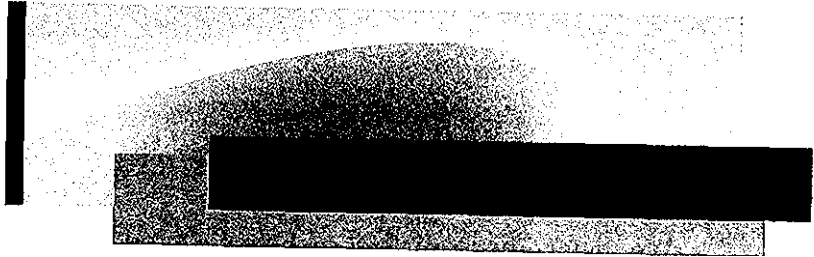


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# Canadian Residents Going Down South

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### **Your opinion counts!**

We review this pamphlet each year. If you have any comments or suggestions that would help us improve the explanations it contains, we would like to hear from you.

Please send your comments to:

Revenue Canada  
Client Services Directorate  
~~400 Cumberland Street~~  
~~Ottawa ON K1A 0L8~~  
~~CANADA~~

The Internal Revenue Service of the Government of the United States of America provided information for the "Do U.S. tax laws apply to you?" section.

**La version française de cette publication est intitulée**  
*Résidents canadiens qui séjournent dans le Sud.*

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# Introduction

This pamphlet will help you understand the United States (U.S.) tax laws that may affect you if you are in the U.S. for a vacation or for your health, **and** you maintain residential ties in Canada. It will also give you information about certain Revenue Canada requirements that may affect you.

The comments in the sections called "Do U.S. tax laws apply to you?" and "How Canadian income tax laws apply" do **not** apply to you if:

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

For U.S. tax information in the above situations, contact the Internal Revenue Service (IRS), 60 Queen Street, Suite 201, Ottawa ON K1P 5Y7. You can also call the IRS at (613) 563-1834. If you are in the U.S., contact the IRS office in your area.

For Canadian income tax information, contact the International Tax Services Office. You will find the address and telephone numbers on page 16 of this pamphlet.

## Do U.S. tax laws apply to you?

**A**s 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're considered a resident alien if you meet the **substantial presence test**.

- If you were in the U.S. for less than 31 days in 1995, you don't meet the substantial presence test. If this is your situation, you are considered a non-resident alien of the United States. Although the comments in this section do not apply to you, you should read "Do you have to file a U.S. return?" on page 12.
- If you were in the U.S. for 183 days or more in 1995, you meet the substantial presence test. If this is your situation, you are considered a resident alien of the United States. Although the comments in this section and the following section do not apply to you, you should read "Residence under the treaty" and "Do you have to file a U.S. return?" on pages 11 and 12 of this pamphlet.
- If you were in the U.S. for 31 to 182 days in 1995, you may meet the substantial presence test.

### **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 your residency status for 1995, you need to find out if you meet the substantial presence test by calculating the number of days you were present in the U.S. during 1993, 1994, and 1995:

- each day in 1995 counts as a full day;
- each day in 1994 counts as one-third of a day; and
- each day in 1993 counts as one-sixth of a day.

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.

If your total is **more than 182 days**, you have met the substantial presence test and are considered a resident alien for 1995. See "Are you a non-resident alien?" on page 8 for more information about your U.S. residency status.

If your total is **182 days or less**, you're considered a non-resident alien for 1995. See "Do you have to file a U.S. return?" on page 12.

#### **Tax Tip**

If you were in the U.S. for 122 days or more in each of 1993, 1994, and 1995, you don't have to calculate your total days — you meet the substantial presence test. See "Are you a non-resident alien?" on page 8 for more information about your U.S. residency status.

### **Example**

Hugh and Anne are residents of Canada, and own a trailer home in Florida, where they spend each winter. Although they have no U.S.-source income, they need to determine their U.S. residency status. To do this, they have to determine how many days they were in the U.S. during 1993, 1994, and 1995.

During 1995, they were in the U.S. from January 1 to April 12, and from November 13 to December 31 (**151 days**).

During 1994, they were in the U.S. from January 1 to April 1, and from November 15 to December 31 (**138 days**).

During 1993, they were in the U.S. from January 1 to April 5, and from November 1 to December 31 (**156 days**).

