted average				**180 days**	**184 days**

*Section 7701(3).

In order to resolve the dual residency issue and alleviate the potential for double taxation, the snowbird can take one of two filing positions for U.S. income tax purposes:

- Invoke the "closer connection exception"[16] under the Code by filing Form 8840 and claiming that he has closer connections with Canada. This exception does not apply to individuals who are in the U.S. for more than 183 days in any particular year.
- Claim an exclusion under the Canada-U.S. Treaty. If an individual is not able to invoke the closer connection exception, he or she will be considered a dual resident and must resort to the tie breaker rules under the Treaty for a determination.

Practice points

Estate planners should bear in mind these ideas:

- Ensure that Canadian clients are meticulous in recording the days, both full and partial, they are present in the U.S. An individual will not satisfy the substantial presence test if he or she spends 120 days or less per year in the U.S.
- Canada and the U.S. are in the final phases of implementing the joint Entry/Exit Initiative of the Perimeter Security and Economic Competitiveness Action Plan,[17] in

which both countries will share information on individuals entering and leaving each country, using "real time data." Any perceived flexibility in day counting is eliminated.

Will the U.S. transfer taxes apply?

Canadian individuals who own assets in the U.S. will undoubtedly question whether they are subject to the U.S. transfer taxes.[18] Although U.S. citizens and U.S.-domiciled persons are subject to U.S. transfer taxes on their worldwide assets, foreign persons are subject to transfer taxes on only assets that are considered situated in the U.S. Several key distinctions should be made when comparing U.S. income taxes with U.S. transfer taxes, particularly as these taxes apply to foreign persons. Exhibit 3, "Comparison of 2015 U.S. Transfer Tax Exclusion Amounts," highlights some of the key distinctions discussed below:

Exhibit 3
Comparison of 2015 U.S. Estate and Transfer Tax Exclusion Amount

	Exclusion Amounts Granted to U.S. Persons			Exclusion Amounts Granted to Foreign Persons (unless otherwise increased by Treaty)		
	Base Amount Under Code	*Indexed for Inflation?*	*2015 Amounts Granted to U.S. Persons*	*Base Amount Under Code*	*Indexed for Inflation*	*Amounts Granted to Foreign Individuals*
Estate tax	$5 million	Yes	$5.43 million ($2,117,800 credit)	$60,000 ($13,000 credit)	No	$60,000
Gift tax-annual exclusion	$14,000	No	$14,000; all tangible and intangible property included	$14,000	No	$14,000; only tangible property as defined under Code included
Gift tax-lifetime exclusion	$5 million	Yes	$5.43 million	None	N/A	N/A
Gift tax-spousal gifts	Unlimited	N/A	Unlimited	$100,000	Yes	$147,000 annual exclusion in 2015
Generation-skipping transfer tax	$5 million	Yes	$5.43 million	$5 million	Yes	$5.43 million

- The determination of whether an individual is a U.S. or foreign person is different for income tax purposes, than it is for transfer tax purposes. Although residency is the determinative factor for income tax purposes, domicile is the determinative factor for transfer tax purposes.[19] Domicile is determined by the individual's personal facts and circumstances including physical presence in a particular country and the intent to remain in that country indefinitely. Relevant factors include location of real and personal property, place of employment, place of voting, and social memberships.
- The U.S. estate and gift taxes do not apply consistently to U.S.-situated assets owned by foreign persons. For estate tax purposes, all U.S.-situs tangible and intangible assets (as defined) are included, while for gift tax purposes, only U.S. tangible assets (as defined)

are subject to U.S. gift tax upon transfer; U.S. intangible assets, such as stocks, bonds and mutual funds, are excluded.

- The U.S. estate tax exclusion granted to foreign individuals for their U.S.-situated assets is $60,000 (a $13,000 tax credit), [20] rather than the $5 million exclusion, indexed for inflation ($5.43 million exclusion for 2015 which is the equivalent of a $2,117,800 unified tax credit) for U.S. persons, unless otherwise increased by an applicable tax treaty. The annual gift tax exclusion[21] for foreign persons is the same as for U.S. persons ($14,000 per donor per donee in 2015) but, foreign persons are not afforded any lifetime gift exclusion amounts. Gifts to a non-U.S. citizen spouse by a U.S. spouse do not benefit from the unlimited marital exclusion but rather, these gifts qualify for only an augmented annual gift tax exclusion[22] of $100,000, indexed for inflation ($147,000 for 2015).

