U.S. TAX UPDATE & FATCA

Thursday, March 2, 2017

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AGENDA

- Reminder/update of tax filing deadlines & thresholds
- Snowbirds
- Foreign reporting
- Owning U.S. real property
- FATCA (Foreign Account Tax Compliance Act)

Who needs to file a U.S. tax return?

- U.S. citizens are subject to U.S. tax law no matter where they live in the world
- U.S. permanent residents are subject to the same rules as U.S. citizens if they want to maintain the status of their green cards
- Non-residents spending a significant amount of time in the U.S. may need to file
- Non-resident individuals or corporations earning income in or from the U.S. will need to file

Remember, if you have a U.S. green card in your possession, it doesn't matter if it is expired, you could technically still be treated as a U.S. person unless you physically surrender it or file a non-resident U.S. return claiming closer ties to Canada

When to file a U.S. tax return?

- A non-resident person or corporation is generally required to file a U.S. income tax return if they earn U.S. source income, no matter if a profit results or not, unless special rules exempt them
- A non-resident person or corporation may also be required to file a U.S. income tax return if they meet certain “residency” requirements or need to claim a treaty exemption
- State return(s) may also be required depending on which state is involved (i.e. each state has its own rules)

NOTE: Keep in mind that the substantial presence test is an income tax test, the 183 day immigration rules are different than these rules (i.e. 183 days over a consecutive 12 month period)

When to file continued….

- If you are living in the U.S. : due April 15th
- Non-resident living outside the U.S. but earning U.S. employment income – due April 15th
- U.S. citizen or green card holder living outside the U.S. : due June 15th
- Non-resident living outside the U.S. with U.S. source income that is not employment income : due June 15th
- EXTENSIONS are available for all
- Every state has its own due dates

Snowbirds

- A person who is ordinarily resident in Canada but spends part of the year in the U.S.
- substantial presence test in the U.S. is usually met over a 3 year period resulting in a Closer Connection form to claim closer ties to Canada (form 8840)
- If in U.S. for 183 days or more in current year, must file treaty election to claim closer ties (form 8833)

NOTE: Keep in mind that the substantial presence test is an income tax test, the 183 day immigration rules are different than these rules (i.e. 183 days over a consecutive 12 month period)

Substantial presence test calculation

To meet this test, they must be physically present in the United States for at least:

- 31 days during the current year, and
- 183 days during the 3-year period that includes the current year and the 2 years immediately before that, counting:
  - All the days present in the current year, and
  - 1/3 of the days present in the first year before the current year, and
  - 1/6 of the days present in the second year before the current year.

Keep in mind that U.S. residency is also determined by the green card test (i.e. have you applied for or do you have a green card)

EXAMPLE #1

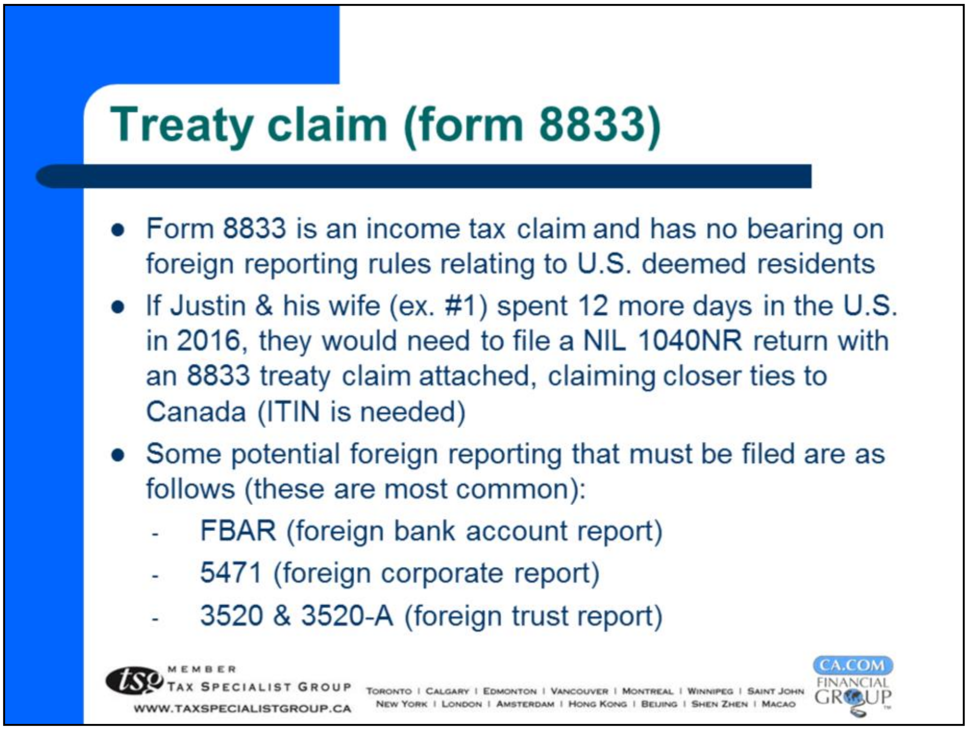
- Justin and his wife have spent the winter months in Arizona every year for the past 5 years
- They leave Canada on October 10th and return March 31st
  - # of days each year would be 172
- # of days under 2016 substantial presence test calculation is 258
- They meet substantial presence test and must file form 8840 or could be deemed U.S. residents for tax purposes

