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Buying and Dying in the United States

Estate Planning Council of Calgary

November 4, 2013

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Greg Gartner CA, QC
Kim G C Moody FCA, TEP
Dale Franko CA, CPA (IL, USA), TEP

Roy Berg has more than 19 years experience in IRS tax controversy, cross-border tax matters, estate planning, and finance and has been admitted to the bar associations of the U.S. Tax Court, California, and Washington. Before becoming the leader of the U.S. tax groups at Moodys LLP Tax Advisors he had experience in public accounting, the private practice of law, and as general counsel. He is also on the Board of Advisors for the *Journal of International Tax* and the International Tax Program at New York University School of Law.

Roy is a member of the U.S. and Canadian Society of Trust and Estate Practitioners ("STEP") and American Bar Association tax sections. He is licensed as a foreign legal consultant in Alberta, Canada and a frequent writer and speaker on IRS tax controversy, regulation, cross-border tax, and estate planning issues, in particular:

- Cross-border tax and estate planning
- 2009 and 2011 Offshore Voluntary Disclosure Initiatives (OVDI):
- Report of Foreign Bank and Financial Accounts (FBAR/ Form TD F 90-22.1);
- Foreign Trusts and filing of Forms 3520 and 3520-A;
- Foreign Entity filings including Forms 5471, 5472, 926, and 8865;
- Hiring Incentives to Retain Employment Act (HIRE Act); and
- Foreign Account Tax Compliance Act (FATCA).

Roy also has experience in public service; the governor for the State of Washington appointed him to the board of directors of the Washington Economic Development Finance Authority, and has been appointed to the Legislative Committee of the Washington State Bar Association.

Roy received a B.A. in Economics from the University of California Berkeley, a J.D. cum laude jointly from Willamette University College of Law and New York University School of law; and his LL.M (Taxation) from New York University School of Law. As an undergraduate Roy was a member of the University of California Berkeley's intercollegiate swim team.

Kim G C Moody, CA, TEP is a Chartered Accountant, Registered Trust and Estate Practitioner and a tax specialist practicing in Calgary under the partnership of Moodys Tax Advisors. His main area of expertise is tax and estate planning for the owner-manager of private corporations, executives, professional athletes and other high net worth individuals. Kim obtained his Bachelor of Management degree from The University of Lethbridge and his CA designation from The Institute of Chartered Accountants of Alberta. Kim has completed the CICA In-Depth Tax Program and many other tax related courses.

Kim is the Past Chair and Deputy Chair of the Board, Past Treasurer, as well as Past Chair of the Technical Committee for the Society of Trust and Estate Practitioners of Canada (STEP). In addition, Kim is the past Chair of the Board of Governors for the Canadian Tax Foundation. He is also a member of the CBA/CICA Joint Committee on Taxation and a member of The Canadian Petroleum Tax Society. Kim has a keen interest in planned charitable giving. He is a past Chair for the Southern Alberta Round Table for the Canadian Association of Gift Planners. Kim is a co-founder of the Tax Specialist Group ("TSG") – an association of tax specialist firms across Canada. Kim is the recent recipient of the Queen Elizabeth II Diamond Jubilee Medal and recipient of the Business in Calgary 2012 Leader of Tomorrow Award.

Kim is the author of numerous articles, papers and courses on tax and estate planning and he has lectured extensively for a number of organizations on tax, estate planning and planned giving, including STEP and the Canadian Tax Foundation. He is a past instructor for the Certified Financial Planners designation and the Institute of Chartered Accountants of Alberta's Professional Development Program.

Kim is married to Vivian and they have four sons – Alexander, Lucas, Jacob and Benjamin.

Greg Gartner CA, QC, LLB specializes in the area of giving tax advice to owner-managed and public businesses, with particular emphasis on business re-organizations, purchases, and sales and estate planning in both the domestic and Canada/US cross-border environments. He is also regarded as a leading expert in agricultural tax. In addition to practicing law since being called to the Alberta Bar in 1993, Greg has also gained more than 15 years of experience as a Chartered Accountant as well.

Greg is a member and former executive of the Tax Specialists Section (North). He is a member of the Alberta Branch of the Canadian Bar Association. He is a member of the Society of Trusts and Estate Practitioners ("STEP") and also of the Tax Lawyer/Accountants discussion group. Greg is a frequent speaker on law and tax issues he has lectured in the Faculties of Business and Law at the University of Alberta and lectured for the Legal Education Society and for the Institute of Chartered Accountants of Alberta. Greg is also involved in extensive lecturing and consultation for Alberta Agriculture, most notably in the yearly "Tax Update Course for Professionals".

Greg received his Bachelor of Commerce (B. Comm.), Masters of Business Administration (MBA), and Bachelor of Laws (L.L.B) from the University of Alberta.

