Moving to the US

If you are considering permanently moving to the US, there are a number of important tax considerations in both Canada and the US that should be addressed such as immigration, health insurance, income tax implications in Canada and the US, what to do with your Canadian investments, new estate documents, etc. Here, we will be covering mostly the tax issues. There are some very good books that cover these issues in a more comprehensive fashion. We have provided some additional resources at the end of this discussion.

Residency

A resident of Canada is subject to Canadian income tax on worldwide income. A nonresident of Canada is subject to tax on income from Canadian sources, such as interest, dividends, rents, pensions, as well as bonuses and deferred compensation that was earned in Canada as a resident.

While a resident of the US is also subject to US income tax on worldwide income, the US is only one of three countries in the world that tax their citizens on their worldwide income regardless of where they reside. A nonresident, non-citizen of the US is subject to US income tax on income from US sources only.

The US and Canada allows a foreign tax credit for foreign income taxes paid on foreign source income. A credit is a dollar for dollar reduction in tax payable. The foreign tax credit is the primary method of avoiding double tax.

The US and Canada have similar, but different rules for determining residency. It is critical that you understand the basic residency rules so that you do not inadvertently become a resident and you greater control of the date of your residency.

Note: We will be giving you a bunch of rules with a lot of numbers in them, but don't assume that determining your beginning residency date is black and white. Determining your actual first day of residency is as much art as it is science.

<u>Canadian Residency</u>

The term resident is not defined by the Income Tax Act (the Act). The determination of Canadian residency is based on a number of factors based on common law and statutory provisions of the Act.

In common law, residency is based on the economic and non-economic relationships existing between the taxpayer and Canada. The concept of residency under Canadian domestic law is premised on the assumption that 1) every person must have a fiscal residence somewhere, and 2) it is possible for a person to be simultaneously resident in more than one country for tax purposes.

The Canadian Supreme Court case Thomson, noted:

> "*The graduation of degree of time, object, intention, continuity and other relevant circumstances, shows,…that is common parlance "residing" is not a term of invariable elements, all of which must be satisfied in each instance. It is quite impossible to give it a precise and inclusive definition. It is highly flexible and its many shades of meaning vary not only in the contexts of different matters, but also in different aspects of the same matter. In one case it is satisfied by certain elements, in another by others, some common some new*."

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To counter the imprecision, the Act contains a number of provisions that deal with residency on individuals and corporations. An individual may become a Canadian resident when he or she is 1) is a "factual resident" due to maintaining significant residential ties with Canada, 2) is "physically present" in Canada for at least 183 days in any given year, aka a deemed resident, or 3) ordinarily resident in Canada.

A **factual resident** has significant residential ties with Canada. Residential ties include factors such as the presence of a dwelling place and a spouse or dependent in Canada. Secondary residential ties include:

- Personal property in Canada
- Social ties in Canada such as memberships in recreational and religious organizations
- Economic ties such as employment with a Canadian employer, active involvement in a Canadian business, bank accounts, retirement accounts, etc.
- Landed immigrant status or work permit in Canada
- Provincial or territorial hospitalization and medical insurance
- Canadian driver's license
- Vehicle registered in Canada
- Seasonal dwelling in Canada
- Canadian passport
- Membership in Canadian unions or professional organizations

None of these factors may individually be sufficient to result in residency,

A **deemed resident** is a person that sojourns in Canada for 183 days or more in a year. To sojourn can mean simply physically present, even casually. Thus an individual may acquire Canadian residency even if he or she has a permanent home in another country and comes to Canada on a vacation or business trip lasting more than 182 days in any given year, without intent to discontinue his or her residency elsewhere or to acquire residency in Canada. However, merely driving across the border for daily commute does not constitute sojourning.

An individual is **ordinarily resident** in the place where he or she has a "settled routine and regularly, normally and customarily lives." Factors that have been found material for determining if a person is ordinarily resident in Canada are:

- Past and present habits of the individual's life;
- Regularity and length of visits
- Ties within the country, including property and investment, employment, family, business, cultural and social ties;
- Ties elsewhere;
- Permanence of other purpose of stay abroad

An individual does not have to be physically present in Canada in order to be ordinarily resident in Canada.

