

TAX RULES AND GUIDELINES FOR CANADIANS TRAVELLING TO THE U.S. AND ABROAD

Although the snow seems far away, the winter season is approaching and many will seek haven in warmer climates south of the border. However, it is necessary that all Canadians who have travelled extensively to the United States or abroad evaluate their residency status. The Canada Revenue Agency has issued guidelines in this regard and we summarize some of the issues outlined therein.

If you believe you may be affected by these guidelines, you are advised to consult with your professional tax advisor.

If you spent part of the year in the United States (U.S.) for health reasons, to vacation, or for other reasons, and you still maintained residential ties in Canada you may be affected by these rules. However, these rules do not apply to you if you :

- are a U.S. citizen;
- have been granted permanent resident status by the U.S. Immigration and Naturalization Service
- (i.e., granted a “green card”); or
- have residential ties to a country other than the U.S. and Canada.

FACTUAL RESIDENT

You are a factual resident of Canada if you keep significant residential ties (see page 5 sidebar) in Canada while living or travelling outside the country. The term **factual resident** means that, although you left Canada, you are considered, to be a resident of Canada for income tax purposes.

If you spend part of the year in the U.S. for health reasons, to

CONTINUED ON PAGE 2

RESIDENCY STATUS

While you are outside Canada, it is important that you know your residency status. Before you complete your Canadian income tax return, you need to determine if you are:

- a **factual resident**,
- a **deemed resident**,
- a **non-resident**, or
- a **deemed non-resident** of Canada.

ALERTS...

How US Tax Laws Apply	PAGE 3
What is the Substantial Presence Test?	PAGE 4
Do you own U.S. Property?	PAGE 5
US Estate Tax for Non-Resident Aliens	PAGE 5

FACTUAL RESIDENCY (CONTINUED)

vacation, or for other reasons, and you maintain residential ties in Canada, you would usually be considered a factual resident of Canada.

You may be a factual resident if you are:

- working temporarily outside Canada;
- teaching or attending school in another country;
- commuting (going back and forth daily or weekly) from Canada to your place of work in the United States; or
- vacationing outside Canada.

As a factual resident, you are taxed on your income as if you never left Canada. You will continue to:

- report all income you receive from sources inside and outside Canada for the year, and claim all deductions that apply to you;
- claim federal and provincial or territorial non-refundable tax credits that apply to you;
- pay federal tax and provincial or territorial tax where you keep residential ties in Canada;
- claim federal and provincial or territorial refundable tax credits that apply to you; and
- be eligible to apply for the GST/HST credit.

DEEMED RESIDENT

Certain people who live outside Canada and who sever their residential ties with Canada are deemed residents of Canada for income tax purposes.

Types of deemed residents

You may be a deemed resident of Canada if you are:

- ◆ a member of the Canadian Forces;
- ◆ a member of the Canadian Forces overseas school staff who chooses to file a return as a resident of Canada;
- ◆ a federal or provincial government employee who was a resident of Canada just before being posted abroad or who received a representation allowance for the year;
- ◆ a person working under a Canadian International Development Agency (CIDA) assistance program

who was resident of Canada at any time during the three-month period just before starting duties abroad;

- ◆ a dependent child of one of the first four persons described above and your net income for the year was not more than the basic personal amount; or
- ◆ a person who, under an agreement or convention (including a tax treaty) between Canada and another country, is exempt from tax on at least 90% of your world income in that other country because of your relationship to a resident (including a deemed resident) of Canada.

As a deemed resident, you will continue to:

- report all income you receive from sources both inside and outside Canada for the year;
- claim all deductions, federal non-refundable tax credits, and federal refundable tax credits that apply to you as if you resided in Canada for the year; and
- be eligible to apply for the goods and services tax/harmonized sales tax (GST/HST) credit.

You are subject to federal tax just like other residents of Canada. Instead of paying provincial or territorial tax, you have to pay a surtax for non-residents and deemed residents of Canada. You cannot claim provincial or territorial tax credits.

However, if you have business income from a permanent establishment in a province or territory in Canada, you have to pay provincial or territorial tax on that income, and you may be entitled to certain provincial/territorial credits related to that income.

Did you live in Quebec just before you left Canada?

Even though you may be considered a deemed resident of Canada, under Quebec law you may also be considered a deemed resident of that province. If this is the case, you may have to pay Quebec income tax while you are serving abroad.

NON-RESIDENT

To be considered a non-resident, there must be some permanence to your stay abroad. If you leave Canada to settle in another country and you sever significant residential ties with Canada, you are considered to be a non-resident for income tax purposes, unless you are a deemed resident.

If you become a non-resident, in the year you leave Canada you are considered to be an emigrant for income tax purposes.

