



Wealth
Management

the Navigator

INVESTMENT, TAX AND LIFESTYLE PERSPECTIVES FROM RBC FAMILY OFFICE SERVICES

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Taxation of a tax-free first home savings account (FHSA) for U.S. persons

Understanding the U.S. tax implications

An FHSA is a registered account to help Canadian residents save on a tax-free basis to purchase their first home. Contributions to an FHSA are tax deductible and qualifying withdrawals to purchase a first home are tax-free for Canadian tax purposes. U.S. persons who hold an FHSA may be subject to additional tax and filing requirements. The Internal Revenue Service (IRS) has not provided any specific guidance on the U.S. treatment of FSAs. Until the IRS issues an official position, all parts of this article are based on the unofficial assumption that the FHSA receives no special status for U.S. tax purposes. It's important to seek advice from a qualified cross-border tax advisor before opening an FHSA.

This article is intended for U.S. citizens and other persons considered to be U.S. residents for U.S. income tax and U.S. transfer tax purposes who reside in Canada. The information provided is based on U.S. federal tax and the Canada-U.S. income tax treaty (Treaty). For U.S. tax purposes, a spouse refers to a person to whom you are legally married (it does not generally include a common-law partner). Therefore, any reference to a spouse in this article refers to a legally married individual only. This article also assumes you have a basic understanding of the Canadian tax benefits of an FHSA. If you would like further information on the FHSA, please ask your RBC advisor for a separate article.



Overview of the U.S. tax system

Foreign trust rules

The U.S. income tax system includes complex non-U.S. trust rules (referred to as the U.S. foreign trust rules). A detailed discussion of the U.S. foreign trust rules and filing requirements is beyond the scope of this article. However, as a general overview, these rules may affect U.S. persons who are involved with a non-U.S. trust (a foreign trust). The tax implications to a U.S. person who has an interest or involvement with a foreign trust depends on whether the foreign trust is classified as a foreign grantor or foreign non-grantor trust, as well as the person's role in the trust (i.e. owner, contributor or beneficiary). An FHSA that is set up as a trust may be treated as a foreign trust for U.S. income tax purposes. In this article, it's assumed this is the case.

U.S. transfer tax

The U.S. transfer tax system consists of a U.S. gift tax, U.S. estate tax and U.S. generation skipping transfer tax (GSTT). The U.S. transfer tax system is discussed in greater detail in a separate article that you may obtain from your RBC advisor. However, as a general overview, U.S. gift tax may apply to gifts made during your lifetime and U.S. estate tax may apply to the fair market value (FMV) of property you own upon your death. GSTT imposes another layer of gift or estate tax if you make a taxable gift or bequest to a "skip person" such as a grandchild or great-grandchild.

U.S. tax treatment

Contributions to an FHSA

For U.S. tax purposes, an FHSA is not a tax-free account and contributions would not be deductible from income for U.S. tax purposes. An FHSA set up as a trust may be classified as a foreign grantor trust to a U.S. person who makes contributions to the plan.

You will generally be subject to U.S. income tax annually on investment income, including realized capital gains, in your FHSA. In addition, if you hold passive foreign investment companies (PFICs) in your FHSA, you may also be subject to the PFIC rules. If you would like more information on the PFIC rules, please ask your RBC advisor for a separate article on this topic.

If you have paid Canadian taxes on other investment income in the current or prior years, you may have accumulated unused foreign tax credits under the U.S. tax rules. You may be able to use these foreign tax credits to reduce your U.S. income taxes on income and capital gains earned in your FHSA.

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As mentioned above, the FHSA may be classified as a foreign grantor trust and you may be subject to foreign trust filing. In recent years, the U.S. government has provided some relief from the foreign trust filing requirements for certain tax-favored de minimis savings trust. You should speak with your qualified cross-border tax advisor to understand if this relief applies to your FHSA.

You should also consult with your qualified cross-border tax advisor to determine if you should set-up and contribute to an FHSA. In particular, you'll want to consider the after-tax return of investing in this plan, taking into account both the Canadian and U.S. tax implications of doing so and any additional U.S. tax preparation fees you may incur.

Withdrawals from an FHSA

For Canadian tax purposes, a withdrawal from your FHSA that is treated as a qualifying withdrawal is generally not subject to tax.

Withdrawals from your FHSA can also be received tax-free for U.S. tax purposes, although additional reporting may be required.

