STEP Canada

STEP LONDON & SOUTHWESTERN ONTARIO
CHAPTER LAUNCH EVENT

THURSDAY, October 17, 2013 @ 4:30 p.m.

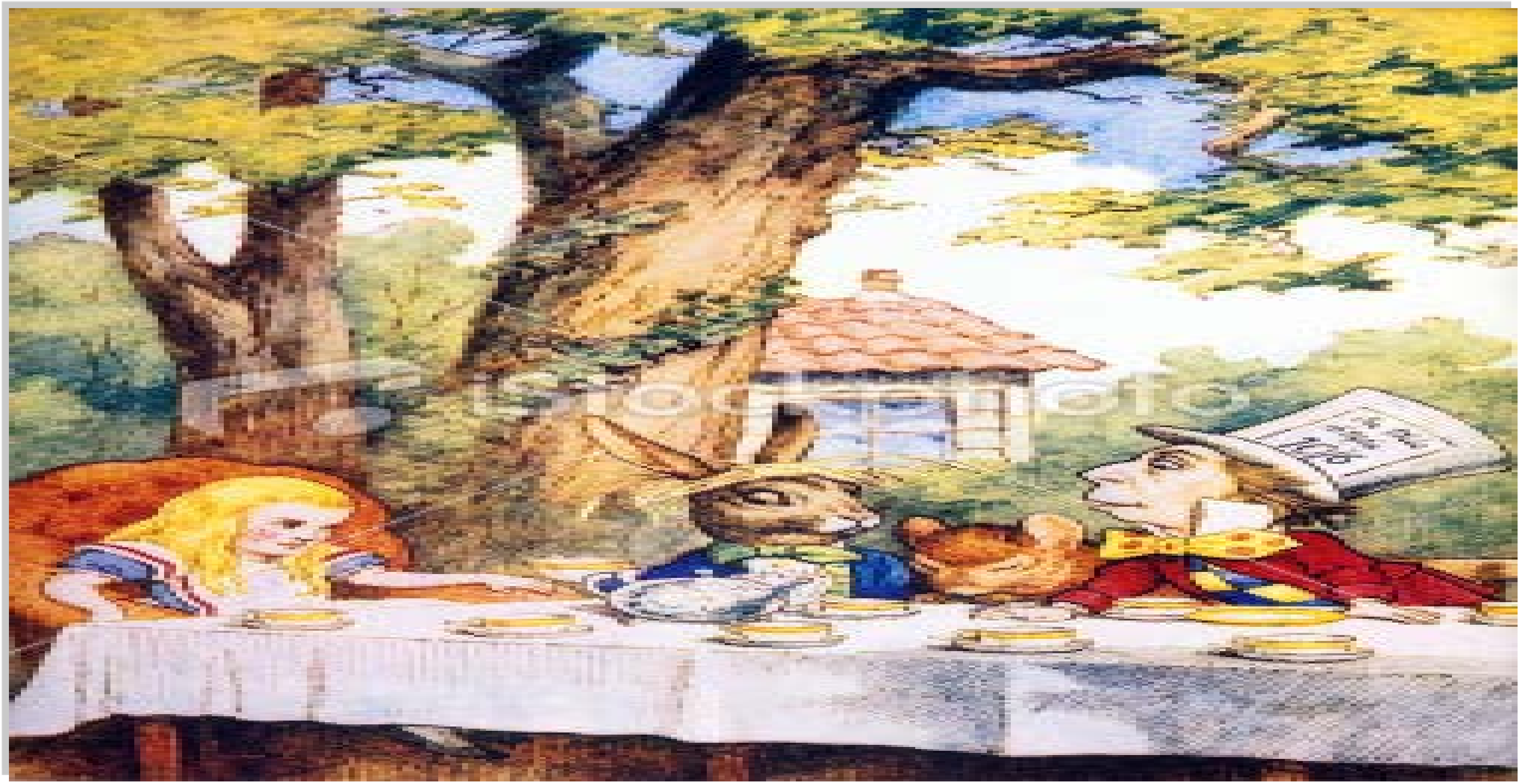
U.S. TAX UPDATE: ISSUES THAT CANADIAN ADVISORS SHOULD BE AWARE OF FOR THEIR CLIENTS

