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EY Wealth Insights — Canada

Coming or going? Canadian income tax considerations for immigrants and emigrants

If you're thinking of either moving to or leaving Canada, you'll have a long list of details to work through and tax may not be at the top. But there are several important issues to think about from a tax perspective, including at what point in time you'll begin or cease to be a resident of Canada for tax purposes. In this article, we review some of the factors that affect residency before summarizing several key tax implications of becoming or ceasing to be a Canadian resident.

How am I treated for tax purposes in the year when I come to or leave Canada?

If you immigrate to, or emigrate from, Canada in a calendar year, you will generally be a part-year resident: Canadian resident for the period you reside in Canada and nonresident for the period before or after you are resident.

As a part-year resident, you are taxed on worldwide income for the portion of the year you are a resident of Canada. A part-year resident is also subject to tax on certain Canadian-source income received for the part of the year prior to establishing residence or subsequent to relinquishing residence.

If you are resident for part of a year, you will find that you can claim certain federal non-refundable tax credits only to the extent they relate to the period of residence, and other credits must be prorated on the basis of the number of days of residence in the year.

What factors are taken into account in determining whether I'm resident in Canada?

Because an individual's Canadian tax liability is based on residence, the date on which you become, or cease to be, a resident of Canada is relevant in determining how, and how much of, your income is subject to Canadian tax. Often, the date of the physical move is recognized as the date Canadian residence begins or ends. However, other factors must be taken into consideration, including the extent to which you establish or cease to have residential ties with Canada.

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Certain residential ties are almost always considered to be significant for the purpose of determining residence status, such as the location of your home, spouse, common-law partner and dependants. In addition, the Canada Revenue Agency (CRA) has stated that where an individual entering Canada applies for and obtains landed immigrant status and provincial health coverage, these ties will usually constitute significant residential ties with Canada and, subject to certain exceptional circumstances, such an individual will be determined to be resident in Canada.[1]

Secondary residential ties are also considered collectively in determining residential status. A few examples include:

- personal property in Canada (e.g., furniture, clothing, automobiles and recreational vehicles)
- social ties in Canada (e.g., memberships in Canadian recreational or religious organizations)
- economic ties in Canada (e.g., employment with a Canadian employer and active involvement in a Canadian business, and Canadian bank accounts, retirement savings plans, credit cards and securities accounts)

When am I considered to become a nonresident of Canada?

The CRA considers the date on which you become a nonresident of Canada to be the date on which you sever the majority of your residential ties to Canada. This date is usually the latest of the following:

- The date when you leave Canada
- The date when your spouse (or common-law partner) or dependants leave Canada
- The date when you become a resident of the country to which you are immigrating (unless you are re-establishing residence in that country, in which case you will become a nonresident on the day you leave Canada, regardless of whether your spouse or dependants remain behind temporarily)

Individuals who cannot be considered nonresidents because they have retained significant residential ties with Canada remain factual residents of Canada and are subject to Canadian tax on worldwide income. However, an income tax treaty between Canada and the other country may modify this determination.

Determination of an individual's residence status can only be made on the basis of the specific facts of each case. The CRA has published a summary of factors to consider in its Income Tax Folio S5-F1-C1, *Determining an Individual's Residence Status*.

[1] Income Tax Folio S5-F1-C1, *Determining an Individual's Residence Status*, paragraph 1.25.

What are the tax implications if I leave Canada to live somewhere else?

Except in very unusual circumstances, individuals who become nonresidents of Canada for income tax purposes become residents of another country. Accordingly, tax consequences that arise include both the Canadian tax and host country tax issues.

For example, many countries are like Canada, in that there is one set of rules for residents and another for nonresidents. However, some jurisdictions have a subset of rules for short-term residents or expatriate employees. It may also be necessary to consider any tax treaty between Canada and the destination country to determine residence status and the best way to reduce any double tax that may arise as a result of the departure.

Because Canada taxes its residents on their worldwide income but taxes nonresidents on only certain Canadian-source income, an individual leaving Canada and becoming a nonresident will be concerned about how this change in tax status will affect his or her future personal taxes.