Each day they were in the U.S. during 1995 counts as a full day (**151**). Each day they were in the U.S. during 1994 counts as one-third of a day ( $138 \times 1/3 = 46$ ). Each day they were in the U.S. during 1993 counts as one-sixth of a day ( $156 \times 1/6 = 26$ ).

They add the subtotals:  $151 + 46 + 26 = 223$ . Since this total is more than 182 days during the three-year period, they meet the substantial presence test, and they are considered resident aliens by the U.S. for 1995.

For more information on this subject, see Chapter 1 of IRS Publication 519, *U.S. Tax Guide for Aliens*.

## **Are you a non-resident alien?**

You are a non-resident alien if you don't meet the substantial presence test.

If you have determined that you are a non-resident alien, read "Do you have to file a U.S. tax return?" on page 12.

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 1995;
- your **tax home** is in Canada; and
- you had a **closer connection** to Canada than to the U.S. during 1995.

## **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 1995, 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;
- 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. Immigration and Naturalization Service for 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 won't be eligible to claim the closer connection exception.

### **How do you advise the IRS about your closer connection to Canada?**

You have to file IRS Form 8840, *Closer Connection Exception Statement (Under Section 7701(b))*, to advise the IRS that your tax home is in Canada, and that you have maintained more significant ties in Canada than in the U.S. during 1995. We have included a copy of this form in the middle of this pamphlet. You can also get copies from any IRS office in the U.S., and from the Internal Revenue Service, ~~60 Queen Street, Suite 201, Ottawa ON K1P 5Y7.~~

If you have to file a U.S. income tax return for 1995, attach Form 8840 to your U.S. return. If you don't have to file a return, send Form 8840 by the due date for filing Form 1040NR, *U.S. Nonresident Alien Income Tax Return*, (June 17, 1996) to the following address:

**Internal Revenue Service Center**  
~~Philadelphia, Pennsylvania~~  
~~U.S.A. 19255~~

Each individual claiming the closer connection exception has to file Form 8840. Therefore, if you have a spouse and children, each of them must also file Form 8840 to claim the exception.

**Note**

If you do not file Form 8840 by June 17, 1996, you won't be eligible to claim the closer connection to Canada, and you will be considered a resident alien. However, you should let the IRS know if you tried to comply with the filing requirements, but were unable to do so for valid reasons. For information on your U.S. tax requirements, see "Do you have to file a U.S. return?" on page 12.

**Example**

Hugh and Anne have determined that they are resident aliens for 1995, because they meet the substantial presence test. However, they file Canadian income tax returns as residents of Canada, and their family, belongings, and permanent home are in Canada. Also, they maintain social and religious ties in their home town in Canada.

Since Hugh and Anne have closer ties to Canada than to the U.S., and they were present in the U.S. for less than 183 days during 1995, they may be considered non-residents of the U.S. under the closer connection exception.

Hugh and Anne each have to submit Form 8840 by June 17, 1996, to advise the IRS of their closer connection to Canada, or they won't be eligible for the exception. If they don't file on time, they may be subject to U.S. income tax on their worldwide income.

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 computing 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, and your personal and economic ties are closer to Canada than to the U.S.

To find out if Article IV applies to you, contact the International Tax Services Office. You should also get Form 8833, *Treaty-Based Return Position Disclosure Under Section 6614 or 7701(b)*, from the IRS. For more information on this subject, get IRS Publication 519, *U.S. Tax Guide for Aliens*.

## Do you have to file a U.S. return?

### Resident alien

Generally, resident aliens have to file a U.S. tax return to report worldwide income for the year.

If you are a resident alien who cannot be considered a non-resident alien under Article IV of the *Canada-U.S. Income Tax Convention* or under the closer connection exception, you should contact the IRS for information on how to file your U.S. return. The address and telephone number are on page 16 of this pamphlet.

### Non-resident alien

If you are a non-resident alien, your income that is subject to U.S. income tax is divided into two categories:

- income that is **effectively connected** with a trade or business in the U.S. (including income from the sale or exchange of U.S. real property); and
- income that is **not effectively connected** with a trade or business in the U.S., but is from U.S. sources (including interest, dividends, rents, and annuities).

Effectively connected income, after allowable deductions, is taxed at the same rates that apply to U.S. citizens and residents. Income that is not effectively connected is taxed at 30% or a lower treaty rate.

