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Moving To Canada After The Presidential Election? Be Careful With Taxes

Some voters say they will move to Canada if Trump is elected, while others say they will leave if Clinton is elected. Most people in both camps are probably not serious. Even those who are serious may mean temporarily, not a permanent move. Hollywood stars in particular could probably keep working as they are with minor inconvenience. But there are tax consequences. Unless you give up your U.S. citizenship, even if you move abroad, you still must file your Form 1040 every year with the IRS.

Even if you earn all your money abroad, the IRS gets to tax it. You must report your worldwide income regardless of whether you ever set foot in the U.S. State taxes are another matter, and a move abroad–even one that is politically motivated–might save you plenty in state taxes. Not so with the IRS. America's global income tax compliance and disclosure laws can be a burden, especially for U.S. persons living abroad. Foreign banks are sufficiently worried about keeping the IRS happy that many no longer want American account holders.

Americans living and working in foreign countries must generally report and pay tax where they live. But they must also continue to file taxes in the U.S., where reporting is based on their worldwide income. Claiming a foreign tax credit generally does not eliminate double taxes. What's more, the annual foreign bank account reports called FBARs carry big civil and criminal penalties. Enforcement fears are palpable, and even civil penalties can quickly consume the balance of an account.

Some of this is due to FATCA, the Foreign Account Tax Compliance Act, which compels non-U.S. banks to inform on American depositors. It also requires an annual Form 8938 filing if your foreign assets meet a threshold. One more law adding to the mix: the IRS even has the power to revoke passports. But no matter how much you are fed up with taxes and politics, leaving America can be costly. To exit, you generally must prove 5 years of IRS tax compliance.

Plus, if you have a net worth greater than $2 million, or have average annual net income tax for the 5 previous years of $160,000 or more, you pay an exit tax. It is a capital gain tax, calculated as if you sold your property when you left. A long-term resident giving up a Green Card can be required to pay the exit tax too. Sometimes, planning and valuations can reduce or eliminate the tax, but it is nothing to ignore. In 2015, there were approximately 4,300 expatriations, and 2016 is on pace to exceed it.

So if you move to Canada after the election, but keep your U.S. citizenship, is there any tax savings? There might be if you are careful. A key question will be whether you are still a state resident or domiciliary. Most people find it is easier tax-wise to move from State X to State Y than to move overseas. Let's say State X is California–with a 13.3% tax–and State Y is Texas or Washington, both with no state income tax.

Any move analysis is comparative. Where do you own property, vote, have a driver's licence, vehicles registered, etc? But more than with a state move, many people who move abroad seem to keep ties to their old state. And that can make a later state tax fight tougher. One key variable is the duration of your move. A temporary move out of your high tax state probably doesn't count. If you plan to come back, you are probably still fully taxed there.

You can have only one domicile, and it depends on your intent. How do you measure intent? Objective facts, and many are relevant. Start with where you own a home. If you own several, compare size and value. Consider if you claim a homeowner's property tax exemption as a resident. Where your spouse and children reside counts too, as does the location where your children attend school. And the details matter.

Presumably not many people will exit the U.S. after the Presidential election, regardless of who is elected. Those who do will probably keep their U.S. citizenship, but they might want to consider giving up their old state's residency. Most states have a state income tax, and their impact varies. But if you play your cards right, you might at least be able to save on state taxes.

For alerts to future tax articles, email me at Wood@WoodLLP.com. This discussion is not legal advice.