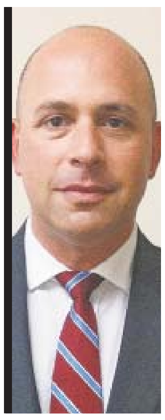
Escaping Trumpland might be costly



MERRICK WEALTH

By Peter Merrick

However, before packing their suitcases, these people should know that moving to Canada may distance them from Trump, but not from Uncle Sam.

Peter Merrick, TheIceSolution.com

The government of Canada's immigration website crashed on Nov. 8, the night of the U.S. presidential election. It was no coincidence. While Donald Trump received more than 61 million popular votes and 306 Electoral College votes, many Americans seem to abhor the thought of him becoming their president at his Jan. 20, 2017 inauguration.

Per Immigration, Refugees and Citizenship Canada (IRCC) the site was temporarily inaccessible to users because of the significant increase in the volume of traffic. Apparently, a lot of Americans started looking at their option to moving north during election night.

However, before packing their suitcases, these people should know that moving to Canada may distance them from Trump, but not from Uncle Sam. The potential for hundreds of thousands of American ideological refugees seeking a new home within Canada prompted me to approach Veronika Chang, a tax lawyer with Morris Kepes Winters LLP in Toronto. She is a tax specialist with extensive experience working in the United States, especially in the areas of the *Canada/U.S. Income Tax Convention* and the Internal Revenue Service. I asked her what the tax pitfalls of this move north might mean.

Chang first explained that under the Internal Revenue Code, the United States taxes "U.S. persons" on their worldwide income and such a person is defined as one who is: an American citizen, a resident, or a U.S. partnership, a U.S. corporation, or a U.S. estate and trust. So, a U.S. citizen is subject to U.S. tax, and it doesn't matter if they reside in Canada or south of the border.

Our conversation moved to the example of American actress Lena Dunham, who said she would leave for Canada if Trump won. If she does move to Canada, she must become aware that she will need to continue to file annual income tax returns in the U.S., and if she becomes a resident of Canada, she also needs to file Canadian returns and pay Canadian taxes. "Lena won't be double-taxed because she can claim a foreign tax credit for taxes paid in Canada on her U.S. return. But she must endure the pain of double filing," said Chang.

One of my questions was, if Dunham wants to buy a house in Canada what should she know? Assuming she comes and remains a Canadian resident, Chang explained that Dunham must worry about the capital gains tax upon sale. Unlike Canada, the U.S. limits the capital gains exemption to $250,000 per person; any gain over $250,000 and you have to pay Uncle Sam.

What if Dunham uses a Canadian entity or a Canadian trust to buy that house?

"Well, Uncle Sam tends to dislike Americans using a non-U.S. structure as an investment vehicle, so Lena would then have to file additional tax forms to disclose her interest in the Canadian structure," said Chang.

And what if Dunham should die in Canada? Chang explained that Americans are subject to the U.S. estate tax on their worldwide assets. This tax applies only to those whose worldwide gross assets exceed the exemption for U.S. estate tax, which is US$5.45 million. So, if Dunham dies here in Canada and her worldwide assets are above the exemption limit, she is subject to the estate tax.

One of Trump's campaign promises was that he would repeal the current estate tax regime and, instead, institute a capital gains tax regime. These details still remain to be seen, but he is basically proposing a death tax similar to the one currently imposed in Canada. This can mean one of two things, Chang explained.

First, as in Canada, the deceased is deemed to have sold all his or her worldly belongings at the time of death and pay the tax on the gain. Second, in the U.S. one's inherited assets get stepped-up basis which means the inherited assets get a new basis equal to their fair market value. The example that Chang used was this: imagine Grandpa dies and leaves his house worth $1 million, which he had purchased for $100,000. Whoever inherits the house will take the house with a stepped-up basis of $1 million, which upon the sale reduces his or her future capital gain. So, if the house is later sold for $1.1 million, the gain is only $100,000. The gain accrued during Grandpa's lifetime – $900,000 – is never taxed. A loophole for sure.