As a non-resident alien, you have to file a U.S. tax return, by June 17, 1996, if:

- you have income that is effectively connected;
- you have income that is not effectively connected and which did not have sufficient tax withheld at source; or
- you have income that is not effectively connected and which had too much tax withheld at source.

For more information, get IRS Publication 519, *U.S. Tax Guide for Aliens*, or contact the IRS at the address and telephone number shown on page 16 of this pamphlet.

### **Did you receive U.S. gambling or lottery winnings?**

As a non-resident alien, you are subject to tax on the gross gambling or lottery winnings at the rate of 30% at the time of winning. However, winnings from blackjack, baccarat, craps, roulette, and big-6 wheel are exempt from tax.

If you received tax-exempt winnings, or if the correct tax was collected at the time of winning, you do not have to file a tax return if this is your only U.S. income.

#### **Note**

You cannot claim gambling losses or expenses, such as hotel or meal costs, against gambling winnings, unless you are in the gambling business.

### **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 receive rental income from this property?**

As a non-resident alien, you are subject to U.S. income tax on rental income you receive from U.S. real property. You are considered to have received the income from a U.S. source, even if it was paid to you while you were in Canada. Rental income is **not** effectively connected and, as such, is subject to a 30% tax on the gross income, with no expenses or deductions allowed.

However, under the *Internal Revenue Code*, you can elect to permanently treat rental income as income that is effectively connected with the conduct of a U.S. trade or business. If you make this election, you are taxed on the net income. You can claim expenses related to owning and operating the rental property during the rental period, including a mandatory depreciation charge. For information on rental income and expenses, get IRS Publication 527, *Residential Rental Property*.

To make this election, attach a letter to Form 1040NR, *U.S. Nonresident Alien Income Tax Return*, stating that you are making the election. Include the following information:

- the location of all your real property in the U.S.;
- the extent of your ownership in the property;
- a description of any major improvements to the property; and
- any previous choices and revocations you have made of the real property income choice.

Tenants or management agents (withholding agents) have to withhold non-resident tax from the gross rent and send it to the IRS using Form 1042, *Annual Withholding Tax Return for U.S. Source Income of Foreign Persons*, and Form 1042-S, *Foreign Persons' U.S. Source Income Subject to Withholding*. If you want to be exempt from the non-resident withholding tax and are making the election, you have to give the tenant or management agent Form 4224, *Exemption From Withholding of Tax on Income Effectively Connected With the Conduct of a Trade or Business in the United States*.

For more information on U.S. withholding taxes, get IRS Publication 515, *Withholding of Tax on Nonresident Aliens and Foreign Corporations*.

### **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. You then have to file Form 1040 NR, *U.S. Nonresident Alien Income Tax Return*, to report the gain or loss.

If you own the real property with another person such as your spouse, each of you has to file a Form 1040NR.

Please note that stock in a U.S. corporation or an interest in a partnership may be treated the same as real estate if the corporation owns a certain amount of U.S. real estate, or if the partnership owns U.S. real estate.

For more information on gains and losses from the sale of U.S. real property, get IRS Publication 519, *U.S. Tax Guide for Aliens*.

### **U.S. estate tax for non-resident aliens**

The U.S. imposes an estate tax on the transfer of a deceased person's taxable estate. 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 (for example, debt security, regardless of how or where the security was purchased); and
- interest in a partnership, if the partnership is doing business in the U.S.

The U.S. estate tax is based on the fair market value of the asset on the date of death, so there is no impact from a profit or loss because of a deemed disposition on the date of death. Non-resident aliens cannot claim foreign tax credits on a U.S. estate tax return for deemed-disposition capital gains income taxes paid to Canada.

The IRS requires Form 706 NA, *United States Estate (and Generation-Skipping Transfer) Tax Return (Estate of a Nonresident Not a Citizen of the United States)*, for U.S. assets valued at more than U.S. \$60,000. For more information on U.S. estate taxes, get IRS Publication 448, *U.S. Estate and Gift Tax Guide*.

**Note**

U.S. estate taxes for non-resident aliens may change as a result of proposed amendments to the Canada-U.S. Tax Convention. At the time of printing, these amendments had not yet entered into force. For more information on U.S. estate taxes, please contact the IRS.

