



Grant Thornton

Selected U.S. Tax Issues for Canadians spending time in the United States

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U.S. Taxation of Non-Residents and Residents

Residents and Citizens of the United States

- Subject to U.S. tax on worldwide income under U.S. tax rules – some limited treaty protection in some cases
- "U.S. persons"

Non-Residents of the United States

- Subject to U.S. tax on U.S. source income under U.S. tax rules – treaty protection even in respect of certain U.S. source income

Residency/reporting: Days in U.S.

- Substantial presence test – day-count
- Closer connection statement (Form 8840 required)
- Treaty override (tie-breaker)
 - Treaty based return (Form 8833 may be required)
- Green card test (not based on days in the U.S.)

Residency/reporting: Days in U.S.

Substantial Presence Test

- (1) At least 31 days or part days of U.S. presence in the current year;
and
- (2) Sum of:
 - days in current year
 - $\frac{1}{3}$ of days in 1st preceding year
 - $\frac{1}{6}$ of days in 2nd preceding yearexceeds 183

Residency/reporting: Days in U.S.

- Closer connection statement (exemption from substantial presence test) if:
 - 1) Present on less than 183 days in current year and
 - 2) Tax home in and closer connection to foreign country

Form 8840 required on a timely basis

- Possible Treaty protection if closer connection exception is not available (e.g., exceed 183 days present in the U.S. in a year or if no form 8840 filed on time)

U.S. Tax Treatment of Canadian Tax-Favoured Accounts

Examples

- RRSPs/RRIFs
- TFSAs
- RESPs

Not tax-deferred vehicles for U.S. tax purposes, therefore, in general, income within these plans should be reported each year for U.S. tax purposes

Exception – for RRSPs/RRIFs, there is an election available under the Canada-U.S. Tax Treaty – to defer U.S. taxation - timely filed form 8891

U.S. Tax Treatment of Canadian Tax-Favoured Accounts

Are RRSPs/RESPs/TFSA's trusts for U.S. tax purposes?

If so:

- Is there a U.S. "grantor"?
- Is there a U.S. owner?
- Is there a U.S. beneficiary?

These can affect U.S. treatment of the trust income
U.S. Filing and reporting requirements

Additional U.S. Filing and Reporting Requirements

Common Examples

- FBAR – Form TD F 90-22.1 – Treasury reporting form re foreign bank and financial accounts
- Form 8938 – IRS reporting form – foreign financial assets
- Form 3520-A – if US owner and possible US beneficiary
- Form 3520 – if US owner, distribution to US person, US person held an obligation, reportable event
- Form 8621 – PFIC reporting form

U.S. Trust Returns

U.S. domestic trust

- U.S. court has primary supervision over administration and
- One of more U.S. persons has the authority to control all substantial decisions of the trust
- Certain trusts that have elected to be treated as U.S. trusts
- Reports worldwide income
- Files form 1041

U.S. Trust Returns

Non-U.S. trust

- Treated as a foreign trust
- Files form 1040NR
- Subject to U.S. tax on U.S. source income – subject to certain treaty protection

U.S. Persons Holding Canadian Mutual Funds

Current Position

- Canadian mutual fund trusts probably classified as corporations – per an IRS Chief Counsel Advice on specific facts in a non-income tax situation
- In this case, virtually every such mutual fund trust will be considered a passive foreign investment company ("PFIC") by virtue of its income and assets (unless the mutual fund has elected to be treated as a partnership for US tax purposes)
- PFICs are potentially subject to punitive anti-deferral rules

U.S. Persons Holding Canadian Mutual Funds

PFIC Rules

What is a PFIC?

- Basically, a foreign (i.e., non-U.S.) corporation if:
 - 75% or more of its gross income is passive income or
 - The average percentage of its passive assets is at least 50%
- Look-through rules in respect of 25% investee corporations

U.S. Persons Holding Canadian Mutual Funds

PFIC Rules

Elective regimes (highlights)

- Qualified Electing Fund election ("QEF")
 - Current recognition of undistributed income and capital gains (at capital gain rates)
 - Timeliness of election
 - **Requires detailed information from the PFIC**
- Mark to Market election
 - Applies for Marketable PFICs
 - Mark to market results in ordinary income or loss

U.S. Persons Holding Canadian Mutual Funds

PFIC Rules

Default regime (highlights)

- All distributed income and gains taxed as ordinary income
- Gain on disposition considered ordinary income
- Non-deductible penalty interest can apply to distributions and gains "treated as" deferred from earlier years – mechanism can result in penalty equal to the entire distribution or gain
- Loss on disposition can't offset gain elsewhere

U.S. Persons Holding Canadian Mutual Funds

PFIC Rules (Cont'd)

- Tax-deferred reorganizations don't apply to a PFIC, i.e., all reorganizations are taxable
- Deemed disposition at death or expatriation
- Form 8621 filing

U.S. Persons Holding Canadian Mutual Funds

Scope of PFIC Rules

- Mutual funds held inside Canadian registered plans (e.g. RRSP, RESP, TFSA) may also be affected – the prevailing view appears to be that PFICs within an RRSP that is the subject of the treaty deferral (by filing form 8891) are likely not subject to the PFIC regime, but those within RESPs, TFSAs or non-electing RRSPs likely are.
- PFIC rules can also apply to the shares of private or public Canadian corporations if they meet the income or asset test

U.S. Persons Holding Canadian Mutual Funds



- PFIC rules are complex
- Strategies to minimize impact are available, including no longer holding Cdn mutual funds, but care must be taken
- If you have clients who may be affected, contact a U.S. tax specialist

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