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US Residency

All US citizens and non-citizens of the US that are residents of the US (referred to as resident aliens) are required to file a US tax return if they meet certain income thresholds. To be clear, if you are considered a resident of the US, you are subject to the tax laws of the US, even if you are here illegally. You are a resident alien if you meet one of the following tests:

1. Lawful Permanent Resident, e.g. Green Card holder, or
2. You meet a 183-day substantial presence test. This is a two-part test and if you fail the first part of the test, you are generally considered a US resident, with limited exceptions. If you fail only the second part of the test, you can file Form 8840 to claim a closer connection to a foreign country (Canada) and will not be consider a US resident, assuming that in fact you do have a closer connection to Canada.

Part 1 of the test – You are physically present in the US at least 183 days during the calendar year. Note that each partial day counts as one day. The only exception is if you are flying and you simply pass through the U.S. on your way to another foreign destination.

Part 2 of the test – You are physically present in the U.S. for at least 183 days using the three year formula below, where year X is the most recent taxable year.

Year X - each day counts as one day

Year X-1 – each three days counts as one day

Year X-2 – each six days counts as one day

For example, if you spent 122 each year, each of the last three years, this is what you would have:

In 2015, you spent 122 days, times 1/1 = 122 days

In 2014, you spent 122 days, times 1/3 = 41 days

In 2013, you spent 122 days, times 1/6 = 20 days

Total number of days using the formula, equals 183 days and you fail Part 2 of the test and are considered a US resident unless you file Form 8840 and show that you have a closer connection to Canada.

Note: If you arrive in the US on November 1 and leave on March 31, you would have been in the US a total of 121 days. If you did this year in and year out, you would pass the second part of the test most years. Every leap year, you would have stayed in the US 122 days and therefore failed the test and must therefore file Form 8840 to avoid being considered a US resident and subject to tax. What makes this rule confusing are primarily two things, the fact that the test has two parts and the fact that immigration has even different rules.

With regards to the immigration rules, the easiest way to explain the difference is to say they are looking at a rolling 12-month period versus the calendar year that the IRS uses. For example, if you stay in the U.S. from October 1 through April 1, you would have been in the U.S. 183 consecutive days, yet only be in the U.S. for 92 days in the first year and 91 days in the second year. If you assume no other days in the U.S. in either year, you clearly passed both parts of the residency test for tax purposes, but failed the test for immigration purposes. To make matters worse, the Customs agents are not consistent in their application of the rules. Fortunately, you are typically looking at only being hassled by the Customs agent and nothing serious comes of it, but it does make it confusing for you when you are constantly getting conflicting answers.

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Canada-US Treaty
The Treaty is covered in much more detail in another section, but we have summarized the section that pertains to residency.

If it turns out that you are considered a resident of both Canada and the US, you can use the Treaty "tie-breaker" rules to determine which country you are a resident of. The tie-breaker rules are to be applied, in order, until an answer is found. The rules, in order are:

- Permanent home available
- Personal and economic relations (center of vital interests)
- Habitual abode
- Citizenship

If residency has not been determined after applying these tests, then the competent authorities of the two countries will make the final determination.

Canadian Departure Tax
When you exit Canada, Canada Revenue Agency (CRA) will treat your property, other than "taxable Canadian property", as if they were sold on the date of exit. The resulting gain or loss on the "deemed disposition" of you assets is reported, along with your other income, on your final Canadian return and one-half the net capital gain is taxed at your ordinary income tax rate.

Taxable Canadian Property is essentially the Canadian government can gain access to, or exercise some control over, in the event you fail to pay taxes owing on the property. Examples are Canadian real estate and registered accounts such as RRSP, RRIF and LIRAs.

For RRSP accounts, we recommend you "realize" any actual capital gains from a US tax perspective prior to exiting Canada; and that you continue to hold any securities that are in an unrealized loss position from a US tax perspective.

Non-taxable Canadian property includes your businesses, foreign real estate, non-registered investment accounts, and personal property. This property will be deemed to be disposed of on the day you exit Canada. The deemed disposition rules allow for the netting of capital losses against capital gains in order to minimize this tax. To calculate the gain or loss on your property, complete Form T1243, Deemed Disposition of Property by an Emigrant of Canada. Use Form T1161, List of Properties by an Emigrant of Canada, to list all of your assets and include with your final return.

According to the Fifth Protocol to the Canada-US Treaty, the deemed disposition value of your Canadian non-taxable property will become the cost basis of the property for US tax purposes. However, an election must be made on your US tax return(s) to utilize this treaty provision and to reset the basis on this property.

