2015 TAX FILING SEASON NEWSLETTER

Welcome to the 2015 tax filing season and our annual tax update newsletter for cross-border filers. Humor is hard to find in the tax law, especially at this time of the year and in light of what both the IRS Commissioner John Koskinen and the National Taxpayer Advocate Chief Nina Olson predict. According to both, the upcoming tax season will be miserable and the worst since 2001 due to the lowest level of funding and further increases in legal and reporting complexities. And while what is funny to one may not be funny to all... I will give it a try with an old tax joke which came from a client:

At the end of the tax year, Revenue Canada sent an inspector to audit the books of a local hospital. While the CRA agent was checking the books he turned to the CEO of the hospital and said, "I noticed you buy a lot of bandages. What do you do with the end of the roll when there's too little left to be of any use?" "Good question," noted the CEO. "We save them up and send them back to the bandage company and every now and then they send us a free box of bandages." "Oh," replied the auditor, somewhat disappointed that his unusual question had a practical answer. But on he went, in his obnoxious way. "What about all these plaster purchases? What do you do with what's left over after setting a cast on a patient?" "Ah, yes," replied the CEO, realizing that the inspector was trying to trap him with an unanswerable question. "We save it and send it back to the manufacturer, and every now and then they send us a free package of plaster." "I see," replied the auditor, thinking hard about how he could fluster the know-it-all CEO. "Well," he went on, "What do you do with all the leftover foreskins from the circumcisions you perform?" "Here, too, we do not waste," answered the CEO. "What we do is save all the little foreskins and send them to the CRA Office, and about once a year they send us a complete p..."

Old and tired but still good to hear. Let's make the season another success!

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US TAX CHANGES FOR 2014

A Year After the Obama Taxes – What did we Learn?

Last year was the first ever when we filed your US tax returns under the 2010 Affordable Care Act's two new taxes: a 3.8% net investment income tax (**NIIT**) applicable to taxpayers with adjusted gross income over $200,000 ($250,000 for married filing joint) and a 0.9% additional Medicare tax on wages in excess of $200,000 ($250,000 for married filing joint) (**Additional Medicare tax**), gingerly nicknamed as the "Obama" taxes. For majority of you who are employed by Canadian entities and provide services primarily in Canada or covered by the Canada-US Totalization agreement for US service provision, Additional Medicare tax proved to be not an issue.

A different story unfortunately played out with NIIT, as many of you who are US citizens in Canada faced US tax liability on your 1040s for the first time ever or saw further increase in your overall US taxes due, having it for some of you a combined US and Canadian tax rate to go as high as 53.33% (yikes!). Because of the lack of specific guidance from the CRA on the "Obama" taxes, including their credibility on the Canadian returns, we cautiously filed your T1s claiming a credit for a portion of NIIT which we believed would "logically" be creditable. Luckily for us, the CRA fully accepted our position (100% acceptance rate!) to utilize as a foreign tax credit a portion of NIIT which arises from US-source investment income. NIIT which is computed on the Canadian portion of investment income is not creditable in Canada. Additional Medicare tax for services in the US is also fully creditable.

Despite some practitioners taking a position that entire NIIT must either be creditable or if not, is unconstitutional and therefore should not be reported on the US return and remitted by US citizens residents of a foreign country, we forgo to align with them. Unless, we receive from either of the governments any contrary guidance to the existing one (or lack thereof), we will continue to file your 2014 tax returns in the same manner as we did them for 2013 for purposes of NIIT and Additional Medicare tax.

A Year After PEP and Pease rules restored – What did we Learn?

In addition to reverting to the top 39.6% tax bracket for 2013 (which remains in effect in 2014) The American Taxpayer Relief Act of 2012 restored the phase-out of personal exemptions and itemized deductions. As a result, you may benefit from "shifting" certain itemized deductions (e.g., mortgage interest expense, property taxes, etc.) to alternating years. This shifting will only be effective when a tax minimization strategy is also taken on the Canadian return. Also be mindful that the Alternative Minimum Tax, if applicable, may reduce or eliminate the benefit of this strategy. Be sure to contact us if you wish to consider this strategy.

