

# Moving to the U.S.

Leaving Canada and moving to the United States can be an overwhelming event for both advisors and their clients.

Each year, approximately 30,000 Canadians move to the U.S. with little or no idea of the complexities. Often, the many similarities in culture, currency, language and consumer goods lead many transferring clients to believe their situation is simple. In fact, the differences in taxation, investing, health-care, and wills and estate planning are profound.

Let's look at some of the financial planning considerations applicable to a person emigrating from Canada to the U.S. for employment, with the caveat that this overview can't provide a complete review of every technical aspect of a client's move. While each individual situation is different, any Canada-U.S. transition plan should include an analysis of eight areas:

1. Immigration planning looks at legal requirements the client must consider before living and working in the U.S. on a permanent or temporary basis.
2. Customs planning addresses relocating the client's physical assets to the U.S.

3. Cash management planning includes development and review of the client's net-worth statement (see Net Sheet, page 10), location of assets, currencies and a review of the cash inflows and outflows that will take place during a move.

4. Income tax planning reviews the client's current and projected tax situation for opportunities to reduce current and future tax liability both before and after making the big move.

5. Independence planning develops detailed projections using current assets, projected income and expenses to determine the client's ability to be financially independent given his lifestyle objectives while in the U.S., or in some cases upon return to Canada.

6. Risk management examines the client's situation for risk exposures such as illness, disability, death or incapacity, and determines the best courses of action to address them.

7. Estate planning reviews the level of control clients want in managing their assets in the event of incapacity or death, and puts the necessary documents in place to achieve that control.

8. Investment planning reviews the client's current investments and

## TAKE THE TEST!

- Carefully read the article, "Moving to the U.S.," by Brian Wruk and Terry Ritchie.
- Then visit [www.cecorner.advisorce.com](http://www.cecorner.advisorce.com) to register and answer a multiple-choice exam about the material.
- A CE Certificate will be issued electronically through the website after you pass the exam with a score of 65% or greater.

## OBJECTIVE

"Moving to the U.S." is eligible for the following CE credits, accredited by the following organizations:

- 1.00 Advocis**
- 1.00 Investment Dealers Association of Canada**

determines the best allocation, currency and location of assets when moving to, and living in, the U.S.

Kevin Hazleton has been a senior executive with an oil and gas company in Calgary for the past 13 years and recently accepted an offer with the U.S. affiliate in Houston, Texas. Kevin, 52, is married to Sherri, 48, and they have four children: Jake, 22; McKenna, 17; Chase, 13; and Evan, 10. McKenna, Chase and Evan will be moving to Texas with the family, but Jake will remain in Canada to finish university.

Kevin has been offered an annual salary of US\$220,000 with the opportunity to receive a bonus of up to 25% of annual compensation.

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**NET SHEET** The financial position statement must look at values in both currencies.

Description	Current Values		Ownership of Assets
	CDN\$ \$1.00	US\$ \$0.8455	
<b>Cash &amp; Equivalents</b>			
Chequing	\$12,750	\$10,780	Kevin
Family Chequing	\$6,534	\$5,524	Joint
Family Savings	\$36,975	\$31,262	Joint
Subtotal	\$56,259	\$47,567	
<b>Investment Assets</b>			
C\$ Managed Investment Portfolio	\$2,236,221	\$1,890,725	Kevin
U\$ Managed Investment Portfolio	\$965,755	\$816,546	Kevin
Various Mutual Funds	\$480,651	\$406,390	Joint
Various Mutual Funds	\$210,991	\$178,393	Sherri
Subtotal	\$3,893,618	\$3,292,054	
<b>Retirement Assets</b>			
RRSP	\$725,334	\$613,270	Kevin
RRSP	\$127,553	\$107,846	Sherri
Subtotal	\$852,887	\$721,116	
<b>Personal &amp; Real Estate</b>			
Personal Residence in Canada	\$1,750,000	\$1,479,625	Joint
Automobiles	\$65,000	\$54,958	Joint
Personal Effects	\$150,000	\$126,825	Joint
Subtotal	\$1,965,000	\$1,661,408	
<b>Totals</b>	<b>\$6,767,764</b>	<b>\$5,722,144</b>	

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Kevin's employer has agreed to cover the costs of his move as well as the legal fees for U.S. immigration purposes. The Hazletons are looking forward to the opportunity, but uncertain as to whether they'd like to live there on a permanent basis. They have friends who live in Texas and became U.S. citizens (dual citizens U.S./Canada) and the Hazletons are curious about the implications of such a decision for their own family. They plan to move by the end of this May.

