

Expert Report of Allison Christians

- 1] I am the H. Heward Stikeman Chair in the Law of Taxation at McGill University, Faculty of Law, where I teach courses on Canadian individual and corporate income tax law, international and comparative tax law, and tax policy. Before joining the Faculty of Law at McGill University in 2012, I taught US individual, corporate, and international tax law at the University of Wisconsin Law School and at the Northwestern University School of Law in Chicago, Illinois. I have been a full time tax law professor for 12 years. I attained my juris doctor degree (JD) at Columbia University in New York, where I was awarded top academic distinction as a James Kent Scholar and a Harlan Fiske Stone Scholar. I attained my LL.M.(Tax) at New York University, the top graduate program for taxation in the United States. Before entering academia, I practiced tax law at Wachtell, Lipton, Rosen & Katz in New York, where I focused on the US taxation of domestic and cross-border mergers and acquisitions, spin-offs, restructurings and associated issues and transactions involving private and public companies, and at Debevoise & Plimpton in New York, where I focused on the taxation of private equity funds. I have written numerous articles, essays, and book chapters on international and comparative tax topics and am the co-author of a leading international tax casebook.
- 2] You asked me to consider three questions:
- I. To what extent is Canada a destination for US Persons (as defined in FATCA and the Intergovernmental Agreement) who seek to evade the payment of taxes?
 - II. Under what circumstances and to what extent would a US Person (as defined in FATCA and the Intergovernmental Agreement) resident in Canada who reports and pays taxes in accordance with Canadian law: owe taxes to the United States; and be liable in the United States for penalties or fines in relation to the reporting or paying of United States taxes?
 - III. With respect to each circumstance under which a US Person resident in Canada who reports and pays taxes in accordance with Canadian law also owes taxes to the United States (as set out in question 2(a), above), do the laws of Canada require such a US Person to disclose or report any information or document relating to that circumstance?
- 3] In answering these questions I make the following assumptions:
- a. That the affected individuals reside at all relevant times exclusively in Canada for Canadian federal tax purposes and are liable to tax in Canada as such pursuant to ITA s. 2.¹

¹ The terms s. and section herein refer to provisions in the *Canada Income Tax Act* (R.S.C., 1985, c. 1 (5th Supp.) as amended (ITA) and the *Income Tax Regulations* thereto (ITR); the use of the symbol § refers to provisions of the *U.S. Internal Revenue Code of 1986*, as amended (IRC), and treasury regulations thereto (Regulations). References to the Tax Treaty are to the *Convention between The United States of America and Canada with respect to Taxes on Income and on Capital*, signed at Washington on 26 September 1980, as Amended on 14 June 1983, 28 March 1984, 17 March 1995, 29 July 1997, and 21 Sept. 2007.

- b. That the financial lives of the affected individuals at all relevant times are located in Canada, that is, that all sources of income including that from employment, business, property, or gains, are earned in Canada and would be subject to taxation in Canada on an annual basis under applicable federal, provincial, and territorial law.

I. TO WHAT EXTENT IS CANADA A DESTINATION FOR US PERSONS (AS DEFINED IN FATCA AND THE INTERGOVERNMENTAL AGREEMENT) WHO SEEK TO EVADE THE PAYMENT OF TAXES?

- 4] It is my opinion that Canada is not a destination for individuals with US Person status,² for three reasons.
- 5] First, Canada has a comprehensive and well-regulated income tax system that is in fundamentals very similar to the tax system in the United States, although Canada's system features generally higher tax rates of tax. In my opinion, individuals seeking to escape taxation by leaving the United States would not find relief by moving to Canada.
- a. Both countries impose comprehensive, worldwide taxation on personal income at the national and subnational level.³ In Canada, top income earners face a combined federal and provincial tax rate as high as 49.5%⁴ for incomes in excess of \$136,270.⁵ In the United States, top income earners face a combined rate as high as 46.3%⁶ once income reaches \$406,751 (or higher, depending on filing status).⁷
 - b. Both countries compute income for tax purposes on a net basis, by generally allowing deductions for expenses paid or incurred in earning income.⁸ Both countries also provide specified deductions against income

² "US Person" is a defined term in US law. IRC § 7701(a)(3) and regulations thereunder. In this opinion, I use the terms "US Person," "US Person resident in Canada," and "Canadian resident(s) with US Person status" interchangeably. The latter best describes the class of persons to whom this opinion relates.

³ In the United States, gross income includes all income from whatever source derived. IRC § 61. In Canada, income is defined as that which arises from an office, employment, business, property, or other enumerated source, together with capital gains. ITA s. 3.

⁴ As adjusted by inflation and combined with top provincial rate: OECD, Table I.7. Top statutory personal income tax rate and top marginal tax rates for employees, http://stats.oecd.org/index.aspx?DataSetCode=TABLE_I7.

⁵ Federal Income Tax Rates, 2014, <http://www.cra-arc.gc.ca/tx/ndvdl/fq/txrts-eng.html>; Brackets are adjusted annually for inflation.

