Wealth Management

the Navigator

INVESTMENT, TAX AND LIFESTYLE PERSPECTIVES FROM RBC FAMILY OFFICE SERVICES

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Moving to Canada

An overview of the Canadian tax system and planning strategies

Are you a newcomer to Canada or have you returned to Canada after an extended absence? This article provides an overview of the Canadian tax system and planning strategies for individuals who move to Canada and establish Canadian residency for income tax purposes.

Overview of the Canadian income tax system

Canada has a comprehensive personal income tax system.

Income tax is imposed at both the federal and provincial or territorial levels of government on an individual basis. In addition, the federal government has entered into tax treaties with many countries in the world that impose income tax, to avoid double taxation and to facilitate the administration and enforcement of Canada's tax laws and those of its international partners.

While the Departments of Finance for the federal, provincial and territorial governments determine personal income tax legislation, this legislation is administered by the Canada Revenue Agency (CRA), except for the province of Quebec where Revenu Québec carries out tax administration. Personal income tax is collected by the CRA for the federal, provincial and territorial governments and by Revenu Québec for the province of Quebec.

In Canada, income tax is imposed based upon your residency, not your citizenship. Residents of Canada are required under the Income Tax Act (the Act) to pay tax on their worldwide income. Non-residents also have an obligation to pay tax but only on their Canadian sourced income. This article will focus primarily on taxation for a Canadian resident.

For Canadian residents, income tax is calculated on an individual basis based on their net income for tax purposes in the tax year (which runs from January 1 to December 31).

If your move to Canada is the result of an international employment assignment and you've entered into a special agreement with your employer (e.g. a tax equalization or a tax protection agreement), the calculation of your ultimate liability for income tax under the agreement

must be considered and may affect the type of tax planning that may be appropriate for you.

Canadian residency status

You're either a resident or a non-resident for tax purposes. This status is relevant with respect to determining your Canadian income tax liability and filing requirements. A resident may be either a factual or deemed resident of Canada.

The date you become a resident for Canadian income tax purposes may differ from the date you become a resident for immigration purposes or obtain Canadian citizenship.

Based on the domestic tax laws of Canada and the foreign country, you may be considered resident in both countries for income tax purposes. However, where there's a tax treaty between Canada and the foreign country, certain rules may apply that may deem you to be a non-resident of one country. These rules are commonly referred to as the "treaty tie-breaker" rules. If there's no tax treaty, you may be resident in both countries and have income tax and filing requirements in both countries.

Determining your Canadian residency status can be complicated. A more detailed discussion regarding the determination of Canadian residency status is provided in a separate article. Your RBC advisor can provide you with a copy of that article. As well, it's important to speak with a qualified tax advisor to determine your residency status for tax purposes.

Deemed acquisition rules

For Canadian tax purposes, on the date you become a tax resident of Canada, you're deemed to have disposed and reacquired certain worldwide assets you own at fair market value (FMV). The assets to which the deemed acquisition rules apply include foreign currency, securities (such as stocks, bonds, rights, options) and real estate located outside of Canada but exclude real estate located in Canada. This deeming rule applies whether or not you physically move the assets to Canada when you move here. The deemed acquisition rules ensure any gains or losses that accrued before your Canadian residency are not included in determining your future Canadian tax liability.

Since you're deemed to have reacquired your assets at their FMV on that date, that value becomes the new adjusted cost base (ACB) of your assets for Canadian tax purposes. On the future disposition of these assets, this ACB is used to determine your capital gains and losses for Canadian tax purposes.

If you moved to Canada from a foreign country and did not dispose of your assets before your move, it's possible

For Canadian tax purposes, on the date you become a tax resident of Canada, you're deemed to have disposed and reacquired certain worldwide assets you own at fair market value (FMV).

the foreign country may not levy tax on the accrued gains. If this is the case, you may not be subject to tax on the value of the accrued gains (up to your Canadian residency date) due to the deemed acquisition rules in Canada. This tax windfall may apply to a number of your assets that have accrued gains, except assets such as real estate located in the foreign country. This is because real estate generally continues to be subject to tax in most foreign countries even after you leave their tax system.

Moving foreign assets to Canada

After you've attained Canadian residency status for income tax purposes, there are no Canadian income tax implications associated with physically moving foreign currency or securities in-kind to Canada. However, when you convert foreign denominated cash to Canadian dollars or use it to purchase another asset or investment, you're disposing of that foreign currency, which is a taxable event and may result in a foreign currency exchange gain or loss. The gain or loss is calculated as the difference between the value of the foreign denominated cash converted to Canadian dollars on the date you establish Canadian residency and the value of the cash converted to Canadian dollars on the date it's converted or used to purchase another asset. For individuals, the total annual gain or loss that's more than $200 on converting foreign denominated cash is subject to Canadian tax.