Speaker : Edward Northwood, The Ruchelman Law Firm, Toronto

Topics

1. Current status of US legislative changes as affecting cross border estate planning and FATCA (Foreign Account Tax Compliance Act) phase-in
2. Summary of implications of US citizens and green card holders giving up US status
3. Brief review of options for acquiring and holding US real property.

THE GIFT AND ESTATE TAX SURPRISES



PRIMARY INDIVIDUAL INCOME TAX CHANGES

- Top federal rate now 39.6% on ordinary income over $400K ($450K joint) for US taxpayers
- Long term capital gains and qualifying dividends tax rate now increased to 20% for same classes of taxpayers (which will apply to Canadians who sell US real properties)
- Itemized deductions and personal exemptions phased out or limited for those with income over $250K ($300K joint)
- NB – 3.8% additional tax on net investment income for US taxpayers with income over $200K ($300K Joint) now in effect (under “Obamacare” law); this does <u>not</u> apply to NRAs

GIFT AND ESTATE TAX CHANGES EFFECTIVE FOR 2013 UNTIL……..

- US Gift, Estate and GST Tax Exemption all = $5M, Indexed for Inflation
  [2012 = $5.12M; 2013 $5.25M]
- Tax Rate for transfers over
  $1M = 40%
- Portability for U.S. spouses
  - Essentially, unused exemption on first death may be used on second death
- All permanent (that is, no "sunset")
- Many States still impose a separate estate tax

WHAT DID NOT CHANGE

- Valuation discounts for Family LP's and Companies remain
- QDOT Laws still apply
- Canada/US Treaty applies to Increased Estate Tax Exemption and Death Tax Credits
- DOD Basis Bump remains applicable to all Decedents' Assets [both US citizens, US domiciliaries and NRA's]
- State estate taxes remain a deduction for federal purposes (there used to be a credit)

CANADA/U.S. TREATY – DEATH TAXES

- Prorated unified credit
  - [US situs assets/worldwide estate] x U.S. credit
  - Means that if net worth < $5M, no U.S. estate tax on U.S. assets
- Marital credit = additional [prorated] unified credit
- Canadian capital gains and accrued income taxes creditable as foreign death tax (and vice versa)
- TREATY ELECTION REQUIRED

