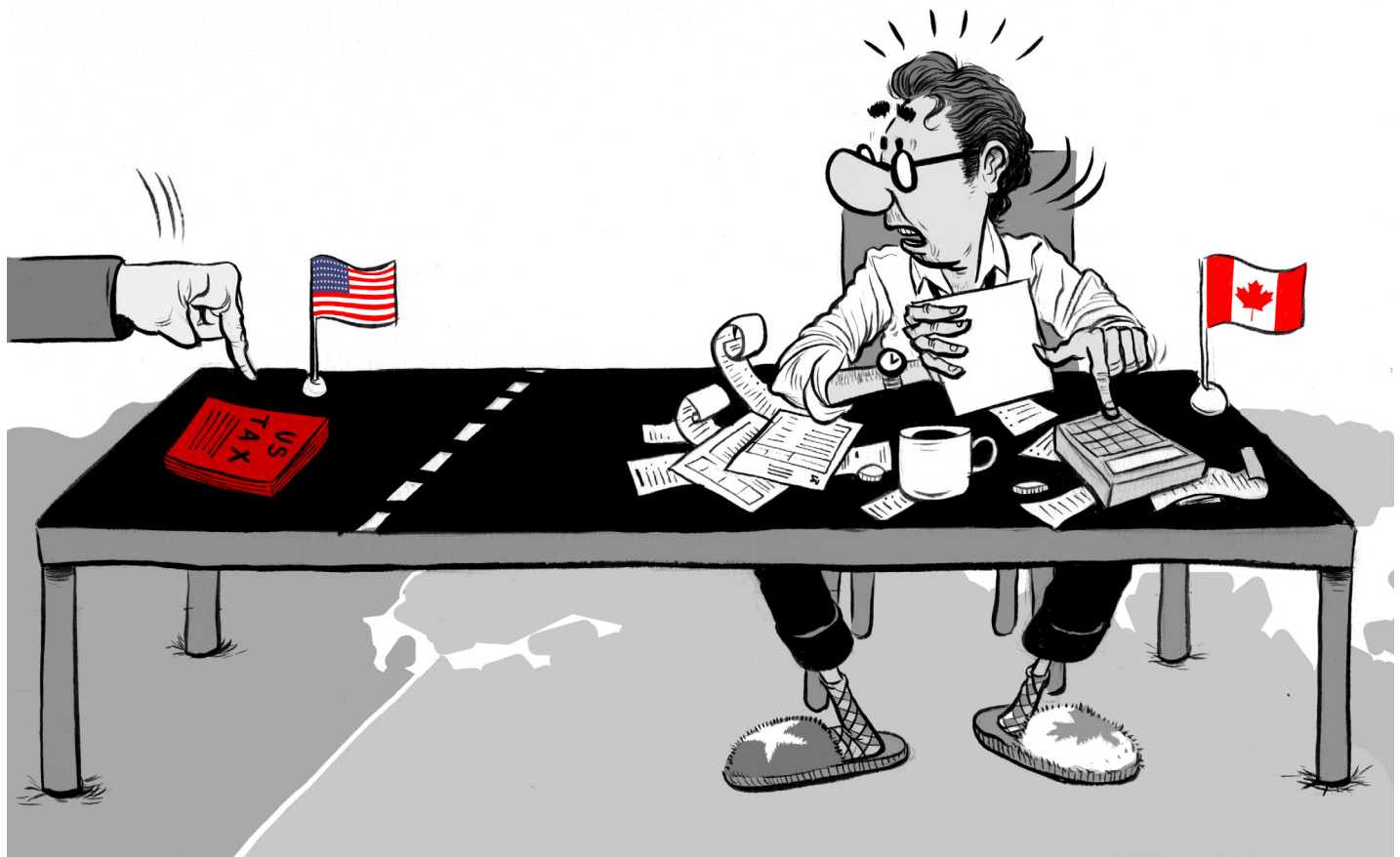


IDENTITY CRISIS

Does the IRS Think You're American?



You may not work, live, or spend much time in the United States, but if you think that means you're not subject to U.S. taxes, you could be in for a surprise.

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Ronald, a 31 year-old journalist, never thought that having an American mom would be such an inconvenience.

He was born in Canada to Korean immigrants who became Canadian citizens. Before he was born, his mother obtained dual U.S.-Canadian citizenship because the family had settled in Texas for a short time. The family eventually moved to Ottawa where Ronald was born. Under the advice of his parents -- who believed it would open up job prospects for him -- Ronald became a U.S. citizen when he was in his 20s but he had never lived or worked in the U.S.