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Presentation Overview

Overview

1. **Counting Days and Counting Sheep: Why 2014 will be a wake up call for all Canadians traveling to the US**
2. **Ownership of US Vacation Real Estate**
3. **Ownership of US Rental Real Estate**

Additional Resources

1. *"Renouncing your US citizenship: Failed amendment may signal that now is the time to get out!"* July 4, 2013, by Alexander Marino, JD, LLM (US Tax).

   www.moodystax.com/renouncing-your-us-citizenship-new-law-may-keep-you-out-forever/

2. *"Renouncing your US citizenship: Is divorcing Uncle Sam right for you?"* March 19, 2013, by Alexander Marino, JD, LLM (US Tax).

   www.moodystax.com/renouncing-your-u-s-citizenship-is-divorcing-uncle-sam-right-for-you/

3. *"STOP! Know the changes to US tax law before purchasing that US vacation property."* March 13, 2013, by Roy A. Berg, JD, LLM (US Tax).

   www.moodystax.com/stop-know-the-changes-in-us-tax-law-before-purchasing-that-us-vacation-property/

4. *"Beware of the US 'Snowbird Visa TAX BOMB!"* May 13, 2013, by Roy A. Berg, JD, LLM (US Tax).

   www.moodystax.com/beware-of-the-us-snowbird-visa-tax-bomb/

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Additional Resources Cont'd

5. *"IRS says hundreds of thousands of US citizens are not reporting Canadian Trusts."* May 9, 2013,by Roy A. Berg, JD, LLM (US Tax).

   www.moodystax.com/irs-says-hundreds-of-thousands-of-us-citizens-are-not-reporting-canadian-trusts/

6. *"IRS hates quite disclosures and they really mean it"* June 6, 2013, by Roy A. Berg, JD, LLM (US Tax).

   www.moodystax.com/irs-hates-quiet-disclosures-and-they-really-mean-it/

7. *"Carefully Consider US tax effects of Canadian 'prescribed-rate loan' strategy"*. September 11, 2013, by Roy A. Berg, JD, LLM (US Tax).

   www.moodystax.com/carefully-consider-us-tax-effects-of-canadian-prescribed-rate-loan-strategy/

Counting Days and Counting Sheep

Why 2014 will be a wake up call for all Canadians traveling to the US

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Is Your Client a US citizen?

1. Born in the US = US Citizen
2. Born in Canada to two US Citizens = US Citizen
3. Born in Canada to <u>one</u> US Citizen = US Citizen if:

<u>Born on or after November 14, 1986</u>:
-US Parent resided in US for five years
-Two of which were after that US parent's 14th birthday

<u>Born before November 14, 1986</u>:
-US Parent resided in US for ten years
-Five of which were after that US parent's 14th birthday

US green card holders

– Termination of income and reporting requirements not effective until Form 8854 filed

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Counting Days and Counting Sheep:
2014 CHANGES EVERYTHING!

Why Counting Days is Important:

1. US Consequences:
   A. US income tax consequences
   B. US estate tax consequences
   C. US immigration tax consequences

2. Canadian Consequences
   A. Canada’s “Departure Tax”
   B. Loss of Provincial Health Care

Counting Days and Counting Sheep:
2014 CHANGES EVERYTHING!

Why Have So Few Practitioners Encountered Audit Triggered by Day Count?

Historically, Canadian Border Services Agency (CBSA) and US Customs and Immigration Service (USCIS) only keep track of people **entering the country**

In order to obtain an accurate day count must contact both CBSA and USCIS

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Counting Days and Counting Sheep:
2014 CHANGES EVERYTHING!

2011 Canada and the US launched the ***“Exit/Entry Initiative”***

- Enacted in four phases
- Final two phases scheduled to go into effect 6/31/2014
- Travelers will be required to swipe passports both when:
  - Enter the respective country; **AND**
  - Depart the respective country

BOTH COUNTRIES WILL BE ABLE TO INDEPENDENTLY DETERMINE DAY COUNT FOR TAX AND IMMIGRATION PURPOSES

http://www.cbsa-asfc.gc.ca/agency-agence/reports-rapports/pia-efvp/atip-aiprp/ee-es-phase-2-eng.html

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Tax “Day Count” ≠ Immigration “Day Count”!

TAX

Department of the Treasury
Internal Revenue Service

182 Days in the Calendar Year

IMMIGRATION

180 Days in Rolling 12 Months – Treaty, “Closer Connection”, and “Substantial Presence” are irrelevant

0 Days | **120 Days** | **182 Days** | **365 Days**

No action required | **File Form 8840** | **Treaty tie-breaker exception *may* apply**

Tax "Day Count" ≠ Immigration "Day Count"!