⁶ IRC §1 as adjusted by inflation, combined with top state and municipal tax rates: *see* OECD, Table I.7. Top statutory personal income tax rate and top marginal tax rates for employees, http://stats.oecd.org/index.aspx?DataSetCode=TABLE_I7

⁷ 2014 Rates; brackets are adjusted annually for inflation.

⁸ IRC § 61-68; ITA s. 2-4.

for certain non-income related items. In the United States, additional deductions include mortgage interest on a principal residence, certain state, local, and property taxes, charitable gifts, and other specified items.⁹ In Canada, additional deductions include spousal support payments, moving expenses, and RRSP contributions.¹⁰ Net income as computed under each system therefore generally varies.

- c. Both countries grant a reduced tax rate on capital gains and certain dividends. The top US rate is 15 per cent for long-term capital gains (generally, gain on the sale of capital assets held for at least one year),¹¹ and for most corporate dividends received by individuals.¹² The Canadian tax for capital gains is generally half the regular rate of tax, which yields a maximum effective rate of up to about 25%,¹³ and Canada also grants a reduced tax rate on dividends paid by Canadian, but not foreign, corporations.¹⁴
- d. Both countries provide various tax credits designed to achieve social and economic policy objectives, which reduce tax otherwise owing and in certain cases may be “refundable,” such that the taxpayer receives a net cash transfer through the tax system.¹⁵ It is not clear whether refundable credits received from the United States constitute income for Canadian tax purposes or vice versa. Accordingly, the final tax computed under each system generally varies.
- e. In cases of income tax overlap, both countries generally accord the primary right to tax to the country in which income arose, as reflected in the Tax Treaty, which has been in place and periodically updated since 1942. Accordingly, each country generally either exempts income that arose in the other country, or credits taxes paid to the other country on income that arose therein.¹⁶
- f. Both countries impose taxes on corporations as entities separate from their owners.¹⁷ Both countries impose income tax on the owners of other forms of entity, such as partnerships.¹⁸ Both countries impose taxes on trusts, either at the entity or at the owner/beneficiary level.¹⁹ To the extent that mismatches in the entity residence rules create jurisdictional overlaps, a tie-breaker rule in the Tax Treaty generally assigns entity residence

⁹ IRC § 101 *et seq.*; 153 *et seq.*; 161 *et seq.*; 211 *et seq.*

¹⁰ ITA s. 58 *et seq.*

¹¹ IRC § 1(h)

¹² IRC § 1(h)(11)

¹³ ITA s. 3(b).

¹⁴ ITA s. 82.

¹⁵ US persons who are not factually domiciled in the United States and who meet various income or family composition requirements may be eligible for certain of these credits depending on income thresholds, but are not eligible for others regardless of income.

¹⁶ IRC §§ 911, 901 *et seq.*; ITA § 126, Tax Treaty Art. XXIV (Elimination of Double Taxation).

¹⁷ IRC § 7701(a)(3); ITA s. 248(1).

¹⁸ IRC §§ 701-777, 1361-1379; ITA s. 96 *et seq.*

¹⁹ IRC §§ 641-685; ITA s. 104 *et seq.*

exclusively to one of the two countries.²⁰ The owner of income or the taxpayer entitled to deductions may be differentially identified under the two systems from time to time.²¹

- g. As a result, a Canadian resident with US Person status who pays income tax in Canada does not usually owe income tax to the United States. However, because the two tax systems are not identical in every respect, certain items of Canadian-source income may not be exempted, nor certain taxes credited, by the United States, either within a single tax period or permanently.²² I refer to such circumstances herein as “Tax Treaty Gaps.”

6] Second, Canada is not a tax haven, rather it is a highly cooperative member of the international community on matters involving tax and financial information sharing. In my opinion, individuals seeking to evade taxation by moving assets to a secrecy jurisdiction would not consider Canada a favorable destination.

- a. Canada is not a tax haven according to the OECD definition. Tax havens are characterized by the OECD as having four key factors: (1) No or minimal tax on the relevant income; (2) No effective exchange of information with respect to the regime; (3) The jurisdiction’s regimes lack transparency; (4) The jurisdiction facilitates the establishment of foreign-owned entities without the need for a local substantive presence or prohibits these entities from having any commercial impact on the local economy.²³ Canada does not satisfy any of these conditions. According to a 2011 peer report written by the OECD Global Forum on Transparency and Exchange of Information for Tax Purposes, “The CRA has received requests for all types of ownership and identity information from its [Exchange of Information] partners including with respect to companies, partnerships and trusts and there have not been any instances where ownership and identity information could not be provided as a result of it not being available.”²⁴
- b. The United States does not have an official definition of the term “tax haven,” but the US Senate has identified criteria that the United States would consider in evaluating whether a jurisdiction is an “Offshore Secrecy Jurisdiction.” These include a holistic evaluation of “corporate,

²⁰ Tax Treaty Art. IV. This provision also contains tie-breaker rules for individuals, however these are not applicable in the case of US citizens. Art. XXIX (exception for US citizens).

