We learned from this response that the CRA is of the view that a testamentary CRT is not a gift by a GRE. As a result, no donation tax credit can be claimed in the year of death or the year prior to death.

More recently, CRA was asked whether the equitable interest in the CRT could be characterized as property that is substituted for the remainder interest in the property owned by the deceased at the time of death that is received by the GRE on and as a consequence of the death of the individual. If this argument was accepted, the rules that permit the GRE to use the donation tax credit in prior years would apply. In technical interpretation 2017-0734261E5, the CRA provided its views on the application of subsection 118.1(5.1) of the *Income Tax Act* to this issue.

CRA explained that an equitable interest in a trust is created upon the transfer of any property to a trust with the requirement that the property be distributed to a beneficiary at some future date (i.e., when an income interest of another person ends). It has been the CRA's longstanding view that the subject of a gift to the qualified donee is not the property transferred to the CRT, but the equitable interest in the CRT. More particularly, the CRT receives the property and the qualified donee receives an interest in the CRT.

In order to determine whether an equitable interest in a CRT, to which the property is transferred, is considered to be substituted property for the property received by the GRE on and as a consequence of the death, CRA considered the ordinary meaning of the term "substituted property" and the extended meaning of substituted property in subsection 248(5) of the *Income Tax Act*.

The Canadian Oxford Dictionary (2001) defines "substitute" as follows:

> . . . A thing that is or may be used in place of another, often to serve the same function but with a slightly different effect. . . replace (a person or thing) with another. . .

Black's Law Dictionary (1999) defines "substitution" as follows:

> . . . the property by which one person or thing takes the place of another person or thing.

Subsection 248(5)(a) of the *Income Tax Act* provides that where there are multiple substitutions, the final property held will be considered to be substituted for the original property held.

CRA concluded that the equitable interest in the CRT is created as a result of the transfer of property to the CRT by the GRE. The gift of the equitable interest in the CRT is considered to have been made to the qualified donee when the property is transferred to the CRT, provided that the equitable interest in the CRT vests with the qualified donee at that time (and all other requirements are met). The GRE does not receive the equitable interest in the CRT in return for the transfer. CRA further explains that the property received by the GRE on and as a consequence of the death of the individual is not substituted property for or replaced by the equitable interest in the CRT received by the qualified donee. As a result, the equitable interest in the CRT is not property received by the GRE on and as a consequence of the death, or property substituted for that property. Therefore, subsection 118.1(5.1) does not apply.

However, the GRE may receive a donation receipt for the gift of the equitable interest in the CRT to a qualified donee and use the donation receipt in the year that the gift is made or any of the five following years.

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THINKING OF BECOMING A "TAX EXPATRIATE"? — WHAT YOU NEED TO KNOW

By Paul Bercovici, LL.B., Principal, Marks Paneth LLP

INTRODUCTION

Most countries that impose an income tax on individuals base the tax on residency. As a general rule, most countries tax residents on their worldwide income and tax nonresidents on income "sourced" to the country.[1] For example, many countries (including the US) tax nonresidents on income derived from the provision of personal services in the country and on passive income (for example, interest, dividends and royalties) that is "sourced" to the country. The US is one of the few countries in the world that taxes individuals on the basis of both citizenship and residency. A noncitizen of the US is considered to be a "resident alien" of the US (and therefore subject to US federal income tax on his or her worldwide income) if: (i) the individual is a "lawful permanent resident" of the US (i.e., a "green-card holder"); or (ii) if they meet the "substantial presence test"[2] for a particular taxation year. While it is true that in most cases US citizens who do not live in the US and who are subject to income tax in their country of residence will generally be entitled to relief from double taxation,[3] such individuals will wind up paying more tax than they otherwise would if the US tax rate on the particular item of income is higher than the rate imposed by the individual's country of residence.

There is a long history of individuals who have chosen to voluntarily relinquish their US citizenship or terminate their "lawful permanent residency" status in order to relieve themselves of the ongoing obligation to pay US federal income taxes and to file annual income tax returns (including all necessary international information returns).[4] After all, many reason, why should I pay US federal income

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1 For US federal income tax purposes, for example, interest is "sourced" to the residence of the payer of the interest and dividends are "sourced" on the basis of whether they are paid by a US or a foreign corporation.