Trump's proposal could mean that the inherited assets will no longer get stepped-up basis. Instead, they will get carryover basis (i.e., Grandpa's basis), thereby preserving the inheritor's tax on the gain upon sale. So, in our example, the grandson will inherit the house and also inherits Grandpa's basis in the house which is $100,000. When that house is sold for $1.1 million, the grandson will be taxed on the gain of $1 million.

However, Trump did say he will exempt those with assets under US$10 million. Whether he means that much per person or per couple isn't clear. In any case, his plan nonetheless replaces the estate tax with capital gains tax.

"In certain cases, the U.S.-Canada Treaty provides a U.S. estate tax credit for Canadian capital gains tax at death," said Chang. "Under Trump's plan there is no longer a U.S. estate tax. Whether or not the treaty will apply, we just don't know."

My next question was, what if you are Canadian who now lives in the U.S. and want to return to Canada? I found out that if you are not an American citizen or have not held a green card for more than eight years, no problem. You can depart the U.S., hand in your green card, and end your relationship with Uncle Sam. This is provided you don't keep any U.S. properties.

But if you are a naturalized U.S. citizen, have been the proud owner of a green card for eight years or more, or hold on to your green card (i.e., move to Canada without properly turning in your green card), then you are in the same boat as Dunham. If you held a green card for at least eight of the past 15 years, then you are considered a long-term resident and are basically treated the same as any other American citizen, except that you don't have the right to vote.

My final question to Chang was this. If you want to renounce your U.S. citizenship or long-term residency, what should you be mindful of? Unfortunately, her answer was this. "You will still have to deal with the U.S. exit tax. This is another tax based on capital gains which applies to those with assets over US$2 million."

So far, the exit tax has not been on Trump's radar. But then again, who knows what the future will bring?

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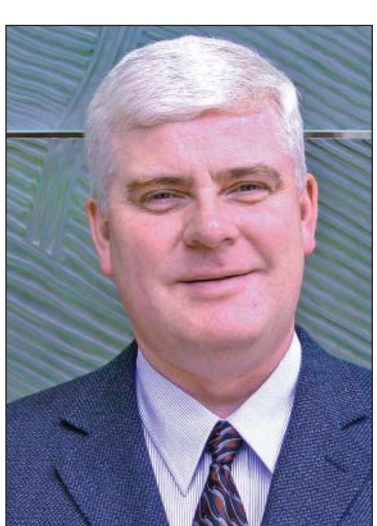
Design bonuses, compensation to long-term performance

Continued from page 5

too. For example, CEOs and other senior executives often have a duty to act responsibly at all times in the interests of the corporation and its shareholders. Penalties can range from fines to clawbacks to hits to the company's reputation, he says.

It's also highly desirable to have companies with strong records of corporate social responsibility so CEO compensation should be designed to reward that type of behaviour, MacDonald says.

"The responsibility isn't just for shareholders 10 years down the road, it's for your existing shareholders, too. You have to align the interests of companies or providers of services with the interests of clients and in this case, the client is a shareholder. You need to recognize the need to hire very good people in executive positions and ensure their compensation doesn't act contrary to the interests of the company with risky actions or short-term views of things," he says.



MacDonald

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Don MacDonald, IGM Financial

On the flipside, however, you don't want to tie a CEO's hands because they'll need to take some risks to properly position the company for the future.

"It's a real balancing act," he says.

So, how do you get investors to buy into the long-term view? MacDonald says annual general meetings represent an ideal opportunity to report on corporate responsibility and acknowledge companies that are socially responsible tend to perform better over the long haul.

"It is certainly an area where companies want to be very descriptive of what they're doing and why," he says.

It can also be beneficial to tout the success of investors such as Warren Buffett, who is famous for his strategy of buying good companies that are undervalued for a variety of reasons and holding them for the long term.

"If a company is well run and properly governed, you should think twice before you dump the stock over a three-month decline, which could be totally unrelated to what the company is doing," MacDonald said.