²¹ This may happen, for example, due to differential deeming rules in each country. In most cases, income and deduction differences caused by such deeming rules are reversed or reconciled in future tax periods.

²² See discussion in Part II.

²³ The Organization for Economic Co-operation and Development, “Towards Global Tax Co-operation; Report to the 2000 Ministerial Council Meeting and Recommendations by the Committee on Fiscal Affairs,” at 10.

²⁴ Global Forum on Transparency and Exchange of Information for Tax Purposes Peer Reviews: Canada 2011, Combined: Phase 1 + Phase 2, April 2011 (hereinafter, “OECD Peer Report”) at 17, available at

http://www.oecd.org/document/51/0,3746,en_21571361_43854757_47572915_1_1_1_1,00.html.

business, bank, or tax secrecy rules and practices which [...] unreasonably restrict the ability of the United States to obtain information [...] unless [...] such country has effective information exchange practices.”²⁵ To my knowledge Canada has never been included in any proposed list of secrecy jurisdictions compiled by the United States.

7] Third, Canada and the United States have a deep and longstanding cooperative relationship in tax compliance and enforcement. In my opinion, individuals seeking to thwart US tax compliance and enforcement efforts would not seek assistance in this effort by moving to Canada.

- a. Since 1942, Canada and the United States have had in place an extensive bilateral information-sharing regime, which is contained within the Tax Treaty.²⁶ Since 1985, Canada and the United States have had in place a Mutual Legal Assistance Treaty that provides for a broad range of legal assistance in criminal matters.²⁷ Beginning in 1996, Canada and the United States began an “automatic” exchange of information regime. Article XXVII(2) of the Tax Treaty obliges each to obtain tax information for the other even where it would not normally collect such information for domestic law purposes.
- b. In addition, Canada and the United States have a Simultaneous Examination Program and a Simultaneous Criminal Investigation Program in place.²⁸ These programs allow for detailed, coordinated compliance and enforcement efforts, providing mechanisms under which the CRA and the IRS may act jointly, in close cooperation and constant communication, to undertake corresponding audits of related taxpayers in Canada and the US.

8] Accordingly, in my opinion Canada is not a destination for individuals with US Person status who seek to avoid or evade taxation.

²⁵ In a prior proposed version of FATCA, the “Stop Tax Haven Abuse Act” of 2007, “Stop Tax Haven Abuse Act” (Proposed) s.681.IS at F(b)(B), thirty-four (34) jurisdictions were identified as tax havens. Canada was not listed. Though this act was not adopted by the United States (it has been reintroduced several times and continues to sit before the Senate as a reform and expansion of FATCA), it provides the clearest understanding of the criteria and definition of a tax haven from the US perspective. In short, the United States will deem a jurisdiction to be a tax haven if it does not cooperate with information sharing regarding US persons with assets in that jurisdiction.

²⁶ *Convention and Protocol between Canada and the United States for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion in the case of Income*, 4 March 1942.

²⁷ *Treaty Between the Government of Canada and the Government of the United States of America on Mutual Legal Assistance in Criminal Matters*, 18 March 1985, Can TS 1990 No 19.

²⁸ See e.g. Treasury Inspector General for Tax Administration: Office of Inspections and Evaluations, “Inspection of the Exchange of Information Process at the Plantation, Florida, Office” (25 July 2012), online: www.treasury.gov/tigta/iereports/2012reports/2012IER006fr.html.

**II. UNDER WHAT CIRCUMSTANCES AND TO WHAT EXTENT
WOULD A US PERSON (AS DEFINED IN FATCA AND THE
INTERGOVERNMENTAL AGREEMENT) RESIDENT IN CANADA
WHO REPORTS AND PAYS TAXES IN ACCORDANCE WITH
CANADIAN LAW: OWE TAXES TO THE UNITED STATES; AND BE
LIABLE IN THE UNITED STATES FOR PENALTIES OR FINES IN
RELATION TO THE REPORTING OR PAYING OF UNITED
STATES TAXES?**

- 9] Canadian residents may have US Person status because the United States includes all US citizens as permanent tax residents in the United States for federal income tax purposes.²⁹ Accordingly, every Canadian resident who is a US citizen, whether or not they are also a Canadian citizen, is defined as a US Person for US federal income tax purposes (but not generally for state tax purposes). US Persons are subject to US federal taxation on all of their income from all sources, wherever derived.³⁰
- 10] Under a specific set of circumstances, Canadian residents who have US Person status may be subject to US taxation on their Canadian-source income (circumstances referred to herein as Tax Treaty Gaps). The extent to which they are actually so subject is not known because taxpayer data is confidential in both Canada and the United States and neither country, to my knowledge, compiles or discloses aggregate statistics of the amount of tax paid by Canadian residents on Canadian source income to the United States. However, IRS estimates provide that fewer than 10% of all individuals who file US tax returns from a “tax home” located outside the United States ultimately owe any tax to the United States.³¹ Regardless of whether any tax is due, the United States requires extensive tax and asset reporting documentation, for which noncompliance attracts extensive penalties.

