



# US TAX ALERT

October 2008 – Issue 2-08 – Amended November 2008

**US TAX ALERT** is a synopsis commentary on topics of special interest – usually topics relating to recent changes in the law, administrative practices or interpretations by taxation authorities. Professional advice should be obtained before acting on any of this information.

## US TAX FILING REQUIREMENTS – AN INTRODUCTION

In the next while we intend to issue four **US TAX ALERT** 's, this being the first one.

- ◆ US Tax Filing Requirements – An Introduction
- ◆ US Tax Rules – Nonresident Aliens
- ◆ US Tax Rules – US Citizens and Deemed Residents
- ◆ US Tax Rules – Snowbirds

If there is a part of our tax practice where we see more than average non compliance (innocently of course), it has to be people living in Canada failing to file the required US tax returns and other information reporting forms. Tax rules in the United States are more codified than in Canada and therefore reporting requirements are more extensive. In some cases, severe penalties apply for non-compliance.

### US Tax Filing

US tax filing and other reporting by Canadians can be divided into three main categories:

- ◆ US Residents – US citizens, Green card holders and deemed US residents
- ◆ Non-Resident Aliens – Canadians (people living in Canada) owning US investments, vacation properties and rental properties
- ◆ Snowbirds – US winter vacationers

Individuals in the first category must report their world-wide income to the Internal Revenue Service by filing a US personal 1040 tax return and in some cases other information forms each year. The forms can require extensive information. Effectively, the United States requires all such individuals to file US tax returns (no matter where they live in the world) as if they are living in the United States – even if they are not.

If your gross income on your US return is below certain levels, you are not required to file a US tax return. Those levels in 2007 were as follows:

|        |              |          |
|--------|--------------|----------|
| Single | Under 65     | \$ 8,750 |
|        | 65 and older | 10,050   |

|  |                            |          |
|--|----------------------------|----------|
| <b>Married filing jointly</b>                    | Under 65 (both spouses)    | \$17,500 |
|  | 65 or older (one spouse)   | 18,550   |
|  | 65 or older (both spouses) | 19,600   |
| <b>Married filing separately</b>                 | Any age                    | \$ 3,400 |
| <b>Head of household</b>                         | Under 65                   | \$11,250 |
|  | 65 or older                | 12,550   |
| <b>Qualifying widow(er) with dependant child</b> | Under 65                   | \$14,100 |
|  | 65 or older                | 15,150   |

Individuals that fall into the second category are subject to US income tax only on income with a US source. Such income would, for example, include dividends and interest from US investments, rental income from a US condominium or other rental property and capital gains on US real estate. The United States Internal Revenue Service calls such taxpayers *Nonresident Aliens*. Tax is normally paid to the US either as a withholding tax (on US dividends and interest for example), or as a tax on non portfolio income requiring the filing of a US 1040NR tax return.

Snowbirds are typically Canadian citizens and residents who winter vacation in US southern states starting around Christmas and return to Canada in April. Canada is the country where they have their main centre of social, family, home and financial interests and for this reason they are factual residents of Canada and not of the United States.

If Snowbirds own a US vacation property of substantial value, they may become involved in US estate taxes but ordinarily no other US income tax filings are necessary. The US has special rules which can make Canadians subject to US income tax if they are present in the US an average of 120 days per year in three successive years (based on a special formula). In this case, the Canada US Tax Treaty keeps such individuals from being US taxpayers but this requires filing Form 8840 with the US Internal Revenue Service each year.

### **Basis of Taxation in Canada and the United States**

You must file a Canadian tax return if you are a resident of Canada. On the other hand, you are required to file a US tax return if you are resident or deemed resident of the United States or if you are a citizen of the United States - no matter where you live in the world. Many US citizens and Green Card holders living in Canada do not realize that they must file a US tax return reporting their worldwide income – even if they have no US source income.

### **Unfiled US Tax Returns**

The United States usually provides an amnesty for non-compliant filers if they file the current and two years of prior years returns (if no tax was payable for prior years and the current plus five years of previous returns if tax was payable in any of those years.) which will get their US filings up to date. If this is done, no penalties are likely to be applied. On the other hand, if US non tax filers get caught by the IRS, penalties are likely to apply and exempting tax provisions may not be allowed – a very expensive process.

Although not a subject of this **US TAX ALERT**, US citizens, deemed residents and Canadians with substantial assets in the United States may be subject to US estate tax.

### Double Taxation

Canadian taxpayers required to file US tax returns often wonder if they will be paying tax on the same income both in Canada and the United States – double taxed. Briefly, the answer is no. If you are a resident of Canada and receive income that is taxed in the United States, Canada will allow a foreign tax credit for US taxes paid on such income. The US allows the same credit in the reverse situation. Also, there are a number of special rules in the Canada-US Tax Convention mentioned below.

It is important to remember that credits for foreign taxes cannot exceed the taxes in the country in which you live. Since Canadian tax rates are higher than those in the US, in the end you will always end up paying the higher Canadian rates.

### Foreign Bank Accounts

If you are a US taxpayer, one US information return that can have expensive consequences if not filed is form TDF90-22.1 to report foreign bank accounts with aggregate balances totaling more than \$10,000. Such accounts include RRSP's and RRIF's. The penalty for not filing is \$10,000 but increases to \$100,000 for violation to not file. Canada has a similar form with stiff penalties as well. If you are a Canadian resident and fail to disclose investment assets outside Canada with an aggregate value in excess of \$100,000 cost you are subject to penalties here.

### The Canada – US Tax Convention

The Canada – US Tax Convention sorts out the rules between the two countries so double taxation should not happen. The Convention allows both countries the right to get tax information from the other country on anyone suspected of cross border tax avoidance. The tax treaty also limits withholding tax rates and in many cases dictates which country can or cannot tax certain kinds of income. There are many mitigating provisions in the tax treaty but both countries may restrict their use if taxpayers have not filed returns on time.

### The Canada – US Tax Convention

As mentioned earlier, the United States has a host of forms that taxpayers may need to file to comply with US tax law. Some of the important ones are as follows:

- ◆ Form 1116 – Foreign Tax Credit
- ◆ Form 2555 – Foreign Earned Income Exclusion
- ◆ Form 4852 – Substitute W2
- ◆ Form TDF90-221 – Foreign Bank Accounts
- ◆ Form 8833 – Treaty Reliance – Tie breaker, social security, residency etc.
- ◆ Form 8891 – RRSP – beneficiary, contributions, withdrawals and deferral election
- ◆ Automatic Extension to June 15 – no form
- ◆ Form 2350 – Filing Extension - Foreign Earned Income Exclusion
- ◆ Form 3520-A – Ownership of foreign trusts (Grantor trusts)
- ◆ CPT56 – Canadian Social Security Coverage – US exemption
- ◆ Forms 5471, 8805 and 8858 – Foreign Ownership

There are many ways to become caught up in the US tax system. Be aware if you own property in the US or spend any amount of time there on an ongoing basis. If you are a member of a family some of which are US citizens, you too may be a US citizen and subject to US tax filings each year.

*J. E. Arbuckle Financial Services Inc.  
30 Dupont St. E., Suite 205, Waterloo, Ontario N2J 2G9  
Phone: 519-884-7087 Toll Free: 1-877-883-3970 Fax: 519-884-7089  
Email: [info@finplans.net](mailto:info@finplans.net)*

