

Questions and Answers from Pathways to U.S. Tax Compliance & Renunciation Solutions for
U.S. Citizens Living in Canada, Windsor Canada – November 2, 2019

Question: Can a nonresident alien individual (“NRA”) married to a citizen or resident of the United States (“US person”) file a joint United States income tax return?

Answer: Yes. An NRA and US person can elect to file a joint "*US Individual Income Tax Return*" (“Form 1040)

Rule¹: IRC §6013(a)(1)-*Joint returns of income tax by husband and wife*. No joint return shall be made if either the husband or wife at any time during the taxable year is a nonresident alien.

IRC §6013 (g) *Election to treat nonresident alien individual as resident of the US*.
A nonresident alien individual with respect to whom this subsection is in effect for the taxable year shall be treated as a resident of the US—

- (A) for purposes of chapter 1 for all of such taxable year, and
- (B) for purposes of chapter 24 (relating to wage withholding) for payments of wages made during such taxable year.

(2) Individuals with respect to whom this subsection is in effect. This subsection shall be in effect with respect to any individual who, at the close of the taxable year for which an election under this subsection was made, was a nonresident alien individual married to a citizen or resident of the US, if both of them made such election to have the benefits of this subsection apply to them.

Explanation:² If, at the end of a married couple’s tax year, one spouse is a US citizen or a resident alien and the other spouse is a nonresident alien, the couple can elect to treat the nonresident spouse as a US resident for the entire year. This includes situations in which one spouse is a nonresident

¹ I.R.C. § 6013.

² I.R.S., Pub. 519, *U.S. Tax Guide for Aliens*, (Feb. 25, 2019), at 9, available at <https://www.irs.gov/pub/irs-prior/p519--2018.pdf> ; See also I.R.S., *About Publication 501, Standard Deduction, and Filing Information* (last updated Nov. 5, 2019), available at <https://www.irs.gov/forms-pubs/about-publication-501>.

alien at the beginning of the tax year, but a resident alien at the end of the year, and the other spouse is a nonresident alien at the end of the year.

1. If the election is made: (a) the United States will tax each spouse on worldwide income, and (b) neither spouse can claim under any tax treaty not to be a US resident.
2. The couple can file joint or separate returns in later years.
3. If the couple does not elect to treat the nonresident alien spouse as a US resident alien, the US person may use head of household filing status. To use this status, the US person must pay more than half the cost of maintaining a household for dependents or relatives other than the nonresident alien spouse.

Practice Point

Since Canadian residents pay more tax to Canada than would be due to the US, there is generally no benefit to filing jointly. Thus, many Canadian tax professional advise against the IRC §6013(g) election. Included among the reasons for not making the election is that making the election triggers the international information return filing requirements, results in taxation of the NRA's worldwide income and limited treaty benefits to those allow US persons.³

Canadians making an IRC §6013(g) election will not be subject to US self-employment tax or the net investment income tax. See IRC §§ 1402(b), 1411

Question: If a married NRA and US person file separately, how do they allocate their deductions and credits?

Rules: Over 100 sections of the Internal Revenue Code apply to NRAs. See *e.g.* IRC §2(d). *Nonresident aliens*. In the case of a nonresident alien individual, the taxes imposed by sections 1 and 55 shall apply only as provided by section 871 or 877.

Explanation:⁴

1. The NRA reports his or her ECI on Form 1040NR.
2. The NRA can deduct expenses relating to the ECI. Except for certain itemized deductions, the NRA can claim deductions only to the extent they relate to ECI. NRAs can deduct certain itemized deductions effectively connected with their US trade or business. These

³ Treas. Reg. § 1.6038-2.

⁴ Pub. 519, *supra* note 2; I.R.S., *Nonresident Alien Figuring Your Tax* (Last Updated Jun. 28, 2019), available at <https://www.irs.gov/individuals/international-taxpayers/nonresident-alien-figuring-your-tax>; I.R.S., *NRA Withholding* (last updated Aug. 26, 2019), available at <https://www.irs.gov/individuals/international-taxpayers/nra-withholding>.

deductions include: (a) State and local income taxes, (b) Charitable contributions to US non-profit organizations, (c) Casualty and theft losses, from a federally declared disaster, and (d) other itemized deductions. The NRA uses Schedule A of Form 1040NR to claim itemized deductions.