U.S. CONGRESS' AND IRS' OBSESSION WITH FOREIGN REPORTING

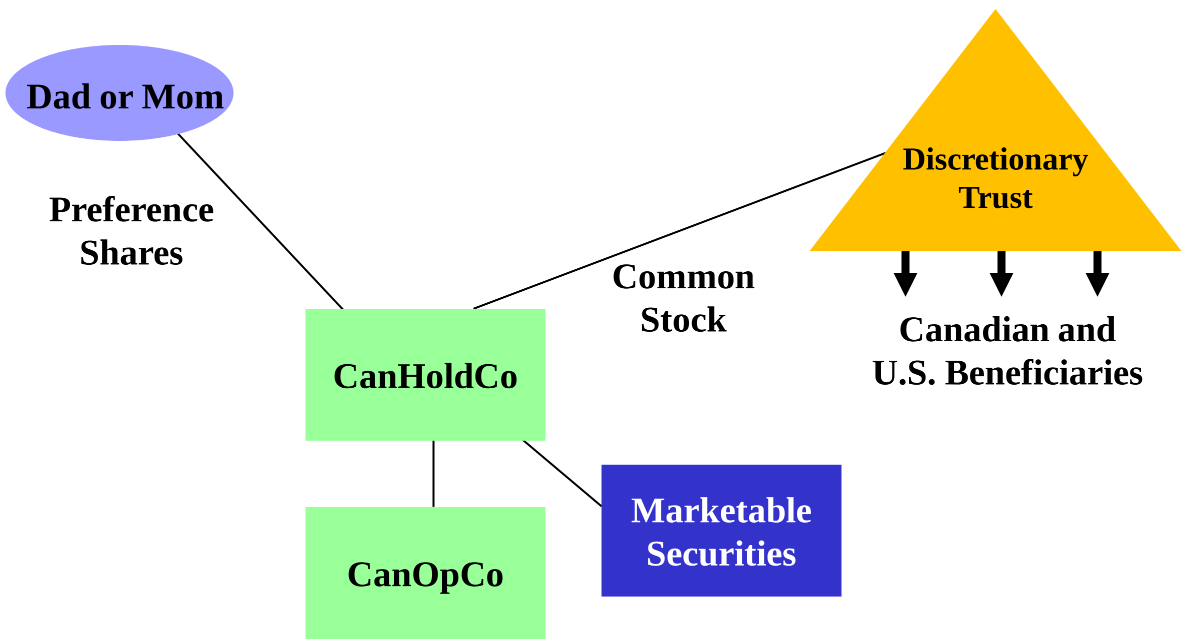
- Offshore Voluntary Compliance
  - 2009 OVC Program
  - 2011 OVD Initiative
  - 2012 Continuation of OVDI, but meaner
  - "Relief" for Canadian residents
    - IRS Fact Sheet 2011-13
    - Streamlined Filing Guidance published 31st August 2012
- FATCA "whistle-blowing" (effective 2014)

POT POURRI OF FOREIGN COMPLIANCE FORMS

- FBAR (TD F 90-22.1)
- 8938 (attachment to 1040)
- 5471 (CFC)
- 8621 (PFIC)
- 8891 (RRSPs)
- 3520 and 3520-A (Foreign Trusts)
- Failure to timely file any of these can lead to substantial penalties, <u>even if no income tax owed!</u>