Health Care Reform and Health Care Coverage Exemption for Dual Residents

Starting in 2014, every American citizen or resident is required to have health insurance or make a payment on his or her federal income tax return. This is called "shared responsibility payment". The individual shared responsibility provision requires that an individual and each member of his/her family to do one of the following:

- Have qualifying health coverage called minimum essential coverage;
- Qualify for a health coverage exemption; or
- Make a shared responsibility payment when filing their 2014 federal income tax return in 2015.

Many people already have minimum coverage and do not need to do anything more than maintain that coverage and report their coverage when they file their tax returns.

Americans in Canada who meet either the physical presence test (over 330 full days outside the US during a 12 month rolling period) or the bona fide residency test, and Canadians who have a significant US presence days but retain their Canadian residency, and thus provincial health insurance coverage, are exempt from US health insurance coverage mandate. Such exemption must be affirmatively stated on Form 8965 which will be filed with your 2014 1040 and possibly with some 1040NR returns. If your gross income is below the applicable minimum threshold for filing a federal income tax return, you are exempt from the individual shared responsibility provision and are not required to file a federal income tax return solely to claim the coverage exemption.

Farewell to 8891

Contrary to the best traditions of annually creating more paperwork, the IRS finally took a step in the right direction by eliminating previous annual filing requirements for Form 8891 for Canadian RRSPs and RRIFs held by US citizens and residents. The relief from annual reporting also applies to members of Canadian registered pension plans (RPP) and deferred profit sharing plans (DPSP) and is effective immediately. The previous reporting requirements existed to allow the registered plan holders to defer any income accumulated in those plans until distribution. The elimination means that income in the eligible plans now automatically qualifies for tax deferral akin to the tax deferrals enjoyed by IRA and 401(k) holders. American citizens and residents who are the holders and beneficiaries of RRSPs, RRIFs, RPPs and DPSPs are still required to include actual distributions from the plans in the year received on their US tax returns. US taxpayers who failed to satisfy their previous reporting and elections requirements are automatically treated as having made the election to defer US tax for all prior tax year for undistributed income earned in the eligible plans, provided that have not included any of that undistributed income in their US taxable income for any of the prior years.

The policy change does not affect any other US reporting requirements that Americans with RRSPs, RRIFs, RPPs and DPSPs may have to meet for the purposes of forms FinCen 114 or 8938, or both.

Final Reporting Rules for Specified Foreign Financial Assets on 8938

Starting with 2011 tax returns, many of you noticed a significant increase in the number of pages in your 1040 and often 1040NR. This was a result of a newly introduced form 8938. The form was attached to an individual tax return conditional on an individual who had an interest in specified foreign financial assets and the aggregate value of the specified foreign financial assets' interests exceeded the applicable reporting threshold. The threshold varied depending on the filing status and the residency country, either US or foreign.

In December of 2014, the US Treasury and the IRS issued final regulations clarifying some ambiguities that were present since the time the form was initially introduced.

Particularly, starting with 2014 tax returns, the form is no longer required to be filed by an individual who is present in the US over 183 days in a year but makes a "tie-breaker rules" election to a foreign country under a bi-lateral tax treaty, provided that the individual timely files Form 1040NR and attaches Form 8833.

This applies to Canadian snowbirds who overstay in the US 182 days in a single year or Canadians who provide services in the US but retain Canadian residency (excluding commuters).

Secondly, under the final rules, invested shares and options are no longer considered reportable assets on form 8938. It is still unclear whether other types of equity awards granted which delay transfer of property, such as RSUs, stock option rights, SARs, etc., are exempt from reporting.