3. NRAs reporting ECI may claim: Foreign tax credit, Child and dependent care credit, Retirement savings contributions credit, Child tax credit, Credit for other dependents, Adoption credit, Credit for prior-year minimum tax, and Education and Earned Income Credits

4. NRA are not liable for US self-employment tax.

5. Question: What are the US filing requirements of a Canadian citizen residing (i.e., NRA) in Canada and commuting from Canada to the US for work?

Answer: The Canadian-US commuter will be required to file a US federal and state tax nonresident returns (if the state where they work has an income tax). The commuter will only report and pay tax on US source income on their US tax filings.

The Canadian-US commuter will also have to comply with Canadian filing requirements and will receive a credit on their Canadian tax return for US federal & state income tax paid, as well as social security tax and Medicare taxes withheld from their wages. Canadian Revenue Agency (CRA) will generally request a transcript from the US taxing authorities to prove the amount of taxes paid.

Practice Point: If the commuter is a US citizen, or green card holder (including a Commuter Green Card), he or she must file taxes in both countries, declaring worldwide income as well as any other information form or FBAR required of a US citizen. Foreign tax credits will generally be allowed to prevent double taxation under the US-Canada Treaty.

Rule:⁵

Under IRC § 7701(b), an NRA is considered a US resident for income tax purposes if the individual is a “lawful permanent resident” of the United States (the green card test) or meets the "substantial presence test." A “commuter” green cardholder (like any “other” green cardholder) is considered a lawful permanent resident of the United States under US immigration laws. Therefore, the “commuter” green cardholder will be considered a US resident for income tax purposes until such time

5 I.R.S. SCA No. 199950009, *Commuter Green Cards* (Sept. 13, 1999), available at <https://www.irs.gov/pub/irs-sca/9950009.pdf>; Ian Weinstock, *U.S. Tax Residency, Some Black-and-White Rules, Some Gray*, The CPA Journal (March 2018), available at <https://www.cpajournal.com/2018/03/27/u-s-tax-residency/>; Canada Revenue Agency, *Income Tax Folio S5-F2-C1, Foreign Tax Credit* (last updated Nov. 30, 2015), available at <https://www.canada.ca/en/revenue-agency/services/tax/technical-information/income-tax/income-tax-folios-index/series-5-international-residency/folio-2-foreign-tax-credits-deductions/income-tax-folio-s5-f2-c1-foreign-tax-credit.html>.

that their status has been revoked, or administratively or judicially determined to have been abandoned

Explanation

The United States requires US persons [citizens and residents] to pay federal taxes on worldwide income, despite where they live and work. By contrast, Canada requires its citizens and residents to pay taxes based on their residency. Generally, a taxpayer living in Canada over 183 days in a year, will be considered a resident for tax purposes and must pay taxes to the CRA. A taxpayer may also be considered a deemed resident of Canada even if they live in the US.⁶

Question: What are the US filing requirements of a Canadian citizen residing in Canada (i.e., an NRA) engaged in a trade or business in the US?

Answer: The NRA may need to file Form 1040-NR and applicable state tax return if he or she is engaged in a trade or business in the US (unlike most Canadian provinces and territories, each state that levies an income tax requires a tax return separate from the US federal forms)

Rules: Over 100 sections of the Internal Revenue Code apply to NRAs. See *e.g.*,

IRC §2(d). *Nonresident aliens*. In the case of a nonresident alien individual, the taxes imposed by sections 1 and 55 shall apply only as provided by section 871 or 877.

IRC §871: *Tax on nonresident alien individuals*. The US taxes NRAs on effectively connected income.

Explanation⁷

The NRA may need to file Form 1040-NR if he or she is engaged in a trade or business in the US.

⁶ Canada Revenue Agency, *Factual Residents – Temporarily Outside of Canada* (last updated Feb. 20, 2019), available at <https://www.canada.ca/en/revenue-agency/services/tax/international-non-residents/individuals-leaving-entering-canada-non-residents/factual-residents-temporarily-outside-canada.html>; Canada Revenue Agency, *Folio 1 Residency* (last updated Nov. 24, 2015), available at <https://www.canada.ca/en/revenue-agency/services/tax/technical-information/income-tax/income-tax-folios-index/series-5-international-residency/folio-1-residency.html>.

