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U.S. citizens living in Canada have a lot of extra tax-filing hoops to jump through

By Jamie Golombek

Filing your taxes is never fun, but if you're a U.S. citizen living abroad the process (and the expense) is so cumbersome it's inspiring some...

U.S. citizens living in Canada face an enormous tax-filing burden. Not only do they have to file Canadian tax returns, but they also must contend with U.S. tax-filing requirements as the U.S. imposes taxes based on citizenship, not residency.

What's particularly challenging is the enormous cost of U.S. tax compliance, which goes well beyond simply filing a U.S. tax return. For example, all foreign financial accounts - including a bank account, brokerage account, mutual fund, trust, or other type of foreign financial account over $10,000 - must be disclosed annually to the U.S. Department of Treasury. If the value of those accounts is large, they must also be disclosed on an additional form to the IRS.

Furthermore, if the U.S. citizen holds a TFSA, RESP or RDSP, these accounts are not recognized as tax-preferred by the U.S. and the income from these must be reported annually on a U.S. return. Most U.S. tax professionals consider these Canadian plans to be foreign grantor trusts from a U.S. tax perspective and thus also subject to onerous and costly information return filings.

To make matters worse, U.S. citizens are generally cautioned to avoid purchasing Canadian mutual funds as they are considered to be passive foreign investment corporations under U.S. tax law and must be extensively disclosed.

While most dual citizens find that, at the end of the day, no U.S. tax is owing, the compliance burden and costs of filing are prohibitive and have caused many U.S. citizens living abroad to explore the process of renouncing their U.S. citizenship. Indeed, the number of renunciations has increased exponentially in the last number of years, up from 231 people in 2008 to 3,415 in 2014.

Of course, the process isn't cheap. In September 2014, the U.S. quadrupled the processing fee for renunciation from US$440 to US$2,350. Wealthy U.S. citizens could also be hit with an "exit tax."

But all hope is not lost: There is a growing movement both in the U.S. and by U.S. citizens living abroad to lobby the U.S. government to change the rules.

Last week, University of Virginia School of Law professor Ruth Mason presented a paper titled, "Citizenship Taxation" at the Second International Tax Research Symposium held in conjunction with the 69th Congress of the

International Fiscal Association in Basel, Switzerland.

In her paper, she states that the U.S. is the only country that taxes its citizens' worldwide income, even when those citizens live indefinitely abroad. She critically evaluates the traditional arguments for taxing non-resident citizens but also raises new arguments against citizenship taxation, including that it puts the U.S. at a disadvantage when competing with other countries for skilled employees.

Mason argues that while citizenship based taxation was originally designed to punish "economic Benedict Arnolds" who fled the U.S. during the Civil War to avoid both the Civil War taxes and the draft itself, in today's global economy and our interconnected world, there are both professional and personal opportunities that U.S. citizens can only obtain by moving outside the U.S.

As Mason writes, "Concerns about a few high-profile, rich tax defectors who can be sanctioned with targeted anti-abuse regimes should not drive tax policy governing seven million Americans who reside abroad."

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References

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