



TAX LETTER

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EMIGRATION FROM CANADA U.S. CITIZENS AND TAX-FREE SAVINGS ACCOUNTS SOME GST/HST QUIRKS YOU MIGHT NEED TO KNOW AROUND THE COURTS

EMIGRATION FROM CANADA

If you are considering emigrating from Canada, tax considerations will be extremely important. The tax implications can be (and are) the subject of a whole book; below we review just some of the most important highlights. It is generally wise to obtain professional advice that is tailored to your specific situation.

Will you become a non-resident of Canada?

Once you become non-resident, you will no longer be subject to Canadian tax on all of your sources of income. You will generally be taxed only on certain “Canadian-source” income (e.g., income from rent on property in Canada, dividends from Canadian corporations, or capital gains on Canadian real estate). From a Canadian tax point of view, it may therefore be desirable to

become non-resident. Of course, taxes should not be an overriding consideration; other issues such as health care, cost of living and lifestyle must not be overlooked.

There is no definition of “resident” in the Income Tax Act; instead, the rules have been developed by the courts over many years. The CRA’s basic interpretation of the rules can be found in Interpretation Bulletin IT-221R3, available on cra.gc.ca.

Just because you are moving out of Canada does not automatically mean that you will become non-resident.

First, you have to establish that you have taken up residency somewhere else. Canadian courts have held that you have to be resident somewhere. Generally, you are considered resident in the place where you regularly, normally or customarily live in the settled

routine of your life. There are no precise rules to be applied; each case depends on its facts.

Second, since it is possible to be resident in more than one country at the same time, you must establish that you have “cut your residential ties” with Canada. Those ties are evidenced by such things as:

“Significant” residential ties

- keeping a home in Canada
- having your spouse remain in Canada
- supporting dependent children who remain in Canada

“Secondary” residential ties

- keeping personal property such as furniture, clothing, and automobiles in Canada
- having bank accounts with Canadian banks
- having credit cards issued by Canadian financial institutions
- social ties such as memberships in Canadian clubs and religious organizations (on a resident basis)
- maintaining provincial health care coverage
- keeping a Canadian driver’s licence, or a vehicle registered in Canada
- professional memberships in Canada (on a resident basis)

“Minor” residential ties

- having a seasonal residence in Canada
- renting a safety deposit box in Canada
- renting a post office box in Canada
- keeping a telephone listing in Canada
- continuing to use stationery and business cards with a Canadian address

No one factor is conclusive, but in the CRA’s view all of the “significant” ties and most of the “secondary” ties must be cut to establish non-residence. The CRA will also

look at your general mode and routine of life, and whether you are making regular or extended visits to Canada.

EXAMPLES

1. X is transferred from Calgary to his company’s Bermuda office temporarily. He keeps his Canadian bank accounts and club memberships. His wife and children remain in Canada, and continue to live in his Vancouver home. He visits them regularly.

X will likely be considered by the CRA to remain resident in Canada throughout the time he is in Bermuda.

2. Y is transferred from Calgary to her company’s Bermuda office for a three-year posting. She and her husband sell their Calgary home and buy a new home in Bermuda, where they move with their children. Y cancels her Canadian credit cards and closes most of her Canadian bank accounts, but keeps one savings account at a Calgary bank branch.

Y will likely be considered by the CRA to have become a non-resident of Canada. Keeping one Canadian bank account will not cause her to remain resident in Canada.

Note that certain people are deemed to be resident in Canada even though they are working abroad. This includes members of the Canadian Forces and Canadian diplomats posted outside Canada, as well as their spouses if the spouse was ever resident in Canada for tax purposes.

Tax treaty “tie-breaker” rules

Canada has tax treaties with about 85 countries, including of course the United States and all of our significant trading partners other than tax havens. The tax treaties provide rules for determining residence, if a person is found to be resident in both countries.