**Need more information?**

While you are in Canada, if you need more information about U.S. tax laws or tax filing procedures, write or visit:

Internal Revenue Service  
~~60 Queen Street, Suite 201~~  
~~Ottawa ON K1P 5Y7~~

You can call the IRS at ~~(613) 563-1834~~, or you can fax them at ~~(613) 230-1376~~.

If you are in the U.S., contact the IRS office in your area.



## How Canadian income tax laws apply

If you are living or travelling in the U.S. but maintain residential ties in Canada, you are usually considered a **factual resident of Canada**.

Residential ties include:

- a home in Canada;
- a spouse (see the definition of spouse in your income tax guide) or dependants who stay in Canada while you are in the U.S.; and
- personal property in Canada.

Other ties that may be relevant include social ties in Canada, a Canadian driver's licence, Canadian bank accounts or credit cards, and hospitalization insurance with a province or territory of Canada. For more information, get Interpretation Bulletin IT-221, *Determination of an Individual's Residence Status*, and its Special Release.

As a factual resident, you have to report your world income (all income you receive from sources inside and outside Canada) for 1995. You can claim all deductions, non-refundable tax credits, and provincial or territorial tax credits that apply. You are subject to federal tax and provincial or territorial tax for the province or territory where you maintain residential ties.

### Completing your Canadian tax return

Most of the information you need to complete your return is in your income tax guide. However, we have included in this pamphlet some additional information to help you complete your return.

## **Identification**

Complete the identification area on your return, but **do not** show a date of entry or departure. Only immigrants and emigrants use these spaces. If you enter a date of entry or departure, we may reduce your claim for non-refundable tax credits.

On the line for “your province or territory of residence,” enter the name of the province or territory with which you have residential ties.

## **Income**

As a factual resident, you are subject to tax on your world income as though you had resided in Canada for the whole year. Be sure to report all amounts in Canadian dollars.

### **Did you receive Form NR4 with an amount in box 18?**

Human Resources Development Canada sends Form NR4, *Statement of Amounts Paid or Credited to Non-Residents of Canada*, to all individuals who receive Old Age Security (OAS) and Canada Pension Plan (CPP) benefits and have an address outside Canada. If you are a factual resident of Canada who has received Form NR4, include the OAS or CPP benefits in your total income and write “factual resident” at the top of page 1 of your return.

### **Did you receive U.S. lottery or gambling winnings?**

This income is not taxable in Canada, so you do not have to report it on your Canadian return.

**Did you have property rentals in the U.S.?**

If so, keep records to support your income and expense claims. For information, get the income tax guide called *Rental Income*.

**Do you own or did you dispose of capital property inside or outside Canada?**

You can no longer claim a capital gains deduction for gains realized after February 22, 1994, other than qualified small business corporation shares and qualified farm property.

However, if you owned capital property or eligible capital property at the end of February 22, 1994, and you have not used up all of your \$100,000 capital gains exemption, there is a special election that may be available to you. This election will allow you to report a capital gain that accrued before February 23, 1994, so that you can benefit from the unused part of your \$100,000 capital gains exemption.

For more details, get the income tax guide called *Capital Gains* and the package called *Capital Gains Election Package*. These publications have the information and forms you will need to determine and calculate your deduction.

**Non-refundable tax credits**

**Can you claim medical expenses paid in the U.S.?**

You can claim eligible expenses that were paid for yourself, your spouse, and certain other individuals who were dependent on you for support. You can claim medical expenses that were paid in any 12-month period ending in 1995, if they were not claimed in 1994.

Your total expenses have to be more than 3% of your net income (line 236) or \$1,614, whichever amount is less. For more information on medical expenses, see line 330 in your income tax guide, or get Interpretation Bulletin IT-519, *Medical Expense and Disability Tax Credits*.

### Going south for the winter?

Whether you go for seven days or six months, the same benefits apply when it comes to bringing goods into Canada. There are no special benefits for Canadian residents who go south for the winter. That is one important message added to our updated *I Declare* booklet, the source most travellers use to determine their customs entitlements.

If you spend part of the year in the U.S. for health or pleasure reasons, you are admitted as a “visitor” by the U.S. Immigration Service. We consider that you remain a resident of Canada and, when you return, you are limited to the same exemptions as other returning residents.

