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Americans living in Canada: Be aware that the IRS is watching you

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“The Star-Spangled Banner” is a heartfelt anthem that we’ve always loved hearing at professional sports games here in Canada. Who isn’t moved by words such as, “O say does that star-spangled banner yet wave / O’er the land of the free and the home of the brave?”

However, for the more than one million Americans living in Canada, the U.S. might not feel like the “land of the free.” After all, U.S. citizens living in Canada are still subject to U.S. tax law and must report their worldwide income to the Internal Revenue Service (IRS) as well as the Canada Revenue Agency (CRA). If you’re an American living in Canada, beware: the IRS is watching you.

The IRS enforces many different tax rules on U.S. citizens living abroad. We’ve written about five of the most common tax traps for U.S. citizens living in Canada before, but there are other issues to consider, too. Here are five additional cross-border tax issues for Americans living in Canada.

Principal residence

When U.S. citizens sell their principal residence in Canada, they’re not taxed on the gain by the CRA; however, the IRS will tax the portion of the gain that exceeds US$250,000. The issue? If there’s no capital gains tax paid in Canada, there are no foreign tax credits available to offset tax owing in the U.S.

Foreign accounts in the aggregate of $10,000

The IRS requires that U.S. citizens file a Report of Foreign Bank and Financial Accounts (FBAR) for each year that they have a financial interest in or signing authority over certain foreign financial accounts. The FBAR requirements cast a wide net, ensnaring several kinds of accounts, including corporate, trust, and joint accounts. Since penalties for failing to file can be severe, U.S. citizens must be careful to report all relevant accounts each year.

U.S. gift and estate tax

U.S. citizens who make gifts are subject to the U.S. gift tax regime. Not all gifts are taxable, however, and there is a large lifetime gift tax exemption amount of US$11.2-million in 2018, a recent change courtesy of U.S. President Donald Trump's new tax law. Drawing this lifetime gift tax exemption down may create U.S. estate tax (or death tax) issues down the line, though. Another key point: U.S. citizens often unintentionally trigger gift tax by taking certain action – adding children on title to real estate as an estate planning measure, for instance. Note that in 2026, President Trump's new tax law sunsets, and the $11.2-million exemption amount is set to drop back down to 2017's exemption of $5.49-million (which will be adjusted for inflation). Careful, long-term gift and estate tax planning is therefore still essential today.

Term life insurance

If a U.S. citizen owns a term life insurance policy upon death, the policy's proceeds are included when calculating the value of the policyholder's gross estate for U.S. estate tax purposes. If the proceeds increase the U.S. citizen's estate beyond the exemption amount in the year of death, an estate tax liability may result. Holding a term life insurance policy in an alternative ownership structure such as an irrevocable life insurance trust can be an effective estate planning tool.

Whole life insurance

The CRA and IRS don't see eye-to-eye on whole life insurance. Income earned inside a Canadian whole life policy that is tax-exempt by the CRA might not be tax-exempt by the IRS, leaving the U.S. citizen liable to pay tax to the IRS on income earned inside a Canadian whole life policy. U.S. citizens in Canada may want to reconsider owning whole life insurance policies.

Some U.S. citizens living in Canada simply don't want to deal with U.S. tax obligations for the rest of their lives. Renouncing U.S. citizenship is the only way to effectively end all U.S. tax obligations, though the process can be long, daunting, and expensive.

First, the renunciation fee is US$2,350. Also, before renouncing, a U.S. citizen must generally show that they have been tax-compliant for at least five years, or they risk being deemed a "covered expatriate." Covered expatriates may be subject to U.S. exit tax. Individuals worth US$2-million or more as of their renunciation date are also considered "covered expatriates."

Through careful planning, it is possible to avoid being deemed a "covered expatriate," and, in turn, avoid the U.S. exit tax. Speak to a cross-border adviser to find out your options for avoiding or mitigating U.S. exit tax exposure if you are considering renouncing your U.S. citizenship.

Renunciation is often an emotional decision for Americans living in Canada and one that should not be taken lightly. However, if you are willing to give up citizenship to "the land of the free and the home of the brave," you may experience even more freedom – at least from a tax-planning perspective.

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