²⁹ IRC § 7701(a)(30) and regulations thereunder. The United States is the only country in the world that comprehensively treats individuals as resident for tax purposes by virtue of their status as citizens or legal permanent residents under relevant immigration and nationality laws, as amended from time to time by statute and at common law (including retroactively). Eritrea is the only other country known for attempting to impose a tax on Eritrean citizens who live permanently outside the country, however, the United States, Canada, and other countries have rejected the right of Eritrea to collect this tax. UN Security Council Resolution 2023 (2011), Adopted by the Security Council at its 6674th meeting, on 5 December 2011.

³⁰ IRC § 61.

³¹ National Taxpayer Advocate, 2011 Report to Congress, Vol. 1 at 156 (Dec. 31, 2011), at <http://www.taxpayeradvocate.irs.gov/2011-annual-report-to-congress> (in tax year 2009 “88 percent of all taxpayers claiming the foreign earned income exclusion (FEIE) did not have U.S. tax liability after applying the exclusion. After the application of the [foreign tax credit], only about nine percent of these taxpayers had a U.S. tax liability”). Only persons with a tax home outside of the United States are eligible for the FEIE. See IRC § 911 and regulations thereunder.

- 11] A large majority of Canadian residents who have US Person status likely do not owe taxes to the United States in most years because the United States generally relieves such tax both statutorily and in accordance with the Tax Treaty.³²
- 12] Where there are systemic mismatches involving identification of income or deductions, timing of income or deductions, character of income, or rate of tax, certain Canadian residents who have US Person status may be subject to U.S. taxation on Canadian source income that is unrelieved by statute or the Tax Treaty within a given tax year or, in a few discrete cases, permanently. Whether US tax will ultimately be imposed in such Tax Treaty Gap cases, and at what rate, depends on the individual's overall income for US tax purposes, as offset by available credits and deductions. Below, I briefly outline some of the most common situations in which income may arise for US tax purposes at a time or in a manner in which it would not so arise for Canadian tax purposes, thus creating a Tax Treaty Gap.
- a. Canada does not include gains from the sale of owner-occupied housing in income for tax purposes, but the United States does include such gains with an exemption for the first \$250,000 in the case of individual taxpayers and \$500,000 for married couples filing joint returns, assuming various requirements are met.³³ Therefore such gains are not included in income in Canada but will be included in income for US tax purposes. I note that this represents a structural difference between the two systems in that the United States allows a deduction for mortgage interest during the term of owner-occupation,³⁴ while Canada does not.
 - b. Similarly, Canada does not include certain items, such as lottery winnings³⁵ or strike pay,³⁶ in the concept of income, while the United States does include these items.³⁷

³² IRC §§ 901 *et seq.*, 911; Treaty Art. XXIV. For example, if a Canadian resident earns \$50,000 in income from employment in Canada, in most cases she will pay income taxes in Canada in some amount. If she is also deemed to be a resident of the United States for tax purposes, she must also declare and file a US tax return showing the employment income and calculating a provisional tax liability to the United States. She may then elect to either deduct the Canadian tax she paid from her US tax owing via a foreign tax credit, or deduct the entire earned income amount assuming she meets specified requirements, via an exemption. The foreign tax credit applies only to foreign taxes that are imposed on income "in the US sense" and is limited to the amount of US income tax that would otherwise apply. The income exclusion is adjusted annually and is limited to USD \$100,800 in 2015, with a further exemption available as a housing amount. See IRS Online Guidelines: <http://www.irs.gov/Individuals/International-Taxpayers/Foreign-Earned-Income-Exclusion>; IRS Online Guidelines: <http://www.irs.gov/Individuals/International-Taxpayers/Foreign-Housing-Exclusion-or-Deduction>. Taxpayers may in certain cases elect instead to deduct the Canadian tax against income, rather than against tax. IRC § 164(a)(3).

³³ ITA 40(2)(b), (c); IRC § 121.

³⁴ IRC § 163(h)(2)(D). The economic effect of this structural difference is likely equivalent. In the United States, deductible interest payments reflect a reduction of tax during the owner occupation, while taxable capital gain on the sale, if any, represents an economic recapture of those prior deductions, so that on net, there is no final tax impact in most cases. In Canada, there is no upfront reduction in tax so no need to recoup the tax on final sale.