CONSEQUENCES TO "OVERSTAYING"

- \> 180 but < 365 = <u>3 year bar</u>
- \> 365 = <u>10 year bar</u>

IMMIGRATION

180 Days in Rolling 12 Months – Treaty, "Closer Connection", and "Substantial Presence" are irrelevant

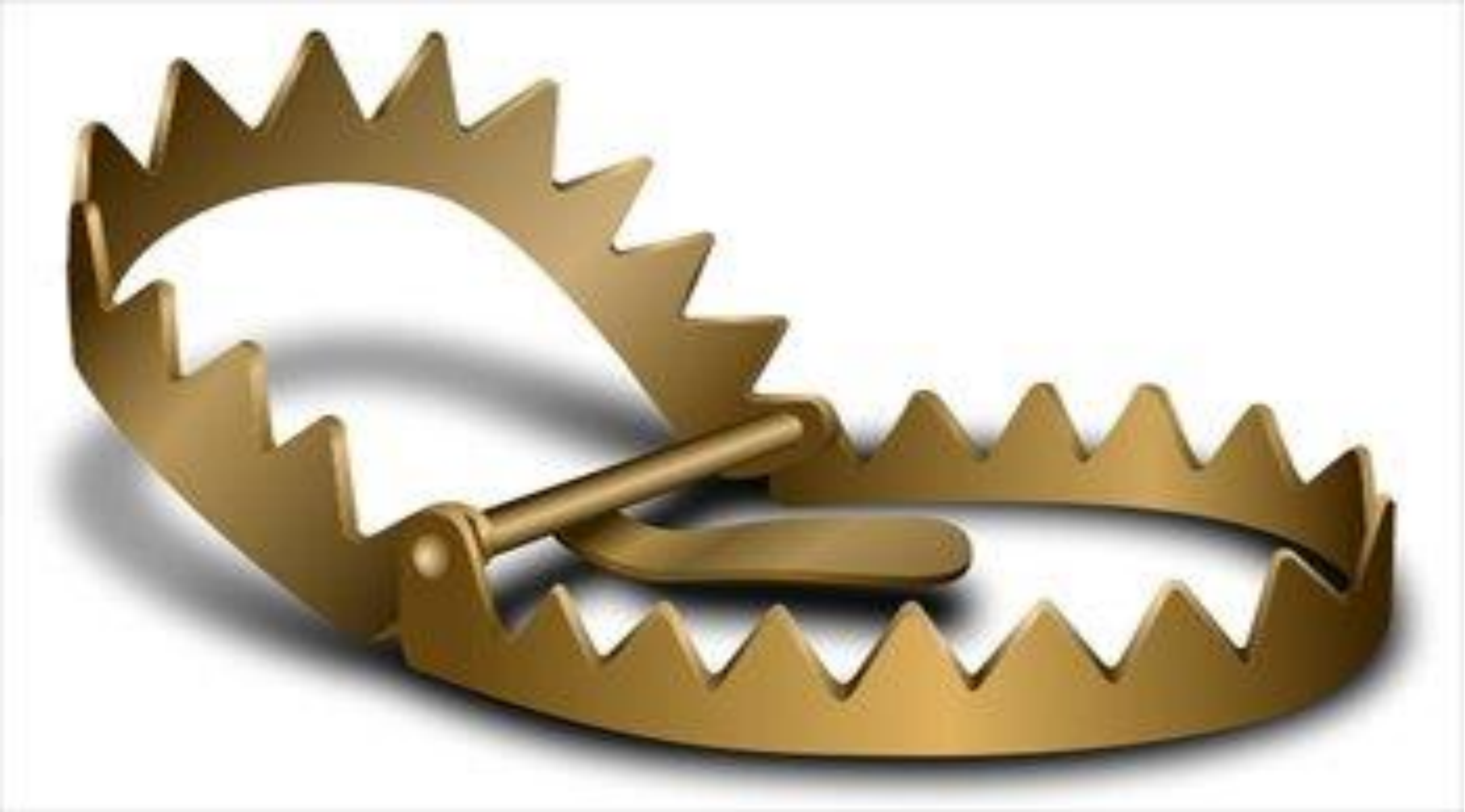
0 Days | **120 Days** | **182 Days** | **365 Days**

No action required (0–120 Days)

File Form 8840 (120–182 Days)

Treaty tie-breaker exception *<u>may</u>* apply (182–365 Days)

To Whom Do Reporting Obligations Apply?
“SNOWBIRD VISA TAX BOMB” … It’s A Trap!



To Whom Do Reporting Obligations Apply?
“SNOWBIRD VISA TAX BOMB” … It’s A Trap!

1. Allows applicants to reside in the US for 240 days per year if:
   - Over the age of 50
   - Spend $500,000 on home
   - $250,000 of which is on a principal residence
   - MUST reside in the home at least 180 days per year
2. Trap for the uninformed:
   - Guaranteed to satisfy “Substantial Presence Test” – MUST file Form 8840
   - **Only a three day window to qualify for “Closer Connection Exception.**” If present in US ≥ 183 days WILL be subject to same reporting obligations as US Citizens

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Options for Owning US Vacation Property

Cross-Border Real Estate Trust
Personal Ownership
Joint Tenancy with Right of Survivorship
Tenancy in Common
Non-recourse Mortgage
Canadian Corporation
Canadian Partnership
Life Insurance

Options For Owning US Vacation Property

Does This Section Apply To You?

