Tax Planning for Canadian Snowbirds

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Planning for Snowbirds

- Spending time in the U.S.
- Non-tax considerations
- Purchasing U.S. real estate
- Renting out U.S. real estate
- Selling U.S. real estate
- U.S. gift and U.S. estate tax

Residency for Tax Purposes

- Canada like most countries taxes its residents on their world-wide income
- Every country has their own rules to determine residency
- It is possible to meet the residency requirements in Canada, while at the same time being considered a resident of the U.S. (ie. Snowbird)
- In those cases, the Canada-U.S. tax treaty provides tie breaker rules

Resident in Canada for Tax Purposes

- For Canadian tax purposes, residency is a **question of fact**.
- The most important thing to consider when determining residency status in Canada for income tax purposes is whether or not you maintain, or you establish, residential ties with Canada.

Significant residential ties

- Home
- Spouse
- Dependents in Canada

Secondary ties

- Personal property
- Social ties
- Economic ties
- Canadian driver's license
- Passport
- Health insurance

Retiring abroad?

- Severing ties permanently with Canada can expose client to:
  - Departure tax!
  - Lack of medical coverage
  - Foreign tax regime
    - significant filing requirements when it comes to offshore accounts
    - U.S. income tax on world-wide income
    - U.S. gift tax on world-wide assets
    - U.S. estate tax on world-wide estate

Becoming non-resident?

- Prior to becoming non-resident:
  - Be proactive as to when you will become non-resident and obtain professional advice
  - Rebalance investments prior to moving
  - Close TFSA account – do not make contributions while non-resident!
  - Calculate departure tax – plan to mitigate if possible?
  - Update financial institutions that you are becoming non-resident
  - If you take the position that you severed your ties, but CRA indicates that you did not sever your ties, you may be exposed to Canadian tax on your world-wide income while living abroad

Questions to ask your client

- What allows the client to stay in the U.S.?
  - U.S. citizen
  - U.S. Green Card
  - U.S. Visa
- How long do they plan to stay in the U.S.?
  - How many days on average per year?

Who is a U.S. Taxpayer?

- U.S. Citizens no matter where they reside
- U.S. Green Card Holders
- Individuals who meet the Substantial Presence Test

U.S. Taxpayers are subject to U.S. tax on their world-wide income

Who is a U.S. Citizen?

- U.S. Citizenship
  - ✓Born in the U.S.
  - ✓Born in Canada to 2 U.S. citizens
  - ✓Born in Canada to 1 U.S. citizen – "Accidental Citizens"
  - ✓Naturalized citizen

Best advice, ask a U.S. immigration lawyer

For more information, https://www.uscis.gov/us-citizenship

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Individuals who meet the Substantial Presence Test

- IRS looks to who has a "substantial presence" in the U.S. to determine residency
- The substantial presence test looks at:

31 days in the current year

AND

183 days over 3 years

- 100% of days in the current year
- 1/3rd of days in the prior year
- 1/6th of days in the 2nd prior year
- This equates to 122 days in the U.S. in each of the last 3 years.

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Substantial Presence Test

Watch days spent in the U.S. – Keep a travel log!

2018:	122	*	100%	= 122
2017:	122	*	1/3	= 40.67
2016:	122	*	1/6	= 20.33
TOTAL				**183**

- You can use an app installed on your phone (ie. TracKingDays or other)
- You can request a report online from the U.S. Customs Border Protection I-94 website. See: https://i94.cbp.dhs.gov/I94/#/home
- Information collected by both Canada and the U.S. – information is being shared

Closer Connection to Canada

If substantial presence test is met!

Two exceptions to substantial presence test:

Closer Connection Exemption	Treaty tie breaker provisions
<183 days	>183 days

Tie Breaker Rules

- Canada U.S. Tax Treaty will need to be consulted in the event a client meets both Canadian and U.S. residency requirements.