Employment income

Determining what employment income to report in the year of departure from Canada is not always straightforward. Often, employment income earned must be allocated between the resident and nonresident periods. Employment income may also need to be reviewed to determine whether income received while resident in Canada is foreign source (as foreign-source income may be eligible for a foreign tax credit to reduce Canadian tax) and whether any income received in the nonresident period is Canadian source and therefore subject to Canadian tax.

The allocation of employment income to determine the amount earned or received in a certain period is most often determined by reference to time. It's important to note that whether the payer is a Canadian or a foreign company has no bearing on the preliminary determination of the income's source.

Frequently, the date of departure does not correspond to the date of change from the Canadian company's payroll to the foreign company's payroll. In this case, it is necessary to determine what income was received as a resident (and is therefore taxable in Canada) and what Canadian-source income was received as a nonresident (and is therefore also taxable in Canada). For example, a bonus that is received after you have become a nonresident of Canada, but was earned while you were resident and working in Canada, would be considered Canadian source and taxable in Canada.

Canadian benefits

Canada generally retains the right to tax Canadian benefit payments made to nonresidents. Examples of such payments include the following:

- Old Age Security (OAS) pension
- Canada Pension Plan (CPP) or Quebec Pension Plan (QPP)
- Superannuation or pension benefits
- Deferred profit-sharing plan (DPSP), registered retirement savings plan (RRSP), pooled registered pension plan (PRPP) and registered retirement income fund (RRIF) payments
- Retiring allowances
- Payments from a retirement compensation arrangement
- Death benefits
- Employment insurance benefits

As a nonresident of Canada, you would be subject to a flat 25% withholding tax on the gross Canadian benefit payment. The 25% tax represents your final Canadian tax liability, and you do not need to file a Canadian tax return to report the Canadian benefit payment. If you are a resident of a treaty country, this flat withholding rate may be reduced under the treaty.

Alternatively, you may elect to report your Canadian benefit payments on a Canadian tax return, pay tax at incremental tax rates and claim applicable deductions and credits. Making this election may result in a refund of all or some of the 25% tax withheld. If you intend to make this election, you can apply to the CRA to request a reduction in the flat withholding rate to be applied to the payments.

Personal assets

Generally, on the date that you're no longer a resident of Canada, you're deemed to dispose of property owned at that date, with specific exceptions, for proceeds equal to fair market value at that time.

The exceptions include:

- Real property in Canada
- Capital property and inventory used for a business you carry on through a permanent establishment in Canada
- Pension rights, such as registered pension plans (RPPs), RRSPs, RRIFs and DPSPs and the right to CPP or OAS benefits
- Other excluded rights and interests, such as tax-free savings accounts (TFSAs), registered education savings plans (RESPs) and registered disability savings plans (RDSPs)
- Employee stock options
- Life insurance policies in Canada (other than segregated fund policies)
- For certain short-term residents of Canada (i.e., resident for no longer than 60 months in the 10-year period before emigration), the property you owned when you became a Canadian resident or inherited after becoming a resident of Canada

This means that any accrued gains on your assets at the date you leave Canada will be taxed in the year of your departure.

Instead of having to pay the tax liability from the deemed disposition immediately, you are allowed to file an election to post security with the CRA and pay the tax when the property is actually sold, without interest charges. In addition, if you return to Canada (regardless of your period of non-residence), you can elect to unwind the deemed disposition on departure for property you still own when you return to Canada.

If you are later subject to foreign tax on the actual disposition of the property in a country with which Canada has a tax treaty, you may be eligible to amend your Canadian departure tax return to claim a foreign tax credit for the portion of the foreign tax that relates to the departure gain on the property.

Regardless of whether you elect to defer the tax on deemed disposition, there may be additional reporting requirements in your year of departure if the value of the assets you own when you cease your Canadian residency exceeds $25,000 (some exceptions apply).

Rental income

Canada retains the right to tax nonresidents on income from Canadian real property. Therefore, should you receive rental income from a Canadian rental property, you will continue to be taxable on this income even after becoming a nonresident of Canada.

As a nonresident, you will be subject to a 25% withholding tax on gross rental income. The person who pays the rent to you must withhold and remit this tax. Where rental payments are made to an agent, the agent is responsible for withholding and remitting the tax.