- Are you purchasing US vacation property for personal, and not rental, purposes?
- Were you born in the US?
- Are both of your parents US citizens?
- Was one of your parents born in the US and lived there for >4 years?
- Do you have, or have you ever had, a US green card?
- Are you domiciled in the US?
- Do you spend more than 121 days in the US, on average?
- Do you spend more than 182 days in the US in any year?

If any of the foregoing describes your situation, you already have US tax issues and should consult experienced US tax counsel

Options For Owning US Vacation Property
WHAT NOT TO DO…avoid common US ownership structures

- **DO NOT** own property in either US Limited Liability Company ("LLC") or Revocable Living Trust ("RLT")
  - **Neither LLCs nor RLTs will avoid US estate tax**
  - **LLCs are taxed as partnerships in the US but in Canada are taxed as corporations. Result can be**
    - **Double tax; AND**
    - **"Taxable Benefit" for Canadian income tax purposes (see "Corporations" below)**
    - **Higher income tax in US (15% individual versus 35%)**
  - **RLTs are ignored for US Income tax purposes, but not necessarily for Canadian tax purposes. Result can be double tax.**

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Options For Owning US Vacation Property
Initial Analysis

- First Step is to determine the extent of exposure to US estate tax:

(Value of US Assets ÷ Value Worldwide Assets) x Exemption

- Second Step is to determine which option makes the most economic sense:
  - Cost to set up
  - Cost to administer
  - Canadian and US tax consequences

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Options For Owning US Vacation Property

Cross-Border Real Estate Trust

Personal Ownership

1. US real property held by Canadian Trust – use extreme caution
   - Can be non-US situs asset (therefore excluded from US estate tax)
   - Common mistakes using typical CDN discretionary trust to acquire US real property:
     - Drafting errors
     - Funding errors
     - Titling errors
     - Errors in operating the trust
     - Foreign tax credit mismatch
2. Personal Ownership
   - Spouse with $0 worldwide assets owns property
   - Result is that spouse will enjoy FULL EXEMPTION
   - **MUST modify wills to avoid double application of US estate tax**

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Options For Owning US Vacation Property
Joint Tenancy with Right of Survivorship (“JTWROS”) (do not use)
Tenancy In Common (“TIC”)
Non-recourse Mortgage

3. JTWROS (do not use)
   - Avoids probate, but little else
   - Presumption that spouse dying first furnished 100% consideration to purchase
   - Can result in double application of US estate tax
4. TIC
   - Only ½ value of the property included in each spouse’s estate
   - Can be eligible for US discounts against value (typically 15%)
   - **MUST modify wills to avoid double application of US estate tax**
5. Non-recourse Mortgage
   - Reduces value of property for US estate tax inclusion
   - Can be difficult to obtain and expensive to maintain

Options For Owning US Vacation Property

Canadian Corporation (Do Not Use)
Canadian Partnership
Life Insurance

6. Canadian Corporation (do not use)
   - Not subject to US estate tax
   - SIGNIFICANT Canadian income tax consequences on "taxable benefit" of the shareholders
   - Will also result in paying higher income taxes upon disposition of property (15% rates in the US versus 35% corporate rates)
7. Canadian Partnerships
   - Unclear whether will be subject to US estate tax. Can make "check the box" election, but MUST be timely done
8. Life Insurance
   - Very simple and can be very effective way to provide liquidity for US tax
   - Can result in lowering the applicable Exemption

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Options for Owning US <u>Rental</u> Property

Direct (Personal) Ownership
Canadian Corporation
U.S. Corporation
Canadian Corporation owns US Corporation
Canadian Corporation owns US Limited Liability Company (LLC)

US and Canadian Taxation on Income and Gains

- Canada taxes its residents on worldwide income (including income or gains arising from the US)
- The US taxes US-sourced income or gains
- How do these two taxation regimes reconcile with each other?
  - Tax treaty
  - Foreign tax credits/deductions
  - Credits/deductions for foreign taxes paid by foreign subsidiaries
  - But sometimes they don't reconcile !!

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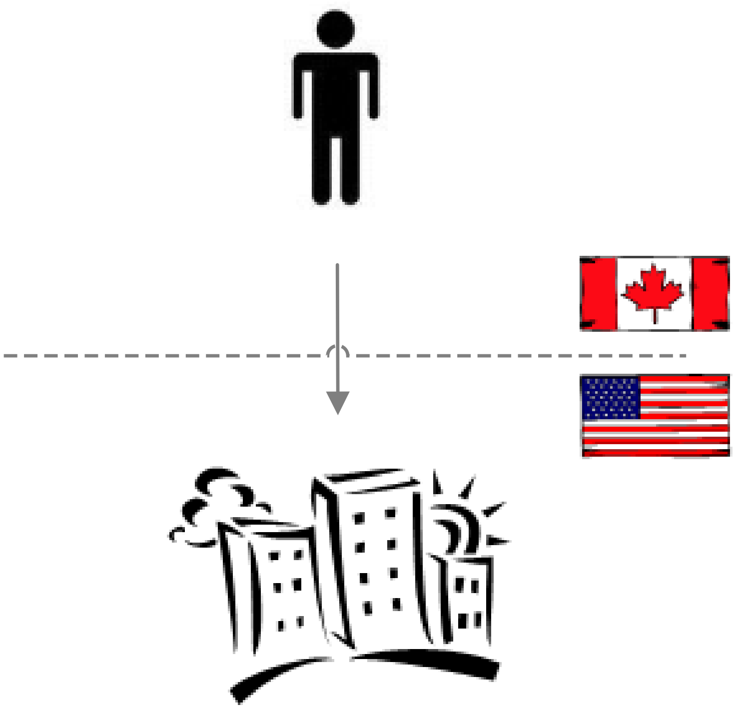
Options For Owning US Rental Property
Individual (Personal) Ownership