For all following years, if your situation does not change, you will be considered a non-resident. As a non-resident, you have to report certain types of Canadian-source income on your return.

The most common types include:

- income from employment in Canada;
- income from a business carried on in Canada;
- the taxable part of Canadian scholarships, fellowships, bursaries, and research grants; and
- taxable capital gains resulting from dispositions of taxable Canadian property.

DEEMED NON-RESIDENT

Effective after February 24, 1998, if you are a factual resident of Canada and a resident of another country, according to a tax treaty Canada has signed with another country, you may be considered a deemed non-resident of Canada.

You become a deemed non-resident of Canada when your ties with the other country become such that, under the tax treaty, you would be considered a resident of that other country.

If on February 24, 1998, you were already a resident of a country with which Canada has a tax treaty, you are not a deemed non-resident of Canada. You will only be considered a deemed non-resident of

Canada if after February 24, 1998:

- ✓ you ceased to be a resident of that treaty country and then became a resident of that country again; or
- ✓ you moved from that treaty country and became a resident of another country with which Canada has a tax treaty.

The ordinary effects of ceasing to be a resident of Canada will apply.

HOW U.S. TAX LAWS APPLY

As a Canadian resident who spends part of the year in the U.S., you are considered either a **resident alien** or a **non-resident alien** of the U.S. for tax purposes.

Resident aliens are generally taxed in the U.S. on income from all sources worldwide, and non-resident aliens are generally taxed in the U.S. only on income from U.S. sources. Therefore, it is important for you to determine if you are a resident alien or a non-resident alien.

ARE YOU A RESIDENT ALIEN?

You are considered a resident alien if you meet the substantial presence test.

If you were in the U.S. for 183 days or more in 2009, you meet the substantial presence test.

If this is your situation, you are considered a **resident alien** of the U.S. and should consult with your tax advisor to determine your obligations regarding the filing of a U.S. tax return.

If you were in the U.S. for less than 31 days in 2009, you do not meet the substantial presence test.

tax & business ALERT has been prepared by LEVI & SINCLAIR, LLP for the general information of our clients, staff and other interested parties. The enclosed comments are of a general nature and are not intended to cover all aspects of the subject matter. Prior to implementing any planning based upon information in this publication, the specific facts pertaining to any particular situation should be carefully considered. We will be pleased to assist in this regard and to provide further details pertaining to the matters discussed herein.

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If you were in the U.S. for 31 to 182 days in 2009, you may meet the substantial presence test (see page 4 sidebar).

If this is your situation, you are considered a **non-resident alien** of the U.S. and should consult with your tax advisor to determine your obligations regarding the filing of a U.S. tax return.

ARE YOU A NON-RESIDENT ALIEN?

You are a non-resident alien if you **do not** meet the substantial presence test. If you have determined that you are a resident alien because you meet the substantial presence test, you can be considered a **non-resident alien** if:

- you were present in the U.S. for less than 183 days in 2009;
- your **tax home** is in Canada; and
- you had a **closer connection** to Canada than to the U.S. during 2009.

What is a tax home?

If you are employed or self-employed, your tax home is the location of your principal place of business or employment, regardless of where you maintain your family home.

If you are not employed or self-employed, your tax home is where you regularly live. It can be a house, an apartment, or a furnished room, and you can rent or own it. It must have been available to you continuously and at all times throughout 2009, and not just for short stays during the year.

How do you determine a closer connection to Canada?

You are considered to have a closer connection to Canada than to the U.S. if you maintain more significant ties to Canada. Some important ties include the location of the following:

- your permanent home and business activities;
- your family;
- personal belongings, such as cars, furniture, clothing, and jewellery;

WHAT IS THE SUBSTANTIAL PRESENCE TEST?

This test uses the number of days you were in the U.S. during a three-year period (the current and the two previous years) to determine if you are a resident alien or a non-resident alien.

To determine whether you meet the substantial presence test for 2009, calculate the number of days you were present in the U.S. during 2009, 2008, and 2007. The days do not have to be consecutive, and you are treated as being present in the U.S. on any day you were there for part or all of the day.

Each day:

- in 2009 counts as a full day;
- in 2008 counts as one-third of a day; and
- in 2007 counts as one-sixth of a day.

If your total is **at least 183 days**, you have met the substantial presence test and you are considered a **resident alien** for 2009.

- social, political, cultural, or religious organizations to which you belong;
- the jurisdiction where you vote; and
- the jurisdiction where you hold a driver's licence.

If you have applied to the U.S. Citizenship and Immigration Services for Lawful Permanent Resident status in the U.S. (i.e., applied for a "green card"), or you have been granted permanent residency status (i.e., granted a "green card"), you will not be eligible to claim the closer connection exception.