Generally, under these rules, a person is deemed resident in the country where he or she has a “permanent home available”. A person who has a permanent home in both countries or neither is deemed resident in the country where his or her “personal and economic relations” are closer (also called “centre of vital interests”). If this cannot be determined, one looks to the “habitual abode”, and if that does not answer the question, it is determined by citizenship.

If you are resident in another country under a “treaty tie-breaker” rule, then you are deemed by the Income Tax Act (subsection 250(5)) *not* to be resident in Canada, even if you have not cut your ties with Canada.

Thus, if you move to a country with which Canada has a tax treaty, it is easier to become non-resident, by means of a “permanent home” or having your “personal and economic relations” stronger in the other country.

Departure tax payable when you become non-resident

When you become non-resident, you may be required to pay tax as a result. This is often referred to as the “departure tax”. In fact, it is ordinary income tax payable on capital gains that are deemed to be triggered when you become non-resident.

On becoming non-resident, you are deemed to dispose of much of your property at its

fair market value. Thus, capital gains or capital losses may be triggered, depending on your cost base in each property. However, this rule generally does *not* apply to certain property, including:

- real property (e.g., land and buildings) in Canada, which will instead be taxed when you eventually sell it
- interests you have in RRSPs, RRIFs, RESPs, RDSPs, TFSAs and a whole alphabet soup of other plans and arrangements
- various rights you may have, such as under an employee stock option agreement
- property used in carrying on an active business through a permanent establishment in Canada.

This is only a very general overview; the departure tax has many complications, and you should obtain professional advice relating to your specific situation. Note also that in most cases you can defer paying the departure tax until you actually sell the underlying property, although you may have to post security with the CRA.

Note that if you do not pay your Canadian tax liability, the CRA can, under Canada’s tax treaties with some countries, arrange for the local tax authority to enforce collection of the Canadian tax you owe. This can happen in the United States, Germany, the Netherlands and Norway.

Passive income — withholding taxes

Once you are non-resident, Canada will impose a withholding tax on most kinds of “passive” income, other than interest (which since 2008 is taxed to non-residents only in limited circumstances). This includes:

- dividends from Canadian corporations
- rent on real estate in Canada
- royalties paid from Canada
- pension income, including OAS and CPP/QPP payments
- RRSP/RRIF withdrawals

The withholding tax rate is 25%. However, if you are resident in a country with which Canada has a tax treaty, the rate may be reduced to 15%, 10%, 5% or even zero. The tax on interest, dividends and some royalties is generally reduced by treaty; the tax on other amounts may not be. In each case you must check the details of the particular tax treaty. Note that, in many cases, the Canadian withholding tax will be allowed as a foreign tax credit in the country of which you are resident, so the withholding tax will not represent a real cost to you.

Conclusion

If you are considering becoming non-resident, it is wise to undertake substantial planning ahead of time, with respect to both Canadian and foreign taxes. With adequate professional advice, there are many opportunities to reduce the taxes that may otherwise apply in both jurisdictions.

U.S. CITIZENS AND TAX-FREE SAVINGS ACCOUNTS

The Tax-Free Savings Account (TFSA) has been in place since 2009. As of 2011, taxpayers can invest up to a total of \$15,000 in a TFSA, and these funds can earn interest or dividends that are tax-free. The capital can also be withdrawn tax-free at any time.

U.S. citizens living in Canada should generally not open TFSAs. The income will be taxable each year on their U.S.

return. As well, the TFSA must be reported with other foreign financial accounts on Form TD F 90-22.1 (available from www.irs.gov) to the Dept. of the Treasury, and possibly on Forms 3520 and 3520-A as a “foreign trust”.

U.S. citizens who have opened TFSAs should consider withdrawing the funds (there is no tax cost). The withdrawal will reinstate the taxpayer’s TFSA contribution room for Canadian tax purposes. If, at some point in the future, Canada and the U.S. negotiate an amendment to the Canada-U.S. tax treaty to accommodate TFSAs, or the IRS announces administrative relief, then the funds can be contributed back to a TFSA.