Rental: 42% US tax, 0% CDN tax → ETR 42%
Capital gain: 23% US tax, 0% CDN tax → ETR 23%



Advantages
- Flow-through of income/gain (no double tax)
- Preferential US capital gains rate
- Simple structuring

Disadvantages
- Personal US filings in each jurisdiction, multiplied by each investor, e.g. spouse
- FIRPTA
- No protection from US estate tax
- No protection from liability
- No US entity for financing, banking, operations, etc.

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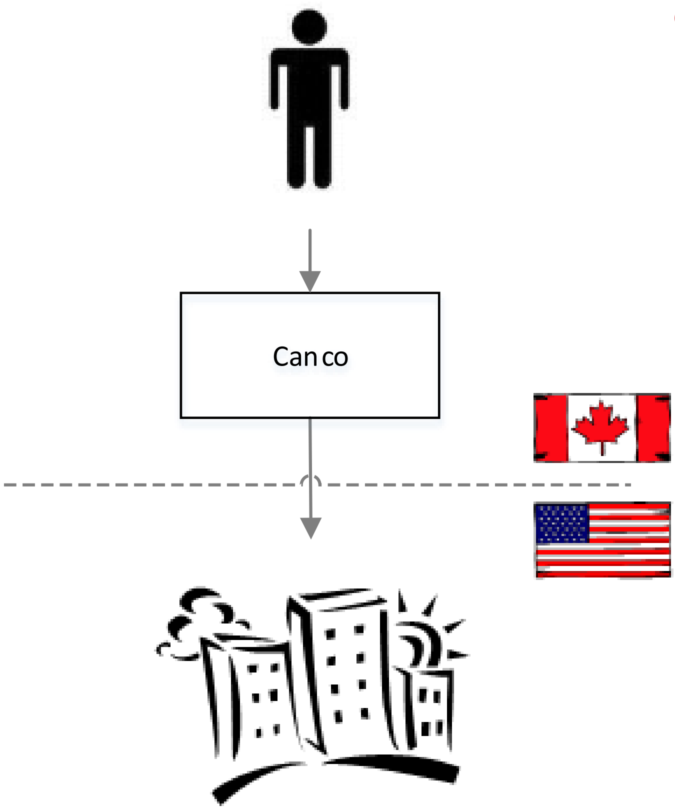
Options For Owning US <u>Rental</u> Property
Canadian Corporation



***Rental:* 43% US tax, 16% CDN tax → ETR 59%**

***Capital gain:* 43% US tax, 2% CDN tax → ETR 45%**

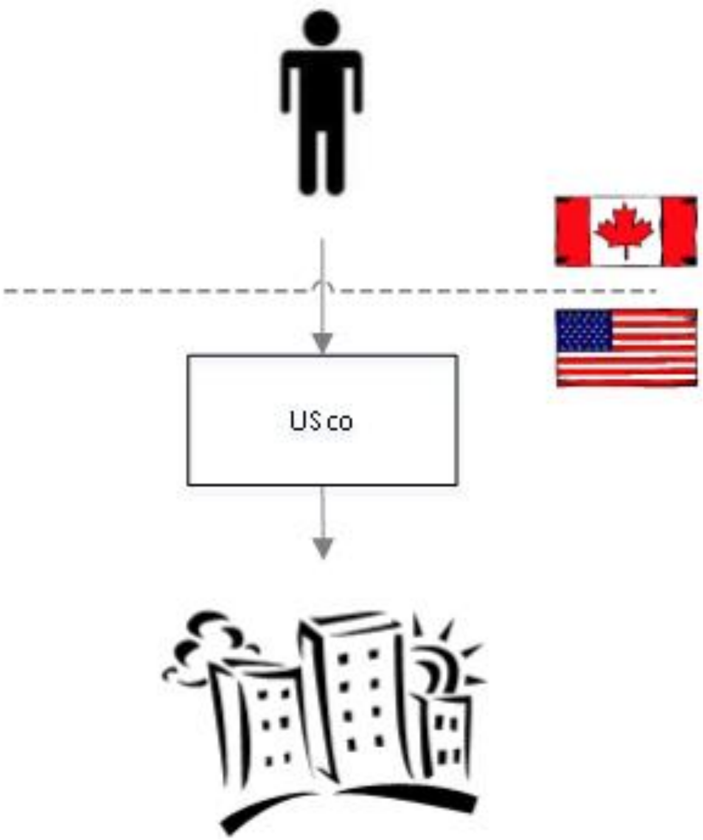
Advantages

- Simplified US filings
- Protection from US estate tax
- Protection from liability

Disadvantages

- Double taxation (corporate & personal)
- Not entitled to preferential US capital gains rate
- FIRPTA
- No US entity for financing, banking, operations.