- The treaty has tie breaker rules that should be applied sequentially:
  - Permanent home
  - Center of Vital Interests
  - Habitual abode
  - Citizenship
  - Mutual Agreement

However, U.S. Citizens cannot use the treaty to break U.S. residency for tax purposes

Tax filing requirements for Snowbirds

No substantial presence

- Recommend filing Form 8840 to certify no substantial presence

Substantial presence

- Required to file Form 8840 to claim Closer Connection Exemption by June 15th

Closer Connection under Treaty

- Required to file Form 1040NR and claim exemption under treaty by filing Form 8833 plus more!

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Spending time abroad

- Snowbirds should ensure that they investigate all immigration requirements of their destination
- Most countries have a limit on how long one may spend in the country
- In the U.S. spending more than 6 months less a day (182 days), without a proper visa or Green card, is an immigration violation. Canadians can use a B-2 Visa for tourism purposes.

Spending time in the U.S.

- Canadians are allowed to visit the US for vacation or tourism purposes for a total of 6 months during any continuous 12 month period.
- Admission for six months is always discretionary!
- Part day = full day
- Promoting Tourism to Enhance Economy Act in February 2017 proposed Canadians 55 and up who own or rent property could stay up to 240 days – **not enacted**
- More recently Trump administration is targeting overstays
- Stay on the safe side – if you want to know how much longer you can stay in the U.S., you can check at: https://i94.cbp.dhs.gov/I94/#/home
- Could be denied entry next time or banned from the U.S. in the future

Compliance Restrictions

- You may not be able to provide advice to clients who move abroad
  - Trade restrictions may apply
  - You may not be able accept new money or make changes for clients who are considered non-residents for Compliance purposes

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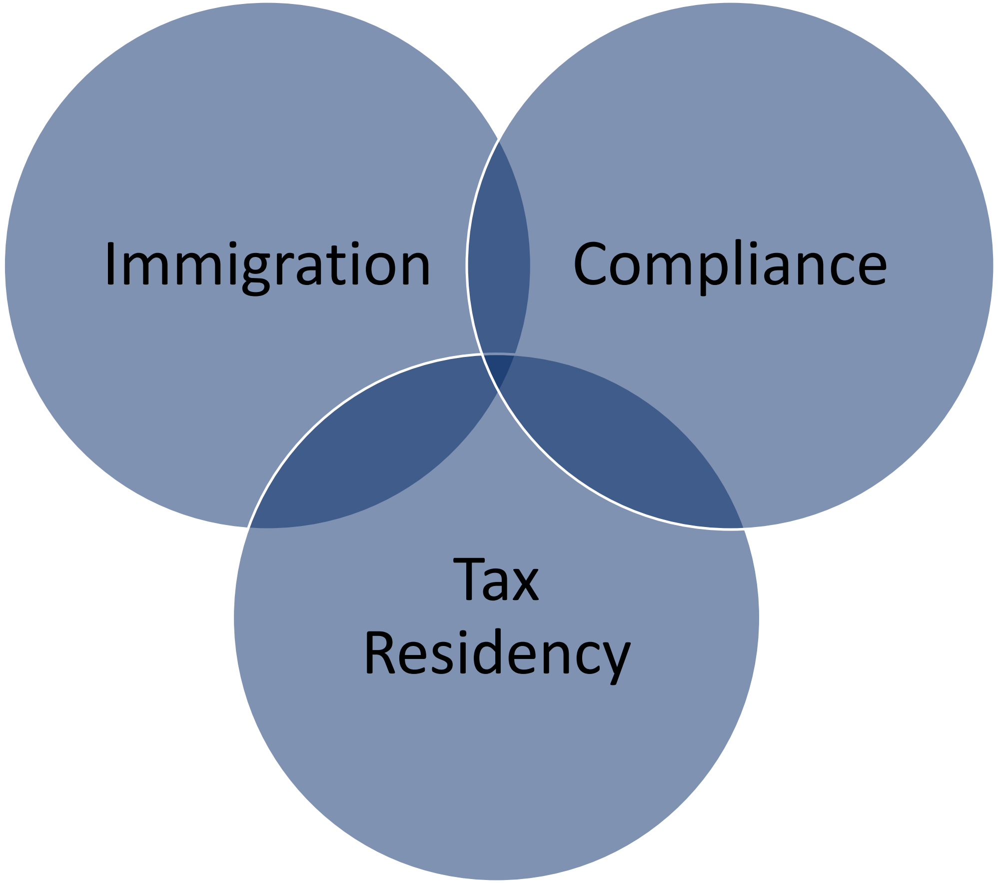
Residency for different purposes