SOME GST/HST QUIRKS YOU MIGHT NEED TO KNOW

The Goods and Services Tax (GST) and Harmonized Sales Tax (HST) form a *very* complex system, with myriad special rules and exceptions. The rules have changed many times, including in May 2010 when the “place of supply” rules changed (for determining when HST applies and at what rate).

Here are a baker’s dozen of unusual GST and HST rules from the *Excise Tax Act* (ETA) — some less well-known than others — that might affect your business.

1. **Medical and other health clinics.** When revenues are shared between a doctor (or other health care provider) and a clinic, it is often unclear whether the clinic is paying the doctor for health care services (exempt), or the doctor is paying the clinic for the use of the clinic’s facilities (taxable). This determination depends on both the contractual

arrangements and the facts. (See CRA Policy P-238.) These arrangements need to be carefully reviewed by a GST expert to ensure that the right taxes are being remitted by the right parties. Otherwise there can be a nasty (and expensive) surprise when the CRA audits either business!

2. **Cosmetic-related health care services.** An amendment introduced in 2008 broadens the instances where these are taxable. Cosmetic surgery (e.g. facelift, teeth whitening, laser spots removal) has always been taxable unless it is needed for medical or reconstructive purposes, but the new rule applies to *all* health care services “in respect of” a cosmetic service. Thus, for example, a **nursing service or dental hygienist service** that relates to a cosmetic treatment may now be taxable.
3. **Charges between related companies** can often be free of GST under a special election (ETA section 156), but only if the effect is merely to eliminate cash flow. This election cannot save tax. If one of the companies is making exempt supplies such as residential rents, so that it cannot claim full input tax credits, the companies cannot make the election. (A different election under ETA section 150 is available to eliminate tax in certain cases, but only where one of the companies is a financial institution.)
4. Not all **health care services** are exempt. Those that are not regulated by at least 5 provinces, or covered by public health insurance in at least 2 provinces, are not on the “exempt” list. For example, the services of **acupuncturists, massage therapists and naturopaths** are taxable,

if they are regulated by the province! (There is an exception for a “small supplier”, with no more than \$30,000 per year of annual taxable supplies, who chooses not to register for GST/HST.)

5. **Services** are now generally taxed based on the **customer’s address**. Thus, in general, if a consultant in Ontario bills an Alberta client, only 5% GST applies, but if a consultant in Alberta bills an Ontario client, the Ontario 13% HST rate applies. However, there are many exceptions to this rule. One exception is for “**personal**” services (e.g., haircuts), which are taxed based on where they are performed ... but this rule excludes a “**professional**” service (e.g. a lawyer or accountant), which normally follows the general rule! This rule may have surprising effects. For example, a hotel with a spa that provides massage therapy should likely be charging GST or HST based on the customer’s home province, if massage therapy is a “professional” service.
6. A **vendor selling real property** that has GST or HST buried in the price (where the vendor wasn’t able to claim an input tax credit on purchasing the property) can often recover that GST or HST, by way of a special input tax credit or rebate. These obscure rules, in ETA section 193 and 257, are often overlooked by lawyers and accountants advising vendors of property.
7. If you acquire a **service or intangible property** (e.g. downloaded software or a movie) **from outside Canada**, and you are not charged GST/HST, you may have a legal obligation to self-assess and pay the GST or HST to the Canada Revenue

Agency. This is called an “imported taxable supply”. The CRA is unlikely to assess consumers for this, but they have the legal right to do so. If you acquire an imported taxable supply for your business, and you are not able to claim input tax credits (e.g. because your sales are exempt), the CRA may find this on auditing your business and assess you.

