Assets That Will Likely Result in Net Taxes Paid to the US by US Citizens in Canada Who File Tax Returns in the US and Have Only Canadian Source Income

Investments in a Registered Educational Savings Plan

Income earned in a RESP is not taxed in Canada until it is removed from the RESP. The US requires that income from an RESP that was established by a US citizen be taxed in the hands of the US citizen in the year that it is earned. Because no tax is paid in Canada, the US citizen cannot take a foreign tax credit against taxes due against this income in the US. When the income is taken from the RESP in Canada, taxes are paid on this income. Because this income has already been declared in the US, it does not have to be declared again. You cannot take a tax credit in the current year in the US for taxes paid on Canadian source in past years.

The US citizen pays taxes twice on the same income, once to the US and once to Canada.

To add insult to injury, in the year the income is earned and taxed in the US, the US also imposed tax on the Canadian government's contribution to the RESP.

Investments in a Registered Disability Savings Plan

The tax treatment is similar to the RESP.

Investments in a Tax Free Savings Account

Income earned in a TFSA is not taxed in Canada when it is removed from the TFSA. The US requires that income from a TFSA that was established by a US citizen be taxed in the hands of the US citizen in the year that it is earned. Because no tax is paid in Canada, the US citizen cannot take a foreign tax credit against taxes due against this income in the US. When the income is taken from the TFSA in Canada, no taxes are paid on this income.

The TFSA is similar to a Roth Account in the US. The RRSP is similar to an IRA. This similarity between the RRSP and the IRA is recognized in the US-Canada Tax Treaty. The similarity between the TFSA and the Roth is not. The US citizen investing in a TFSA in Canada will not get the full benefit of the TFSA.

Investments in Canadian Mutual Funds

Canadian mutual funds may not pay out all of the income they earn in a fiscal year. If all of the income is not distributed this is reflected in an increased value of the mutual fund (its net asset value rises). If an owner of the Canadian mutual fund sells shares in the fund

before the income is distributed, the owner will realize a capital gain. The capital gain is taxed at a lower rate than the income that was not distributed would have been taxed if it had been distributed. The US views this as an attempt at avoiding taxes on the income the US citizen's asset earned.

The US requires that in addition to paying taxes on the income distributed by the mutual fund (as does Canada), holders of Canadian mutual funds must also report and pay taxes on the undistributed income in a fiscal year. The rate that the taxpayer will pay in the US will not be at the capital gains rate but at a higher rate. When the individual realizes the gain in Canada, the individual will again pay taxes, but will be unable to take a credit based on these taxes against the tax paid on the undistributed income in some earlier year. Not only is the tax credit lost, but the rate paid to the US will be greater than the rate paid in Canada. With respect to the taxes due in Canada, the US citizen in Canada is more than "double taxed."

In relation to US taxes on a Canadian Mutual fund, if a US citizen has not been paying taxes on the unrealized income of the fund while he/she held the fund, the sale of a Canadian mutual fund triggers a convoluted tax process by which the tax payer must divide up the capital gains over the period of time that this asset was held before it was sold. The taxpayer must then pay a tax at the current marginal tax rate for the proportion of the gain attributed to the year of the sale. For the proportion of the sale attributed to previous years, the tax rate is the maximum rate that was in force for that year. In addition, interest must be paid on the attributed unpaid balances in each year from the year of the attribution until the year of the sale.

Notice that the objective is to make sure that the US citizen does not avoid taxes on income earned in the year that it was earned by keeping it in an investment vehicle that permits the delayed receipt of income. Essentially, the Canadian mutual fund is structured to permit a person to delay paying taxes now and paying taxes at a future date at a lower tax rate.

Gains from the Sale of a Principal Residence

No capital gains are paid on the sale of a principal residence in Canada. If you are US citizen, however, you must file this capital gain on your income tax return. There is a lifetime $250,000 [US] capital gains exemption for a principal residence. If you are successful in selling a series of principal residence homes during a rising market, you may have to pay a substantial amount in capital gains taxes to the US (but nothing in Canada).

You cannot take a foreign tax credit in Canada for taxes you pay in another country on Canadian income.