Options For Owning US Rental Property
US Corporation



Rental: 49% US tax, 14% CDN tax → ETR 63%

Capital gain: 49% US tax, 14% CDN tax → ETR 63%*

**May be reduced if repatriated through liquidation of USco*

Advantages

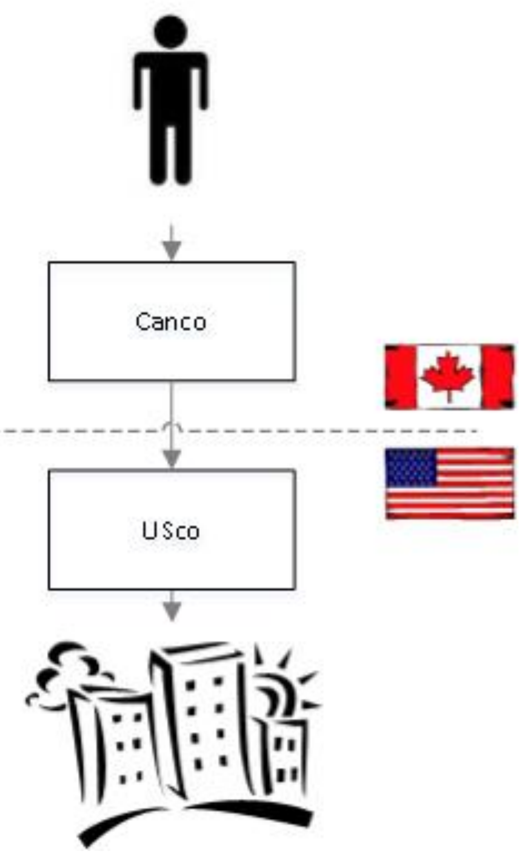
- Simplified US filings
- No FIRPTA
- US entity for financing, banking and operations
- Protection from liability

Disadvantages

- No protection from US estate tax
- Double taxation (corporate & personal)
- No tax-free capital dividend from "CDA"
- Not entitled to preferential US capital gains rate
- High US withholding tax
- "FAPI"

Options For Owning US Rental Property

Canadian Corporation Owns US Corporation



***Rental:* 43% US tax, 11% CDN tax → ETR 54%**

Capital gain:* 43% US tax, 11% CDN tax → ETR 54%

**May be reduced if repatriated through liquidation of USco*

Advantages

- Corporate US filings only
- Protection from US estate tax
- No FIRPTA
- Low US withholding tax
- US entity for financing, banking and operations
- Protection from liability
- Likely no net “FAPI”

Disadvantages

- Double taxation (corporate & personal)
- No tax-free capital dividend from “CDA”
- Not entitled to preferential US capital gains rate
- Complex structuring

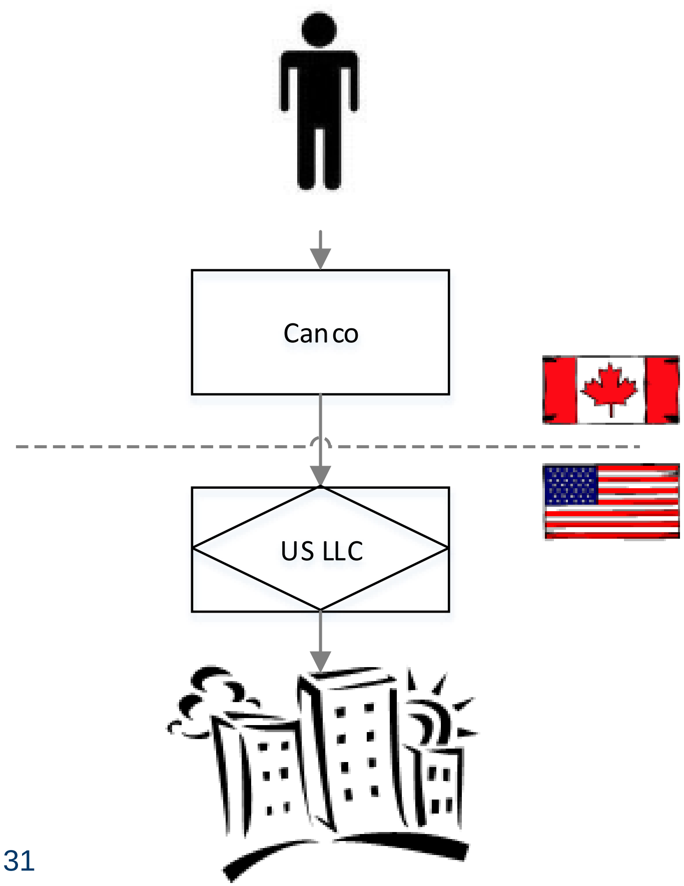
Options For Owning US Rental Property

Canadian Corporation Owns US Limited Liability Company (LLC)