Finally, for the assets jointly held by unmarried taxpayers or by couples where one is a US citizen and the other is not, the full value of the asset (rather than the individual's allocable interest) must be considered and reported when determining whether the applicable reporting threshold has been exceeded. Similarly, in the case of joint owners who are married but file separate returns, the full value of the specified foreign financial assets must be reported by each taxpayer on their form 8939, even though only one-half of the value is considered in determining each individual's reporting threshold.

Reporting and income inclusion associated with foreign accounts and assets continues to be a focus for the IRS. Taxpayers should be diligent in determining their taxable income and fulfilling reporting obligations.

Why the New IRS Repair Regulations are Important?

On September 13, 2013, the IRS released final regulations addressing the treatment of repairs and maintenance expenses for federal income tax purposes. The new regulations affect ALL taxpayers with US tax compliance obligations who holds real and tangible property used in a trade or business or for production of income. They go way beyond just repairs and change the treatment of repairs and maintenance, materials and supplies, spare parts, and acquisition costs.

The compliance with the new regulations is mandatory for the tax years beginning on or after January 1, 2014. Failure to comply with the new regulations can result in the assessment of additional tax, interest and penalties at a federal level (and possibly state, if filing is required).

The new regulations impact the manner in which your business, which also includes proprietary and rental activity, treats repairs and maintenance expenditures for income tax purposes. Items that you have expensed in the past may now be required to be capitalized, and vice versa. There are several options how the taxpayers may become compliant with the new repair regulations when filing their 2014 US tax returns.

If you are an American in Canada and file forms C, E or F with your 1040 or a Canadian and file forms C or E with your 1040NR, please contact us immediately to allow us to determine the best tax compliance options for you under the new repair regulations.

Failure to File US Tax Returns and Hiding Income Offshore

On January 28 of 2015 the IRS said avoiding taxes by hiding money or assets in unreported foreign accounts (which also include Canadian) remains on its annual list of tax scams known as the "Dirty Dozen" for the 2015 filing season. The IRS continues to encourage US citizens, residents and Green Card holders to come forward voluntarily and get their taxes and filing requirements in order by offering several taxpayer friendly amnesty programs, including Streamlined Foreign Offshore Procedures, Streamlined Domestic Offshore Procedures and Offshore Voluntary Disclosure Initiative (OVDI).

Illegal scams can lead to significant penalties and interest and possible criminal prosecution. Since the famous UBS case, numerous individuals have been identified as evading US taxes by hiding income in foreign banks, brokerage accounts or nominee entities and then using debit cards, credit cards or wire transfers to access the funds. Others have employed foreign trusts, employee-leasing schemes, private annuities or insurance plans for the same purposes.

While there are legitimate reasons for maintaining financial accounts abroad, there are reporting requirements that need to be fulfilled. US taxpayers who maintain such accounts and who do not comply with such reporting requirements are breaking the law and risk significant penalties and fines as well as the possibility of criminal prosecution. With the new foreign account reporting requirements (FATCA) being phased in as of June 2014, failure to comply with US tax and reporting obligations will continue to be increasingly costly. The currently offered IRS tax amnesty programs will remain open for an indefinite period until otherwise announced.

IRS Payments and Refunds

Hanson Crossborder Tax Inc. made a commitment to electronically file 100% of its eligible US tax returns. Unfortunately, 1040NR or dual-status 1040 returns or 1040 statements (when an individual is a non-resident in the first part of the year and a resident at the year-end and the other way around, respectively) continue to remain ineligible.

There are several reasons why we are departing from the old school paper-filing method. First of all it is to protect your identity. IRS e-file meets strict security guidelines. It uses secure encryption technology to protect a taxpayer's tax return. Secondly, it expedites a delivery of a refund. The fastest way to get your refund is to combine e-file with direct deposit into your bank account. Please be advised that only US bank accounts (located in the US) are eligible for direct deposit. Finally, if you owe taxes, you can e-file and set up automatic payment on any day until the April 15 due payment date. You can pay electronically from your bank account (again, the bank account should be located in the US). You can also pay by check, money order, debit or credit card.