³⁵ Gambling gains, which would include lottery winnings, are not included within the concept of income in Canada pursuant to ITA 40(2)(f), but they are so included and are subject to a special regime for the limitation of losses in the United States. IRC § 165(d); see also *Zarin v. Commissioner*, U.S. Ct. App 3d Cir., 916 F.2d 110, 1990

- c. The United States has a number of tax shelter rules to restrict certain deductions for passive income losses to passive income.³⁸ A passive loss that is limited in one tax year may be claimed when the investment is ultimately disposed of. This can create income in one year that is offset by a deduction in a later year for US tax purposes, in a manner that does not align with the investment outcome for Canadian tax purposes. Canadian residents who have US Person status therefore may be subject to US tax on certain Canadian-source income from passive investments where there is no such income for Canadian tax purposes, while in a subsequent year the situation would be reversed.
- d. The United States has a number of rules that deem income to be earned by the shareholders of certain foreign corporate entities. Controlling US shareholders of non-US corporations must generally include deemed dividends in income, calculated annually by reference to certain types of passive income earned by the corporation.³⁹ US shareholders in certain non-US investment companies must generally include in their income their share of all income, including unrealized gains, earned by the investment company.⁴⁰ The United States generally exempts later income distributions to the shareholder as “previously taxed income.”⁴¹ Canadian residents who have US Person status therefore may be subject to US tax on certain Canadian-source income earned by Canadian corporations, even where there is no distribution of such income to the shareholder, while in a subsequent year the situation would be reversed.⁴²
- e. The United States has a number of rules that deem income to be earned by the owners (grantors) or beneficiaries of non-US trusts in specified cases. This may in some cases include the income and gains earned in Registered Education Savings and Disability Plans (RESPs and RDSPs), and Tax Free Savings Accounts (TFSA). Canadian residents who have US Person status therefore may be subject to US tax on certain Canadian-source income earned within such plans even where there is no distribution of such income to the taxpayer. Similar to the treatment of deemed versus actual distributions in cases involving corporations, in a subsequent year the situation would be reversed. To my knowledge the United States has not provided guidance with respect to whether and to what extent any contributions to such plans by the Government of Canada, or the

³⁶ *Canada v. Fries* [1990] 2 SCR 1322.

³⁷ IRC § 61.

³⁸ IRC § 469. Passive income generally means the kind of income that arises from the mere ownership of income-producing assets, namely, dividends, interest, rents, and royalties.

³⁹ IRC § 951 et seq.

⁴⁰ IRC § 1291; IRC § 1297 (known as the Passive Foreign Investment Company, or “PFIC” rules.). Where the shareholder cannot calculate her share of annual unrealized income from PFIC, such as a mutual fund, the United States imposes penalties and interest on any amount included upon the disposition of such investment.

⁴¹ IRC § 959(a) (CFC rules) and 1293(c) (PFIC rules).

⁴² When the situation is reversed, a foreign tax credit may or may not be available to eliminate the double tax that would otherwise occur, depending on the circumstances.

investment income and gains pertaining to such contributions, would constitute income to US Persons who make contributions to, or are beneficiaries of, such plans.

- f. The United States recently enacted a Net Investment Income Tax (“NIIT”), a 3.8% excise tax on certain “unearned” or passive income received by US Persons, including but not limited to capital gains, rents, dividends, interest, annuities, etc.⁴³ The NIIT is not eligible for offset by foreign taxes via credit. Therefore, Canadian residents who have US Person status may be subject to US tax on certain Canadian-source investment income even if Canadian income taxes have already been paid on such income, and even if such Canadian income tax exceeds the total amount of tax provisionally computed on such income for US tax purposes.
- g. Beginning in 2014, all Canadian residents who have US person status are subject to an annual “shared responsibility payment” to the United States if they do not demonstrate that they have health care coverage or have a health coverage exemption as defined (colloquially known as the Obamacare penalty).⁴⁴ This is a tax for some purposes, and a penalty for other purposes, under US law.⁴⁵ To my knowledge the payment would not be eligible for offset by foreign taxes via credit, either because it is in the nature of an excise tax rather than an income tax,⁴⁶ or because it is a penalty. The payment is calculated as the greater of a flat fee or a percentage of household income, as adjusted from year to year.⁴⁷ For tax year 2014, the maximum payment is USD\$2,448 per household member, including children, for an annual maximum payment per household of USD\$12,240.⁴⁸
- h. All US tax information must be reported in US dollars, with currency conversions calculated under specified rules. Transactions undertaken in Canadian dollars by Canadian residents who have US Person status may give rise to “foreign currency transaction” gains for US federal tax purposes.⁴⁹ Foreign currency transaction gains are generally subject to tax as ordinary income (rather than capital gain) for US federal tax purposes.

⁴³ IRC § 1411. The NIIT applies to US persons who have incomes above a specified threshold, generally USD\$200,000 for single filers and USD\$250,000 for married couples filing jointly. This tax was adopted to help pay for health insurance of US residents under the Affordable Care Act, commonly known as Obamacare. Individuals who are not resident within the United States are generally ineligible for health care coverage under Obamacare even if they are US Persons for federal tax purposes.