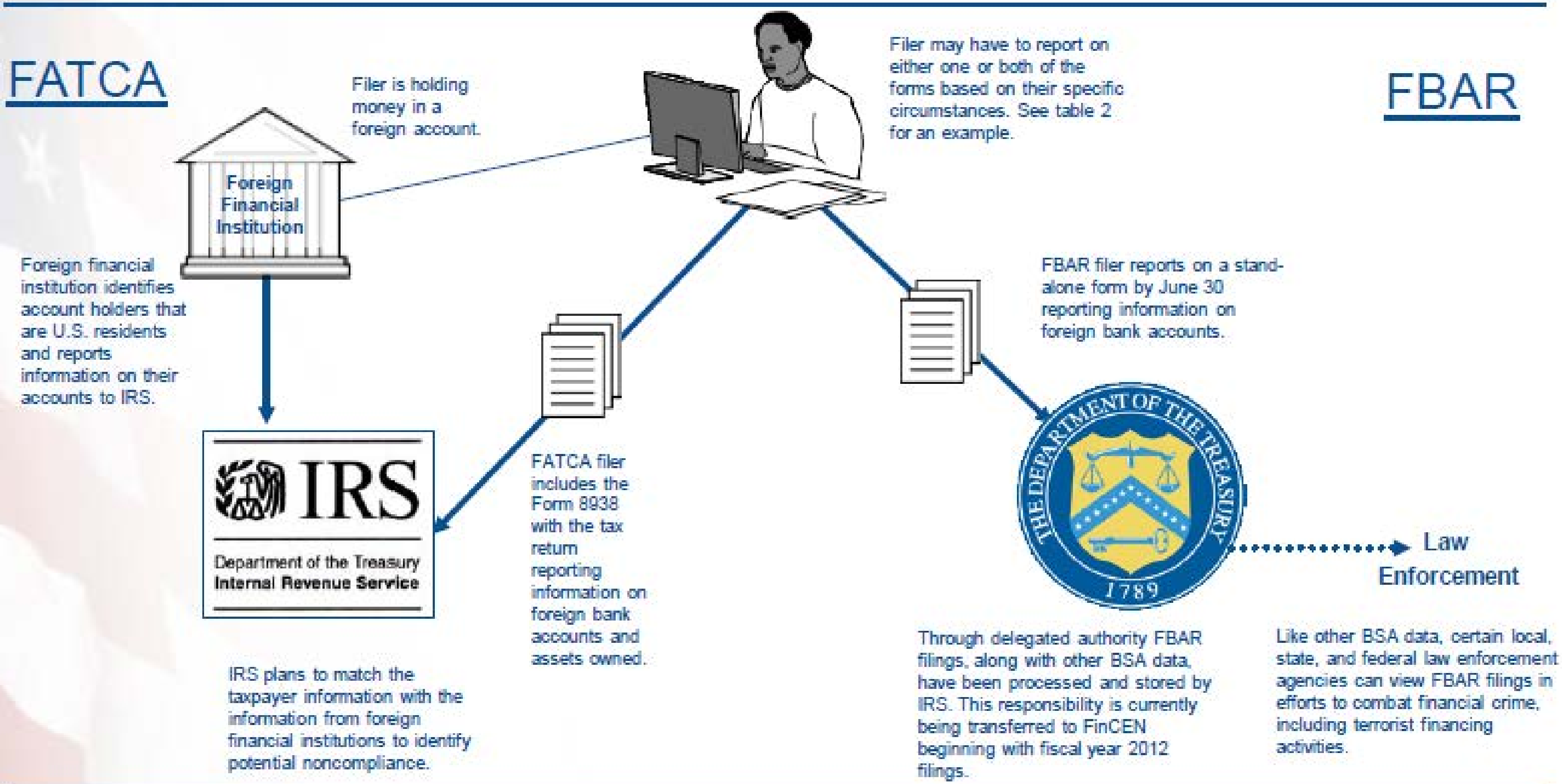
COMMON CANADIAN STRUCTURES EXPOSING U.S. TAXPAYERS TO ANTI-DEFERRAL RULES

Typical Canadian Freeze



Background

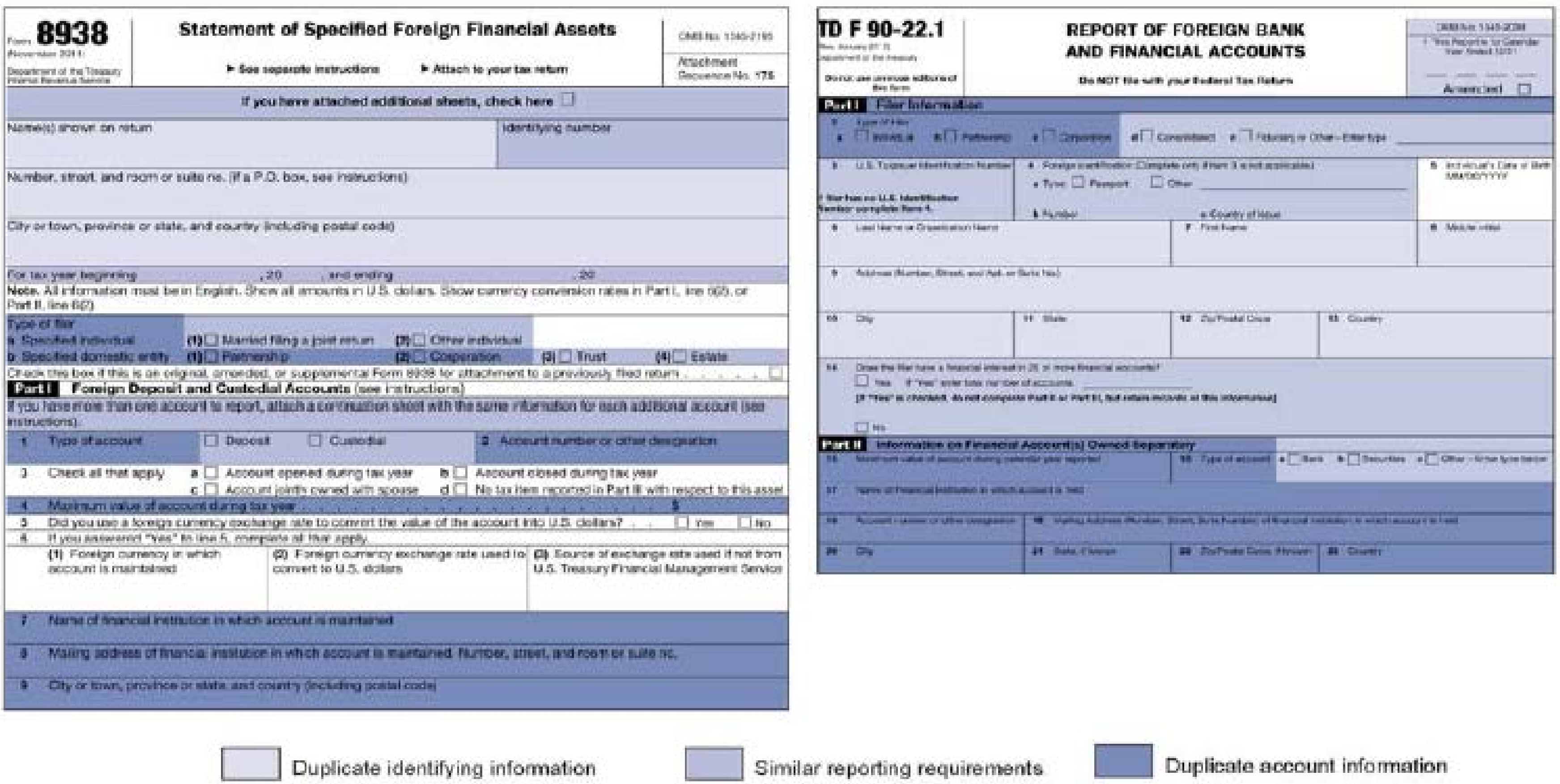
Figure 1: Illustration of Information Reporting under FATCA and FBAR



Source: GAO analysis of Form 8938 and FBAR reporting requirements.

Figure 2: Duplicative or Similar Reporting Requirements

GAO
Accountability * Integrity * Reliability



Source: GAO analysis of the Form 8938 and FBAR

Note: The entire Form 8938 can be found here: http://www.irs.gov/pub/irs-pdf/f8938.pdf and the FBAR here: http://www.fincen.gov/forms/files/f9022-1_fbar.pdf.

Supplement 1
Table 3: Comparison of Form 8938 and FATCA Penalty Regimes

	Form 8938	FBAR
Failure to File	$10,000	Maximum of $10,000
Continuing Failure to File	After 90 days from notice, an additional $10,000 for each 30 day period. Maximum additional penalty is $50,000	not applicable
Reasonable cause exception	Yes	Yes
Accuracy-related penalty	40 percent of the underpaid tax amount	not applicable.
Willful failure to file or willfully causing another to fail to file	not applicable	$100,000 or 50% of the account balance, whichever is greater
Fraud	75 percent of the underpaid tax amount attributable to fraud	not applicable
Criminal Penalties	Yes	Yes
Statute of Limitations	3 years after the date of filing or from when the information is reported to IRS and 6 years after the return was filed if the taxpayer fails to report over $5,000 in gross income from foreign assets	6 years to assess penalty and 2 additional years to collect after assessment

Source: GAO analysis of Form 8938 and FBAR instructions.

