Tax Strategy: The demands on U.S. citizens in Canada entering “nightmare” territory

BY PAUL DELEAN, THE GAZETTE JUNE 19, 2014

If you think provincial and federal tax collectors here are rapacious, you probably haven’t dealt with the American equivalent, the Internal Revenue Service (IRS).

While Canadian tax cheats usually get off with a fine, the American agency puts people in jail.

It’s also much more demanding of American citizens who pay their fair share and play by the rules. They’re obligated to file annual tax returns with the IRS regardless of where in the world they live, listing in detail such things as bank accounts, RRSPs and inheritances.

Failing to do so, even if you don’t owe money, can result in fines and penalties.

“It’s one of the only countries that taxes on citizenship, not on residency,” noted David Altro, a local notary and U.S. attorney who specializes in cross-border taxation and has co-authored a new book with partner Jonah Z. Spiegelman, Americans Living In Canada — Smile, The IRS Is Watching You.

As stringent as the rules for tax-reporting have become for Americans, particularly since 9/11, they’re about to get even tougher as of July 1 for those living in other countries, including Canada.

A measure called the Foreign Account Tax Compliance Act (FATCA), to which Canada has pledged cooperation, will require banks and investment firms in other countries to inform the IRS of any accounts held by Americans.

In Canada, financial institutions will have the duty to ask customers if they’re American citizens and share the information with Canada Revenue Agency (CRA), and CRA will notify the IRS.

“The rules have always been there, but now they’re really enforcing them,” Altro said.

Procrastination or obfuscation really aren’t an option, he said.

“You can’t lie about that stuff. The old concept of ‘head in the sand, they won’t find me’ is no longer possible. You don’t want the IRS to be calling you. If they come to you first, you’re already in trouble.”

Renouncing U.S. citizenship is an option some resort to, but Altro said even that comes at price, since the IRS may impose what amounts to an exit tax, depending on your financial situation.

Altro said the complications go both ways for people with assets and ties to both Canada and the U.S.

An American moving back to the U.S. usually would be better off terminating a Canadian RRSP after resuming U.S. residence than before, because of the much lower tax hit, he said.

A tax-free savings account (TFSA) is a misnomer for Americans in Canada, since the IRS doesn't recognize its tax-free status and expects the growth to be reported as income on U.S. tax returns.

Canadians who have been snapping up U.S. real estate since the financial crisis of 2008 should understand that creates tax-reporting obligations in the U.S., Altro said.

When you sell as a non-resident, you'll be subject to a withholding tax of 10 per cent of the selling price, which gets remitted to the IRS and you then have to file to get back. There are also potential estate issues if you die as owner of U.S. property.

For those straddling two tax systems, the red tape has always been there, Altro said, but now "it's becoming a nightmare."

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