NOTE: 120 days is the magic # each year in order to not meet the test

EXAMPLE #2

- Gwen and Henry are retired and spend time in Florida every year
- # of days in last 3 years is 2016: 132, 2015: 125, 2014: 110
- # of days under 2016 substantial presence test calculation is 192 (191.999 rounded up)
- They meet substantial presence test and must file form 8840 or could be deemed U.S. residents for tax purposes

NOTE: 120 days is the magic # each year in order to not meet the test



NOTE: $10,000 failure to file penalties can apply to the foreign reporting forms if they should be filed and are not

Foreign Reporting

- FBAR
  - Aggregate total in all foreign financial accounts (i.e. accounts outside the U.S.) is over $10,000
- 5471
  - 10% or greater ownership in foreign corporation
- 3520 & 3520-A
  - Ownership in, distribution received from or contribution made to foreign trust (i.e. TFSA, RESP, family trust, etc.)

NOTE: No tax implications but failure to file penalties are at risk

OWNING U.S. VACATION PROPERTY

- Using your vacation home for rental purposes requires the filing of an income tax return in the U.S.
- If the property is used solely for personal use then a filing requirement does not exist until the property is sold
- This applies to individuals and corporations; separate rules and tax rates exist for individuals and corporations
- Never a good idea to hold personal use property in a corporation