⁴⁴ IRC § 5000A (“Requirement to maintain minimum essential coverage”). In order to avoid being subject to the shared responsibility payment, US Persons must file Form 8965 and attach it to their annual income tax return, as discussed more fully *infra*.

⁴⁵ *National Federation of Independent Business v. Sebelius*, 132 S.Ct 2566 (2012).

⁴⁶ The applicable provision is contained in Subtitle D of the United States Code, “Miscellaneous Excise Taxes.”

⁴⁷ IRC § 5000A(c); *see also* Congressional Research Service, Individual Mandate Under ACA, Aug. 12, 2014 at <https://www.fas.org/sgp/crs/misc/R41331.pdf>.

⁴⁸ The payment is only calculated for the first five individuals of a household.

⁴⁹ IRC § 988.

Therefore, Canadian residents who have US Person status may be subject to US tax on certain proceeds of transactions, even if such transactions produce no gain, and even if they produce a loss, for Canadian income tax purposes.

- i. In addition to the federal income tax, the United States has federal estate and gift taxes, which are designed to give rise to taxation in certain succession transfers, mainly involving higher income taxpayers. Like income taxes, US estate and gift taxes apply to all deemed tax residents and are not generally mitigated by statute or treaty.⁵⁰ Therefore, Canadian residents who have US Person status, and in some cases their spouses or heirs regardless of their status as US Persons, may be subject to US estate or gift tax in specified cases, even if no part of the estate or gift arises from US sources.
- j. Other timing, character, and taxpayer mismatches may occur which may result in US taxation of Canadian source income received by Canadian residents who have US Person status, as well as in some cases their spouses and heirs.

13] Canadian residents who have US Persons status must fulfill annual tax form filing and financial asset reporting obligations to the United States, in most cases unrelated to any tax due. Failure-to-file, failure-to-pay, accuracy-related, and information return penalties are generally assessed in cases in which US Persons fail to make required form submissions. Some of the most common required annual filing forms, and the penalties for not filing them, are described below. Additional forms may also be required and may be subject to non-filing penalties whether or not tax is due.

- a. An annual tax return must be filed (Form 1040 or applicable substitute) if annual income thresholds are met, whether or not any tax is due.⁵¹ A failure to file a tax return is subject to a late filing or a late payment penalty of a maximum of 25% of any balance due.⁵² I note that foreign tax credits and foreign income exemptions are only available by filing, so failure to file may result in assessed tax obligations, penalties, and interest, even if such taxes, penalties, and interest would have been eliminated if the requisite filing had been completed.
- b. An attestation of “Health Coverage Exemption” (Form 8965) must be filed annually with the annual income tax return in order to avoid a penalty for lack of health insurance. Failure to file the Health Coverage Exemption form may result in the automatic assessment of a shared responsibility payment of up to USD\$2,448 per household member, including children, for an annual maximum penalty per household of USD\$12,240.⁵³ This

⁵⁰ Tax Treaty Art. XXIX B (Taxes Imposed by Reason of Death).

⁵¹ IRC § 6012-6017. For the most recent tax year, the income thresholds ranged according to family status from USD\$10,150 for single filers to USD\$20,300 for couples filing joint returns, with specified exceptions

⁵² IRC §§ 6651, 6501(c)(1), (2), (3).

⁵³ IRC § 5000A.

penalty is administered by the IRS but is unrelated to any tax liability that may be owed by a US Person.

- c. A foreign bank account report, or “FBAR,” must be filed annually with the U.S. Financial Crimes Enforcement Network to disclose all assets held outside the United States if their combined value reaches USD\$10,000 at any time during the year.⁵⁴ Depending on whether the failure to disclose is deemed to be willful or not, a failure to file or omission in FBAR filing may be subject to penalties that range from USD\$10,000 to the greater of USD\$100,000 or 50% of the highest balance in each non-US financial account, as converted to US currency in the time and manner prescribed by statute.⁵⁵ FBAR penalties are administered by the IRS but are unrelated to any tax liability that may be owed by the owner of the account.⁵⁶
- d. A “Statement of Specified Foreign Assets” (Form 8938) must be filed annually to disclose all financial assets held outside the United States if their combined value reaches a specified amount, ranging from USD\$200,000 to USD\$600,000, depending on filing status, for those factually domiciled outside the United States.⁵⁷ Whether or not any tax is due in connection with such assets, failure to file Form 8938 is subject to a penalty of USD\$10,000 each year, rising to USD\$50,000 for continuing failure to file after receiving notification from the IRS.
- e. Canadian residents who have US Person status and who contribute to or are beneficiaries of certain savings vehicles, including some RESPs, RDSPs, and TFSAs, may be required to file an “Annual Information Return of Foreign Trust With a US Owner” (Form 3520A) or an “Annual Return to Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts” (Form 3520), or both. Failure to file Form 3520A if required is subject to a penalty of the greater of USD\$10,000 or 5% of the gross amount of the trust or plan that is deemed to be owned by the US Person, whether or not any tax is due.⁵⁸ Failure to file Form 3520 is subject to a penalty of the greater of USD\$10,000, 35% of annual contributions to the trust or plan, 35% of gross distributions received from the trust or plan, or 5% of the gross amount of the trust or plan that is deemed to be owned by the US Person, whether or not any tax is due.⁵⁹

⁵⁴ 31 USC § 5314 and regulations thereunder; 31 CFR Chapter X.