To avoid the hardship of having to sell non-liquid assets to pay the exit tax, CRA permits you to defer payment of the tax until the property is actually disposed of if you provide "adequate security" to the CRA. To make the election of defer tax, you should complete Form T1244, Election, Under Subsection 220(4.5) of the Income Tax Act, to Defer the Payment of Tax on Income Relating to the Deemed Disposition of Property.

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Canadian Registered Retirement Savings Plan
Canadian Registered Retirement Savings Plans (RRSPs) and related plans (RRIF and LIRA for example) are exempt from departure tax when an individual ceases Canadian residency and are not required to be withdrawn before departure. If an individual withdraws funds from an RRSP during non-residency, the distribution will be taxed at a rate of 25%. The rate can be reduced to 15% if paid as periodic pension payments to a resident of the US. You cannot take periodic payments from and RRSP, you must convert the RRSP to a RRIF in order to take periodic withdrawals. As a US resident, you can convert to an RRIF at any time.

As a resident of the United States who maintains RRSPs (and related accounts), you will need to provide disclosures of accounts and balances to the Internal Revenue Service as part of the tax return. If proper elections are made, the United States will not tax income earned in an RRSP until funds are withdrawn. At a minimum, you will need to file Form 8839 to report and defer the income from your RRSP. If the total of all of your non-US financial accounts equal or exceed US$10,000 you will also be required to file Form TD F 90-22.1. This form is changing to FinCEN 114(a). If the total of your non-US financial accounts exceeds US$50,000, you will also need to file Form 8938.

Note: Not all states all you to defer that tax on RRSPs, even if you make the federal election under the Treaty. California is an example of a state that does not allow for the deferral.

Totalization Agreement
Social security taxes payable in Canada are significantly lower than the social security taxes payable in the US on the same level of compensation. The Agreement on Social Security between the US and Canada (the "Totalization Agreement") may allow Canadian employees temporarily transferred to the US to continue to be covered by the Canadian system and avoid the higher US contributions.

Employees working in the United States during 2013 are subject to US Social Security tax of 6.2% of the first US$113,700 of taxable compensation or a maximum of US$5,840.40. In addition, the employee is subject to Medicare tax of 1.45% of total compensation. The employer must pay a matching US Social Security tax and the Medicare tax. If you are self-employed, you pay both the employee and employer portion of the tax. The wage base is adjusted for inflation each year. Also, beginning in 2013 you must pay 0.9% additional Medicare tax on earned income of more than US$200,000 (US$250,000 for married couples filing jointly).

Under the Totalization Agreement, an employee sent by his or her Canadian employer to work in the US can continue to be covered by CPP for assignments up to 60 months. During that period, the employee would be exempt from US social security and Medicare tax on the same income.

While not paying into US social security can result in short-term savings to both the employee and employer, you should consider your long-term plans for living in the US. If you are confident that your stay in the US will be short and that you will not be interested in retiring in the US, then not paying into the US system makes sense. However, if you will be in the US for an extended time or

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you think you might want to retire to the US, you should consider the benefits of paying into the US social security system. The first benefit is that with as little as six units of coverage, you can qualify for US social security retirement benefits. In 2013, you must earn $1,160 to qualify for a unit of coverage. You are limited to four units of coverage each year. You spouse is eligible for approximately an additional one-half of your benefits. The spouse does not have to work to receive benefits. As long as you are not self-employed, the return on your investment is good; you pay half of the tax (your employer pays the other half) and if you are married you get 150% of the benefit. Additionally, if you work ten years and have 40 units of credit, you and your spouse will qualify for free Medicare Part B coverage (medical insurance).

To establish an exemption from US social security and Medicare taxes, the Canadian employer should file CRA Form CPT56 to request a Certificate of Coverage from the Department of National Revenue, Taxation in Ottawa. The approved certificate should be maintained by the US payroll agent. The Canadian employer should file a T4 each year indicating the CPP contributions. A footnote on the T4 should read "Filed for purposes of the Canada-US Totalization Agreement."

Resources:

Totalization Agreement

CRA Guide – Emigrants and Income Tax

Application for Certificate of Coverage under a Social Security Agreement

Social Security Administration

Book - *The Border Guide*

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