

CASE IN POINT

Sales Tax Estate Planning Underwriting & Product Newsletter

TFSA and US person for income tax purposes



Candice was born in the USA and moved to Canada with her family when she was a young child. She never applied for a US passport nor initiated any renunciation of her US citizenship upon reaching age 18 or later. She is considered to be a US person for US income tax purposes.

An advisor meets with Candice through her parents when Candice is working as a systems analyst after completing college. The advisor discusses the importance of saving and investing money for the future. Candice is ready to begin a planned savings program. The two of them discuss the merits of setting up a tax-free savings account. Are there any issues they should consider?

US citizens and deemed US residents for tax purposes have a number of issues to contend with if considering a tax-free savings account (TFSA). These accounts are not considered tax deferred accounts by the US Internal Revenue Service (IRS). They have no special status under the Internal Revenue Code. There are no relieving provisions contained in the Canada-United States Tax Treaty. What does that mean for Candice and others like her? Income tax must be paid on all growth annually. Since the type of growth is not reported for Canadian purposes, the default may well be treating all growth as ordinary, passive income. This tax treatment eliminates the benefits of a TFSA for most Canadian taxpayers who are deemed US Persons for income tax purposes.



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Peter works with independent advisors and other professionals raising awareness on issues and concerns faced by affluent individuals, professionals and business owners. He supports efforts in researching and developing optimal solutions for clients aimed at improving their financial well-being and supporting their personal wishes and lifestyles. He has provided 1000s of workshops, seminars and technical support throughout the country on tax, retirement income and estate planning issues, concepts and strategies to both advisors and consumers. As an accredited Registered Financial Gerontologist, a good deal of his time is spent on building awareness and educating people of all professions who work with or specialize in the needs, expectations and issues of elders. Comprehensive lifestyle planning is an important element of these processes.

The Sales, Tax, Estate Planning, Underwriting & Product (STEPUP) team provides internal and broker support, including seminars, education, advanced concept illustrations & Client case technical consultations.

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There may be some situations where a U.S. taxpayer has enough other investment income subject to Canadian taxes that they will be able to offset U.S. tax on TFSA income with foreign tax credits.

As a US citizen residing in Canada, Candice should be filing a US individual income tax return (Form 1040) to report her worldwide income each year in addition to filing a Canadian income tax return. A TFSA is considered a foreign trust. As such, some onerous and expensive information disclosures are required. The US Internal Revenue Service or IRS requires the following to be filed annually:

1. Form 3520 Annual Return to Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts
2. Form 3520A Annual Information Return of Foreign Trust with a U.S. Owner.

If these forms are not completed and filed on a timely basis, the IRS can assess a penalty equal to the greater of \$10,000 or 5% of the gross value of the TFSA at the close of that tax year (fair market value as of Dec. 31st) or 35% of the amount of the contribution or of the withdrawal. That works out to a minimum penalty of \$10,000 USD per year.

3. If the client's total non-US financial accounts exceed \$10,000 USD at any time of the year, then they must file a Report of Foreign Bank and Financial Accounts, FinCen Form 114, including information on all accounts. This may trigger additional form disclosures.
4. For example, if the client invests in mutual funds or Exchange Traded Funds (ETFs), then they would also need to complete Form 8621, Information Return by a Shareholder of a passive Foreign Investment Company.

A tax preparer will likely charge an additional fee to file these forms. That becomes another consideration.

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