#### U.S. Immigration Planning

The Hazletons need some form of legal status to reside in the U.S., so a well-planned immigration strategy is the foundation of

any Canada-to-U.S. move, and the first step in a proper transition plan. Poor planning can cause many complications.

Since the move is through an American company related to his Canadian employer, Kevin is eligible for a U.S. L-1 employment visa through that employer. This visa is initially issued for two years and can be renewed for a total of seven.

Given the Hazletons' potential desire to reside permanently in the U.S., this visa can ultimately lead to lawful permanent residence (through the issuing of a U.S. green card) and eventually citizenship. Sherri and the children were issued L-2 visas as dependants of Kevin. The L-2 visa allows Sherri to work in the U.S.

#### Customs Planning

In most cases, it's best to either sell personal goods in Canada before moving or only bring required items. Leaving valuable or simply a large volume of items in Canada could be considered a significant enough tax tie for the CRA to assume an intention to return, and such an indication can compromise a non-resident tax filing position.

To ease their move, the Hazletons will need to file U.S. Customs Form 6059B—*Customs Declaration*, which requires a complete inventory of all goods they'll bring into the U.S. The family should not cross the border with cash, traveller's cheques, money orders, stock or bond certificates, or other negotiable financial instruments exceeding \$10,000 in

either currency. Doing so will require the filing of specific Canada Border Agency and U.S. Department of Treasury forms. Instead, they should wire large amounts of currency or investments from their Canadian bank or brokerage firm to their new U.S. bank or brokerage after arriving in the U.S.

To simplify things, it's best to sell motor vehicles in Canada prior to moving to the U.S. The Hazletons are likely to get a higher price in Canada because the cars may not meet U.S. emissions and safety standards, and the instruments are denominated in kilometres rather than miles. Depending on the year, make and model of their vehicles, the Hazletons might also be required to pay customs duties. They are also required to complete U.S. Department of Transportation Form HS-7—*Declaration* and Environmental Protection Agency Form 3520-1—*Import Declaration*. In all, car importation is a hassle best avoided.

### Cash Management Planning

First, develop a net-worth statement that lays out assets and liabilities the Hazletons might have, and address any planning opportunities or obstacles that might occur when they move. Next, review their net worth to look for strategies to improve the Hazletons' overall financial position during their transition. Then you need to advise the family to maintain a higher level of liquidity during the move to the U.S. to cover any unexpected expenses or requirements. After settling, the family should establish an emergency fund that covers three to six

months of living expenditures until they've firmly established their cost of living in the States.

Although the Canadian dollar has performed better than the U.S. dollar over the past few years, it's still difficult for the majority of Canadians to get over the hurdle of converting loonies to greenbacks. Currency speculation is difficult even for the experts, but given the Hazletons likely will be in the U.S. for a long time, they should start developing a plan to convert their Canadian cash. The Hazletons should pool as much of their cash as possible, together at one time, get competitive quotes from a few financial institutions, and then consider contacting a discount currency-exchange firm to concurrently exchange and wire funds directly to their accounts in the U.S.

Although the family has a good credit rating in Canada, it will likely be difficult to obtain credit in the U.S. In order to start establishing a credit rating and obtain a U.S.-issued credit card, the Hazletons should get a letter of reference signed by the manager of their Canadian bank. If they have access to their Canadian credit bureau file, they should have that available when making a U.S. credit application.

A copy of their Canadian credit file should be available from the Canadian subsidiaries of the credit-reporting agencies in the U.S. They should not apply for credit online or through the mail, but rather make a personal appointment at the U.S. financial institution where they'll bank. At this meeting they should have their original U.S. Social Security and Canadian Social Insurance

cards available, Canadian passports and U.S. immigration visas, along with a copy of Kevin's offer of employment, and if already working, his most recent pay stub.

