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# Proposed tax changes could have a big impact on U.S. citizens living in Canada

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Financial advisors who have United States citizen clients living in Canada may want to prepare them for a proposed change in U.S. tax laws that would affect their personal investments outside of their native land.

Under the current U.S. tax system, U.S. citizens are required to pay income taxes on their worldwide income, including employment and investment-related income. The Republicans recently put forward a proposed bill entitled Tax Fairness for Americans Abroad Act of 2018 that would give non-resident U.S. citizens exemptions from paying taxes on both their foreign earned and unearned income.

For example, U.S. citizens living in Canada who have a tax-free savings account (TFSA) have to pay taxes on the gains in the TFSA under the current U.S. tax system, even though the investment is not subject to taxes in Canada. Under the proposed bill, they wouldn't have to pay taxes on realized TFSA gains.

Some believe the bill is unlikely to pass because it was proposed before the Democrats took over the House of Representatives on Jan. 3, and there's a great level of divisiveness between the two parties.

"It would be awesome," for U.S. citizens living in Canada if the bill does pass, says Terry Ritchie, director of cross-border wealth services at Calgary-based Cardinal Point Capital Management Inc. "However, it's unlikely to ever see the light of day – but I guess anything is possible down there these days."

Advisors should still consider the proposal and how it might impact their clients' overall unique financial planning initiatives, Mr. Ritchie says. If the bill were to pass, it could trigger some decisions, such as buying or selling of certain assets held outside of the U.S. For example, some U.S. citizens living in Canada who are approaching retirement may wish to sell their homes and buy property in a warmer climate, such as the southern U.S.

As for the implications, Mr. Ritchie uses the example of a couple who are U.S. citizens living in Canada who bought a home for $250,000 and then sold it for $1-million. For Canadian tax purposes, there would be no capital gains taxes imposed on the $750,000 capital gain.

Assuming the Canadian dollar is at par with the greenback, the U.S. citizen homeowner in Canada might be eligible to receive a US$250,000 capital gains exclusion (under certain circumstances) under the proposed rules. If the clients were a married couple who are U.S. citizens in Canada filing U.S. taxes jointly, they could potentially have a total exclusion of US$500,000 (US$250,000 each). To qualify, Mr. Ritchie says the sellers must have owned and occupied the home as their principal residence for at least two years before they sell it.

Under the current U.S. rules, based on the long-term capital gain rates and after the application of the U.S. standard deduction, Mr. Ritchie calculates their net tax liability would be about US$21,930 based on taxes paid on the remaining capital gain of US$250,000. However, under the proposed bill, there would be no capital gains taxes owed in the U.S. on the sale of the property.

The proposed bill is unlikely to affect most U.S. citizens living and working in Canada who aren't selling major assets. Since the application of the foreign tax credit system, taxpayers are generally entitled to apply taxes paid in Canada against their U.S. taxes. When two countries tax the same amount of income, the country in which the income was sourced taxes the income first. Most U.S. citizens don't pay taxes in the U.S. on Canadian-generated personal income because the Canadian rates are generally higher and enough to generate sufficient foreign tax credits to offset U.S. taxes.

If the law were to change, U.S. citizens living in Canada would still have to file tax returns in both the U.S. and Canada, as they do now. Also, the proposed bill states the exemptions would apply only to U.S. citizens abroad who are in compliance with their American tax filings and have filed for at least the past three years.

"Even if you don't owe tax, or money, to the American government, you have to prove you don't owe money and file," says Max Reed, a cross-border tax lawyer with SKL Tax in Vancouver. He recommends U.S. citizens in Canada not take any action on their investments based on the proposed bill, also believing the odds of it passing are slim.

Charles Bruce, a former tax counsel at the U.S. Senate finance committee, who now serves as legal counsel to the Washington-based American Citizens Abroad advocacy group, doesn't see the proposed bill as a long shot.

"I wouldn't be [in support of this change] if I thought was a big, fat waste of time. I think we'll get to this; the issue is when," says Mr. Bruce, who has been lobbying for the change for years. The U.S. is one of only two countries in the world, along with the tiny African nation Eritrea, that taxes on citizenship; other countries, including Canada, tax on residency.

The change would be great for American investors abroad, Mr. Bruce says. He encourages these people to review their assets with their advisors to see how they might be able to lower their tax bills if the bill does go through. "You'd have to examine the possibility to restructure a bunch of holdings," Mr. Bruce says.

The proposal doesn't specifically address business income, which was targeted as part of the Trump administration's Tax Cuts and Jobs Act, which passed in late 2017. That bill included a cut in the corporate tax rate to 21 per cent from 35 per cent and imposed a "transition tax" – known as the global, intangible low-taxed income, or "GILTI," tax – of up to 15.5 per cent on U.S. citizens living and running privately held companies in other countries. The GILTI tax can be imposed on a U.S. citizen shareholder if, under the new law, more than 10 per cent of the non-U.S. corporation's earnings are deemed to come from intangible assets.

Even if the proposed bill doesn't pass, Rick Robertson, a professor emeritus at Ivey Business School at the University of Western Ontario, says advisors should be talking about it with their clients. "I would make sure my clients knew that this is going on and keep abreast of it."

He also recommends advisors stay on top of the issue and in touch with accountants and lawyers with expertise in U.S. tax laws.

Mr. Robertson also suggests advisors help American clients in Canada take stock of investments and assets that might be affected, such as property, equities and TFSAs.

"You may not want to run out and sell, but I think what you want to do is establish their value," he says. "After that, it's a wait-and-see."

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