To do list prior to traveling south:

- Reroute mail
- Tax return preparation
- Cash management
- Make RRSP contributions
- Make TFSA contributions
- Arrange for someone to look after Canadian property

Non-tax considerations - Insurance

- Health Insurance
  - Snowbirds will need additional coverage
  - Not all coverage is created equal
  - Need to compare different options
- Life Insurance and Critical Care
  - People often procrastinate in their purchase of insurance
  - Leaving Canada for an extended period of time may create urgency and be a catalyst to act

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Non-tax considerations – Wills and POAs

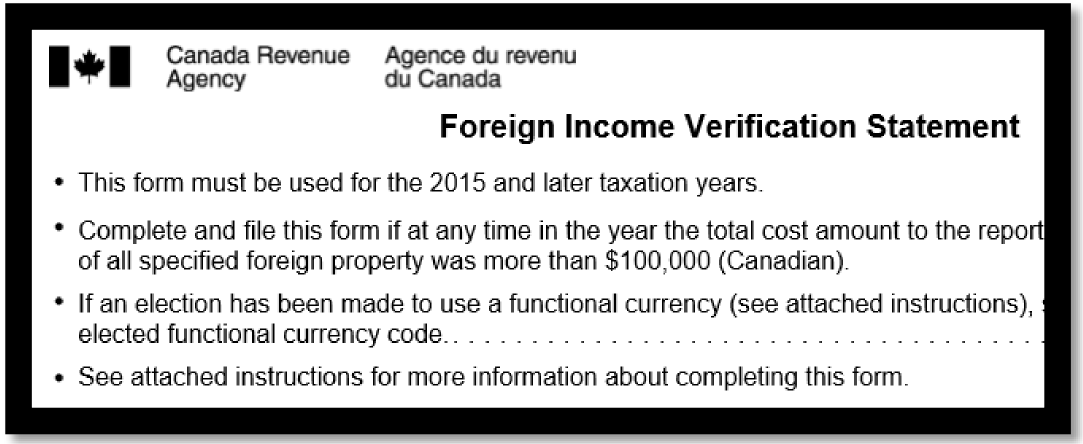
- Wills
  - Need to be reviewed regularly.
  - If property is in a foreign jurisdiction, it may be advisable to deal with asset under a separate will
- Power of Attorney
  - This is a good time to remind clients to have a power of attorney in place. No one is too young to require a power of attorney!
  - Consider if a limited power of attorney is required to deal with affairs during their absence.

Canadian purchase of Foreign Property

- How will the property be used?
  - Personal
  - Mixed use
  - Rental – Active or Passive?
- How will purchase be funded?
- Where is it located?
- How and when will it be sold?

Foreign Investment Reporting

- Do you hold foreign property with a total cost of $100,000 CAD?
  - T1135 Foreign Income Verification Statement
  - Cost **not FMV**
  - Exclusion for personal use property:
    - Used primarily (50% or more) by individual or related party for personal use
    - If rented out for part of the year with no reasonable expectation of profit



Canada Revenue Agency | Agence du revenu du Canada

Foreign Income Verification Statement

- This form must be used for the 2015 and later taxation years.
- Complete and file this form if at any time in the year the total cost amount to the report
of all specified foreign property was more than $100,000 (Canadian).
- If an election has been made to use a functional currency (see attached instructions),
elected functional currency code. . . . .
- See attached instructions for more information about completing this form.