With respect to the payment of tax on Canadian rental property, you have three alternatives:

- Your agent or the tenant withholds, remits and reports the 25% tax from your gross rent and you do not need to file a Canadian tax return to report the income. Because this option does not allow for any deductions against gross rent, it is not usually the preferred alternative.
- You can elect to file a Canadian nonresident rental tax return within two years from the end of the taxation year in which the rents were received and pay tax at graduated tax rates on the net rental income. Generally, all reasonable expenses that relate to earning the rental income are deductible in computing the net rental income. Your agent or tenant is still required to withhold and remit tax from the gross rent at the 25% rate; however, this withholding tax is creditable against the tax liability as determined on your tax return, and any excess tax withheld is refundable.
- You can elect to have the initial 25% withholding tax be based on the anticipated net rental income (excluding depreciation claims) rather than the gross rent. The election is made by filing Form NR6 before the beginning of each taxation year (1 January), or in the year in which the property is first being rented before the date on which the first rental payment is due. To have the withholding tax reduced in this manner, the CRA must approve your Form NR6, you must appoint an agent who is resident in Canada and you must file your Canadian tax return within six months from the end of the taxation year in which rents were received. If you do not file your return by the due date, the election becomes invalid and you may be assessed nonresident tax, plus interest, on your gross income.

Tax tips

If you are leaving Canada, you should establish the date on which you become a nonresident and ensure that it can be supported. It's also important to keep detailed travel logs to substantiate travel inside and outside Canada during the year.

- Canadian bank or investment accounts – If these accounts are to be retained, notify the Canadian payers of interest and dividends so that they can withhold and remit the appropriate amount of withholding tax.
- Canadian rental property – If you rent your Canadian home or another property after ceasing Canadian residence, you'll be subject to 25% Canadian nonresident withholding tax on the gross rental income. A better alternative may be to elect to file a Canadian income tax return, reporting net rental income (deducting applicable expenses), in which case Canadian marginal tax rates will apply.
- RRSP contribution room – Consider making RRSP contributions for the year of departure.
- RRSP investments – It's generally beneficial to leave RRSPs in place when you end your Canadian residence, provided that maintaining funds in a Canadian RRSP does not give rise to any tax issues in your new country of residence. Advise RRSP administrators of your departure, as certain RRSP trading restrictions may exist for nonresidents under local securities law.
- RRSP Lifelong Learning Plan or Home Buyers' Plan loans – These loans should be repaid within 60 days of departure from Canada to avoid the outstanding loan balances coming into income in the year of departure.
- RESP contributions – These may be made only when the beneficiary is a resident of Canada. Accordingly, RESP contributions should be made prior to the beneficiary's departure.
- TFSA contributions – You may continue to hold a TFSA after ceasing residency in Canada, but you cannot make contributions or accrue contribution room while a nonresident. Accordingly, you should make your contributions before you leave Canada. Note that your new country of residence may not necessarily treat the accrued income and gains in a TFSA as tax-free within the plan or when withdrawn from the plan.

What are the tax implications if I move to Canada?

Once you establish Canadian residence, your worldwide income is taxable in Canada at graduated tax rates. Since foreign-source income received after you become a resident of Canada may also be subject to foreign tax, to avoid double taxation, a foreign tax credit is available (within certain limits) for foreign taxes paid on this income. However, if income tax rates in the country from which you are leaving are lower than Canadian rates, it would be beneficial for you to arrange to receive as much income as possible in that country before establishing Canadian residence.

Employment income

The considerations described above in relation to the taxation of employment income when departing Canada also apply to those entering Canada. In both situations, employment income must be allocated between the resident and nonresident periods, and the source of the income needs to be determined.

Personal assets

When you become a Canadian resident, you're deemed to have disposed of and reacquired each property you owned immediately before establishing residence (with the exception of taxable Canadian property (TCP), inventory and certain intangible assets in respect of a business carried on in Canada, and certain excluded rights or interests) for proceeds equal to the fair market value of the properties at that time. This does not trigger a taxable transaction but merely establishes a new cost base for your property.