CANADIAN TAX CHANGES FOR 2014

New Income Tax Brackets and Rates

During 2014, the province of Ontario continued to be on a roll with an agenda of how to further squeeze more money out of top earners. If during the prior filing season we saw the province enacted a 2% increase to the top marginal tax rate effectively creating a new combined (federal and Ontario) top marginal tax rate of 49.53% on taxable income earned by individuals which exceeded $500,000, the 2014 Ontario Budget made further populist changes. As provided in the comparative tables below, for 2014 tax year, the top bracket was lowered from $500,000 to $220,000. In addition a bracket with a new Provincial tax rate of 12.16% was introduced on taxable income ranging between $150,000 and $220,000. It's been confirmed that the new taxable income thresholds will not be adjusted for inflation in future years. What these changes mean to Americans in Canada whose income includes investment income that starting with 2014 tax year if you make over $220,000, you combined tax rate can be as high as 53.33%. Welcome to a bright new world!

2014 COMBINED FEDERAL AND ONTARIO PERSONAL TAX RATES

Taxable Income	Salary/Interest	Capital Gain	Eligible Dividends	Other Dividends
First $40,120	20.05%	10.03%	(6.86%)	5.35%
40,121 – 43,953	24.15	12.08	(1.20)	10.19
43,954 – 70,651	31.15	15.58	8.46	18.45
70,652 – 80,242	32.98	16.49	10.99	20.61
80,243 – 83,237	35.39	17.70	14.31	23.45
83,238 – 87,907	39.41	19.70	19.86	28.19
87,908 – 136,270	43.41	21.70	25.38	32.91
136,271 – 150,000	46.41	23.20	29.52	36.45
150,000 – 220,000	47.97	23.98	31.67	38.29
Over 220,000	49.53	24.76	33.82	40.13

2013 COMBINED FEDERAL AND ONTARIO PERSONAL TAX RATES

Taxable Income	Salary/Interest	Capital Gain	Eligible Dividends	Other Dividends
First $39,723	20.05%	10.03%	(1.89%)	2.77%
39,724 – 43,561	24.15	12.08	3.77	7.90
43,562 – 69,963	31.15	15.58	13.43	16.65
69,964 – 79,448	32.98	16.49	14.19	17.81
79,449 – 82,422	35.39	17.70	17.52	20.82
82,423 – 87,123	39.41	19.70	19.88	23.82
87,124 – 135,054	43.41	21.70	25.40	28.82
135,055 – 509,000	46.41	23.20	29.54	32.57
Over 509,000	49.53	24.76	33.85	36.47

Changes to Foreign Income Verification Statement – Form T1135

Form T1135 continues to evolve with the CRA's new changes for the 2014 and later tax years.

While the CRA's T1135, Foreign Income Verification Statement, has been around since 1998, the level of details of foreign investments with a cost of over $100,000 required to be reported on the form made it considerably more onerous in 2013 when the original format was revamped. The government believed that the additional information on the form would assist it in effectively combatting international tax evasion and aggressive tax avoidance. Alas, we are not so sure.

What we are sure of, however, is that the reporting under the new rules will not be easy. The 2013 changes caused a huge compliance issue to financial institutions, accountants and taxpayers. As a result, the CRA eased its initial requirements and announced less strict "transitional rules" for the 2014 tax filing season, including an extension of the filing deadline to July 31, 2014.

For the 2015 tax filing season the extended deadline is no longer available and the form will have to be filed by April 30 (or June 15 for self-employed). For a typical Canadian investor who holds foreign stocks, bonds and funds with Canadian financial institutions, the 2014 permanent changes to the form should simplify reporting obligations from the initial 2013 proposal although would require more work than the reporting on the pre-2013 tax forms. For those Canadians who own stocks, real estate, etc. outside Canada, the rules remain arduous and can take several days to complete (speaking from personal experience).