8. If a GST-registered **agent sells goods for a principal who is not required to collect tax**, the agent is considered to have bought and sold the property from the principal, and must collect GST or HST on the full price charged to the customer. For example, suppose you have a used boat (which you used for your own pleasure) that you want to sell. You leave it with a boat dealer, who sells it for you and takes a commission. The dealer must collect and remit GST or HST on the full sale price (not just the commission), even though you would not have to do so if you sold the boat yourself.
9. If your business collects a “**deposit**” from a customer, no GST or HST applies until you apply it as “consideration” for the purchase. However, based on a recent Tax Court case (*Tendances et Concepts Inc.*), what you think is a “deposit” might actually be a “payment on account”, in which case the GST or HST applies as soon as you have collected the deposit. As well, once you have **invoiced** an amount, the entire GST or HST is normally “payable” and must be remitted for that reporting period. These rules are tricky, and if you get them wrong, when the CRA audits your business they will assess you for not

having remitted GST or HST in the right reporting period.

10. If you are **selling commercial real property** to a GST-registered purchaser, the purchaser normally accounts for the GST and usually claims an offsetting input tax credit, so that the purchaser doesn’t actually pay any amount in tax. However, the sale is still “taxable” for GST purposes. As a result, if your purchase and sale agreement says that any GST/HST is “included” in the sale price, you will only get 100/105ths, 100/113ths or some other percentage of the sale price (depending on the province) when the deal closes. Be careful about how the agreement is worded!
11. The sale of **vacant land** is often exempt when sold by an individual, but there are many exceptions. For example, if you have previously severed the land into more than two parts, it will be taxable. If you have been renting out the land, it may be taxable. A sale by a corporation is always taxable. If a farm has a farmhouse on it, the farmhouse portion (plus one-half hectare of land) is usually exempt. Again there are lots of special rules and exceptions, and you may need professional advice to make sure you’re getting it right.
12. If your business **sues another person for breach of contract**, and the original contract bore GST or HST, any amount you receive as damages or in a settlement will normally be considered to be GST- or HST-included, so that you must remit tax out of the total and the defendant may be able to claim an input tax credit. Make sure to “gross up” for

the GST or HST in any claim or settlement in such cases.

13. An employed **musician** who is also GST-registered can often claim input tax credits for tax paid on buying musical instruments used in employment, under a special rule in ETA subsection 199(5).

As you can see, the GST and HST are very complex. The legislation and regulations run to thousands of pages. The above only scratches the surface of the complexity.

AROUND THE COURTS

Lump-sum workers' compensation payment led to loss of age credit

In the recent *Sveinson* case, the taxpayer worked for Corrections Canada, apparently as a prison guard. He was involved in several violent incidents with inmates, and was diagnosed with post-traumatic stress disorder. In 2008 he received a settlement of over \$35,000 from the provincial Workers' Compensation Board (WCB).

The WCB payment was not subject to income tax. However, under the Income Tax Act it was included in "net income", and then an offsetting deduction was allowed in computing "taxable income". The result was that Mr. Sveinson had high "net income" for 2008. As a result, he could not claim all of the age credit available to taxpayers over 65, which is reduced once income exceeds a certain threshold.

Mr. Sveinson appealed to the Tax Court of Canada. He argued that the WCB payment was supposed to be tax-free.

Unfortunately, the rules of the Income Tax Act are clear, and the Tax Court judge ruled against Mr. Sveinson. The WCB payment increased his net income, and so his age credit was reduced.

The taxpayer also argued that the amount he received was compensation for being the victim of a criminal act, which is not taxable. However, this rule applies only to compensation from the provincial Criminal Injuries Compensation Board, which was not what he had received.

As a result, Mr. Sveinson was out of luck. As is usually the case, the technical rules of the Income Tax Act determined the result, rather than any sense of justice or "fairness".

This letter summarizes recent tax developments and tax planning opportunities; however, we recommend that you consult with an expert before embarking on any of the suggestions contained in this letter, which are appropriate to your own specific requirements.