### Income Tax Planning

Income tax is by far the most complex planning area in these kinds of transitions. Unfortunately, many individuals think moving to the U.S. will automatically lower their tax burden, so that becomes the sole determinant for the transfer. However, this isn't always the case (see *Tax Comparisons*, page 15). Despite lower overall marginal income tax rates, payroll tax rates are higher and certain state and local taxes also need to be considered. A good transition plan should quantify the client's initial and future projected tax position in the U.S. before the move. The results for the Hazletons could be entirely different relative to the utilization of U.S. or Canadian retirement plans, whether they owned a house with a mortgage, lived in a state that imposed income taxes or generated various sources of investment income.

The U.S. tax system offers several benefits not found in the Canadian system. Mortgage interest, property taxes, charitable donations, state income taxes and some sales taxes may be itemized and deducted from income. The ability for the Hazletons to deduct sales taxes should be an attractive benefit since Texas is one of seven states that does not have an income tax. If the sum of the Hazletons' itemized deductions does not exceed US\$10,700 (for 2007), they're entitled to take what is re-

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ferred to as the standard deduction.

In the U.S., married taxpayers are entitled to file either jointly or separately. Filing jointly allows a married couple to obtain the benefits of lower tax brackets for both husband and wife, even if only one spouse has an income.

For U.S. investments, interest income is taxed at ordinary marginal rates. Dividends are generally taxed at a maximum rate of 15% and capital gains generally at either a maximum rate of 15% (for the sale of investments held longer than one year) or at the taxpayer's respective marginal rate (for the sale of investments held less than one year).

The relatively low tax rates are partially offset by the high cost of U.S. Social Security (FICA) and Medicare taxes which individual employees are generally required to pay (see Filing Facts, page 17). Presently U.S. employment income is subject to a 6.2% FICA payroll tax (up to a maximum income threshold of US\$97,500 for the 2007 tax year) and a Medicare payroll tax of 1.45% of employment compensation (no maximum income threshold).

Kevin's employer would also contribute an equal amount for U.S. Social Security and Medicare tax. Assuming a base salary of US\$220,000, annual payroll taxes on this amount would be \$6,045 for FICA ( $\$97,500 \times 6.2\%$ ) and \$3,190 for Medicare ( $\$220,000 \times 1.45\%$ ). Conversely, the maximum payroll taxes in Canada would only be \$1,989.90 for CPP and \$720 for unemployment insurance.

For individuals moving to and

working in the U.S. on assignments not exceeding five years, there may be the opportunity to opt out of paying U.S. payroll taxes on income earned there. Through the filing of CRA Form CPT56—*Certificate of Coverage under the Canada Pension Plan Pursuant to Article V of the Agreement on Social Security between Canada and the United States*, an individual sent to the U.S. by a Canadian employer could continue to pay CPP contributions as opposed to paying FICA and Medicare taxes.

This exemption is only available if the move is through a Canadian employer affiliated with the new U.S. employer.

#### Ceasing Tax Residency

The determination of residency is very important, since a resident of Canada is taxable on his or her worldwide income. What's to be avoided is being a tax resident of both countries. The following factors are taken into account by the CRA when determining whether a Canadian has properly severed his or her residential ties:

- Do you have a permanent home available to you in Canada?
- Does your family live in Canada? (This typically refers to a spouse and children, not to parents.)
- Where are your social and personal ties—including church, social clubs and professional organizations?
- Where are your economic ties—including employment or business operations, bank accounts and driver's licence?
- Have you established residential ties to another country and are you resident in that country for

tax purposes?

- Do you intend to return to Canada at a later date?

To cease Canadian residency, there must be a degree of permanence to the client's stay abroad. Administratively, the CRA has indicated that if you are absent from Canada for two years or longer, you'll be presumed to have become a non-resident, provided you've severed your residential ties and established them in another country. The two-year rule does not, however, have strong support in law; so for greater certainty the Hazletons should take the following actions:

- Consolidate bank accounts and transfer the bulk of funds to a bank account in the U.S.
- Transfer or liquidate investments to a U.S. account and close their Canadian brokerage accounts.
- Tell all Canadian financial institutions to withhold non-resident tax from any investment income earned outside of their RRSPs. The tax withheld under the Canada-U.S. Tax Treaty (10% for interest, 15% for dividends) represents their final Canadian tax obligation with respect to this income and a Canadian tax return is not required to be filed to report this income.
- Apply for a driver's licence in the U.S. as soon as possible and then cancel the Canadian licence.
- Obtain credit cards with U.S. financial institutions and then cancel their Canadian cards.
- Terminate their Canadian health-care and other medical insurance coverage.
- Maintain a personal file outlining

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their efforts to cease residency in Canada.