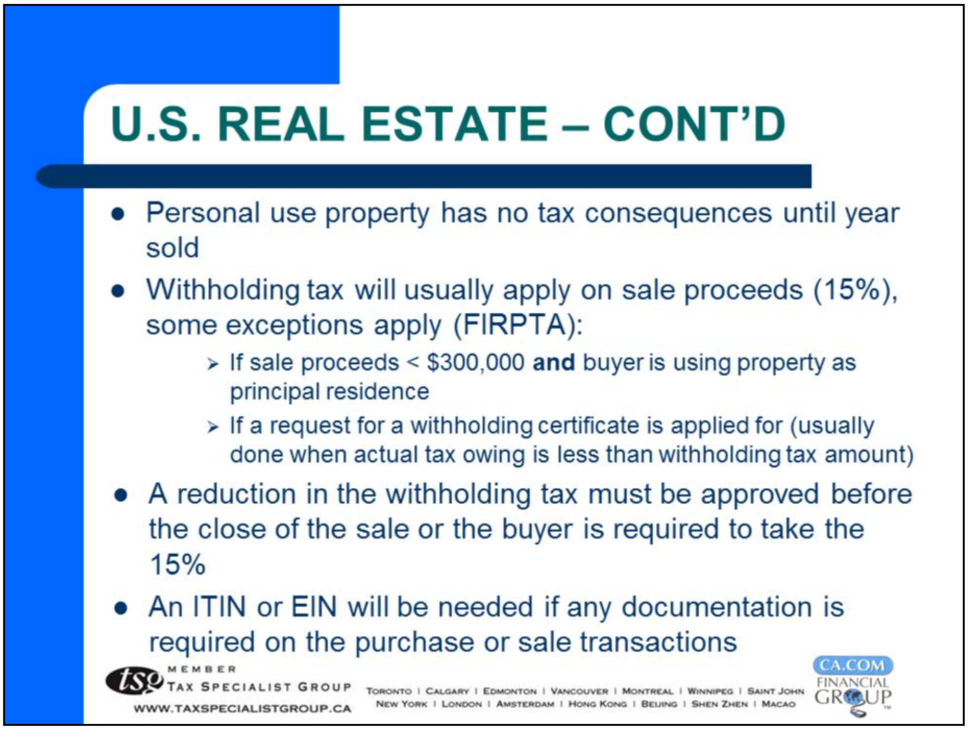
U.S. REAL ESTATE

Rental property

- 30% withholding tax on gross rents collected
- Must be directly remitted by agent to IRS
- W-8 ECI can be filed to elect not to have withholding taxes apply (effectively connected income)
- U.S. form 1040NR is used to report net rental income or 1120F
- Due June 15th of following year (individual); corporation due dates depend on year-end (15th day of 3rd or 6th month after year-end)
- T1135 foreign reporting in Canada required if cost over $100,000 (not for personal property)

U.S. REAL ESTATE – CONT'D

- If rental property used for personal use at any time during the year, all expenses must be prorated
- If personal use is not much different than rental use then expenses are significantly limited (i.e. vacation home restrictions); expenses cannot exceed income
- Depreciation is mandatory in the U.S. which will sometimes create a loss for tax purposes but that's okay; not allowed in Canada (<u>NOT</u> if vacation home restrictions apply)



- ITIN required in year of purchase if seller is wanting to file a reduced withholding tax application (8288-B form) or withholding taxes are applicable (8288-A form)

- FIRPTA stands for Foreign Income Real Property Tax Act and applies to dispositions of real property held by foreign individuals of the U.S.

ITIN/EIN

- An ITIN or EIN is needed when filing most U.S. tax documents
- Individual Taxpayer Identification Number (ITIN) is used by individuals not eligible for a SSN; W-7 application but must meet a specific requirement to apply
- Employer Identification Number (EIN) is used by corporations or other entities; SS-4 application

EXAMPLE #3

- Martin and Sandi bought a property in Miami Florida with the intention of renting it out until they retire
- They bought it June 3, 2016 as joint tenants in common for $210,000
- They started renting it out on August 1, 2016 (short term renters only); no personal use
- Total income collected for 2016 was $5,000

Example #3 cont'd….

- Total expenses before depreciation was $3,650
- Depreciation is approx. $3,000
- Total net loss reported for 2016 is ($1,650)
- Because the property is owned jointly, both taxpayers must file a 1040NR and report their share
- A W-8ECI was given to the management company collecting the rent on their behalf so no tax withholding is required

REMEMBER: this must also be reported on the Cdn tax returns and if there is personal use, the personal use percentage of expenses must be excluded!

EXAMPLE #4

- Frank and Janet have owned and enjoyed their California vacation property for the past 10 years (they are Wpg residents)
- Due to poor health, they now have to sell it
- They bought the property for $135,000 and plan to sell it in 2017 $215,000
- The buyers are from Alberta and also plan to use it as a vacation property

Example #4 cont'd…

- 15% withholding tax will be taken if a withholding certificate is not filed (i.e. $32,250)
- Property is owned jointly so they must both file a 1040NR to report their share of the gain (i.e. $40,000)
- Gain amount is low enough to trigger 0% federal tax but a California return must also be filed and any taxes resulting must be paid

NOTE: FIRPTA 15% is a federal tax only; however, each state has their own rules regarding property dispositions so state tax may be withheld also

OWNING U.S. ASSETS

- Joint tenants in common is best form of ownership for individuals for U.S. estate tax purposes: each person's ownership percentage is looked at
- U.S. estate & gift taxes do not apply to corporations or other entities, only individuals
- Applies to any U.S. property/citus asset owned by an individual

U.S. ESTATE TAX

- Non-resident U.S. estate may be applicable if U.S. property is owned when a person dies
- Canadians are required to file a U.S. estate tax return if the gross value of the U.S. assets are over $60,000
- The Canada-U.S. Tax Treaty allows Canadians access to a proportionate share of the U.S. Estate Tax Exemption as well (FMV U.S. assets/worldwide assets * exemption amount)
- Estate tax exemption is currently $5,490,000; $5,450,000 (2016).

