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Immigration

Americans beware — don't move to Canada without knowing consequences of U.S. exit tax

By **Veronika Chang**

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(April 20, 2017, 9:34 AM EDT) -- Last year more than 30,000 Americans were refused entry into Canada, a jump of 31 per cent over 2015 and four times the total from 2014. That is according to the Canada Border Services Agency, which is responsible for border security.

Judging from the crash of Canada's immigration department website immediately following the U.S. election in November, it is likely that many of these rejected Americans were fleeing the Trump regime. Some people simply packed and headed north. However, Canadian immigration rules aside, it is not so easy to leave the U.S. behind; bodies can move, but money is another matter.

Except for a handful of countries without income tax, only two countries in the world impose income tax based on residency — the African nation of Eritrea and the U.S. It makes sense that a country should only tax people who live or work within its border, but the U.S. is different in that America stands pretty well alone in extending its tax reach to its citizens. For the record, Eritrea imposes a meagre two per cent flat tax on its citizens abroad while U.S. income tax can be as high as 39.6 per cent.

The U.S. not only taxes its residents, but also American citizens no matter where they reside. So Americans taking refuge in Canada may be surprised to learn that Uncle Sam tags along. In addition to filing requisite Canadian tax returns, Americans in Canada must continue their U.S. tax filings as they have in the past, but that's not all. They may also have to file other forms.

We would expect Americans living in Canada to open bank accounts here. Depending on the amounts in Canadian (and other non-U.S.) accounts, they may have to file a form commonly known as FBAR (Report of Foreign Bank and Financial Accounts), as well as a Statement of Specified Foreign Financial Assets (Form 8938). Failure to file FBAR and Form 8938 can cost Americans a minimum penalty of $10,000 — for each form.

Americans in Canada may also face limited investment options. For example, they will discover that Tax Free Savings Accounts aren't really so tax-free since income earned in the TFSAs is fully taxable by the IRS. Mutual funds aren't so attractive to Americans either, as they may be considered a passive foreign investment company which invokes a complicated and punitive U.S. tax regime.

What about Americans who start or continue their business in Canada? The U.S. government wants a portion of that too, and will hit these people with another $10,000 penalty for failing to report their entrepreneurial endeavours outside the U.S.

These are only a few of the IRS tax forms which may be required of Americans residing in Canada. But it doesn't end there. Uncle Sam also wants a piece of the pie when you die, and a large piece at that. Americans are subject to the U.S. estate tax if their worldwide gross assets exceed the current exemption amount, which in 2017 is US$5.49 million. Americans will find themselves handing over 40 per cent of any amount above that total to the feds. President Trump says he will repeal the estate tax, but he also said he would repeal Obamacare.

To divorce Uncle Sam, Americans living in Canada will want to renounce their U.S. citizenship, but that opens another can of worms because divorce comes with a settlement agreement. First, the person must pay a $2,350 fee for the privilege. Then, if they have an average net income tax liability for the past five years of over $162,000 (for 2017), and a net worth of $2 million or more, or fail to certify on the IRS Expatriation Statement that U.S. federal tax obligations have been complied with for the past five years (failing to file this form leads to a $10,000 penalty), that person is considered a "covered expatriate" which means you must pay an exit tax.

The exit tax is a mark-to-market regime, which means a deemed sale; all your worldly belongings are deemed to be sold for their fair market value, and any gain from this sale is taken into account on a U.S. income tax return. But the pain doesn’t end there. In a name-and-shame game, the U.S. will publish the names of all those who renounced their citizenship. And if a covered expatriate makes a gift or bequest to a U.S. citizen or resident, the recipient of such gift or bequest must pay a tariff of 40 per cent.

Canada is not considered a tax haven. So, in addition to paying Canadian tax, Americans living in Canada must continue with their U.S. tax obligations unless they have prepared a careful tax plan, and for that they are wise to seek legal and financial advice.

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