However, an exchange gain or loss isn't triggered if foreign denominated currency is used to invest in assets or accounts considered to be "cash on deposit," provided the investments are denominated in the same foreign currency. For example, a gain or loss is generally not triggered if you use the foreign currency to purchase a term deposit in the same foreign currency or if you transfer the foreign currency to a high-interest savings account denominated in the same foreign currency. However, if you purchase investments such as bonds or stocks, even if these investments are denominated in the same foreign currency, you'll trigger a foreign exchange gain or loss on the currency.

If you own securities in a foreign account and you decide to transfer them to a Canadian investment account in-kind, you may want to provide the Canadian financial institution with the stepped-up ACB of those assets as a result of the deemed acquisition rules, as outlined earlier. For assets you decide to maintain outside of Canada, you should keep

records of their stepped-up ACB for Canadian tax purposes. For investments you decide to consolidate with a Canadian financial institution, but it's determined they can't be transferred in-kind and are disposed of, the disposition is reportable for Canadian income tax purposes.

Unwinding a deemed disposition

If you were previously a tax resident of Canada and gave up your Canadian residency status, you would have been deemed to have disposed of certain property you own (such as non-registered investments or foreign real estate) at its FMV. Any capital gains realized as a result of this deemed disposition would have been taxable on your Canadian income tax return in the year of departure (known as a "departure return"). The tax liability resulting from this realization of accrued capital gains is known as "departure tax."

If you have now moved back to Canada and still own property that was subject to this departure tax in the year you moved away, there's a special tax election you can file to unwind the departure tax you originally paid.

The election effectively reduces or eliminates the tax that was triggered when you left Canada, potentially resulting in a refund of the Canadian tax you previously paid. Therefore, the Canadian tax on the capital gains that had accrued before you left Canada is deferred until you sell the property. In addition, if your marginal tax rate in the year the property is sold is lower than when you departed Canada, you'll incur less Canadian tax on the eventual sale. Conversely, if your marginal tax rate is higher in the year the property is sold, you'll pay more tax on that accrued capital gain.

It's important to speak with a qualified tax advisor to determine if you're eligible to make an election to unwind any previously paid departure taxes and to ensure this strategy is right for you.

Net income for tax purposes

Your net income for Canadian tax purposes is basically the income you earned in the year on a worldwide basis, less permitted deductions.

Income includes both employment and investment income. Investment income can take the form of interest, dividends or net capital gains from the disposition of capital property. The income tax treatment for each form of investment income is different. For example, interest income is fully included in income for tax purposes, while only a taxable portion of net capital gains is included. Dividends received from a Canadian corporation are taxed more favourably than interest income. This is due to the dividend tax credit, which reduces taxes payable on this type of income. Dividends received from a foreign corporation, however, are fully taxable, like interest income, and are not subject to the preferred tax rates that are available to dividends from Canadian corporations.

Canada has adopted a graduated tax system, meaning as more income is earned, more tax is payable on that income. Each level of government has set out a number of tax brackets and each bracket is assigned a specific income tax rate.

Permitted deductions may include expenditures such as childcare expenses, investment interest expenses and contributions to certain registered pension plans, provided certain criteria are met.

For more information about the Canadian tax system and the taxation of investment income, ask your RBC advisor for a separate article on tax planning basics.

Amount of tax owing

Canada has adopted a graduated tax system, meaning as more income is earned, more tax is payable on that income. Each level of government has set out a number of tax brackets and each bracket is assigned a specific income tax rate. For taxpayers with low levels of income, a low rate of tax is applied, while individuals with higher levels of income will pay tax at a higher rate on income in the higher tax brackets. A surtax may also apply depending on the province or territory of residence.

In determining the amount of tax owing, certain credits may apply to reduce that amount. Non-refundable tax credits can be used to reduce the amount of tax owing to zero. If these credits are greater than your taxes payable, there will not be a refund of the difference. On the other hand, refundable tax credits may be paid to you (if you're eligible), even if these credits exceed your taxes owing.

A non-refundable credit available to all individual resident taxpayers is the basic personal amount. Any income earned up to this amount is not subject to tax. You may also be entitled to other non-refundable tax credits. Some examples are the donation tax credit if you make a donation to a registered charity, the medical expense tax credit if you paid eligible medical expenses, the tuition tax credit if you paid eligible tuition fees, a foreign tax credit if you paid tax to a foreign country on foreign income taxed in Canada, and the federal dividend tax credit for Canadian dividend income that's included in your income. Examples of refundable tax credits are the employee and partner goods and services tax/harmonized sales tax rebate, eligible educator school supply credit, and the Canada workers benefit.