EXAMPLE #5

- Mary & Hank owned a vacation property in Arizona with a value of $350,000; JTWRS
- Mary's net worth is $1,540,000 and Hank's is $5,320,000 (including their share of the U.S. property)
- Hank died of an unexpected heart attack in May 2016

Example #5 cont'd…

- Hank's net worth for U.S. estate tax purposes is $5,495,000 (i.e. 100% of the value is attributed to each taxpayer unless 50% payment can be proven)
- 350,000/5,495,000=6.37%
- Estate exemption = 347,165
- 350,000-347,165 = $2,835 * 40% = $1,134 of U.S. estate tax owing

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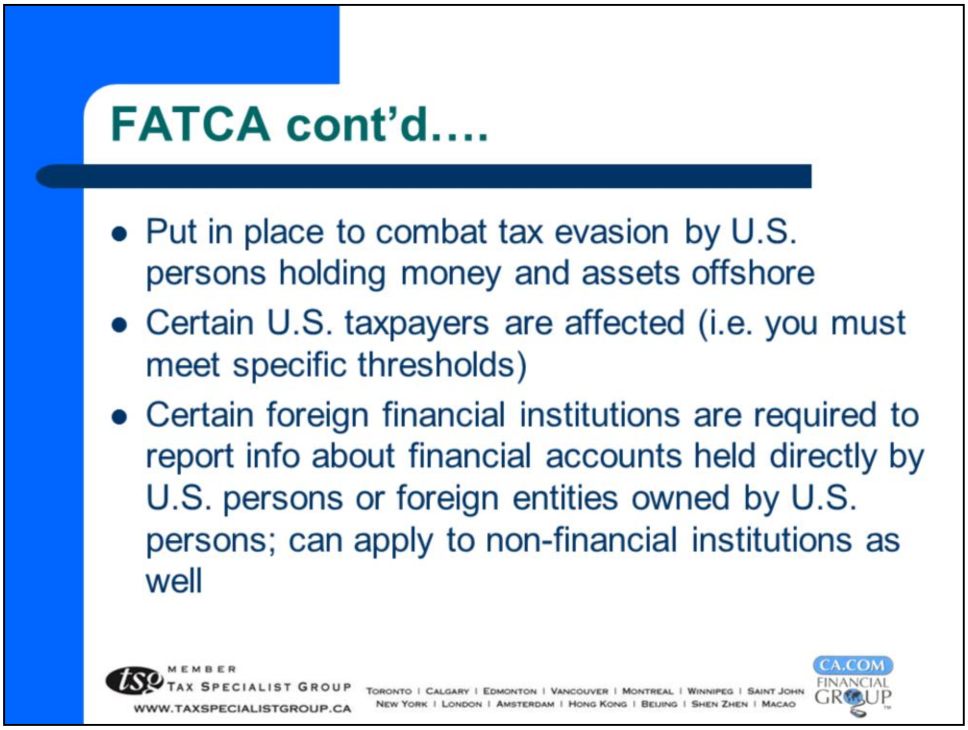
NOTE: If they had owned the property as Joint Tenants in Common, their 50% ownership share would have been used in calculation Hank's estate automatically, which would have meant he is not subject to U.S. estate tax.

FATCA

- Foreign Account Tax Compliance Act
- Includes forms W-8BEN, W-9, W-8ECI, 8938 & FinCEN 114 for individuals
- Includes forms W-8BEN-E & W-8IMY for corporations and trusts



Form 8938 Reporting Thresholds

Reporting thresholds vary based on whether you file a joint income tax return or live abroad. If you are single or file separately from your spouse, you must submit a Form 8938 if you have more than $200,000 of specified foreign financial assets at the end of the year and you live abroad; or more than $50,000, if you live in the United States. If you file jointly with your spouse, these thresholds double. You are considered to live abroad if you are a U.S. citizen whose tax home is in a foreign country and you have been present in a foreign country or countries for at least 330 days out of a consecutive 12-month period.

Taxpayers living abroad. You must file a Form 8938 if you must file an income tax return and:

You are married filing a joint income tax return and the total value of your specified foreign financial assets is more than $400,000 on the last day of the tax year or more than $600,000 at any time during the year. These thresholds apply even if only one spouse resides abroad. Married individuals who file a joint income tax return for the tax year will file a single Form 8938 that reports all of the specified foreign financial assets in which either spouse has an interest.