If you are eligible to claim this exemption, You have to file IRS Form 8840, *Closer Connection Exception Statement for Aliens*, to advise the IRS that your tax home is in Canada and that you maintained more significant ties in Canada than in the U.S. during 2009.

Each year, you have to determine if you are a resident alien or a non-resident alien. And each year, if you are a resident alien with closer ties to Canada than to the U.S., you have to file a new Form 8840.

Residence under the treaty

If you are a resident alien because you met the substantial presence test and you cannot claim the closer connection exception, you may be able to determine your residency status under Article IV of the *Canada-United States Income Tax Convention*.

You may be treated as a non-resident alien under Article IV, for the purposes of calculating your U.S. income tax liability, if you meet the following conditions:

- you are considered a resident of both the U.S. and Canada under each country's tax laws (i.e., you are a Canadian resident and a U.S. resident alien); and
- your permanent home is in Canada.

If you also have a permanent home in the U.S., you may be treated as a non-resident alien if your personal and economic ties are closer to Canada than to the U.S.

DO YOU OWN U.S. PROPERTY?

If you own U.S. property, such as a condominium or house, you should be aware of the tax consequences of renting out or selling U.S. real estate.

DID YOU DISPOSE OF U.S. REAL ESTATE?

As a non-resident alien, gains or losses you have from disposing of U.S. real property interests are considered to be effectively connected with a U.S. trade or business. If you sell or otherwise dispose of U.S. real estate, the purchaser, or his or her agent, is generally required to withhold 10% of the gross sale price at the point of sale. However, there are exceptions to this rule.

WHAT ARE RESIDENTIAL TIES?

Residential ties include things such as:

- a home in Canada;
- a spouse or common-law partner and dependants who stay in Canada while you are in the U.S.;
- personal property, such as a car or furniture in Canada; and
- social ties in Canada.

Other relevant ties may include

- a Canadian driver's licence,
- Canadian bank accounts or credit cards,
- and hospitalization insurance with a province or territory of Canada.

U.S. ESTATE TAX FOR NON-RESIDENT ALIENS

Starting in 2002, U.S. estate tax rates were gradually lowered and ultimately repealed for 2010. Unless new law is enacted beforehand, the U.S. estate tax is scheduled to return in 2011 to its higher pre-2002 levels which provide for tax at 55% plus an additional 5% surtax on estates over \$10 million. The estate tax exemption will be reduced to \$1 million from the 2009 exemption of \$3.5 million.

The taxable estate of a Canadian non-resident alien includes the following assets located in the U.S.:

- real estate and tangible personal property;
- stock in a U.S. corporation;
- debt issued by, or enforceable against, a U.S. entity (but most corporate debt instruments issued after 1984 are exempt from U.S. estate tax); and
- interest in a partnership, if the partnership's principal place of business is in the U.S.

ABOUT LEVI & SINCLAIR

LEVI & SINCLAIR is a firm of chartered accountants that traces its origin in Montreal to 1950. We pride ourselves on being more than just an accounting firm. We offer an effective blend of personalized service, experience and technological leadership, coupled with a steadfast commitment to consistently deliver excellence.

Our Chartered Accountants and Business Consultants provide advisory services on a broad range of issues to both our individual and corporate clients. The members of our firm possess unique talents, expertise and experience, giving our clients access to a knowledge base of considerable breadth and depth. Together with our support personnel, we share a commitment to developing practical solutions for the business challenges of today, and to devising strategies for tomorrow.

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Our firm takes pride in adding value to every client that we serve through our extensive expertise and proactive approach to your financial needs. We match our dedication to adding value with experience and expertise: we have experience in servicing virtually every type of industry and professional practice.

TAXATION

Our office has a strong basis in federal and provincial tax issues. Our tax group has been in existence for 50+ years and is highly qualified and experienced. Our accountants work hard to minimize your taxes, yet make sure that you fulfill your tax requirements ethically while working to add value. We can fill a variety of tax needs, both domestic and international as well as corporate and personal. Our specialties lie in tax reporting and representation, tax planning (business, personal, divorce and litigation), tax structuring of entities and transactions and tax research.

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- Civil and criminal Fraud Investigation
- Management and employee fraud and theft
- Identification of secret commissions and kickbacks
- Business valuation
- Sarbanes-Oxley compliance audits
- Sarbanes-Oxley 404 audits
- Intellectual Property Litigation Support
- Training on fraud awareness and prevention
- Due Diligence Audits
- Insurance claim assistance
- Retail sales audits
- Contract dispute resolution
- Professional negligence litigation support
- Fraud prevention program design, implementation and evaluation
- Bank due diligence audits
- Employee background audits
- Financial discrepancy analysis
- Divorce litigation support
- Insurance claim quantification
- Breach of contract quantification
- Electronic Discovery and Data Recovery
- Computer forensics

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