Canadian renting out U.S. property

U.S. tax consequences

- Option 1: 30% of gross rental income must be withheld by tenant and remitted to the IRS – no requirement to file U.S. return
- Option 2: Elect to file a Form 1040 NR and pay tax on the net rental income
  - Taxpayer completes a W-8ECI to avoid 30% withholding and provide this form to person who is paying rent.
  - Taxpayer must apply for a U.S. TIN and may be required to pay instalments
  - Depreciation in U.S. must be claimed (not optional)
  - Net rental income must be reported on Form 1040NR – tax payable by April 15th and return is due June 15th (can be extended if you file application).
  - Canadian individual will then obtain a refund of excess withheld (if any)

Rental income may also be subject to state and county and/or city tax.

Canadian renting out U.S. property

Canadian tax consequences

- Rental income from foreign property must be reported on Line 130 of individual tax return
- Converted into CAD$ at time of receipt
- Can claim foreign tax credit for federal and state tax paid in the U.S.
- U.S. is allowed to collect tax first, but FTC mitigates exposure to double tax
- However, higher rate between 2 jurisdictions will prevail (generally Canada)

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Canadian renting out U.S. property

Other

- Make sure you have a rental agreement in place.
- Check liability insurance coverage if rented out.
- Check property coverage if rented out.

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What happens if I sell property?

What happens if I die while owning property?

What happens if I gift property?

Canadian selling U.S. property

U.S. tax consequences

- 15% of gross proceeds must be withheld by seller and remitted to the IRS within 20 days of transfer
- Exception 1: Purchase price is greater than $300,000 USD and less than $1 Million USD and property is used by purchaser as a residence (more than 50% of the time in first two years) then ability to reduce from 15% to 10%
- Exception 2: Purchase price is $300,000 USD or less and property is used by purchaser as a residence then ability to reduce from 15% to 0%.
- Or…Apply for a withholding certificate by filing Form 8288-B to reduce or eliminate based on capital gain that is expected to be realized in advance of the sale
- Sale of property must be reported on 1040NR by June 15

Canadian selling U.S. property

U.S. tax consequences

- Capital gain
  - Long term gain subject to tax at preferred rate if property held longer than 12 months (max federal rate 20%)
  - Short term is taxed as ordinary income (max federal rate 37%)
- Recapture
  - Depreciation recapture is taxed as ordinary income (max federal rate 37%)
  - Un-recaptured Section 1250 gain (max federal rate is 25%)
- Principal residence exclusion up to $250,000 USD if main home for 2 out of last 5 years (Note: snowbirds likely will not qualify)

Canadian selling U.S. property

Canadian tax consequences

- Gain/Loss on sale of foreign property
  - Proceeds – convert into CAD$ at time of sale
  - Less: Cost – original cost and additions (converted into CAD$ when paid)
  - Gain or Loss may include foreign exchange gain or loss
- To the extent that foreign tax is paid, foreign tax credit may be available to offset Canadian tax payable
- May be able to claim principal residence exemption
  - Be careful in claiming PRE if U.S. tax cannot be avoided

Example – Selling U.S. Property

- Mike is NOT a U.S. citizen, he is a Canadian citizen and resident
- Mike sells U.S. real estate worth $185,000 USD
- The original cost of the property was $118,000 USD back in 2013 when dollar was at par.
- Capital gain in U.S. is $67,000 USD
- Mike files 8288B to waive withholding at source and files Form 1040NR to report the disposition. He ultimately pays U.S. tax of 20% x $67,000 = $13,400 USD

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Example – Selling U.S. Property

- Capital gain or loss may include foreign exchange gain or loss
- Proceeds: $185,000 USD x $1.30 CAD/USD = $240,500 CAD
  - Assuming this rate is the exchange rate on the date of sale
- ACB: $118,000 USD x $1.00 CAD/USD = $118,000 CAD
  - Assuming this rate was the exchange rate on the date of purchase and no capital improvements were made since 2013

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Example – Selling U.S. Property