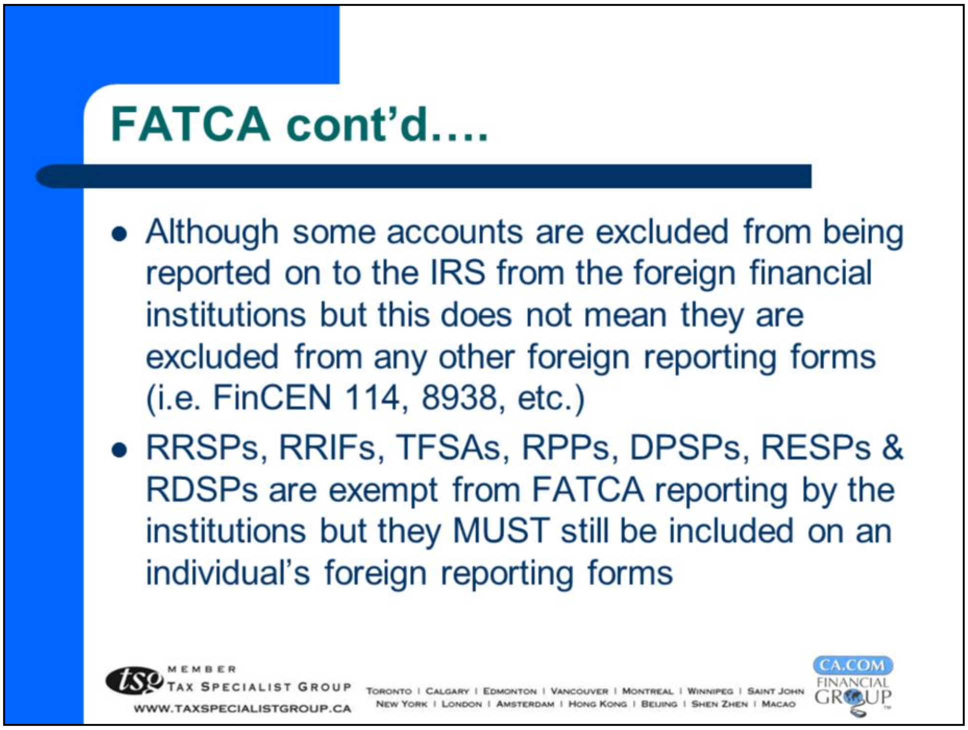
You are not a married person filing a joint income tax return and the total value of your specified foreign financial assets is more than $200,000 on the last day of the tax year or more than $300,000 at any time during the year.

Taxpayers living in the United States. You must file Form 8938 if you must file an income tax return and:

You are unmarried and the total value of your specified foreign financial assets is more than $50,000 on the last day of the tax year or more than $75,000 at any time during the tax year

You are married filing a joint income tax return and the total value of your specified foreign financial assets is more than $100,000 on the last day of the tax year or more than $150,000 at any time during the tax year.

You are married filing separate income tax returns and the total value of your specified foreign financial assets is more than $50,000 on the last day of the tax year or more than $75,000 at any time during the tax year. For purposes of calculating the value of your specified foreign financial assets in applying this threshold, include one-half the value of any specified foreign financial asset jointly owned with your spouse. However, report the entire value on Form 8938 if you are required to file Form 8938.



FinCEN 114 (i.e. FBAR) is required when an individual's foreign financial accounts reach an aggregate balance of $10,000 or more at any time during the year; includes bank accounts, registered and non-registered investment accounts, accounts held jointly with someone else and accounts in which the U.S. person has signing authority

NOTE: there are NO income tax implications to this form any other foreign reporting form but there are non-compliance penalties that can be applied and they are SIGNIFICANT!

W-8BEN

- For non-U.S. citizens and non-resident individuals
- Identifies the foreign person's status with the U.S. payor
- Indicates section of income tax treaty that allows reduced rate of withholding tax (IMPORTANT)

NOTE: W-9 is only for U.S. citizens

W-8BEN-E

- Used by non-U.S. trusts, corporations, etc.
- Identifies the foreign entity's status with the U.S. payor
- Indicates section of income tax treaty that allows reduced rate of withholding tax (IMPORTANT)

W-8IMY

- Used by non-U.S. intermediaries (i.e. the third party “go between” such as investment brokers, trusts, ptnrshps, banks, etc.)
- Identifies the foreign entitys’ status with the U.S. payor
- Indicates section of income tax treaty that allows reduced rate of withholding tax (IMPORTANT)

Questions?

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Thank-you!