Foreign goods or vehicles that you import for your personal use in Canada have to meet all the import requirements, and you have to pay any duties that apply. This means that if you rent, borrow, own, or maintain goods or vehicles outside the country, you cannot bring them into Canada, even for a few days, unless the goods or vehicles meet all the import restrictions, and you pay all duties and assessments that apply.

**What’s the bottom line?** After seven or more days’ absence, you can bring in goods up to a value of \$500 without paying any duties. For goods worth more than \$500, we will charge duties only on the amount over \$500. For example, for a \$600 item, you will have to pay duties on \$100.

## Importing a motor vehicle into Canada?

### Transport Canada requirements

There are restrictive importation rules for vehicles, such as motor homes, trailers, trucks, and cars that are less than 15 years old. Under the *North American Free Trade Agreement* (NAFTA), you can import such a vehicle from the U.S. only if it meets Transport Canada's strict safety and emission standards, or if it can be modified to meet these standards after you import it.

Motor vehicles manufactured to meet **United States safety standards** do not automatically pass Canadian safety standards. You are responsible for determining whether your vehicle complies with Canadian standards, or whether it can be modified to meet the standards after you import it. You cannot import vehicles that cannot be modified to meet Canadian standards.

For information on importing a vehicle originally manufactured to meet U.S. safety and emission standards, and on the federal registration fees that apply, call the Registrar of Imported Vehicles at:

- ~~1-800-333-0588 (from within Canada or the U.S.)~~
- ~~(905) 837-7918 (local calls from the Toronto area)~~

### Import duties

If your vehicle is eligible for importation into Canada, we will apply import assessments. These assessments include:

- duty
- excise tax (if the vehicle is air-conditioned, or if it is a passenger vehicle that weighs over 2,007 kg or 4,425 lbs)
- the goods and services tax (GST)

The following example shows an assessment for a North American car made in the U.S., and imported from the U.S. in 1996.

**Example**

1996 Buick Park Avenue		
Purchase price (including state taxes)		US \$25,000.00
Value for duty ( $\$25,000 \times 1.355^*$ )		CAN \$33,875.00
Duty at 1.8%	\$609.75	
Excise tax on air conditioner	100.00	
Excise tax on excess weight	<u>00.00</u>	
	\$709.75	<u>709.75</u>
Value for tax (value + duty + excise taxes)		\$34,584.75
GST ( $\$34,584.75 \times 7\%$ )		<u>2,420.93</u>
Total cost		\$37,005.68

\*exchange rate (subject to change)

In addition to the total cost of \$37,005.68, you have to pay any provincial or territorial taxes that apply, as well as the registration fee assessed by the Registrar of Imported Vehicles.

The 1.8% duty rate used in the example applies only to eligible vehicles you import during 1996 from the U.S. that are made in the U.S. or Canada. For eligible vehicles imported from the U.S. which are made in Mexico, the duty rate in 1996 is 2.3%. For all other eligible vehicles you import from the U.S., the duty rate in 1996 is 8.6%.

### **Value for duty**

If you import a vehicle within 30 days of the date it was delivered to the purchaser, we will convert the original purchase price, including state sales tax and other costs that apply, to Canadian funds. We will also use this amount to determine the vehicle's value, with no deduction for depreciation.

However, we **do** allow a depreciation deduction for a vehicle you purchase new and import after 30 days but within one year of the delivery date. We **do not** allow a depreciation deduction for a vehicle you purchase used. In this case, we use normal market value information from a neutral source, such as the Canadian or U.S. *Automobile Red Book* (a publication which gives values for vehicles).

In the case of a trade-in, we calculate the value for duty based on the **full value** of the vehicle you are importing, not just the price you paid. In other words, we do not use the difference between the value of the trade-in and the full value of the vehicle.

For more information on bringing goods and vehicles into Canada, please contact your nearest customs office. You will find a list of the regional customs offices on the following page.

You can also get copies of *I Declare* and *Importing a Motor Vehicle into Canada* from any Revenue Canada customs office in Canada, or from a Canadian consulate abroad.

## Your provincial or territorial health care coverage

**B**efore you head south, don't forget to check that your provincial or territorial health-care coverage will continue throughout your stay in the United States. Also, you may find that your province or territory now limits payment for health-care treatment in the U.S., and you may want to get supplementary health-care coverage.

See the government listings in your Canadian telephone book for the address and telephone number of the provincial or territorial ministry of health office that is nearest you.