Moreover, in order to benefit from the unlimited estate tax marital deduction at death, where a spouse is not a U.S. citizen, as stipulated by Reg. 20.2056A-1(c), the estate plan must include the use of a qualified domestic trust (QDOT) or timely transfers must be made to a QDOT by the surviving spouse, [23] unless otherwise provided by treaty. Article XXIXB of the Canada-U.S Treaty allows individuals to claim an increased unified credit[24] beyond that authorized by the Code, and it also allows for a further marital deduction[25] where property is left to a Canadian spouse. Therefore, for certain Canadian individuals, a QDOT may not be required.[26]

Example of U.S. estate tax application

Mary is a Canadian business owner with an estimated net worth of $10 million, which includes a $1.5 million home in the U.S. that she uses when travelling for business, a $1 million U.S. stock portfolio, and a $500,000 U.S. bank account. She is considered a nondomiciliary for U.S. transfer tax purposes.

On Mary's death in 2015, her U.S. home and U.S. stock portfolio will be included for U.S. estate tax purposes, while her U.S. bank account will be excluded. Therefore, $2.5 million of U.S. situated assets will be subject to U.S. estate tax, subject to relief under the Canada-U.S. Treaty.

The Canada-U.S. Treaty increases the standard U.S. $60,000 exclusion afforded to foreign persons and will allow Mary's estate to claim a unified tax credit that is in direct proportion to the value of her U.S. situs assets over her worldwide assets (in this instance, 25% of the U.S. unified tax credit — which as noted previously is $2,117,800 for 2015 — against estate tax otherwise payable). Furthermore, if Mary's assets are left to a Canadian spouse, she can claim an additional marital credit. Thus, the estate tax liability will be zero, computed as follows:

- U.S. estate tax before credits (40% × $3 million)—$1,200,00.
- Less: Unified credit under Treaty (25% × $2,117,800) —$529,450.
- Equals: U.S. estate tax liability before marital credit— $670,550.
- Less: Marital credit under Treaty— $670,550.
- Equals: U.S. estate tax liability after unified credit and marital credits— $0.

In addition to the U.S. estate tax considerations, Mary's estate will also be subject to the Canadian income tax rules that apply on death.

THE CANADIAN RULES

Canada does not have specific estate tax or transfer taxes per se but rather, has a tax regime built around the concept of deemed dispositions. The deemed disposition rules apply: (1) to transfers made by an individual, to any other person (person is defined under the Canadian Tax Act to include individuals, corporations, and trusts [27]), (2) on an individual's death, (3) to certain property held by certain trusts every 21 years,[28] and (4) on emigration. In each of these

circumstances, the individual, or trust as the case may be, is deemed to have disposed of, and immediately reacquired, the property in question for fair market value and therefore, to the extent there are any accrued but unrealized gains in the property, a capital gain and corresponding income tax will result.[29]

In the above noted example, from a Canadian perspective, Mary will be deemed to have disposed of all her assets, including her U.S.-situated assets, immediately prior to death for fair market value and will be taxed on any capital gains arising. However, per the terms of the Canada-U.S Treaty, [30] Canada will allow a foreign tax credit to the extent of any U.S. estate tax paid.

Practice points

When advising clients in matters that involve the Canadian rules, factor in the following:

- The Canada-U.S. Treaty does not recognize state estate taxes that might be payable. Therefore, the individual may be subject to the full extent of those state estate taxes, without relief.
- If a Canadian individual's worldwide estate is less than the U.S. estate tax exclusion afforded to its citizens for a particular year, U.S. estate tax will not be triggered, irrespective of what percentage of assets are situated in the U.S.[31]
- Using gifting strategies to reduce the size of an individual's estate must be approached with extreme caution when dealing with a Canadian individual, given the Canadian deemed disposition rules. In the example above, although gifts from Mary's U.S. stock portfolio are excluded for U.S. gift tax purposes, such gifts will be subject to the Canadian deemed disposition rules.