TCP includes Canadian real or immovable property, capital property used in carrying on a business in Canada, certain shares of Canadian private corporations, certain shares of public companies, and Canadian resource properties. In addition, TCP excludes certain shares and other interests that do not derive their value principally from real or immovable property in Canada, Canadian resource property or timber resource property.

For those properties you're deemed to have reacquired, striking a new adjusted cost base means gains that accrued before you began your Canadian residence are not subject to Canadian tax. However, this also means that property that has fallen in value since you purchased it will now have a lower cost base. Consequently, it may be better to dispose of loss properties before you enter Canada, especially if the resulting loss can be offset against other gains or income in the country from which you are emigrating.

Reporting on foreign investment assets

Residents of Canada holding foreign investments are subject to certain reporting rules. These rules require individuals who own foreign property to file annual information returns.

The following information returns are particularly relevant if you are becoming a Canadian resident:

- **Form T1135, Foreign Income Verification Statement** – Individuals with an interest in specified foreign property — such as shares, bank accounts and real property (other than personal-use property) — with an aggregate cost amount of more than Cdn$100,000 at any time in the year must report and provide details of these holdings annually. However, if the aggregate cost amount is less than Cdn$250,000 throughout the year, a simplified reporting method is available.
- **Form T1141, Information Return in Respect of Contributions to Non-Resident Trusts, Arrangements or Entities** – Individuals who have transferred or loaned property to a nonresident trust, arrangement or entity must file an annual information return.
- **Form T1142, Information Return in Respect of Distributions from and Indebtedness to a Non-Resident Trust** – Beneficiaries of certain nonresident trusts must file an information return for the year in which they receive a distribution or loan from the trust.
- **Form T1134, Information Return Relating to Controlled and Not-Controlled Foreign Affiliates** – Individuals who have an interest in a nonresident corporation or nonresident trust that is considered a foreign affiliate must file an annual information return.

Unless you have been a resident of Canada in the past, you are not required to file these information returns for the year in which you first become resident in Canada.

Relief granted to short-term residents

The term "short-term resident" is not defined in the *Income Tax Act*, but it's generally used to refer to individuals who move to Canada and are resident for less than five years. Short-term residents are granted some relief from the departure tax rules, as well as from the rules relating to participation in a foreign pension plan while a Canadian resident.

An individual who is resident in Canada for no more than 60 months in the 120 months preceding departure from Canada is not subject to departure tax on property that he or she owned before becoming a Canadian resident, or that was acquired while a Canadian resident by bequest or inheritance.

It may be possible for an individual who moves to Canada as a result of an employer request, and remains a member of the former employer's pension plan in the employee's home country, to continue to participate in that pension plan for the first five years of Canadian residence. After five years, certain steps must be taken to avoid the Canadian tax rules deeming the foreign plan to be a retirement compensation arrangement under which the employer's contributions become subject to Canadian tax.

Tax tips

If you are immigrating to Canada, you should establish the date on which you become a resident and ensure that it can be supported. It's also important to keep detailed travel logs to substantiate travel inside and outside Canada during the year.

- Date residence commences – It may also be possible to plan the date of commencement of Canadian residence to take advantage of lower marginal tax rates in Canada.
- Investment portfolios – Review your portfolio prior to establishing Canadian residence. It may be advantageous to sell investments with accrued losses before becoming a Canadian resident if those losses may be used in the country of residence.
- Relocation expenses – Review the tax consequences of any employer benefits paid relating to the relocation to Canada and, if possible, structure the benefits so that they are not taxable in Canada or are received before becoming a resident. Certain moving expense reimbursements are not taxable.
- Stock option plans – Review the tax consequences of exercising stock options from a foreign employer prior to establishing Canadian residence.
- Foreign pension plan – You and your employer may be allowed to continue to contribute to the plan. However, the contributions may restrict your eligibility to use Canadian RPPs, DPSPs and RRSPs. In some cases, you may be allowed to transfer the pension benefits on a tax-deferred basis to an RRSP (although the transfer may not be free of foreign tax).
- Social security premiums – Review the tax consequences of continuing coverage under the social security system of your former country and opting out of the CPP (or QPP). Canada and Quebec have social security totalization agreements with a number of countries.

Learn more

For more information on this and any other topics that may be of concern, please contact your EY or EY Law advisor or one of the following professionals:

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