Closing an FHSA

For Canadian tax purposes, your FHSA will need to be closed by the earlier of December 31 of the year you turn age 71 or December 31 of the 15th anniversary of first opening the account, if you have not used the funds to purchase a qualifying home. The proceeds of an FHSA may also be transferred to your registered retirement savings plan (RRSP) or registered retirement income fund (RRIF) on a tax-deferred basis and future withdrawals from your RRSP or RRIF will be taxable.

The transfer from an FHSA to an RRSP/ RRIF should not be subject to U.S. tax. However, any income earned, and capital gains realized within the FHSA prior to the transfer is still fully taxable for U.S. tax purposes. Speak with a qualified cross-border tax advisor for tax advice on whether such a transfer is recommended.

U.S. transfer tax implications

Gifts to your spouse to contribute to their FHSA

In general, you cannot contribute to your spouse's FHSA directly (as only a holder can contribute to their own FHSA). However, if you gift funds to your spouse to enable them to make contributions, you may be exposed to U.S. gift tax if your spouse is not a U.S. citizen and to the extent you exceed the available gift tax annual exclusion for gifts to a non-U.S. citizen spouse.

If your spouse is a U.S. citizen, there is no U.S. gift tax for funds gifted to them that are contributed to an FHSA. Your U.S. citizen spouse will be subject to the same U.S. tax and foreign trust reporting requirements in respect of their FHSA, as discussed earlier in this article.

Taxation of an FHSA upon death

Upon death, the FMV of the property in your FHSA will not be subject to U.S. estate tax if the beneficiary or successor holder of your plan is your U.S. citizen spouse.

If your beneficiary or successor holder is your non-U.S. citizen spouse, or is someone other than your spouse, you may be subject to U.S. estate tax on property held in your FHSA, to the extent any credits or deductions you may be entitled to do not otherwise eliminate or defer your tax liability.

U.S. beneficiary or successor holder

A U.S. beneficiary or successor holder of your FHSA is not exposed to U.S. income or U.S. transfer tax during your lifetime.

You may be able to designate your spouse as a successor holder, provided your surviving spouse meets the eligibility criteria to open an FHSA. The plan would continue with your spouse as the new plan holder. Where a U.S. citizen spouse is the successor holder of your FHSA, the FHSA will be classified as a foreign grantor trust and your U.S. citizen spouse will be subject to U.S. tax and the foreign trust reporting requirements discussed earlier.

If your surviving spouse is not eligible to open an FHSA, the proceeds of the plan may be transferred on a tax-deferred basis to your spouse's RRSP/RRIF; otherwise, the proceeds will need to be withdrawn and subject to Canadian tax. If your spouse is a U.S. citizen, the transfer of the proceeds of the plan should not be subject to U.S. tax. However, any income earned, and capital gains realized within the FHSA after your death, but prior to the transfer, is still fully taxable for U.S. tax purposes.

If your beneficiary or successor holder is your non-U.S. citizen spouse, or is someone other than your spouse, you may be subject to U.S. estate tax on property held in your FHSA, to the extent any credits or deductions you may be entitled to do not otherwise eliminate or defer your tax liability.

If you designate a U.S. person other than your spouse as the beneficiary of your FHSA, upon your death, the plan will be wound up and the plan proceeds will be distributed to them. For U.S. tax purposes, your FHSA may continue to be classified as a foreign grantor trust until your plan is wound up and a U.S. beneficiary would be taxable on any income and capital gains earned in the FHSA, even if it was not paid out. For Canadian tax purposes, the proceeds paid to your named beneficiary will be subject to tax in their hands.

There may be double taxation if the property in your FHSA is subject to U.S. estate tax and your beneficiary or successor spouse is also subject to Canadian income tax on the proceeds. You should discuss this with a qualified cross-border tax advisor to determine if any planning is available to prevent double taxation.

Summary

An FHSA may provide tax benefits and advantages for Canadian residents saving to purchase a qualifying home. However, where a U.S. person is the plan holder, U.S. tax laws must also be considered. If you're a U.S. person living in Canada, speak to a qualified cross-border tax professional for advice before participating in an FHSA.

This article may contain strategies, not all of which will apply to your particular financial circumstances. The information in this article is not intended to provide legal, tax or insurance advice. To ensure that your own circumstances have been properly considered and that action is taken based on the latest information available, you should obtain professional advice from a qualified tax, legal and/or insurance advisor before acting on any of the information in this article.



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