Canadian tax consequences	U.S. tax consequences
Mike reports capital gain of $122,500 CAD on Canadian tax return	Mike must file Form 1040NR and report disposition of property. Capital gain of $67,000 USD
Tax payable on capital gain = $30,503	Tax payable on capital gain = $13,400 USD
Less: Foreign tax credit for U.S. tax paid = $13,400 x 1.30CAD/1USD = $17,420	U.S. sourced gain therefore U.S. tax cannot be recovered by claiming foreign tax credit for Canadian tax paid
Net tax payable in Canada = $13,083 CAD	Net tax payable in U.S. = $13,400 USD

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Canadians and U.S. estate tax

- Canadian residents may be subject to U.S. estate tax if they die owning certain U.S. assets even if they are NOT U.S. citizens or residents!
- U.S. estate tax starts at 18% and increases to 40% for U.S. assets that exceed $1 million USD.
- Subject to U.S. estate tax on their U.S. situs assets only, NOT their worldwide assets
- Charged on full fair market value of the U.S. situs asset

U.S. Situs Assets for U.S. Estate Tax

- Tangible property including: U.S. real estate and personal property (automobiles and furniture) located in the U.S.
- U.S. securities held in a brokerage account in Canada or outside of Canada
- U.S. Mutual funds including money market funds and U.S. ETFs
- U.S. interests held in registered accounts (RRSPs and TFSAs etc.)
- Business assets owned and used in the U.S.

Does not include:

- Canadian mutual funds with underlying U.S. investments
- U.S. bank accounts and term deposits
- Publicly traded U.S. bonds and treasury bills

Canadians and U.S. estate tax

- Canada-US Tax treaty provides relief for Canadians:
  - Unified credit – greater of:
    - $13,000 USD
    - $4,505,800[1] x the value of U.S. assets / the value of world-wide assets
  - Marital credit if U.S. situs assets transfer to a spouse at death

Note 1: $4,505,800 is the US estate tax on $11.4 million of assets

Note 2: The American Taxpayer Relief Act of 2012 establishes an exemption amount of $5 million and indexes this amount for inflation annually. The Internal Revenue Service (IRS) announced that the indexed exemption amount is $5.6 million for 2018. The *Tax Cuts and Jobs Act* introduced in December 2017 has doubled the original exemption amount from $5 million to $10 million, indexed to $11.4 million for 2019. Unless permanent legislation is enacted, exemption amount will revert back to $5 million plus inflation on January 1, 2026

Canadians and U.S. estate tax

- If Canadian dies with U.S. situs assets less than $60,000 USD then not required to file U.S. estate tax return and no exposure to U.S. estate tax
- If Canadian dies with U.S. situs assets that exceed $60,000 USD but world-wide estate does not exceed lifetime gift and estate tax exemption amount ($11.4 million USD in 2019), estate is required to file U.S. estate tax return to claim treaty credits.
- If Canadian dies with U.S. situs assets and an estate valued in excess of lifetime gift and estate tax exemption amount, then deceased will be subject to U.S. estate tax.

Example – U.S. Estate Tax

- Joe is Canadian citizen and resident in Alberta and passes away in 2019 with $25,000,000 USD in worldwide assets. He was not married at the time of his passing.
- He owns a $10,000,000 USD mansion in New York, but the rest of his assets are in Canada.
- Joe has a substantial presence in the U.S. but files a Form 8840 each year.
- Joe initially paid $8,000,000 USD for the mansion.
- Joe’s estimated U.S. Federal Estate tax is about $2,200,000 USD