2 For example, in determining whether or not an individual meets the "substantial presence test" for the 2021 tax year, the individual must be physically present in the US on at least:
1. 31 days during the 2021 tax year, and
2. 183 days during the 3-year period that includes 2021, 2020 and 2019, counting:
   a. All of the days that the individual was physically present in the US in 2021;
   b. 1/3 of the days that the individual was physically present in the US in 2020; and
   c. 1/6 of the days that the individual was physically present in the US in 2019.

3 Generally in the form of a foreign tax credit, but other forms of relief may also be available depending upon the domestic law of the country of residence and/or whether particular relief provisions of an applicable income tax treaty apply.

4 Examples of two well-known individuals whose "expatriation" appears to

taxes when I do not avail myself of any of the services available to me as a citizen and/or resident of the US. This argument has particular merit in the case of "accidental Americans" — that is, individuals who may, for example, have acquired US citizenship by virtue of the fact that one or both of their parents were US citizens at the time of their birth or as a result of having been born in the US while their parents were temporarily living in the US. This reasoning also applies to individuals who are "lawful permanent residents" of the US but who do not actually live in the US. This is especially true for the very significant number of US citizens and "green card holders" who live in Canada and who are subject to Canadian federal and provincial income taxes on account of being residents of Canada and who remain subject to US federal income tax[5] as a result of being US citizens or "lawful permanent residents" of the US. For the remainder of this article, the voluntary relinquishment of US citizenship and the termination of "long-term residency" by a "lawful permanent resident" of the US will be referred to as "tax expatriation" or "expatriation".

Evidence suggests that ever-increasing numbers of individuals have expatriated from the US in recent years and that this trend shows no real sign of abating.[6] As noted above, it is quite common, for example, for individuals who acquired US citizenship as a result of having been born in the US but who have lived pretty much their entire lives outside of the US, to voluntarily relinquish their US citizenship. In the not-too-distant past, there was no real tax cost associated with such individuals expatriating — in certain circumstances individuals could do so and generally be immediately relieved of any ongoing US federal tax paying and filing obligations. However, since June 17, 2008, there may be a very real income tax cost associated with becoming a "tax expatriate" in the form of an "exit" or "departure" tax. The aforementioned "exit" or "departure" tax is technically a "mark-to-market tax". This article will delve into the US federal income tax ramifications[7] associated with tax expatriation after June 17, 2008.[8]

HOW DOES AN INDIVIDUAL RELINQUISH THEIR US CITIZENSHIP OR TERMINATE THEIR "LONG-TERM RESIDENCY"?

US citizens who decide to voluntarily relinquish their US citizenship generally do so by renouncing their US citizenship before a diplomatic or consular officer of the US. In most cases, a "green card holder" terminates his or her "lawful permanent residency" by filing Department of Homeland Security Form I-407 with a US consular or immigration officer.

It is extremely important to note that where an individual invokes a residency treaty "tie-breaker" provision[9] contained in an income tax treaty entered into between the US and another country to take the position that they should be treated as a resident of the other country (and as a nonresident of the US for US federal income tax purposes), such act constitutes termination of residency by a "lawful permanent resident". US citizens are not permitted to invoke a residency treaty "tie-breaker" provision to take the position that they should be treated as a resident of the other country (and as a nonresident of the US for US federal income tax purposes).

For individuals who are interested in expatriating, the specifics regarding the process of voluntarily relinquishing US citizenship or terminating "long-term residency" (including what forms may need to be completed) should be checked with an immigration attorney who has the requisite experience with such matters.

WHO IS SUBJECT TO THE "MARK-TO-MARKET" TAX?

As a general rule, US citizens who voluntarily relinquish their US citizenship and "long-term residents" who terminate their "long-term residency" status are considered to have "expatriated" for US federal income tax purposes.

In 2008, Congress amended the expatriation tax provisions by enacting *Internal Revenue Code* ("IRC") Section 877A. IRC Section 877A sets out the rules regarding the imposition of the "mark-to-market" tax. For the purposes of the application of IRC Section 877A, the term "long-term resident" means an individual who was a "lawful permanent resident" of the US for at least 8 of the 15 tax years ending with the year the individual ceases to be a "lawful permanent resident".