Factual residents of Canada are subject to income tax at the federal and provincial or territorial level. In the first year of filing a Canadian income tax return, factual residents may need to prorate a portion of certain non-refundable tax credits based on their residency start date.

Deemed residents of Canada are generally not resident in a particular province or territory (except in certain cases under Quebec tax laws) and thus are subject to federal income tax and a federal surtax in lieu of the provincial tax. However, specific types of income sourced to a particular province may be subject to tax in that province. Deemed residents are not entitled to any provincial tax credits.

Federal, provincial and territorial income taxes may initially be collected through a withholding tax taken at source, such as income taxes deducted from employment income paid to you. You may also need to make quarterly tax instalment payments. This, together with any withholding taxes taken at source, are used to determine the amount of tax owing upon filing your Canadian income tax return.

Foreign tax credits

The income earned by a Canadian resident in a foreign country is taxable in Canada. There may be a tax treaty in place between Canada and the foreign country from which the income is sourced that limits the amount of taxes payable in either the foreign country or Canada and/or dictates which types of income are subject to tax in the particular country.

Generally, some or all of the foreign tax paid may be claimed as a foreign tax credit on your Canadian return, potentially eliminating or minimizing the risk of double taxation. These rules are complex. You should speak with a qualified tax advisor to determine how to report your income and any foreign tax credits you may claim. Planning to utilize foreign tax credits in the year they're paid may be necessary and should be reviewed with a qualified tax advisor.

Canadian income attribution rules

As a resident of Canada, it's important to be aware of the Canadian income attribution rules that restrict certain types of tax planning in Canada. It's important to keep these rules in mind, as they may affect planning you've done in your previous country of residence as well as your future tax planning in Canada. A discussion of the types of tax planning affected and the income attribution rules that apply is beyond the scope of this article. However, you can ask your RBC advisor for a separate article that discusses the attribution rules.

Contributing to registered plans in Canada

The federal government offers a number of savings vehicles designed to provide Canadians with options to plan for retirement and to save for various other purposes. These savings vehicles are various registered plans, which provide different tax advantages and benefits. Some of the common types of registered plans include registered retirement savings plan (RRSP), registered retirement income fund (RRIF), tax-free savings account (TFSA), registered education savings plan (RESP), registered disability savings plan (RDSP) and the tax-free first home savings account (FHSA).

As Canadian residents are taxed on their worldwide income, if you receive income from a foreign country, that income is generally subject to Canadian tax.

A discussion of these plans and accounts is beyond the scope of this article; however, if you're interested in learning more, your RBC advisor can provide you with information and articles on these topics.

Foreign income received before Canadian residency

As Canadian residents are taxed on their worldwide income, if you receive income from a foreign country, that income is generally subject to Canadian tax. This is the case even though the income is not Canadian source and relates to a period when you were not a resident of Canada.

You may be able to claim a foreign tax credit on your Canadian return to reduce your Canadian tax liability. The credit is available for foreign income tax incurred in the same tax year. If the Canadian tax you're liable for is higher than the foreign tax incurred, there will be additional Canadian tax you'll need to pay on your Canadian income tax return. Basically, you're paying taxes on that foreign income at the higher of the two counties' tax rates. If the foreign tax was incurred in a different tax year, a foreign tax credit will generally not be permitted on your Canadian return. As a result, you'll end up paying both Canadian and foreign tax on the income, resulting in double tax.

Examples of the types of foreign income you may receive after settling in Canada include a bonus paid from your previous employer in the foreign country or income from employee stock options exercised in Canada that were granted while you were a non-resident of Canada.

If you were paid the bonus or exercised the employee stock options before becoming a Canadian resident, you would not be exposed to the potential Canadian tax or double tax. You should review any tax planning opportunities with a qualified tax advisor before you become a Canadian resident.

Canadian taxation of trusts established outside of Canada

If you're the settlor, trustee or beneficiary of a trust that was created outside of Canada, you should talk to a qualified cross-border tax advisor about the potential tax implications (in Canada or in the foreign country) that may apply as a consequence of your move to Canada.

For example, if you're the sole trustee of a trust that was created outside of Canada, the trust may now be considered resident in Canada under the Canadian tax rules. As a result, the deemed acquisition rules, discussed earlier, will apply to the assets in the trust and the trust will be subject to Canadian income tax as a resident of Canada. It's also possible that the taxation of the trust under Canadian and the foreign country's tax rules may not coincide, resulting in unfavourable tax consequences such as double taxation.