A few permanent changes include:

- Holdings are aggregated on a country by country basis;
- Report the highest FMV at any time during the year using the average exchange rate for the year. Month-end balances may be used to determine the highest FMV;
- Report the FMV at the end of the year using the year-end exchange rate;
- The income and capital gains for the year are reported on a country by country basis;
- A new Category 7 is introduced for aggregated reporting.

Lifetime Capital Gain Exemption Has Increased

Effective 2014, the lifetime capital gain exemption has increased from $750,000 to $800,000 and will be further indexed for inflation. The exemption is limited to the total gains on qualifying property over the shareholder's lifetime. The exemption does not have to be claimed all at once as it is eligible for carry-forward. It is available on the realized gain on disposition of shares, but not assets, of a Canadian Controlled Private Corporation or CCPC. The Capital gain exemption can be multiplied with family members with the use of a family trust. Since there is no reciprocal law under the US tax provisions, the planning is not recommended to family members who are US citizens or residents.

Personal Services Corporations No Longer Offers Tax Break

Effective Jan 1, 2014, business owners benefitting from the small business deduction in the past lost the benefit of choosing dividends over salary income. In the past there was a 2%-3% tax advantage in electing dividends vs. salary payments. The 2013 Federal Budget eliminated the advantage in order to improve the tax integration rules. With the change, business owners pay the same rate of tax regardless of which option is chosen. The difference between the two options is, by choosing salary, owners are subject to CPP and, if chosen, EI contribution cost but create an RRSP room. The change removed planning opportunities and will result in a severe penalty for miscompliance.

Family Tax Cuts and Credits – Lots of New Developments

New Family Tax Cut Credit. Starting in 2014, a couple, with at least one child under the age of 18 could now lower their combined Income Taxes by shifting up to $50,000 of taxable income to the spouse/common law partner in the lower tax bracket. This non-refundable credit has been capped at $2,000 per couple per year and is eligible if both spouses are Canadian residents at the year-end. The credit is unavailable, unless both spouses file an income tax return and do not elect to split any pension income they might have.

The Family Tax Cut is “notional” income splitting as the income is not transferred from one spouse’s tax return to the other like it is done for pension income splitting. Instead, one spouse would claim a new federal non-refundable tax credit for up to $2,000. Because the higher-income spouse’s net income is not reduced, provincial tax savings will not result unless the province introduces a similar tax credit.

If you are a US citizen and file a US tax return as either married filing separately or head of the household, please consult us before claiming the Family Tax Cut credit as it may cause an additional tax due on the US return side.

Children’s Fitness Tax Credit. The Children Fitness Tax credit has been enhanced in the amount and the benefit starting with 2014 tax year. Parents are now able to take advantage of the new $1,000 maximum limit instead of the previous $500. In addition, the previously non-refundable tax credit has now become refundable to allow parents who do not make enough to pay taxes to be able to benefit from the credit.

Universal Childcare Benefit. Effective January 1, 2015 the Universal Childcare Benefit has increased from $100 to $160 per month per child up to age six and became available in the amount of $60 per month for children ages six through 17. These changes will be reflected in monthly payments received starting in July 2015. As these changes come in to effect the existing Child Tax credit, available to individuals with children under 18 when they complete their tax returns, will be eliminated. The Family Caregiver Tax credit will continue to be available for caregivers of infirm dependent family members.

Childcare Expense Deduction. The Childcare Expense deduction is intended to allow parents to deduct childcare expenses incurred to earn employment income, business income or pursue education. Generally, the lower-income spouse is eligible to claim the deduction. The maximum amount that individuals can claim under the Childcare Expense deduction will increase by $1,000 effective for the 2015 calendar year. This will increase the deduction to $8,000 from the current $7,000 for each child under age seven, to $5,000 from $4,000 for each child between the ages of seven and 16 (or infirm dependent children over 16) and to $11,000 from $10,000 for children who are eligible for the Disability Tax Credit regardless of age.

