CPA Practice Advisor

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good understanding of these differences will ...

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By Phil Hogan, CPA.

It’s not uncommon for Americans to move to Canada or for Canadian citizens living

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returns

Canada and the U.S. have very different tax residency rules. Americans are required to file tax returns based on their Citizenship while Canadians are required to file tax returns based on their Canadian residency. Once an American moves to Canada they will be required to file both a U.S. tax return (1040) and a Canadian income tax return (T1).

And although they will be reporting their worldwide income on both their U.S. and Canadian income tax returns, in most cases your client will not pay double tax as the Canada-U.S. tax treaty includes articles that help eliminate the potential of double tax through foreign tax credit calculations.

#2 – They will want to review their investments

Investment planning is imperative when moving from the U.S. to Canada. Many investments that work well for U.S. tax residents simply are not tax efficient for Canadian purposes given the difference in tax rules. Some notable items include:

- Non-taxable interest such as muni-bond interest is fully taxable in Canada.
- Investments that are left in the U.S. after the move to Canada will be subject to significant T1135 foreign assets disclosures that are terribly difficult and expensive to complete and file. In most cases moving investments to Canada is the most efficient option.
- Special Canadian tax elections will need to be filed for ROTH IRA accounts to ensure ROTH accounts remain tax-deferred for both Canadian and U.S. tax purposes.
- Americans often hold their investments inside of revocable trusts. Canadian tax rules would deem a U.S. revocable trust as a Canadian trust and therefore require

complex Canadian trust filings that would not add additional value. In most cases

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As mentioned above both the U.S. and Canada have specific foreign asset disclosure rules. Both countries want to know if their taxpayers own assets outside of the country. Foreign disclosure forms are extremely important to understand as they almost always carry significant penalties if not filed:

- American tax residents with assets outside of the U.S. are required to file Foreign Bank and Financial Account (FBAR) disclosures with the treasury department. U.S. taxpayers will be required to file FBARs (form 114) if the aggregate total of the highest balance in the year of all their non-U.S. bank and investment accounts exceed $10,000.
- Canadian tax residents are also required to disclose their non-Canadian assets, however with very different criteria. If a Canadian tax resident owns assets (bank, investments, real property and other) with a cost basis more than $100,000 form T1135 will be required.

Once again, these foreign disclosure forms are extremely important to file as the FBAR carries a $10,000 per unreported account penalty and the T1135 form carries a $25/day penalty to a maximum of $2,500 (100 days). The $25/day penalty may not seem high, however if you miss filing this form you likely will miss it for the maximum 100 days.

#4 – LLCs don't work well for Canadians

Many Americans have interests in Limited Liability Companies (LLC). The LLC structure has lots of advantages for U.S. taxpayers, however for Canadian purposes it's viewed as a corporation and separate from the taxpayer. The reason this is an important issue to recognize is that there is a significant chance that double tax will occur on LLC income paid to a Canadian resident.

Let's use an example where an American, who wholly owns an LLC that earns

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#5 – Canadians don't have joint tax filing options

Finally, it's often a surprise to those moving to Canada that Canadian tax joint filing is not an available option. For U.S. purposes a married couple has the option of filing jointly. This can be a big advantage if one of the spouse's income is relatively low and one is high. For Canadian purposes each taxpayer files separate tax returns eliminating any advantage inherit in joint filings.

The list above is certainly not exhaustive and proper planning should be done to review a taxpayer's tax and investment situation before moving to Canada. Competent planning can not only reduce the possibility of double tax and penalties but also potentially reduce future tax liabilities.

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Phil Hogan is both a Canadian and U.S. CPA specializing in cross-border tax and wealth management in Victoria BC Canada. Phil helps clients plan for both their investments and tax situation. Phil writes extensively on cross-border financial matters on his blog at www.PhilHogan.com and he can be reached at phil@philhogan.com or via phone or text at 250-661-9417.

Taxes

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