Does the Canadian individual need a U.S. based estate plan?

Although a Canadian individual may wish to have a U.S. power of attorney to deal with U.S. assets, or a U.S. health care directive to conform to the laws of the state in which the individual may spend time (and to ensure ease of use and acceptance), caution must be exercised when considering drafting multiple or replacement documents, particularly when it comes to U.S. wills and trusts.[32] From a drafting perspective, absent prior planning, the execution of a U.S. will may invalidate any prior (and often essential) Canadian will, and the U.S. will may become subject to interpretation by a foreign jurisdiction.

While Canada is a common law jurisdiction and does not have any forced heirship laws per se, the province of British Columbia, under its Wills Estates and Succession Act, [33] allows a court to revoke a will in order to favor a spouse or children, thereby potentially negating any U.S. planning. Moreover, many Canadian planners are of the view that U.S. pour-over wills may not be effective in terms of transferring Canadian property and, in fact, there is a recent court decision in British Columbia on this issue.[34] Thus, although testamentary trusts may be uncommon in a particular U.S. region, they may be preferred for Canada-U.S. planning.

Some of these issues could be potentially averted with a funded inter vivos trust, but such planning must consider the potentially harsh treatment of the Canadian deemed disposition rules. There is also a very complex and potentially arduous set of rules in Canadian Tax Act section 94, commonly referred to as the "nonresident trust rules." Although a discussion of section 94 is beyond the scope of this article, the provision involves an intricate set of rules that can deem a trust created in another jurisdiction, including the U.S., to be a resident of Canada for income tax and foreign reporting purposes. Canadian Tax Act section 94 considers each beneficiary's residency status and the timing of all contributions made to the trust by current and former residents of Canada. These rules have the potential to affect common U.S. trust planning strategies, including grantor trusts and irrevocable life insurance trusts.

Practice points

When evaluating whether a Canadian individual should have a U.S. will in addition to a Canadian one, consider these points:

- A foreign will, including a Canadian will (particularly if signed in accordance with the Uniform International Wills Act[35]), may be effective in the U.S., subject to the ancillary probate rules in each state.
- Where multiple wills, powers of attorney, and health care directives are used, coordination between the documents is essential.

What if the Canadian individual emigrates to the U.S.?

If a Canadian individual makes the U.S. his or her permanent home, aside from the immigration process itself, there are numerous factors to be considered from the Canadian and U.S. tax perspectives. Key considerations include the Canadian departure tax, the U.S. treatment of Canadian tax costs, and tax and Treaty elections and filing requirements.

On emigration from Canada, the deemed disposition concept is triggered and the Canadian individual is generally deemed to have disposed of all of his or her capital property for fair market value, thereby giving rise to a capital gain to the extent there has been any appreciation in the property's value.[36] Although from a Canadian perspective the tax cost of assets is adjusted to fair market value, the U.S. does not automatically recognize this step-up in basis unless the individual makes an election under Article XIII(7) of the Canada-U.S. Tax Treaty to claim that this deemed disposition has also occurred for U.S. purposes.

If the election is not made and the individual subsequently disposes of the property while a U.S. resident, the IRS will determine the gain by reference to the property's original tax cost. Furthermore, to the extent the deemed disposition (for Canadian purposes) and the actual disposition (once in the U.S.) occur in different tax years, a foreign tax credit may not be available to alleviate any instances of double taxation due to the timing differences.

Practice points

When advising clients in the emigration context, consider the following points:

- An individual can make an election under the Canadian Tax Act to defer the payment of income tax arising on the deemed disposition of capital property upon emigration if security is posted equal to the income tax that is due.[37] Security is not required if the federal income tax on the capital gain arising as a result of the deemed disposition is less than CDN$14,500, which for 2015, is the equivalent of a CDN$100,000 capital gain.[38]
- Payment in full of the deferred Canadian income taxes regarding a particular asset is due if the asset is later sold, or the individual dies.
- If an individual later reassumes Canadian residence, it may be possible to unwind the deemed disposition arising on the original departure.