⁷ I.R.S. Form 1040NR, *U.S. Nonresident Alien Income Tax Return* (2018), available at <https://www.irs.gov/pub/irs-pdf/f1040nr.pdf>.

Question: What are the reporting requirements and tax consequences of Canadian plans that allow families to save for children’s education (e.g., Registered Education Savings Plan (RESP))?

Answer: Although not free from doubt, the US donor and/or US donee, must file IRS Forms 3520 and/or IRS Form 3520A. RESP plans are not tax-deferred for US tax purposes, and often contain Canadian mutual funds which will require the filing of Form 8621 each year.

Rules: IRC §6048 (a) *Notice of certain events*

(1) General rule: On or before the 90th day (or such later day as the Secretary may prescribe) after any reportable event, the responsible party shall provide written notice of such event to the Secretary in accordance with paragraph (2).

(2) Contents of notice: The notice required by paragraph (1) shall contain such information as the Secretary may prescribe, including—

(A) the amount of money or other property (if any) transferred to the trust in connection with the reportable event, and

(B) the identity of the trust and of each trustee and beneficiary (or class of beneficiaries) of the trust.

(3) Reportable event: For purposes of this subsection—(A) In general. The term “reportable event” means—

(i) the creation of any foreign trust by a US person,

(ii) the transfer of any money or property (directly or indirectly) to a foreign trust by a US person, including a transfer by reason of death.

IRC § 2652(b)(1) (b) Trust and trustee: The term “trust” includes any arrangement (other than an estate) which, although not a trust, has substantially the same effect as a trust.

Explanation⁸

Canadian plans that allow families to save for children’s education, like RESPs, are for US tax purposes foreign trusts. Because the RESP is treated as a foreign trust, the US person owner must

⁸ I.R.S., *Foreign Trust Reporting Requirements* (last updated Aug. 8, 2019), available at <https://www.irs.gov/businesses/international-businesses/foreign-trust-reporting-requirements>; I.R.S., *IRS Announces the Identification and Selection of Six Large Business and International Compliance Campaigns* (last updated Oct. 22, 2019), available at <https://www.irs.gov/businesses/irs-announces-the-identification-and-selection-of-six-large-business-and-international-compliance-campaigns>; I.R.S., *2018 Instructions for Form 3520, Annual Return to Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts*, available at <https://www.irs.gov/pub/irs-pdf/i3520.pdf>; I.R.S., *2018 Instructions for Form 3520-A, Annual Information Return of Foreign Trust with a U.S. Owner*, available at <https://www.irs.gov/pub/irs-pdf/i3520a.pdf>.

file IRS Form 3520, Annual Return to Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts. And because Canadian plans, like RESPs, are a grantor trusts for IRC § 671–§ 679 and the assets are treated as owned by a person other than the trust, IRS Form 3520-A, Annual Information Return of Foreign Trust with a US Owner, IRS Form 3520 must also be filed. Finally, if the beneficiary of such Canadian plans is a US person, such beneficiary must also file IRS Form 3520.

Question: What are the tax consequences when an NRA married to a US person divorce?

Answer: Some transfers between the spouses incident to divorce will be taxable.

Rule:⁹

IRC § 1041. *Transfers of property between spouses or incident to divorce*

(a) General rule. No gain or loss shall be recognized on a transfer of property from an individual to (or in trust for the benefit of)—

- (1) a spouse, or
- (2) a former spouse, but only if the transfer is incident to the divorce.

(d) Special rule where spouse is nonresident alien. *Subsection (a) shall not apply if the spouse (or former spouse) of the individual making the transfer is a nonresident alien.*

Explanation: 26 CFR § 1.1041-1T—Treatment of transfer of property between spouses or incident to divorce provides as follow:

Q-3: Do the rules of section 1041 apply to a transfer between spouses if the transferee spouse is a nonresident alien?

A-3: No. *Gain or loss (if any) is recognized* (assuming no other nonrecognition provision applies) at the time of a transfer of property if the property is transferred to a spouse who is a nonresident alien. (emphasis added)

⁹ I.R.C. § 1041.

Question: Are the children of a union between a nonresident alien individual (i.e., Canadian) married to a citizen or resident of the US, US citizens?

Answer: It depends.