An individual in the top tax bracket, will save $290 on the federal side from the $1,000 increase to the expense limit.

Family Loan. The CRA’s low prescribed interest rate of 0.75% effective January 21, 2015 (previously the rate was 1%) offers a great opportunity to enter into income-splitting loan arrangement with family members or a family trust. By locking in a family loan at the prescribed rate, and by having the family member invest the lent funds at a higher rate of return, a taxpayer can shift investment income earned on the lent funds to his or her spouse or another family member who has little or no other income and thus pays little or no tax.

If you are a US citizen, resident or Green Card holder, we suggest you consult us before entering into a family loan as depending on the loan terms, the Canadian prescribed rate may not be in line with the US Applicable Federal Rate (AFR), thus creating below-market interest rate issues on your US return.

Major Upcoming Changes in Estate Planning – Testamentary Trusts

The February 2014 federal budget announced significant changes to the taxation of testamentary trusts in Canada. The biggest change is the elimination of the graduated rate taxation that these trusts have enjoyed for the past 40 years. The objective for the change was to mitigate the perceived abuses occurring where multiple testamentary trusts are created upon death, each with access of its own set of graduated rates.

After January 1, 2016, all income retained in a testamentary trust will be taxed at the highest tax rate applicable in the province of the trust residency thus eliminating income splitting opportunity for high net worth beneficiaries. The flat top-rate taxation change will have two exceptions:

(1) graduated rates will apply for the first 36 months of an estate that arises on and as a consequence of an individual's death; and
(2) graduated tax rate will continue to apply in respect of testamentary trusts for the benefit of disabled individuals who are eligible for the Disability Tax credit.

The reason for the 36 months "freebie" is that it is a reasonable period of time to complete the administration of an estate. It is currently unknown whether administrators will be able to apply for an extensions in complex estates.

In addition to taxing testamentary trusts at the highest marginal rate applicable to individuals, the new rules also propose to eliminate the following benefits previously enjoyed by testamentary trusts:

- Exemption from income tax installment rules;
- Exemption from the requirement to have a calendar taxation year;
- Exemption from computing alternative minimum tax;
- The ability to make investment tax credits available to a trust's beneficiaries.

The loss of graduated tax rates after 36 months means that trust planning must be reviewed for both tax and non-tax reasons.

TFSA or RRSP – Which one Shall I Consider

You have until March 2, 2015 to make your 2014 RRSP contributions. A maximum RRSP contribution for 2014 of $24,270 would result in tax savings of up to about $12,000 if you are in the top marginal tax bracket of 49% (see 2014 tax rate tables above). If you are a US citizen or a Green Card holder and have been historically earning annual employment income over $100,000 and maxing out on your RRSP contributions, please consult us to ensure you do not have a shortage of foreign tax credits on the US return.

You can currently contribute up to $5,500 per year to a TFSA, as long as you are 18 or older and resident of Canada. TFSAs became available in 2009, and if you have made no contributions to date, you can contribute a total of $36,500. If you are a US citizen or a Green Card holder owning a TFSA can subject you to an annual Foreign Grantor Trust reporting obligations on two IRS forms 3520 and 3520-A. In addition, if a TFSA holds Canadian mutual funds or ETFs, you may be subject to annual punitive Passive Foreign Investment Company (PFIC) taxation. To avoid onerous US filing requirements and yet being able to enjoy tax-assisted savings, we suggest for Americans to limit their TFSA holding to cash savings account only. Such account should not give rise to the TFSA's trust treatment and deminimus earnings generated in the accounts should avoid taxation on the US return through application of available exemptions, deductions or foreign tax credit.

RRSP CONTRIBUTION LIMIT

Year	RRSP Contribution Limit	Earned Income Required in Prior Year
2013	$ 23,820	$132,333
2014	24,270	134,833
2015	24,930	138,500
2016	25,370	140,944