⁵⁵ Specified relief from FBAR penalties may be available to some US Persons in certain circumstances under various compliance programs, as amended from time to time.

⁵⁶ A person may avoid penalties by showing a “reasonable cause,” which is undefined in US law and appears to be determined at the sole discretion of the US Treasury. Willfulness is under-defined, but includes intentionally failing to learn about the FBAR, a standard which has yet to be explored at common law. If the taxpayer is found willful - including willfully blind to the regime - FBAR penalties rise dramatically and can ultimately include criminal liability. In extreme cases, FBAR criminalizes paperwork mistakes.

⁵⁷ IRC § 6038D.

⁵⁸ IRC § 6048(b)(1). This penalty will apply whether or not any tax is due on Form 1120.

⁵⁹ IRC § 6677.

- f. Canadian residents who have US Person status and who invest in certain Canadian mutual fund companies or who are directly or indirectly controlling shareholders of Canadian corporations, including small business corporations, may be required to annually file an “Information Return of U.S. Persons With Respect to Certain Foreign Corporations” (Form 5471).⁶⁰ Failure to file Form 5471 when required results in an automatic penalty of \$10,000 whether or not any tax is due, and may also result in reduction of foreign tax credits.⁶¹
- g. Canadian residents who have US Person status and who own interests in certain Canadian mutual funds and other investment vehicles may also be required to annually file an “Information Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund” (Form 8621).⁶² Failure to file Form 8621 when required may result in a \$10,000 penalty whether or not any tax is due.⁶³
- h. Canadian residents who have US Person status and who own interests in, make transfers to, or receive income, dispose of, or change their interests in, certain Canadian partnerships may be required to annually file a “Return of U.S. Persons With Respect to Certain Foreign Partnerships” (Form 8865).⁶⁴ Failure to file Form 8865 when required may result in a \$10,000 penalty whether or not any tax is due, with additional USD\$10,000 penalties increasing to USD\$50,000 applied for continuing failure to file after receiving notification from the IRS.⁶⁵

III. WITH RESPECT TO EACH CIRCUMSTANCE UNDER WHICH A US PERSON RESIDENT IN CANADA WHO REPORTS AND PAYS TAXES IN ACCORDANCE WITH CANADIAN LAW ALSO OWES TAXES TO THE UNITED STATES (AS SET OUT IN QUESTION 2(A), ABOVE), DO THE LAWS OF CANADA REQUIRE SUCH A US

⁶⁰ IRC §§ 6038, 6046, and regulations thereunder.

⁶¹ IRC §§ 6038(b)(1) (imposing a USD\$10,000 penalty); 6038(c) (imposing a 10% reduction of the foreign taxes available for credit under IRC Sections 901, 902 and 960). The reduction may be applied in addition to the penalty. IRC Section 6038(c)(3).

⁶² IRC § 1298(f).

⁶³ IRC § 6038D(d). Regulations under section 1298(f) coordinate the Form 8621 filing requirements with the Form 8938 filing requirements, so that Form 8938 reporting may not be required if the individual reports the asset on Form 8621.

⁶⁴ IRC § 6038 (reporting with respect to controlled foreign partnerships); 6038B (reporting of transfers to foreign partnerships); 6046A (reporting of acquisitions, dispositions, and changes in foreign partnership interests).

⁶⁵ CFR 1.6038-3(i).

**PERSON TO DISCLOSE OR REPORT ANY INFORMATION OR
DOCUMENT RELATING TO THAT CIRCUMSTANCE?**

- 14] It is my understanding that the information that would be relevant to a US tax assessment of a collectible tax debt in Canada would generally be reported or disclosed to the CRA by the taxpayer or by a third party charged with such reporting; in cases where the relevant information would not be reported under existing rules, the CRA is empowered to compel such reporting.
- 15] The CRA collects information from taxpayers pursuant to annual tax returns.⁶⁶ The Minister of Revenue may demand a filing of any person whether or not the person is liable to pay tax. Residents must file and declare all sources of income, regardless of where it is earned, while non-residents must generally file and declare Canadian employment income, Canadian business and property income, and gains on the disposition of taxable Canadian property. A nonresident individual who has taxable capital gains, disposes of a taxable Canadian property, or who is subject to tax under Part I on taxable income earned in Canada is subject to the same annual filing requirements as residents. The same rule applies for a non-resident business if it carries on business in Canada.⁶⁷
- 16] The CRA requires resident paying agents, such as payors of compensation and fees, transferors of property, payors of dividends to shareholders, interest to creditors or account holders, and royalties to licensors, and others to disclose all tax-relevant payments to the domestic tax authorities.⁶⁸ Similarly, any person that receives any such payment as a nominee or agent for some other person resident in Canada, and any person who receives interest or dividends in respect of a bearer bond or a similar instrument under which the beneficial ownership is not disclosed, is responsible for filing an information return.⁶⁹
- 17] Information collection from third parties is authorized under Part II of the regulations to ITA s. 221(1)(d), which enables the Governor in Council to require information returns from any person in connection with any information required in connection with assessments under the Act. The CRA routinely collects information returns from third parties to confirm information and detect noncompliance. Thus, employers must file reports detailing compensation paid to employees, and payers of investment income (dividends, interest, rent, royalties, and the like) must report such payments whether made to residents or nonresidents.
- 18] Entities through which individuals might invest in Canada, whether corporations, partnerships, trusts, or estates, are also highly regulated and subject to extensive reporting and tax-related obligations.⁷⁰ Every person who carries on a business or who is required