Rules: The rules are in 8 USC § 1401¹⁰. *Nationals and citizens of US at birth*

Explanation:¹¹

The law in effect at birth determines whether someone born outside the United States to a US citizen parent (or parents) is a US citizen at birth. These laws require that at least one parent was a US citizen, and the US citizen parent had lived in the United States for a period of time.

Question: Are children residing in Canada that are US persons required to file income tax returns?

Answer: Yes.

Rule:¹²

26 CFR § 1.6012-1—Individuals required to make returns of income. (4) *Return of income of minor.* A minor is subject to the same requirements and elections for making returns of income as are other individuals. Thus, for example, for a taxable year beginning after December 31, 1972, a return must be made by or for a minor who has an aggregate of \$1,750 of gross income from funds held in trust for him and from his personal services, regardless of the amount of his taxable income. ***The return of a minor must be made by the minor himself or must be made for him by his guardian or other person charged with the care of the minor's person or property.*** See paragraph (b)(3) of § 1.6012-3. See § 1.73-1 for inclusion in the minor's gross income of amounts received for his personal services. ***For the amount of tax which is considered to have been properly assessed against the parent, if not paid by the child, see section 6201(c) and paragraph (c) of § 301.6201-1 of this chapter (Regulations on Procedure and Administration).*** (emphasis added)

Explanation:¹³

¹⁰ 8 U.S.C. § 1401.

¹¹ U.S. Embassy and Consulates in Canada, *Transmitting Citizenship* (last visited Nov. 18, 2019), available at <https://ca.usembassy.gov/u-s-citizen-services/child-family-matters/birth/transmit-citizenship/>.

¹² Treas. Reg. § 1.6012-1.

¹³ I.R.S., Pub.17, *Your Federal Income Tax For Individuals* (Jan. 30, 2019), available at <https://www.irs.gov/pub/irs-pdf/p17.pdf>; See also I.R.S. Pub. 54,

Children that are US Persons are required to file returns and information reports.

Question: What forms need to be filed when an NRA (i.e., the Canadian spouse) makes a gift to his or her US citizen child?

Rule:¹⁴

IRC §6039F (a) In general. If the value of the aggregate foreign gifts received by a US person (other than an organization described in section 501(c) and exempt from tax under section 501(a)) during any taxable year exceeds \$10,000 [now \$100,000], such US person shall furnish (at such time and in such manner as the Secretary shall prescribe) such information as the Secretary may prescribe regarding each foreign gift received during such year.

(b) Foreign gift: For purposes of this section, the term “foreign gift” means any amount received from a person other than a US person which the recipient treats as a gift or bequest. Such term shall not include any qualified transfer (within the meaning of section 2503(e)(2)) or any distribution properly disclosed in a return under section 6048(c).

Explanation:¹⁵

A foreign gift is money or other property received by a US person from a foreign person that the recipient treats as a gift or bequest. A “foreign person” is a nonresident alien individual or foreign corporation, partnership or estate. A gift to a US person does not include amounts paid for qualified tuition or medical payments made on behalf of the US person.

Thus, whenever a child receives more than \$ 100,000 as gifts from a NRA (i.e., his Canadian parents), a domestic trust owned by a foreign person, or a foreign estate, or receives more than \$ 16,076 as gifts from a foreign corporation or a foreign partnership, Part IV of IRS Form 3520 must be filled out and filed.

Question: Can a NRA (e.g., a Canadian citizen) married to a citizen or resident of the US receive a gift or inheritance free from US estate or gift taxes?

Tax Guide for U.S. Citizens and Resident Aliens Abroad (Jan 25, 2019), available at <https://www.irs.gov/pub/irs-pdf/p54.pdf>.

¹⁴ I.R.C. § 6039F.

¹⁵ I.R.S., *2018 Instructions for Form 3520*, *supra* note 8; I.R.S., *Foreign Trust Reporting Requirements*, *supra* note 8.

Answer: It depends on the amount

Rules:¹⁶ *Section 2523(i)*. Disallowance of marital deduction where spouse not citizen. If the spouse of the donor is not a citizen of the US—

- (1) no deduction shall be allowed under this section,
- (2) section 2503(b) shall be applied with respect to gifts which are made by the donor to such spouse and with respect to which a deduction would be allowable under this section but for paragraph (1) by substituting “\$100,000” for “\$10,000”,..