What if the Canadian individual holds Canadian retirement plans?

Canadian executives will often come to the U.S. with their Canadian retirement plans, including registered retirement savings plans (RRSPs) intact. RRSPs are in some ways akin to the U.S. IRA. RRSP contribution limits are deductible and subject to income-based thresholds, and income earned in the RRSP— including capital appreciation— is not subject to income tax until amounts are withdrawn from the RRSP, or an individual dies. However, unlike the U.S. IRA, an individual is not penalized for taking early distributions from an RRSP, or from collapsing an RRSP in full.

Despite the similarities, the Service does not recognize RRSPs as qualified plans for U.S. purposes[39] and as such, (1) no deductions are allowed for contributions made to the plan while an individual resides in the U.S., (2) earnings and growth within the RRSP are taxable annually to the

beneficiary for U.S. tax purposes unless the appropriate elections and annual filing requirements are made, and (3) proceeds from a Canadian RRSP cannot be transferred into any type of U.S. retirement plan.[40]

In order to ensure that any undistributed and accrued income in an RRSP is not subject to U.S. federal income tax, a one-time election under the Canada-U.S. Treaty must be made.[41] Also, up until 2014, an annual election was required by filing Form 8891 with the individual's U.S. tax return.[42]

Practice points

When planning for clients with Canadian retirement plan assets, the following are relevant considerations:

- Not all states recognize the federal position regarding the deferral of taxation of accrued and undistributed RRSP income. For example, California reserves the right to tax accrued and undistributed income in RRSPs.[43]
- An individual must "annuitize" his or her RRSP plan before the end of the year in which he or she turns 71 by converting the RRSP into a "registered retirement income fund" (RRIF).[44] Once annuitized, minimum distributions must be made from the RRIF each year.
- Periodic withdrawals from an RRSP are subject to a 15% Canadian withholding tax under the Canada-U.S. Treaty, and this tax can be used as a foreign tax credit against any U.S. taxes payable.

Are there any foreign reporting requirements?

When dealing with a Canadian individual, special attention must be paid to the complex and often non-intuitive foreign reporting rules, particularly if the Canadian individual is considered a U.S. person:

- As mandated by the U.S. Bank Secrecy Act, all U.S. persons must electronically file, with the Financial Crimes Enforcement Network, Form 114 (FinCEN 114) which is the Report of Foreign Bank and Financial Accounts (FBAR) by June 30 each year if the aggregate value of all foreign financial accounts (which includes bank accounts, brokerage accounts, mutual funds, trusts, and other type of foreign financial accounts) held by the individual is more than $10,000 at any time during the year. The FinCEN Report 114 supersedes Form TD F 90-22.1 which was used for years prior to 2013.
- In addition, as mandated by the U.S. Foreign Account Tax Compliance Act, all specified individuals, which includes U.S. persons and certain nonresident aliens who have an interest in specified foreign financial assets, must file a Form 8938, Statement of Specified Foreign Financial Assets, if the individual's foreign financial assets (including RRSPs) are more than $50,000 on the last day of the tax year or more than $75,000 at any time during the year. These reporting thresholds are $100,000 and $150,000 respectively for married individuals filing jointly.

Different reporting thresholds apply, however, if an individual resides outside of the U.S. and is considered to have a presence abroad. In these circumstances, the reporting threshold is satisfied only if the total value of the individual's specified foreign financial assets is more than $200,000 on the last day of the tax year or more than $300,000 at any time during the year ($400,000 and $600,000 respectively for married taxpayers filing jointly).

Practice points

The foreign reporting thresholds are expressed in U.S. dollars. Monitor the fluctuations in the Canada-U.S. exchange rates to ensure proper compliance.

What if a Canadian individual relinquishes his or her green card?