The CRA has a questionnaire, Form NR73, that's used to establish an individual's residency status. We would recommend the Hazletons not voluntarily submit this form to the CRA. Once submitted, it can be difficult to change filing positions. However, the family might want to review this form, as it can give them a better idea of the kinds of questions the CRA could ask. Further information related to the CRA's position on residency determination can be found by reviewing CRA Form IT 221R3—*Determination of an Individual's Residence Status*. Both forms are available from the CRA website (<http://www.cra-arc.gc.ca/menu-e.html>).

#### Departure Tax

When leaving Canada, residents are generally considered to have

disposed of most property for proceeds equal to fair market value. If the fair market value of the property exceeds its cost base for income tax purposes, the individual must recognize a capital gain that's taxable in Canada on their final exiting Canadian tax return. The Hazletons would have the option of paying the tax on those gains when they file their tax return for the year they leave Canada or to defer payment until the property is actually sold (the CRA may require security for this option).

There are some exceptions: Canadian real estate, stock options, certain employer-sponsored pension plans and RRSPs will not be subject to the departure tax because there are specific exclusions in the rules for these types of assets. The Hazletons should maximize their RRSP contributions in the year of their move in order to mitigate the departure tax.

The Hazletons are required to file CRA Form T1161—*List of Properties by Emigrant* listing all significant assets worth more than \$25,000. This form is included with their T1 exit tax return that needs to be filed by April 30 of the year following their departure. To support their filings, the Hazletons should obtain documents supporting the valuations of their assets on the date they cease residency.

Since the Hazletons are scheduled to leave Canada at the end of May, they're subject to tax in Canada on their worldwide income up to the date of departure. They would be required to file their final Canadian income tax return for the period from January 1, 2007 until the day they depart in that year, by April 30, 2008. They would include their worldwide income up to the date of departure and any personal tax credits would be pro-rated up to

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#### TAX COMPARISONS Comparison of 2007 federal tax brackets for a Canadian living in Alberta with a U.S. resident. U.S. example does not include state or local taxes.

Canadian taxable income	Per return	U.S. taxable income	Filing single
0 – \$37,178	15.5%	0 – \$7,825	10%
\$37,179 – \$74,357	22%	\$7,826 – \$31,850	15%
\$74,358 – \$120,887	26%	\$31,851 – \$77,100	25%
\$120,888 +	29%	\$77,101 – \$160,850	28%
		\$160,851 – \$349,700	33%
		\$349,701 +	35%

  

Canadian taxable income (\$)	Per return	U.S. taxable income (\$)	Filing joint
0 – \$37,178	15.5%	0 – \$15,650	10%
\$37,179 – \$74,357	22%	\$15,651 – \$63,700	15%
\$74,358 – \$120,887	26%	\$63,701 – \$128,500	25%
\$120,888 +	29%	\$128,501 – \$195,850	28%
		\$195,851 – \$349,700	33%
		\$349,701 +	35%

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the departure date. Taxable income arising from a deemed disposition of their investment accounts would be reported on this final tax return. They would include CRA Form T1243—*Deemed Disposition of Property by an Emigrant of Canada* with their final filed Form T1. Form T1243 would list and calculate the amount of gain or loss on any of their assets subject to the departure tax.

### U.S. Federal Tax Filing

In the year the family exits Canada and takes up U.S. tax residency, they're required to file a U.S. start-up Form 1040. In the year of entry into the U.S., there are two ways the Hazletons can file their U.S. tax returns. First, they can file jointly and take an election under the Internal Revenue Code (IRC 6013(h)) to be considered residents for the entire year no matter when they physically moved (effectively, taking up U.S. tax residency on January 1); or they can file a dual-status tax return. That option includes a period of non-U.S. residence followed by a period of U.S. residence and they'd be taxed in the U.S. on their worldwide income for the resident period.

They would also be required to pay tax at higher marginal rates and forced to itemize their deductions and file separately. Therefore, it may be beneficial for the Hazletons to elect to be treated as full-year tax residents of the U.S.

Review each scenario to determine the optimal filing position for the first year of residency.