The IRC Section 877A mark-to-market tax applies only to "covered expatriates". The term "covered expatriate" includes:

(i) A US citizen who relinquishes their US citizenship or a "long-term resident"[10] who terminates their "lawful permanent residency" status, if the individual:

1. Has an average annual net income tax liability for the 5 preceding tax years ending before the expatriation date that exceeds $171,000 for calendar year 2020 (the "Tax Liability Test");[11]

have been tax motivated include Tina Turner and Facebook co-founder Eduardo Saverin.

5 Depending on the particular facts and circumstances, such individuals may also remain subject to certain state & local income taxes, if for example, an individual remains a "domicile" of a particular state or locality. For more information see footnote 7.

6 For the first three quarters of 2020, the US Department of the Treasury reported that the number of individuals who expatriated was 6,047. This total exceeded the previous high total for an entire year (5,411 in 2016). See, "The ABCs of Expatriation in These Chaotic Times", Holland & Knight (December 7, 2020).

7 The determination of liability for particular state and local income taxes is an entirely separate and distinct exercise. Unlike the federal income tax laws, state and local laws for determining liability to taxation are in no way tied to citizenship or lawful permanent residency status for US federal immigration law purposes. Among those states and localities that do impose an income tax, the determination of residency is generally based on whether an individual is "domiciled" in the particular state or locality or whether the individual meets certain "statutory residency" tests.

8 This article does not consider the federal estate and gift tax issues associated with an individual becoming a "tax expatriate".

9 For example, Article 4, paragraph 2 of the US-Canada Income Tax Treaty provides that where an individual is treated as a resident of both the US and Canada by application of the respective country's domestic law, the individual is entitled to apply a series of "residency tie-breaker" tests to determine a single country of residency for the purposes of the treaty. The tests are applied sequentially until a determination can be made that the individual should be treated as a resident of one country (and as a nonresident of the other) for the purposes of the treaty.

10 As noted above, the term "long-term resident" refers to an individual who was a lawful permanent resident of the US for at least 8 of the 15 tax years ending with the year the individual ceases to be a lawful permanent resident.

11 For the purposes of the Tax Liability Test, an individual who files a joint federal income tax return must take into account the net income tax that is reflected on the joint income tax returns. Based on past experience, this amount increases every year.

2. Has a "net worth" of $2 million or more on the date of expatriation (the "Net Worth Test");[12] or
3. Fails to certify under penalties of perjury that he or she has complied with all US federal tax filing and payment obligations for the 5 tax years preceding the tax year that includes the expatriation date (the "Certification Test").

An individual determines their "net worth" for the purposes of the "mark-to-market" tax by completing a detailed balance sheet as of their date of expatriation. Taxpayers are permitted to use good faith estimates in determining the fair market value and basis of assets and liabilities reported on the balance sheet. Taxpayers are not required to obtain formal appraisals in determining the fair market value and basis of assets which they own as of the date of expatriation. The Instructions for Form 8854[13] provide that where a taxpayer has experienced "significant changes" in the amount of assets and liabilities for the period that began five years before the date of their expatriation, they are required to attach a statement to Form 8854 explaining such changes. The Instructions for Form 8854 do not provide any additional guidance as to the meaning of the term "significant changes".

EXCEPTIONS TO BEING TREATED AS A "COVERED EXPATRIATE"

As a general rule, "dual citizens" and certain minors are not treated as "covered expatriates" for the purposes of the potential application of the "mark-to-market" tax.

In order to qualify for the "dual citizen" exception:

1. The individual must have become, at birth, a US citizen and a citizen of another country and who, as of the expatriation date, continues to be a citizen of, and taxed as a resident of that other country; and
2. The individual must have been a resident of the US for not more than 10 years during the 15 year period ending with the tax year during which the expatriation occurrs.

In order to qualify for the exception available to certain minors:

1. The individual must have expatriated before they were 18 1/2 years of age; and
2. The individual must have been a resident of the US for not more than 10 years before the expatriation occurs.