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Example – U.S. Estate Tax

Canadian tax consequences	U.S. tax consequences
Joe is deemed to dispose of all of his assets at death. Unrealized gain or loss is triggered and reported on final return. Capital gain that is triggered on death will trigger tax payable.	Joe's estate exceeds lifetime gift and estate tax exemption amount and is subject to U.S. estate tax on full value of the asset. U.S. estate tax payable is about $2.2 Million USD
Joe is able to claim a foreign tax credit for the U.S. estate tax paid on the U.S. assets. Expect all of tax to be offset by U.S. estate tax that is paid	U.S. estate tax return is due nine months after date of death.
Joe's beneficiaries receive the property with a cost base equal to the fair market value on the date of the transfer.	Joe's beneficiaries receive the property with a cost base equal to the fair market value on the date of the transfer provided U.S. estate tax return is filed. CAUTION: If no return is filed, gross value of the U.S. assets in excess of $60,000 USD is subject to U.S. estate tax and the beneficiaries of the estate will inherit the U.S. situs assets with a cost basis of NIL

Canadians and U.S. Gift Tax

- U.S. gift tax exposure when Canadian gifts U.S. tangible property
- U.S. situs assets – annual limit to amount that can be gifted
    - $15,000 USD (2019) to anyone other than spouse
    - $155,000 USD (2019) to non-U.S. spouse
    - Unlimited gifts to U.S. spouse
- Amount in excess of limits is subject to U.S. gift tax up to 40%
- Deemed disposition at FMV for Canadian purposes may result in Canadian tax that <u>cannot be offset by claiming a foreign tax credit</u> for U.S. gift tax.

U.S. Situs Assets for U.S. Gift Tax

- Tangible property including: real estate and personal property (automobiles and furniture) situated in U.S.
- Does not include intangible property including U.S. stocks

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Example – U.S. Gift Tax

- Dana is NOT a U.S. citizen or U.S. green card holder, she is a Canadian citizen and resident
- Dana gifts U.S. real estate worth $300,000 USD to her Canadian son (non-U.S. citizen or resident)
- The original cost of the property was $50,000 USD
- Dana is allowed to make a $15,000 USD gift, but not a $300,000 USD gift for gift tax purposes
- Because Dana is NOT a U.S. citizen, she does not get the benefit of the unified credit to offset U.S. gift tax. She is subject to U.S. gift tax on the value of the gift in excess of the annual limit.

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Example – U.S. Gift Tax

Canadian tax consequences	U.S. tax consequences
Dana reports the disposition on her Canadian tax return and pays tax on the disposition as if she sold the property at its fair market value.	Dana is allowed to give a gift of $15,000 USD, but not $300,000 USD. Dana will be required to file a gift tax return and pay gift tax on the value of the gift in excess of the annual limit.
Dana does not receive foreign tax credits to reduce Canadian tax for the U.S. gift tax paid.	
Dana's son's cost base for a future disposition is the fair market value on the date of the transfer.	Dana's son's cost base for a future disposition is the original cost of $50,000 USD. The son does not receive benefit for the tax his mother paid, so he will have more capital gains to report in the future.

Options for owning Vacation Property

- Individual ownership
- Joint tenancy with right of survivorship
- Tenancy in common
- Canadian corporation
- Canadian partnership
- Canadian trust
- US LLC
- US Revocable Living Trust
- US Corporation

Practical considerations

No one size fits all solution!

Is U.S. Estate tax going to be an issue?

How will this affect the overall estate plan?

Will property be sold prior to death?

Cost and complexity to set up and administer?

Will asset be subject to U.S. probate?

Your role as Financial Planner

- Specialized area that may have been overlooked in previous planning
- Tax law on both sides of the border is subject to change
- Identifying potential issues proactively can help create a solid relationship with the client
- Collaborative approach is better for client and all advisors!

- The material presented today and contained in these slides contains a general overview of the subject and is provided solely for educational purposes and may not be applicable to a specific case, set of circumstances or facts.

- This information is current as of the date of publication and should not be regarded as a substitute for professional advice.

- Cross border taxation is complex and dependent on a full understanding of all facts and circumstances. This presentation is not meant to be relied upon in determining U.S. or Canadian tax consequences. Any clients that have U.S. or Canadian tax issues should discuss the issues with their respective tax advisors. We generally recommend a professional working for a Canadian firm that has specific experience in dealing with U.S. tax.

Questions?