I. Effect of Expatriation on Tax*

 Mr. Serbinski is a Chartered Accountant licensed in Ontario and a partner in the firm of Serbinski Partners PC, Chartered Accountants, Toronto, Ontario as well as a Certified Public Accountant licensed in Illinois and a practitioner in the firm of Mark T. Serbinski Certified Public Accountants in Chicago, Illinois. Admitted to practice before the Internal Revenue Service, Mr. Serbinski practices international tax and acts as a consultant to the profession. Further information is available on the internet at http://www.serbinski.com.

1.01 Ceasing to be Taxable in The U.S. or Canada

In order to cease to be taxable in Canada, an individual must give up Canadian residence, and in the case of non-U.S. citizens, U.S. residence. A U.S. citizen may cease to be taxable in the U.S. only under certain circumstances, and only by revoking U.S. citizenship before a consular officer.

(a) Revoking U.S. Citizenship or Long Term U.S. Residence

(i) Mark to Market Tax:

Effective June 17, 2008, new Internal Revenue Code section 877A provides for an expatriation tax for "covered expatriates". Effectively, this means that the expatriate is deemed to have disposed of all capital property at fair market value as of the date of expatriation, and must pay tax on the net gain if it exceeds $600,000 (indexed for inflation. This is called the "mark to market" tax.

In order to be subject to the "mark to market" tax, an individual must first be considered an "expatriate" and then must meet one of several tests to become a "covered expatriate".

(ii) U.S. Citizen Expatriates:

A U.S. citizen becomes an "expatriate" on the earliest of the following dates:
- The date U.S. nationality is renounced before a U.S. consular officer;
- The date the individual provides a written statement of voluntary relinquishment of U.S. nationality which is accepted by the State Department;
- The date the State Department issues a certificate of loss of nationality; or
- The date a U.S. court cancels a certificate of naturalization.

(iii) Long Term Resident Expatriates

An individual is considered a "long term resident" of the U.S. is a person who was a lawful permanent resident of the U.S. for at least eight of the past 15 tax years. Long term residential status is terminated by losing a green card status, either through revocation or by abandoning residential status. An individual also ceases to be treated as a long term permanent resident of the U.S. if they are treated as a resident of another country with which the U.S. has a Treaty, and if they do not waive rights under that Treaty, and notifies the Secretary of State of that treatment.

Caution is therefore required by any long term green card holder who does not meet the residential requirements of that status, since they may inadvertently become expatriates under IRS code 877A.

A U.S. citizen who lives abroad and who does not revoke the application of any foreign tax treaty, is deemed for U.S. purposes to be taxable in the U.S. Accordingly, the 10 year period begins only after the revocation of citizenship and the cessation of the use of treaty provisions.

(iv) Covered Expatriates:

In order to be subject to the "mark to market" tax , an expatriate must be considered a "covered expatriate" by meeting one of the following tests:

1) Average net income tax liability in the U.S. for the past five years must exceed $124,000 per year;

2) The individual must have a net worth exceeding $2 million dollars; or
3) The individual has not complied with U.S. tax filing obligations for the prior five years.

Note the importance for all persons who hold U.S. citizenship or residential status to file U.S. income tax returns each year.

The above tests do not apply to minors, or persons who were born both as a U.S. citizen, and the citizen of another country.

(v) Calculation of the Tax:

Any individual who expatriates on or after June 17, 2008 must complete and file form 8854 to satisfy whether they meet the "expatriate" and "covered expatriate" tests, and to provide net worth, income, and basis information required to calculate the tax, if it is applicable.

The tax is calculated under normal IRS code provisions as if all property was disposed of at fair market value as of the expatriation date, but only if the net gain exceeds $600,000. Wash sale rules, deferral benefits such as incomplete like-kind exchanges, and involuntary conversions are eliminated. The stepped up basis rule applies to property that was held on the date an individual first became a U.S. resident as defined in IRC 7701(b), unless an irrevocable election is made not to have this rule apply.

(b) Leaving Canada - Canadian Taxation of Non Residents

Persons who are not residents of Canada are taxable in Canada on income from Canadian sources. Although this is a very large topic in taxation, this article will limit discussion to the taxation of former residents of Canada who derive income from Canada.

(i) Consequences of Leaving Canada

Where an individual ceases to be a resident of Canada there is deemed to be a disposition of all of the property of the individual at fair market value, and an immediate deemed re-acquisition of the property. The effect of this is to ensure that a person departing Canada will be subject to capital gains tax on accrued increases in property value while a resident of Canada. "Taxable Canadian Property", including real estate, stocks & bonds, and some other assets are exempt from this treatment, but the taxpayer may elect pursuant to Para. 128.1(4) of the Income Tax Act (Canada) to dispose of any or all of these items in any event.

No provision is made in the U.S. for revaluing the capital property at the time of entry into the U.S. Unlike the Canadian capital gains rules, which intend to tax capital gains only while a resident of Canada, dispositions of property by U.S. citizens will be subject to U.S. tax on the entire gain or loss from the date of acquisition.

(ii) Rental Real Estate in Canada

Where a non resident receives rental income from sources in Canada, the non resident may elect pursuant to Para. 216 of the Act to file a return of his income respecting the rental property under Part I, rather than being taxed under Part XIII (withholding taxes - non residents). Even though no personal exemptions may be claimed on such a tax return, an RRSP deduction may be made to the extent a contribution is made within available room. The effect of Para 216 on net income is usually beneficial. Of course, all rental income must be disclosed on schedule E to form 1040 in the U.S., subject to foreign tax credits for taxes paid abroad.

(iii) Registered Retirement Savings Plans

No rollovers of Canadian RRSP's are feasible to U.S. IRA's or similar plans (or visa versa), since such a transfer would be considered a distribution under Canadian law, and would trigger taxation in both countries under the Convention. Accordingly, persons returning to the U.S. after a work period in Canada should consider leaving their RRSP intact, and drawing funds from the plan only upon retirement or as provided for under Canadian law.

Upon withdrawal, Canadian RRSP funds will be subject to a 25% non resident withholding tax (to non residents) and a non resident may elect to file a return under Para 217 of the Income Tax Act respecting RRSP income in any year. Para 217 permits the filing of a return to include only the RRSP income of the non resident, but uses the non resident's world income for calculation purposes. This elective return is normally beneficial to persons not earning any income while a non resident

For U.S. tax purposes, RRSP withdrawals are taxable only to the extent that income (and not contributed principal) was withdrawn from the plan, since no deduction was available in the U.S. when the contributions were made to the RRSP. Further, income earned within the plan while not a U.S. resident or citizen will also not be taxable for U.S. purposes.

Part XIII of the Income Tax (Canada) imposes a withholding tax on various forms of income from Canadian sources earned by non residents.

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Mark T. Serbinski, CA, C.P.A.

Mark T. Serbinski CERTIFIED PUBLIC ACCOUNTANT

Serbinski Partners PC CHARTERED ACCOUNTANTS

1-888-US TAXES (878-2937)