MECHANICS OF THE "MARK-TO-MARKET" TAX

IRC Section 877A is applicable to "covered expatriates" who "expatriate" on or after June 17, 2008. IRC Section 877A provides that "covered expatriates" are subject to US federal income tax on the net unrealized gain in their property as if the property had been sold for its fair market value on the day before their date of expatriation. For the 2020 tax year, the "mark-to-market" tax applies to any net gain on the deemed sale of the individual's property to the extent the gain exceeds $737,000.[14]

Certain assets owned by an individual on the date of expatriation are not subject to the "mark-to-market" tax. These excepted assets include certain deferred compensation items, specified tax deferred accounts and interests in nongrantor trusts. A detailed description of the types of assets that are considered to be assets exempt from the application of the "mark-to-market" tax is beyond the scope of this article. Tax professionals are advised to review the Instructions for Form 8854 as a starter in determining whether a particular asset is exempt from the application to the "mark-to-market" tax.

DEFERRAL OF THE PAYMENT OF THE MARK-TO-MARKET TAX

Taxpayers who are subject to the "mark-to-market" tax are entitled to make an irrevocable election to defer the payment of the tax. Taxpayers who make the election to defer the payment of the "mark-to-market" tax are subject to certain rules, including the following:

- The election must be made on a property-by-property basis;
- The deferred tax is due on a particular property on the return for the tax year in which the property is actually disposed of;
- Interest is payable on the deferred tax amount; and
- Adequate security must be posted (e.g., in the form of a bond).

OBLIGATION TO FILE IRS FORM 8854

Taxpayers are required to attach IRS Form 8854 to their income tax return for the year that includes the date of expatriation. Form 8854 is due by the due date of the tax return (including extensions).

In addition, taxpayers are required to file Form 8854 on an annual basis if they expatriated in a prior year and:

1. Deferred the payment of tax on any property on a Form 8854 filed in a previous year;
2. Reported an eligible deferred compensation item on a Form 8854 filed in a previous year; or
3. Reported an interest in a nongrantor trust on a Form 8854 filed in a previous year

Certain monetary penalties may apply where a taxpayer fails to timely file a complete and accurate Form 8854, unless the taxpayer can demonstrate that the particular failure was due to "reasonable cause" and not due to "willful neglect". In practice, the "reasonable cause" standard can be a very difficult standard to reach.[15]

Conclusion

Individuals who are considering relinquishing their US citizenship or voluntarily terminating their "lawful permanent residency" status should give very careful thought to the income tax implications associated with doing so. US citizens and "long-term residents" may subject themselves to the application of the IRC Section 877A

[12] The Net Worth Test appears to apply to taxpayers on an individual basis. As a result, the Net Worth Test is applied to married couples that file joint federal income tax returns on an individual basis (i.e., each spouse determines whether their "net worth" exceeds $2 million separately).

[13] Initial and Annual Expatriation Statement. Discussed in greater detail later in this article under the heading "Obligation to File IRS Form 8854".

[14] This amount is indexed annually for inflation.

[15] For a more detailed discussion of the "reasonable cause" standard see the authors' article entitled "Don't Forget About International Information Returns — It Could Cost You (Dearly)!, published in the November 2020 edition of Taxes &Wealth Management.

"mark-to-market" tax as a result of relinquishing their US citizenship or voluntarily terminating their "lawful permanent residency" status. As a general rule, a US citizen or "long-term resident" will be subject to the IRC Section 877A "mark-to-market" tax on the net unrealized gain on certain property which they own if:

i. Their average income tax liability for the five years ending before the date of expatriation exceeds a certain amount;

ii. Their "net worth" is 2 million dollars or more on the date of expatriation; or

iii. They fail to certify that they have complied with all of their federal income tax filing and payment obligations for the 5 tax years preceding the date of expatriation.

There are certain very limited exceptions to the application of the "mark-to-market" tax. However, in situations where the tax does apply it can be extremely onerous. Individuals who are contemplating becoming "tax expatriates" are well advised to retain the services of a tax professional who is very well versed in all of the issues associated with "tax expatriation" before they take steps to initiate the process.