⁶⁶ Section 150(2).

⁶⁷ See s. 150(1) and 150(1.1).

⁶⁸ ITR, c. 945, Part II, s. 200(1); ITA s. 201, 202.

⁶⁹ ITA 201(2), 201(3).

⁷⁰ Partnerships must file annual returns that include in most instances disclosure of the names and addresses of partners. ITA s. 233(2). Canadian resident trusts, and certain foreign trusts with Canadian

to pay or collect taxes or other amounts in Canada must keep adequate records that record and explain all transactions for a minimum 6 years from the end of the last taxation year to which the records and books of account relate. Private corporations doing business in Canada must identify in their annual tax returns a list of all shareholders holding 10% or more of share capital. Public corporations generally disclose ownership information under federal and provincial securities laws. Companies formed under federal law have specific information gathering and filing requirements including shareholder registers. Compliance is monitored and audited by Industry Canada or by the Office of the Superintendent of Financial Institutions (OSFI), which provides noncompliance information to the Financial Transactions and Reports Analysis Centre of Canada (FINTRAC), as the case may be.

- 19] In addition, Canadian banks are required to disclose client information under valid and authorized information requests from domestic and international authorities, to comply with laws, regulations, subpoena or court order, and to help prevent fraud.⁷¹
- 20] The CRA may also demand information or documents from the taxpayer or a third party in connection with an audit or investigation involving tax avoidance or evasion. Thus, for example, the CRA could obtain shareholder information from a corporation where necessary for administration of the tax laws, using a “Requirement for Information” under ITA s. 231.2(1). Noncompliance can result in fines or imprisonment or both.⁷²
- 21] Third party information is not limited to Canadian sources, but extends internationally via treaty. The CRA may obtain relevant tax information with respect to Canadian taxpayers (whether or not they are also US persons) pursuant to the exchange of information provisions in its bilateral tax conventions and TIEAs and the multilateral agreement on mutual assistance in tax matters.⁷³ In addition, Canada may request assistance of other countries in pursuing criminal matters involving tax evasion under its network of mutual legal assistance treaties.⁷⁴
- 22] Finally, authorized tax officials have the right to enter a taxpayer’s place of business, any location in which anything is done in connection with the business, or any place where records related to the business are kept. Tax officials may also examine any document of another taxpayer that relates, or may relate to, the information that is, or should be, in the books and records of the taxpayer who is being audited.
- 23] Accordingly, the type of information that may be relevant to the assessment of a US tax debt is already disclosed to the CRA in most cases by the taxpayer or by a third party

source income, must file annual trust information and income returns that include identities of trust beneficiaries in receipt of income. ITA s. 233.2.

⁷¹ Federal Personal Information Protection and Electronic Documents Act (PIPEDA).

⁷² ITA s. 238(1).

⁷³ Convention on Mutual Administrative Assistance in Tax Matters, Jan. 25, 1988, E.T.S. No. 127 (Council of Europe and OECD Member Nations).

⁷⁴ For a list of Canada’s mutual legal assistance treaties currently in force, see Information Exchange Network for Mutual Assistance in Criminal Matters and Extradition at http://www.oas.org/juridico/mla/en/can/en_can-mla-gen-liste.html. These include 33 bilateral agreements and three multilateral agreements.

with the exception of the sale of a personal residence.⁷⁵ Canada and the United States are aware of the Tax Treaty Gaps. In cases involving such Gaps, the necessary tax reporting is required or if need be could be compelled by the CRA. In virtually all cases in which US taxation would actually apply, information compiled by the CRA that identifies Canadian residents who have US Person status could be cross-referenced with the information received by the CRA that is relevant to the Tax Treaty Gaps.

⁷⁵ In the case of a sale by a Canadian resident of a principal residence held in Canada, specified reporting to the CRA may not in all cases be required under existing rules. However, such information would not be reported in the information transmitted to the CRA by Canadian financial institutions under FATCA or the intergovernmental agreement in any case.