Section 2056 (d) (1). Disallowance of marital deduction where surviving spouse not US citizen. Except as provided in paragraph (2), if the surviving spouse of the decedent is not a citizen of the US—

- (A) no deduction shall be allowed under subsection (a), and
- (B) section 2040(b) shall not apply.¹⁷

Explanation¹⁸

Estate Tax: The Code §§ above mean that the unlimited marital deduction does not apply when the surviving spouse who inherits is not a US citizen, even if the spouse is a permanent US resident. But the US spouse can leave assets worth up to the exempt amount (i.e., \$11.4 million (USD) in 2019) to anyone, including his or her noncitizen spouse, without owing any federal estate tax. And if the noncitizen spouse dies first, assets left to the spouse who is a US citizen do qualify for the unlimited marital deduction.

Gifts Given During Life: If the donee spouse is not a US citizen, the tax-free treatment of gifts for spouses is limited to \$154,000 a year (in 2019). This Code indexes this amount for inflation.

Question: Will the US will honor a common-law marriage valid in Canada for US income tax filing and reporting purposes?

Answer: Sometimes.

Rule: Revenue Ruling 58-66, 1958-1 C.B. 60. In Revenue Ruling 58-66, 1958-1 C.B. 60, the Service determined the marital status for federal income tax purposes of individuals

¹⁶ I.R.C. § 2523.

¹⁷ I.R.C. § 2056.

¹⁸ I.R.S., *Some Nonresidents with U.S. Assets Must File Estate Tax Returns* (last updated Sept. 20, 2019), available at <https://www.irs.gov/individuals/international-taxpayers/some-nonresidents-with-us-assets-must-file-estate-tax-returns>.

who have entered a common-law marriage in a state that recognizes common-law marriages. The term “state” means any domestic or foreign jurisdiction having the legal authority to sanction marriages. *See also* Revenue Ruling 2013-17.¹⁹

Explanation:²⁰

Canada recognizes common-law marriage if an individual is living with a person who is not a spouse, but meets any of the following conditions:

- (1) have been living together in a conjugal relationship for at least 12 continuous months,
- (2) the other person is the parent of the individual’s child by birth or adoption, or
- (3) the other person has custody and control of the individual’s child and such child is wholly dependent on that person for support.

If Revenue Ruling 58-66, 1958-1 C.B. 60 applies, the IRS will recognize the Canadian common law marriage for tax purposes.

Question: Can a NRA that owes US taxes compromise his or her US tax debt?

Answer: Yes.

Rule:²¹ *IRC § 7122. Compromises.* The Secretary may compromise any civil or criminal case arising under the internal revenue laws prior to reference to the Department of Justice for prosecution or defense; and the Attorney General or his delegate may compromise any such case after reference to the Department of Justice for prosecution or defense.

Explanation

In 2011, the IRS announced its “Fresh Start Program” to help taxpayers who cannot pay their taxes in full to become tax compliant without unnecessary burden. The “Fresh Start Program” includes a collection alternative known as an Offer in Compromise (“OIC”).

1. The OIC is an agreement between a taxpayer and the IRS to settle a taxpayer’s tax liabilities for less than the amount owed.

¹⁹ *Rev. Rul. 2013-17*, available at <https://www.irs.gov/pub/irs-drop/rr-13-17.pdf>.

²⁰ Canada Revenue Agency, *Marital Status* (last updated Feb. 12, 2019), available at <https://www.canada.ca/en/revenue-agency/services/tax/individuals/topics/about-your-tax-return/tax-return/completing-a-tax-return/personal-address-information/marital-status.html>.

²¹ I.R.C. § 7122.

2. The IRS will accept an OIC if the offered amount reasonably reflects collection potential and the original tax liability is unlikely to be collected in full.

3. Under Treas. Reg. § 301.7122-1, the IRS will also consider hardship, public policy, and equity when accepting an OIC.²²

²² I.R.S. News Release, *IRS Announces New Effort to Help Struggling Taxpayers Get a Fresh Start; Major Changes Made to Lien Process* (Feb. 24, 2011), available at <https://www.irs.gov/pub/irs-news/ir-11-020.pdf>; I.R.M., pt.4.18.3.1 (Feb. 28, 2017), available at https://www.irs.gov/irm/part4/irm_04-018-003.