- US LLC:
  - Single-member LLC – disregarded for US tax purposes
  - Popular vehicle for holding real estate and other investments because of its flow-through characteristics
- A good vehicle for Canadian?
  - A corporation under Canadian tax law .. so what could happen… ?

Options For Owning US Rental Property

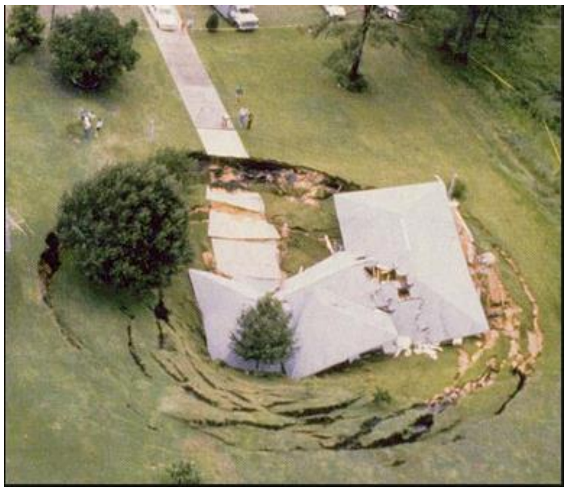
Canadian Corporation Owns US Limited Liability Company (LLC)



Why may someone have used such a structure?

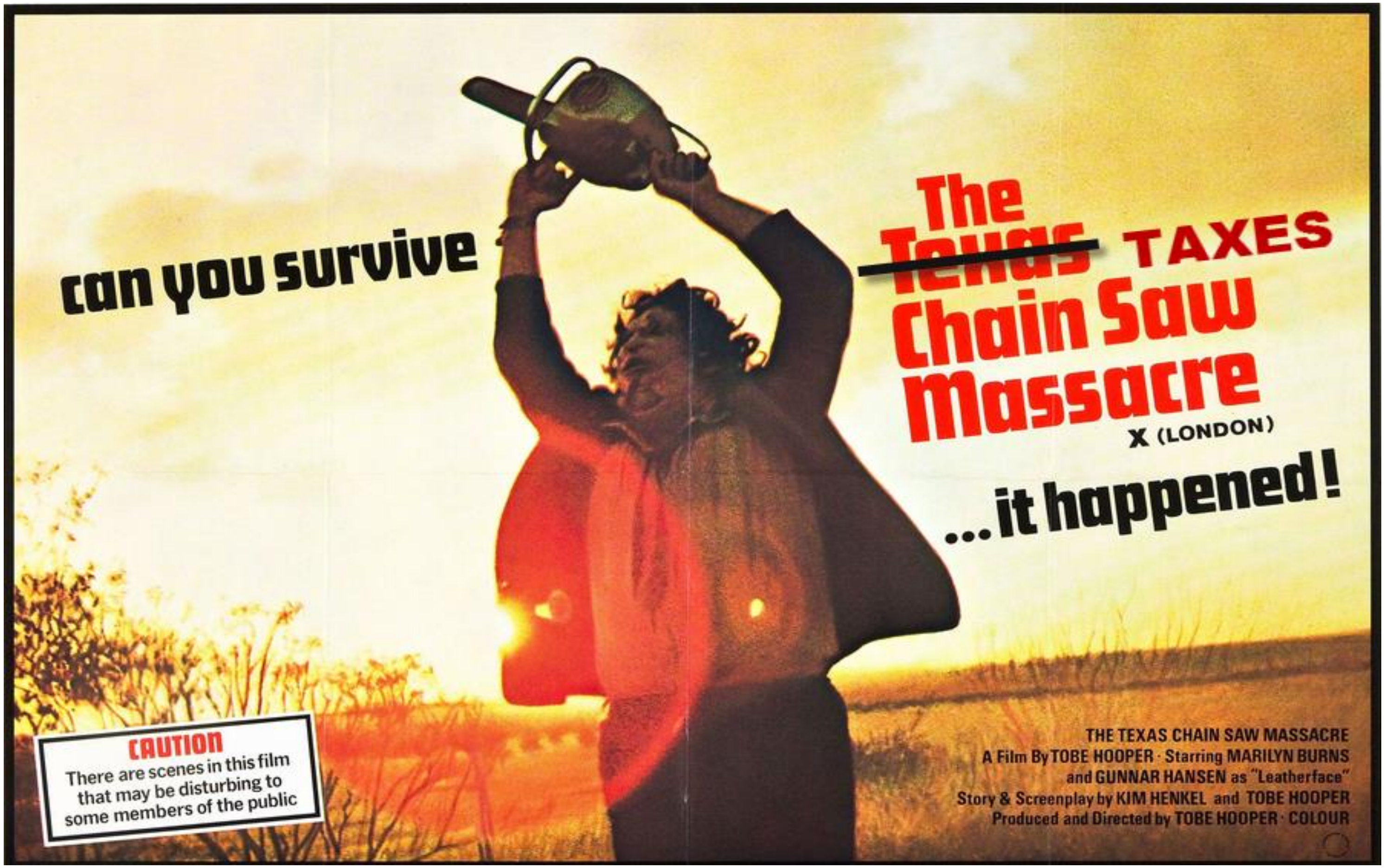
- Popularity of LLC as a holding vehicle
- US LLC provides for a US entity for purpose of financing, banking and operations
- An attempt to reduce US tax return filing obligations because US LLC is disregarded for US tax purposes
- Avoidance of US estate tax
- Multiple level of liability protection
- Incorporated professionals using their professional corporations to invest in the US
- And … lack of awareness of the Canadian/US tax implication!