A Canadian green card holder who relinquishes his or her green card and emigrates from the U.S. back to Canada, will be subject to the U.S. expatriation rules under Section 877A,[45] if he or she was a green card holder for at least eight out of the last 15 years. These are the same rules that apply if a U.S. citizen renounces his or her citizenship.[46] Like U.S. citizens, green card holders benefit from the $600,000 capital gains exclusion from the expatriation rules[47] adjusted annually for inflation ($690,000 in 2015). A green card holder may continue to be subject to U.S. tax and reporting requirements until he or she formally expatriates.[48] In this regard, the individual must file both:

1. Form I-407 with the Department of Homeland Security confirming the cessation of status.
2. Form 8854 under Section 877 to notify the IRS of the change in status.

No good deed goes unpunished

As we continue to face an increasingly globalized world, the "Know Your Client" adage is central to any type of planning. Although the above discussion highlights some of the issues that may be encountered when dealing with a foreign person, additional issues could be lurking in the background. Estate planning done in the U.S. may also trigger issues in a foreign jurisdiction outside the estate and taxation realms —property division, marriage dissolution, and creditor protection may all come to haunt what is a well-intentioned plan. Estate planners should be sure to know their clients and know their own limits.

Residence, domicile, and citizenship each play a role in determining the proper application of U.S. income tax and U.S. transfer tax.

Although residency is the determinative factor for income tax purposes, domicile is the determinative factor for transfer tax purposes.

The Canada-U.S. Treaty does not recognize state estate taxes that might be payable. Therefore, the individual may be subject to the full extent of those state estate taxes.

An individual can make an election under the Canadian Tax Act to defer the payment of income tax arising on the deemed disposition of capital property upon emigration if security is posted.

The foreign reporting thresholds are expressed in U.S. dollars. Monitor the fluctuations in the Canada-U.S. exchange rates to ensure proper compliance.

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1 Shier, "Cross-Border Trusts: A Guide to Cross- Border Design and Administration," Northern Trust, *Line of Sight* (The Northern Trust Company, 2012).
2 The Free Trade Agreement (FTA) was agreed to in October 1987 and signed on 1/2/1988 and phased out a wide range of trade restrictions between Canada and the U.S. The FTA was superseded by the North American Free Trade Agreement (NAFTA) in 1994 which includes Canada, the U.S., and Mexico.
3 Government of Canada, *Canada, and the United States*, available from www.can-am.gc.ca.
4 *Id*.
5 U.S. Department of State, Bureau of Western Hemisphere Affairs Fact Sheet, 9/10/2014, available from m.state.gov/md2089.htm.
6 *Id.*
7 Marr, "The New Question for Canadian Snowbirds Heading South: To Buy or To Rent," *The Financial Post*, 10/21/2014.
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9 Institution of International Education, "Open Door 2014 Fast Facts," available from www.iie.org.
10 Saunders, "Record Number Gave up U.S. Citizenship or Long Term Residency in 2014," Wall St. J, 2/10/2015, available from http://www.wsj.com.
11 Reg. 20.0-1(b)(1).
12 Signed at Washington, D.C., on 9/26/1980, as amended.
13 R.S.C., 1985 c. 1(5th Supp).
14 Section 7701(b).
15 See Canada Revenue Agency, *Canada Income Tax Folio SF-F1-C1: Determining an Individual's Residence Status* for an overview of the factors to be considered when determining residency which includes residential ties, personal ties, economic ties, and social ties. Where residency cannot be determined, case law and the tie breaker rules of any applicable tax treaty are relevant.
16 Reg. 301.7701(b)-2.
17 Announced jointly by President Obama and Prime Minister Harper on 2/4/2011. See "Beyond the Border: A Shared Vision for Perimeter Security and Economic Competitiveness," available at www.dhs.gov.
18 For purposes of discussion, all dollar amounts are expressed in U.S. currency, unless otherwise stated.
19 Reg. 20.0-1(b)(1).
20 Section 2102(b).
21 Section 2503(b).
22 Section 2523(i)(2).
23 Section 2056(d)(2). In order for a trust to qualify as a QDOT, several criteria must be satisfied. They include at least one of the trustees must be an individual citizen of the U.S. or a U.S. domestic corporation; no distributions (other than income distributions) may be made from the QDOT unless a U.S. trustee has the right to withhold an amount equal to the estate tax that would have been payable (with limited exceptions) and the executor of the estate must make a timely election to have the trust qualify as a QDOT. In addition, if the assets in the QDOT exceed $2 million, then at least one of the trustees must be a U.S. bank or other security requirements must be met.
24 Article XXIXB(2) of the Canada-U.S.Treaty.
25 Article XXIXB(3) of the Canada-U.S Treaty.
26 Although the U.S. Treasury Regulations and he Canada-U.S. Treaty may work together to eliminate the need for a QDOT in regards to a Canadian individual, the estate plan may still include a QDOT, particularly if the estate is significant.
27 Canadian Tax Act section 248.
28 Canadian Tax Act sections 104(4) through 104(5.2).
29 Canadian income tax rates are similar to those in U.S., although the top rates are triggered at lower thresholds. However, in Canada, only one-half of capital gains are included in income and certain types of capital gains are entirely excluded from taxation. Gains derived from the sale of a principal residence, as defined in section 54 of the Canadian Tax Act, are excluded from taxation, as are the first $800,000 of capital gains from the sale of "qualified small business corporation shares", as defined by Canadian Tax Act section 110.6(1). See PwC, "Tax Facts and Figures: Canada 2014" for an overview of all personal income tax rates; available from www.pwc.com.
30 Canada-U.S. Treaty Article XXIXB(6).
31 Canada-U.S. Treaty Article XXIXB(2).
Under the terms of the Treaty formula, a Canadian individual's U.S. situs assets will fully be sheltered from U.S. estate tax if the individual's worldwide assets, which form the denominator of the formula, are less than the U.S. unified estate tax credit afforded to U.S. citizens.
32 Although Canada and the U.S. are each signatories to the 1973 Convention Providing a Uniform Law on the Form of an International Will, this is not commonly relied on.
33 S.B.C. 2009, Ch. 13. This replaces the former *Wills Variation Act*, R.S.B.C. 1996 Ch. 490.
34 Canada does not have legislation akin to *The Uniform Testamentary Additions to Trusts Act*, which validates U.S. pour-over planning. See Kellogg Estate (Re), 2013 BCSC 2292.
35 As drafted by the Uniform Law Commission at *1973 Convention Providing a Uniform Law on the Form of an International Will.*
36 Canadian Tax Act section 128.1(4)(b). Note that even where property may be excluded from this deemed disposition rule, Form T1161 under the Canadian Tax Act must still be filed.
37 Canadian Tax Act section 220(4.5). In order to make this election, an individual must file Form 1244, "*Election Under Subsection 220(4.5) of The Income Tax Act, to Defer the Payment of Tax on Income Related to the Deemed Disposition of*