Given that Kevin, Sherri and

**FILING FACTS** Taxes paid by a married couple in the U.S. (Texas) filing jointly compared with the same couple filing in Canada (Alberta). The example assumes a US\$220,000 annual income.

	U.S.	Canada	Difference
Net Tax Payable*	\$59,635	\$70,632	\$10,997
Effective Tax Rate	27.11%	32.11%	5.00%
<b>Marginal Tax Rates:</b>			
Regular Income	28.00%	39.00%	11.00%

\* Includes U.S. FICA and Medicare Tax and Canadian CPP & EI contributions; excludes exchange rates

their children will all have legal U.S. immigration status, they will need U.S. Social Security Numbers (SSNs), which must be obtained through the Social Security Administration using Form SS-5—*Application for Social Security Card*. They must have these numbers for tax filing, dependant tax exemptions, employment and credit lending purposes.

U.S. individual income tax returns are generally due on April 15th of the year following the taxation year. Extensions of time to file are available if necessary. In the year of move, there are many filing options, so a good transition plan will look at each specific situation to determine which elections should be taken to ensure the Hazletons pay the lowest tax possible.

### RRSPs Remaining in Canada

For U.S. tax purposes, a resident of the U.S. who is a beneficiary of a Canadian RRSP is taxable in the U.S. in respect of income earned in that RRSP. Pursuant to the Canada-U.S. Tax Treaty, recognition of that income can be deferred until it's withdrawn. The election is made each year by attaching Form

8833—*Treaty Based Return Disclosure* to the U.S. tax return. Alternatively, IRS Form 8891—*U.S. Information Return for Beneficiaries of Certain Canadian Registered Retirement Plans* should be filed with the Hazletons' U.S. tax returns to defer the U.S. taxation of income accruing within their RRSPs. As a result, the Hazletons should crystallize the value of their Canadian RRSPs prior to departure. Crystallization is a process whereby a client initiates a sale in order to establish a new fair market value. This will be important for future U.S. tax purposes.

A U.S. resident who has an RRSP in Canada is prohibited from actively managing it while resident in the U.S. However, a resolution that allows U.S. residents to manage Canadian RRSP accounts was approved by the Securities and Exchange Commission and the Investment Funds Institute of Canada (IFIC) and Investment Dealers Association (IDA), in June 2000. The majority of U.S. state securities regulators have agreed to these resolutions.

As non-residents of Canada, the Hazletons may want to review

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the methods of withdrawing funds from their RRSPs. The Canadian Income Tax Act dictates lump-sum RRSP withdrawals are subject to a 25% withholding tax, while periodic payments from a RRIF (the greater of twice the annual minimum or 10% of the balance) are subject to a 15% withholding tax per the Canada-U.S. Tax Treaty. This withholding tax would become a foreign tax credit on the Hazletons' U.S. tax return and should offset any tax owing in the U.S. on any taxable amounts there.

### Estate Planning

The purpose of estate planning is to ensure the Hazletons' wealth is transferred smoothly, with a minimum of depletion, to their heirs. Many Canadians mistakenly believe they should get their Canadian wills updated before a move to the U.S. However, when moving to the U.S., wills and estates become much more complex and critical, particularly when property and beneficiaries reside in both countries and non-U.S. citizenship spousal issues are added.

The U.S. imposes estate and gift taxes on the transfer of property. Gift taxes are imposed on transfers made during the client's lifetime and estate taxes are imposed on transfers made at death. These taxes are generally based on the fair market value of the property transferred. Estate and gift tax rates are presently between 18% and 45%, depending on the size of the client's estate. The top U.S. estate tax rate is imposed for estates greater than US\$1.5 million.

U.S. residents are entitled to an exemption of estate tax on the first US\$2 million. As in Canada, at the death of the first spouse, the deceased's estate can transfer an unlimited amount of property to their surviving spouse without any current tax. However, this does not apply in the U.S. if the surviving spouse is not a citizen. In the Hazletons' case, given that neither Kevin nor Sherri are U.S. citizens, a special trust would need to be established through their will or revocable living trust—referred to as a Qualified Domestic Trust—to defer the level of estate tax passing to the surviving spouse that exceeds US\$2 million.

Laws in the U.S. governing wills and the succession of property generally come under state jurisdiction. Given the Hazletons will be residing in Texas, their new estate planning documents should be drafted reflecting the laws of that state. In addition to a new will, they should have general powers of attorney and living wills (also known in Canada as a personal directive) drafted by a lawyer.

