PROPOSED US RESIDENCE-BASED TAXATION

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Canadian Tax Highlights
January 22, 2019

Originally published in Canadian Tax Highlights, Volume 27, Number 1, January 2019. *Reprinted with permission.*

US citizens living abroad are subject to very complex information reporting rules and filing requirements each year. US citizens, regardless of where they reside, are required to file a US income tax return each year and report annually any worldwide income, including any income from foreign assets. The foreign earned income exclusion and/or foreign tax credits may substantially reduce or eliminate a US citizen's tax liability; however, these filing requirements can be costly for someone who has been living outside the United States for most, if not all, of his or her life. In addition to the requirement to file an annual US income tax return reporting worldwide income, various information filings also may apply. For example, form 5471 is complex and may be required if a US citizen has an ownership interest in certain non-US corporations. In addition, a US citizen may be required to file form 3520 with respect to certain interests in non-US trusts. Failure to file a US income tax return and applicable information returns each year on time may result in significant penalties for US citizens residing in Canada. A new bill introduced in the House proposes a residence-based tax system in the United States.

This proposal puts the United States in line with many other countries around the world: the United States is one of only a few countries that tax based on citizenship. The proposed legislation, the Tax Fairness for Americans Abroad Act of 2018 (HR 7358), allows qualified non-resident citizens to exclude foreign-source income from gross income. The exclusion generally applies to income sourced outside the United States. The proposed legislation defines a non-resident citizen as a US citizen with a foreign tax home who has fully complied with the US income tax laws for the previous three years and meets one of two requirements: (1) bona fide residence in a foreign country or countries for an uninterrupted period that includes a full tax year or (2) presence in a foreign country or countries during at least 330 full days during the tax year.

Of course, a qualified non-resident citizen is still liable for tax on US-source income. For instance, if a US citizen is resident in Canada and earned US-source income not otherwise exempt under the Canada-US income tax treaty, he or she must still file a US tax return and report such income under this pro- posed system. The organization American Citizens Abroad has been advocating for residence-based

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taxation for some time. American Citizens Abroad suggests that this proposal would allow more Americans to enter into the global workforce and encourage domestic job growth.

This legislation has only been proposed in the House. It must first pass in the House and the Senate and the president must then sign the law before it becomes effective. A residence-based taxation system would be welcome news to US citizens residing in Canada, but given the political climate in Washington, it seems very unlikely that this proposed law would ever pass both houses of Congress and become effective. With that in mind, Canadian-resident US citizens should be aware that their US tax-filing requirements under current law still require US citizens residing outside the United States to file a US tax return and report their worldwide income.