Canadian Corporation Owns US Limited Liability Company (LLC) How bad can the tax be??



- CRA/IRS Quicksand?
- The Cross-Border Black Hole?
- Cross-Border In**TAX**ication?
- The Cross-Border Toilet Bowl?

Canadian Corporation Owns US Limited Liability Company (LLC)



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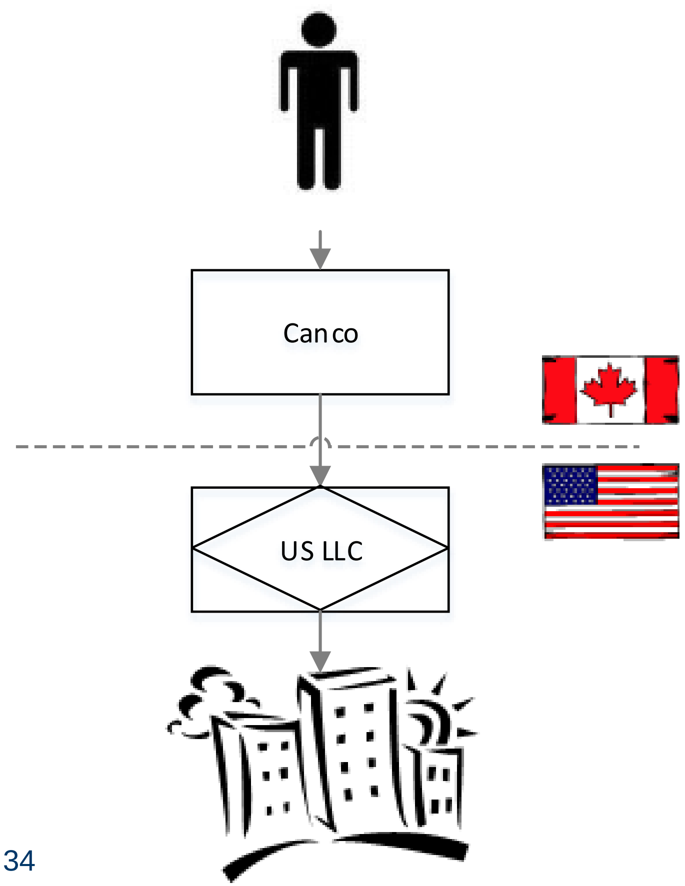
Options For Owning US Rental Property

Canadian Corporation Owns US Limited Liability Company (LLC)



5th Protocol to Canada-US Tax Treaty denies treaty benefit to hybrid entities in certain situations, rules came into force in 2010

Rental Income:

- Canco: US tax of 59% + Canadian tax of 45%
- **TOTAL: 104% tax rate !!**

Capital Gain:

- Canco: US tax of 59% + Canadian tax of 13%
- Investor: Canadian tax of 5%
- **TOTAL: 77% tax rate !!**

A hole that you cannot get out of, unless you start over again with a new structure

Summary of Tax Rates

Form of Ownership	Net US/CDA Tax On Income	Net US/CDA Tax On Gains
Personal Ownership	42%	23%
Canadian Corporation	59%	45%
US Corporation	63%	63%
Canadian Corp owns US Corp	54%	54%
Canadian Corp owns US LLC	104%	77%

Which Is The “Best” Structure?

- No single “best” structure – depends on facts and circumstances
- Ideas for more sophisticated structures:
  - Stacked Canadian-US limited partnerships
    - Flow-through tax treatment, preferential capital gain rates, liability protection, US entity
  - Canadian reverse hybrid
    - Simplifies US filing obligations where there are multiple investors, avoids US Estate tax, partial flow-through treatment, qualifies for treaty benefits
  - Leasing vehicle to obtain flow-through on rental income while avoiding US estate tax with corporate ownership structure

We Are Here To Help

THANK YOU

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