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THE RELATIONSHIP BETWEEN PERSONAL DIRECTIVES AND GOALS OF CARE (ALBERTA)

By Emily Smyth, Associate, Miller Thomson LLP

In Alberta, a person's medical care team uses a document called a "Goals of Care Designation Order," or "GCD", to set out the types of medical care to which a patient does or does not consent, and to guide the delivery of treatment in a manner compatible with the patient's goals and values. In addition, many Albertans have, through a document called a personal directive, designated a substitute decision-maker to act on their behalf in the event they become incapable of making their own personal and health care decisions. The personal directive may also include guidelines or instructions with respect to the types of medical care that the person considers acceptable. In situations where both a GCD and a personal directive are in place, the question becomes "how do they work together?" As this is a question that comes up regularly, it is clear that many people do not understand the relationship between these documents. To begin exploring this relationship, it is necessary to understand the nature and effect of each document on its own. This article is only about the situation in Alberta, and uses terminology found in the relevant Alberta legislation and forms.

A personal directive is a document that a person (the "maker") signs while they have mental capacity. The document appoints someone else (an "agent") to make personal and health care decisions on the maker's behalf in the event the maker loses capacity to undertake those decisions on their own. Personal and health care decisions include everything from medical treatment and health care, to where a person lives and what they wear. When the personal directive becomes effective, the agent steps into the role of determining questions of personal and health care on behalf of the maker. As a personal directive does not come into effect until the maker has lost capacity, these documents also often include guidance with respect to the maker's values, beliefs, and ideas about acceptable care, to guide the agent's decisions. This guidance can come in the form of strict instructions (e.g., "I do not consent to receiving a blood transfusion, regardless of the circumstances or likely success of the procedure"), or in more general value statements (e.g., "I want access to all diagnostic and therapeutic treatments which are designed to improve my condition and may assist me to regain the capacity to make my own decisions"). When making personal and health care decisions on behalf of the maker, there is generally a need for the agent to consult with medical care teams and/or other experts and organizations. During these consultations, and in ultimately making a decision on the maker's behalf, the agent has a duty to follow the instructions set out in the personal directive. This helps ensure that the maker is cared for in a way that aligns with their values and goals. If the maker regains capacity, the personal directive becomes ineffective, allowing the maker to once again undertake their own decisions. The maker directs the preparation and details of the personal directive, and so long as they have capacity, is in almost total control of the provisions of the document.

By contrast, the GCD is a form that is filled out by a medical practitioner in consultation with a patient. It is often done on admission to hospital, but it can also be filled out in a visit to a family doctor, at a care facility, or other medical clinic. The GCD deals only with medical care. The idea is to put into medical terms, by way of a shorthand designation, the patient's goals and values with respect to medical care. There are three main designations of care, namely, resuscitative, medical, and compassionate. These broad designations have multiple sub-designations, depending on the patient's situation and wishes. Each designation correlates to a particular level of treatment, providing the care team with guidance on the types of treatment to which the patient consents. These designations can be updated anytime and should be changed as circumstances evolve. The main use of the GCD is in emergency or critical situations, where it is used by the medical team as a quick reference to understand the patient's wishes. A GCD is not intended to be a substitute for discussions with the patient or as the final say on a decision. It is merely used to guide the medical team when the patient is incapacitated or unable to communicate their decisions and there is no authorized person present to speak on the patient's behalf. A good indication of the intended purpose of this document is the fact that patients are often encouraged to keep the GCD on top of their refrigerator, as this is where paramedics may look for important medical documentation if they are called to a person's home in an emergency.

As is likely clear by now, while both the personal directive and GCD work to provide guidance with respect to a person's medical care when that person is unable to make their own decisions, the particular circumstances in which each document operates are different. The personal directive is used for long-term planning, comes into effect on the maker's incapacity, and may be in effect for days, weeks, or even months or years. If decisions with respect to medical treatment need to be made, the agent will either consent to or decline various treatment plans on the maker's behalf, using the guidance set out in the personal directive to inform their decision. In contrast, the GCD is intended to be used as a temporary measure, when the patient or their substitute decision maker is unable to make a decision on the patient's behalf. This situation most often