"My only tie to the U.S. was a U.S. passport that I used to make it easier to travel to the U.S. for vacation," he relays. "I never worked there."

But, a few years ago, Ronald came across a news article declaring that any 'U.S. person', even if a citizen of another country, needs to comply with tax obligations to the U.S. Internal Revenue Service (IRS), particularly because of new regulations designed to combat tax evasion.

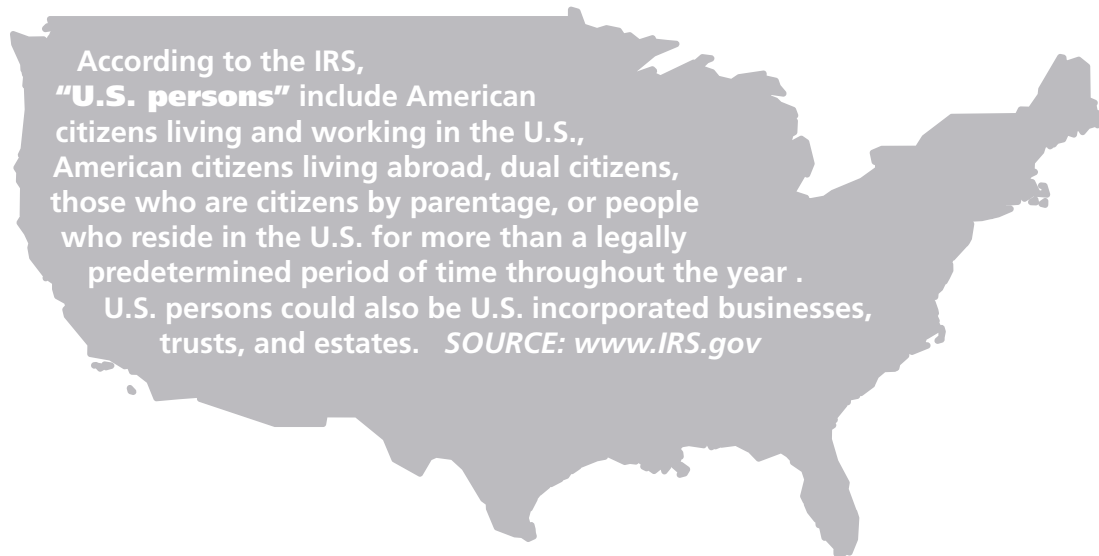
Ronald read that unlike most other countries, the U.S. taxes citizens on their worldwide income, not just the income that they make while in the country, and was becoming more diligent at collecting it. That means that if you are a U.S. citizen, it doesn't matter if you have never set foot on U.S. soil, you still have to report to the IRS and potentially pay U.S. taxes.

"I was floored," he says. "I think of myself as a Canadian, and I didn't realize that having that dual citizenship would make my tax situation so much more complicated."

Ronald's taxes went from being a simple filing in Canada to extraordinarily complicated and expensive. After consulting with his accountant, Ronald must now file a U.S. tax return and do extensive reporting on each of his financial holdings. Ronald, who asked us to change his name in this article, has also spent time working in Europe, and had to report any previous income and financial information from his time overseas.

Are You a U.S. Person?

According to the U.S. State Department, there was an estimated 8.7 million



non-military U.S. citizens living abroad in 2014. Just like Ronald, many elected to obtain U.S. citizenship and have put themselves within the IRS’s reach voluntarily. But those who have their U.S. citizenship papers aren’t the only ones who are responsible for U.S. taxes. Under certain immigration rules, you can be a citizen because of your ancestry, and maybe not even know it.

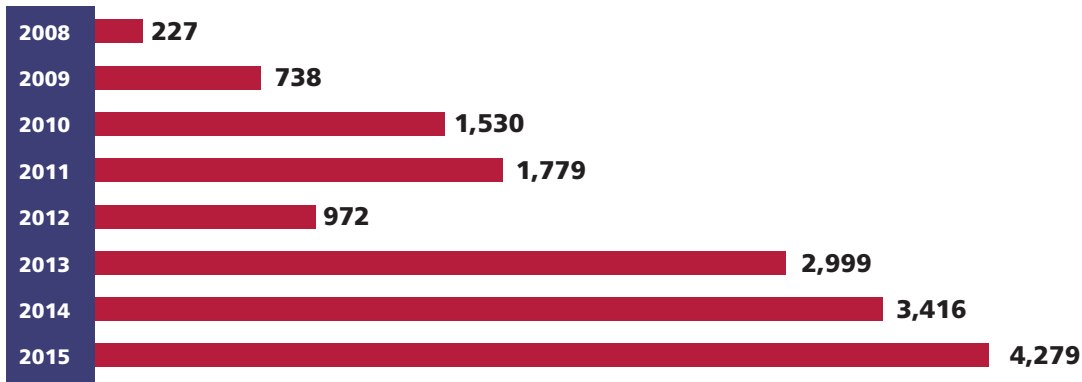
“A lot of people do not realize that you do not necessarily have to be born in the U.S. in order to be considered a U.S. citizen,” relays Tarsem Basraon, Wealth Advisory Services at TD Wealth. “In certain circumstances, you can be considered to be a ‘U.S. person’ for IRS purposes, by virtue of just having a parent who is a U.S. citizen, even if you never obtained a U.S. passport.