Property."
38 See Exhibit 1. This assumes the top Canadian federal income tax rate of 29%; only one-half of capital gains are included in income for Canadian income tax purposes.
39 In order to qualify as a "qualified trust" under Section 401(a), the trust must be formed or organized in the U.S. as part of a specific trade or business.
40 For a detailed discussion and comparison on U.S. and Canadian pension plans, see Leitner, "Selected U.S. Tax Developments — Canada-U.S. Treaty Election for Non-Resident Alien Beneficiaries of Canadian Pension Plans," 6 *Canadian Tax* J. 1017 (2012).
41 Canada-U.S.Treaty Article XVIII.
42 IRS Release, "IRS Simplifies Procedures for Favorable Tax Treatment on Canadian Retirement Plans and Annual Reporting Requirements," 10/7/2014, available from www.irs.gov.
43 State of California, Franchise Tax Board Information Letter No. 2003-004.
44 Canadian Tax Act section 70.
45 Section 877A is titled "Tax responsibilities of expatriation."
46 The U.S. Exit Rules apply if an individual (1) has had an average annual net income tax liability for the preceding five years of more than $160,999 in 2015, (2) has a net worth of more than $2 million as of the expatriation date, or (3) fails to certify the he or she has complied with all U.S. federal tax obligations for the five years preceding emigration.
47 Section 877A(a).
48 In fact, an individual may still be subject to U.S. tax after expatriation. Article XIII(5) of the Canada-U.S. Treaty provides each country with the ability to continue to tax individuals who have been resident in a country for ten of the last 20 years.
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