Since they're non-U.S. citizens and may have assets in Canada and a beneficiary there (notably their son Jake), it's critical their estate plans contain specific language for their executor to consult the Canada-U.S. Tax Treaty for any estate or tax planning opportunities that could be available. We have seen many situations where a couple has moved from Canada to the U.S. and consulted with an attorney who simply assumed both members of the couple were U.S. citizens and in so doing, did the document drafting based on a template that failed

to address these unique estate planning considerations.

The couple should also look at revocable living trusts. These are more widely used in the U.S. than Canada because the income tax treatment of revocable trusts is transparent and not subject to a disposition tax at the time assets are settled into the trust. In some cases, trusts can be a far more effective means to manage and distribute the client's estate. Not only do trusts avoid probate, they also keep your affairs private at death. Given the Hazletons' primary desire is to benefit their children, and with one of them still living in Canada, the role of a U.S. trust could create adverse Canadian tax and administrative burdens.

Under proposed legislation in Canada, if a former Canadian resident (someone who has left Canada within five years) establishes a non-Canadian trust with Canadian resident beneficiaries, the trust is deemed to be a Canadian trust for income tax purposes. So, although the Hazletons will ultimately not be Canadian income tax residents, any trust they establish would be considered Canadian and therefore subject to Canada's more onerous tax burden for trusts.

To get around this, a U.S. trust could be utilized as part of their future planning under two scenarios. First, they could establish a trust five years after leaving Canada; or, second, wait until Jake was no longer a tax resident of Canada. Alternatively, they could exclude Jake as a beneficiary of their U.S. trust and perhaps earmark or fund an

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insurance policy to provide for him if such a plan proved cost-effective.

### Investment Planning

Thanks to the efforts of the IDA, when the Hazletons move to the U.S. they'll be able to leave their RRSPs in Canada and continue to manage them. However, they will need to ensure their Canadian investment dealer is properly registered with both the SEC and the state of Texas.

The Hazletons will need to close their Canadian brokerage accounts per Canadian and U.S. securities rules. Whatever can't be transferred will have to be sold and the cash moved to the U.S.

By far one of the most beneficial

areas in any transition to the U.S. is in the area of foreign tax credit planning. Upon exiting Canada, there are generally foreign tax credits created on the U.S. return, particularly when RRSPs are collapsed and moved to the U.S. The withholding on the collapse of these accounts becomes a foreign tax credit on the U.S. return. These credits have a life of the current year plus 10 years. Through proper tax planning, tax preparation and investment management, it is possible to use up some, and sometimes all, of these foreign tax credits before expiration. This requires an investment portfolio that generates passive foreign income (from outside the U.S.) or foreign pensions and wages for general limitation

foreign tax credits.

Once in the U.S., the Hazletons will see their overall investment expenses decline because of the more competitive U.S. investment product environment. There is also a larger selection of low-cost domestic and international mutual funds and transaction fees available at U.S. discount brokerages, which typically offer lower rates than in Canada. In addition, the Hazletons will find a number of tax-favoured investments available to them. For example:

- Municipal bond interest is not taxable by the IRS;
- Municipal bond interest from the client's state of domicile is not taxable by that state;

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- Federal bond interest is not taxable by the client's state; and
- Roth IRAs allow any gains, dividends or interest to grow tax-free (versus tax-deferred).

Although it would appear the Hazeltons could enjoy a greater level of tax relief in the U.S. than in Canada, it should not be the single determinant for their move. A comprehensive transition and financial plan will go a long way toward making their move as painless and worry-free as possible. **ce**

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*Brian Wruk and Terry F. Ritchie are the authors of The Canadian in America: Real-Life Tax and Financial Insights into Moving and Living In The U.S. available through ECW Press and [www.transitionfinancial.com](http://www.transitionfinancial.com). They are the principals of Transition Financial Advisors Inc. (U.S.) and Transition Financial Advisors Group Canada ULC. With offices in both countries, the firms provide comprehensive fee-only advice and offer comprehensive wealth-management services to clients in either country. Both are professionally designated in financial planning in both countries and Ritchie is licensed to practise before the U.S. Internal Revenue Service as an Enrolled Agent.*

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