

IRS Emigrants' Guidance

On March 8, 2010, the IRS released guidance on rules and procedures for a Canadian resident who emigrates to the United States and wishes to elect a deemed sale of property subject to Canadian departure tax: the election achieves a stepped-up basis for US federal income tax purposes (article XIII(7) of the Canada-US treaty). Revenue procedure 2010-19 (2010-13 IRB 469) applies both to an individual who emigrates after the effective date of March 29, 2010 and to an individual who emigrated before then but after September 17, 2000 and whose election is not statute-barred.

The September 21, 2007 treaty protocol extends to an emigrant non-US citizen the same right that an emigrant US citizen had under article XIII(7): to elect for US federal tax purposes a notional sale and purchase of property subject to Canadian departure tax for its FMV immediately before emigration. The protocol is generally effective retroactive to September 18, 2000, when it was announced by simultaneous press releases from Finance Canada and the US Treasury. The deemed sale election can help taxpayers avoid or minimize the double taxation potential from a timing mismatch that results when a property's historical basis is carried over for US tax purposes, as is generally required under US domestic tax law.

An emigrant taxpayer generally falls into one of four categories.

1) An individual who emigrates after March 28, 2010 holding property that is subject to Canadian departure tax and to US tax (taxable US property). This category includes (a) a non-US citizen who owns US real estate or US-situs personalty that forms part of a US PE's business property, and (b) a US citizen. The individual should report the deemed disposition and make the election by attaching a form 8833 ("Treaty Based Return Position Disclosure Under Section 6114 or 7701(b) of the Internal Revenue Code") to his or her US tax return for the first tax year ending after the change of residence. Attached documentation should establish the property's FMV under the Canadian deemed disposition rules and should confirm that the gain was recognized and reported for Canadian tax purposes. The gain on the deemed sale is generally subject to US tax; double tax is avoided or minimized via foreign tax credits under article XXIV(2) (non-US citizens) and article XXIV(4) (US citizens).

2) An individual who emigrates after March 29, 2010 holding non-taxable US property subject to Canadian departure tax. This category includes primarily a non-US citizen who owns non-US-situs property. The individual should make the election on form 8833 in the US tax return for the first taxable year ending after the change of residence. The new US basis in the property is its FMV on the date of the Canadian deemed disposition. The elected US deemed disposition does not trigger US income tax.

3) An individual who emigrated from Canada after September 17, 2000 and before March 29, 2010 holding taxable US property. This category includes (a) a non-US citizen who owned certain US-situs property, and (b) a US citizen. If the individual has not previously made a timely election, he or she may use form 8833 to report the deemed disposition on an amended US return for the year when emigration occurred, but only if that year is open under the applicable Code section 6511 limitation period; no election is allowed for a statute-barred year. If a previous election was made under article XIII(7) using form 8833 or a similar statement attached to a timely filed US tax return for the deemed disposition year, the IRS generally does not challenge the earlier election or require a new election if the earlier election is not inconsistent with Revenue procedure 2010-19's principles and with all of the individual's filed US federal tax returns and information statements.

4) An individual who emigrated after September 17, 2000 and before March 29, 2010 holding non-taxable US property. Such an individual is treated differently from a category 3 individual in two respects if he or she has not yet sold the property. First, he or she should elect by attaching form 8833 to his or her first US federal tax return filed after March 29, 2010; no amended return is filed for the deemed disposition year. Second, elections are apparently available even

for deemed dispositions in statute-barred years. However, if an individual disposed of the property before making the election, the disposition year must be open and the individual must file an amended tax return to reflect the adjusted basis and claim any applicable refund. If the disposition year is statute-barred, generally no deemed sale election is available; but as for a category 3 individual, the IRS will generally accept a previous timely election in the first US return due after the deemed disposition year and will not require a new election.

Revenue procedure 2010-19 also states that if Canadian law deems a disposition of multiple properties immediately before an individual ceases to be a Canadian resident, he or she may elect under new article XIII(7) only if there is an aggregate net gain for Canadian tax purposes. The individual may not cherry-pick particular properties to be the subject of an election if there is a deemed net loss in aggregate for all the properties.

An individual emigrating from Canada to the United States should also consider any other potential US tax planning strategies in connection with the move, such as a pre-emigration trust to avoid or minimize US estate tax exposure and the conversion of any Cancos that hold primarily passive assets into ULCs in order to avoid the adverse effects of the US CFC and PFIC rules.

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