“If you are considered to be a U.S. person by the IRS, you are then subject to taxation in the U.S. on your worldwide income,” says Basraon. “Even if you live in Canada, as long as you are considered to be a U.S. person, you will still be required to meet U.S. tax filing requirements.”

You’re a U.S. Person, Now What?

“If you are worried about whether you are a U.S. person, you should immediately speak to your tax accountant,” imparts Basraon. “Your tax accountant should be able to refer you to a U.S. tax expert who will be able

US Citizens who Renounced Annually - Year 2008-2015



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to determine if you are a U.S. person. If you are a U.S. person, then you will need to comply with the rules of the IRS.”

If you do have to file that U.S. tax return, it may not necessarily mean that you will have to pay out more in taxes than you already do. The IRS issues a foreign earned income exclusion, which allows you approximately US\$100,000 in income or self-employment income. You can also earn a tax credit for taxes already paid to Canada. With those exemptions, you may not need to remit any payment to the IRS. But, on the other hand, be prepared to spend considerably more time and money on your tax filings. As well, if you are considered a U.S. person by the IRS, you may want to adjust your tax and estate planning strategies. “As a U.S. person, there may be more headaches beyond just the U.S. tax filing requirement,” says Basraon. “For example, under the U.S. taxation regime, U.S. persons may have U.S. tax issues investing in Canadian mutual funds or using a TFSA, as money that is tax-sheltered here may not be in the U.S. Further, as a U.S. person, you are subject to U.S. estate tax, so it may be wise to consult a cross-border tax specialist.”

Ignorance is not a Defense

Many people who aren't sure about their U.S. person status might choose

to ignore any possible responsibilities to the IRS, believing that the IRS won't be the wiser. However, due to recently enacted legislation, Canadian banks are required to report account information to the IRS for U.S. persons. If you fail to comply with tax filing and account reporting requirements, the IRS can enact harsh criminal penalties. A person who willfully fails to file a tax return could be subject to a prison term of up to a year, and/or fines of up to US\$100,000 if criminally convicted.

"Luckily, a person may utilize a voluntary disclosure process whereby U.S. tax returns and other missing forms are filed with the IRS for prior years," says Basraon. "Becoming tax compliant with the IRS before the IRS discovers you are a U.S. person may avoid costly penalties and interest."

What Happened to Ronald?

After Ronald realized he was considered a U.S. person by the IRS, and that he was required to file U.S. tax returns, he decided that he might as well put his U.S. citizenship to work. He recently moved to San Francisco to further his career in the U.S. But he still holds investments here in Canada and is concerned that tax planning and estate planning is going to be difficult. "At one point, I'd considered renouncing my U.S. citizenship," Ronald says. "But then, I realized that U.S. citizenship does come with some advantages."

Basraon warns that, although an option, renouncing U.S. citizenship might not be for everyone and is ultimately a personal decision. "Renouncing your citizenship is a complicated process and involves filing fees and possibly being subject to a punitive exit tax," he says. "You should speak to your U.S. tax professional about whether it makes sense in your circumstances."

Bottom Line

Basraon says that it is imperative that you know your status with the IRS, and whether they consider you a 'U.S. person'. Check with your adviser or tax professional that specializes in cross-border taxation issues, and prepare to file your return on both sides of the border, if necessary. - *Written by*

Denise O'Connell, MoneyTalk Life

ⁱBy the Numbers". U.S. Department of State. Published May 2015. <http://travel.state.gov/content/dam/travel/CA%20by%20the%20Numbers-%20May%202015.pdf>ⁱⁱ American Council of Life Insurers. Survey of Recent Widows. October 25, 2013

ⁱⁱⁱ"Related Statutes and Penalties-General Fraud". Internal Revenue Service. Last updated Feb. 5, 2016. <https://www.irs.gov/uac/Related-Statutes-and-Penalties---General-Fraud>

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