LEAVING AMERICA (AND STOPPING TAXATION)

- If U.S. citizen, or Long Term Permanent Resident, Expatriation rules apply
- All others, fail the days' test (and really depart)
  - Beware retained US situs assets subject to US estate tax
  - Plan for continuing US source income

NEW EXPATRIATION LAW

- Applies to US Citizens and Long Term Permanent Residents expatriating after 16 June 2008, repealing 2004 law
- Exit Tax – similar to Canada but more mean-spirited
  - Deemed sale of all assets, with ability to defer (with interest); applies to Grantor Trust assets as well as personally owned
  - Tax on deemed sales only applies on total gain over $600,000 (indexed for inflation)
  - LTRs use U.S. entry date fmv as cost basis

NEW EXPATRIATION LAW…CONTD…

- Immediate taxation of IRAs and RRSPs (and other tax deferred accounts, except for qualified retirement and pension plans)
- Non-Treaty withholding rates (30%) on deferred compensation plans (that are not tax deferred accounts)
- Nongrantor Trust: 30% withholding on distributions to covered expatriate (that would have been taxable income)

NEW EXPATRIATION LAW…CONTD…

- Applies to "covered expatriates" which is the same class as under 2004 law (more than $2M net worth; or more than $131,000 (indexed) average income tax liability for past five years; or cannot certify compliance with last five years of US tax return requirements)
- Important broader exception: dual citizen at birth; after expatriation will continue to be citizen and tax resident of Treaty country; failed the "days test" for 10 of previous 15 years; and has filed five most recent years of US returns.

NEW EXPATRIATION LAW …CONTD…

- Tax on US recipients of gifts and inheritances from covered expatriates
  - Highest gift and estate tax rates
  - No exemptions (other than $13,000 annual exclusion)
- Hassle visiting U.S.?

PLANNING FOR CANADIANS WITH U.S. SITUS PROPERTY

- Individually
- Foreign Corporation
- Foreign Partnership
- Trust

OWN INDIVIDUALLY

- U.S. situs asset for U.S. gift and estate tax purposes
- Treaty relief
  - Prorated use of unified credit
  - Marital credit
  - Neither credit may be used for lifetime gifts
- Foreign death tax credits

OWN INDIVIDUALLY …CONTD…

- Joint Ownership
  - Not effective for estate tax purposes, but simplifies transfer at death
    - Unified credit available along with treaty benefits (like marital credit)
    - May be appropriate in smaller estates
  - Possible gift at time of purchase
    - No unified credit or treaty benefits
    - Split purchase alternative
  - Tenancy-in-common ownership is better

OWN INDIVIDUALLY …CONTD…

- Nonrecourse Mortgage
  - A dollar for dollar deduction against value of real property includible in estate
  - Becoming easier to obtain
  - Must be bona fide (may not be respected if obtained from a family member)
  - May give rise to income tax issues on interest paid in tax home

FOREIGN CORPORATION (HOLDCO)

- Increased income taxes [corporate rates]
- Deemed income (shareholder benefit) in Canada
- IRS "look through" position for estate tax purposes [other than sham companies, a foreign corporation should readily provide insulation]
- CFC if owner becomes U.S. tax resident [or shares inherited by U.S. persons]

FOREIGN PARTNERSHIP

- "Look-through"
- Check the box …. after death?
- Enterprise for foreign purposes?

TRUST ALTERNATIVE

- Form trust for benefit of spouse and descendants, fund with cash, and have trust purchase U.S. real property
  - Should not be in settlor's estate as long as use only at spouse's consent and not as a trust beneficiary
  - May be less likely to be challenged if descendants use property frequently as well
  - If spouse dies, settlor must pay rent to use the property
  - Avoids deemed income issues
  - Must address special rules in jurisdiction applicable to trust's taxation

DISCLAIMER

NOTE TO READERS

- This Presentation is not intended to be legal advice
- Reading the materials does not create an attorney-client relationship
- The outcome of each case stands on its own merits
- Pursuant to I.R.S. regulations, any conclusions or comments contained herein is not intended or written to be used, and cannot be used by the reader, for the purpose of avoiding tax penalties