Contributing to a foreign pension plan while in Canada

If you continue to contribute to a foreign retirement plan once you become a tax resident of Canada, there are a few matters you should be aware of for Canadian income tax purposes.

Contributions made to the foreign plan are generally not deductible on your Canadian tax return. However, a tax treaty between Canada and the foreign country (e.g. U.S., Germany, UK and France) may provide specific circumstances where you can deduct these contributions.

Foreign pension plans don't qualify for registration in Canada and are treated as unregistered pension plans. The terms of your foreign plan will need to be reviewed to determine which of the various regimes under the Canadian tax rules, such as salary deferral arrangement, retirement compensation arrangement or employee benefit plan, would apply. A discussion on the treatment of a foreign pension plan under the Canadian tax rules and the resulting tax implications is beyond the scope of this article. Depending on which regime the foreign pension plan falls under, there may be implications related to when amounts are taxable to you as income.

The tax implications for a Canadian resident who continues to participate in a foreign pension plan are complex and should be discussed with a qualified tax advisor.

Transferring a foreign retirement plan to Canada

Canadian tax laws generally allow a tax deferral on income earned from foreign pension plans until payments are received from these plans. A foreign tax credit for income taxes paid to a foreign jurisdiction may be claimed to minimize or eliminate double taxation.

In Canada, there are special tax rules that allow for pension income splitting. Spouses can elect to allocate up to 50% of eligible pension income received by one spouse to the other spouse for Canadian income tax purposes.

There are also special tax provisions in the Act that may allow you to move the gross value of the assets from a foreign pension plan to an RRSP or a RRIF on a tax neutral basis. For more information, ask your RBC advisor for a copy of an article on this strategy.

Pension income splitting with foreign plans

In Canada, there are special tax rules that allow for pension income splitting. Spouses can elect to allocate up to 50% of eligible pension income received by one spouse to the other spouse for Canadian income tax purposes. This allocation may result in overall tax savings for the couple. In addition to Canadian pension income, foreign pension income you receive may also qualify for pension income splitting.

For more information about pension income splitting, ask your RBC advisor for a separate article on this topic.

Income tax return filing requirements

If you move to Canada and establish factual residency partway through a calendar year, you must file a "part-year return" reporting your worldwide income from the date you established residency for tax purposes until December 31 of that year.

If you're a deemed resident of Canada, you're considered a Canadian resident starting on January 1 and you must file a "full-year return" and report worldwide income for the entire year.

Canadian residents file individual tax returns on a calendar-year basis. The deadline to file a part-year or full-year individual Canadian income tax return and pay your Canadian tax liability is April 30 of the following year. If you or your spouse are self-employed, the filing deadline for your individual Canadian tax returns is June 15 of the following year; however, the tax liability is still due by April 30 of the following year.

If you don't file your income tax return or pay your tax liability by these deadlines, you may be subject to interest and penalties.

In addition to your tax return, you may need to complete other tax filings such as an information return to disclose foreign income and assets.

Disclosure of foreign income and assets

Canadian residents who at any time in the calendar year own or have a beneficial interest in specified foreign properties with a total cost greater than C$100,000 are required to file an annual information return with the CRA, Form T1135 – Foreign Income Verification Statement.

A Canadian resident individual does not have to file this form for the year they first become a resident of Canada. However, this exception does not apply if you're returning to Canada and you re-establish Canadian residency. For more information on Form T1135, ask your RBC advisor for an article on this topic.

Additional foreign reporting may be required under Canadian tax rules if you have an interest in a foreign corporation or a foreign trust. Speak with a qualified tax advisor for more information.

Social security benefits

Working in Canada

Individuals employed in Canada and their employers must contribute to the Canada Pension Plan (CPP), or the Quebec Pension Plan (QPP) for employees in Quebec, as well as Employment Insurance (EI). Your Canadian employer will deduct these contributions at source from your wages.

If you're an employee of a company that transferred you to Canada to work for a limited period and you continue to be covered by a comparable plan in your home country, you may be able to waive your requirement to contribute to CPP/QPP if you qualify under a social security agreement (or totalization agreement). Canada has entered into several international social security agreements with various countries that offer pension programs similar to the CPP. Quebec has entered into similar agreements regarding the QPP. One of the main objectives of these agreements is to ensure the pension programs for people who've lived or worked in both countries are coordinated.

Speak to your employer or qualified tax advisor about whether you may qualify under a social security agreement for relief from contributing to both social security programs. For more information, visit the Service Canada website.

Retiring in Canada

If you've lived or worked in Canada and in another country, or you're the surviving spouse or common-law partner of someone who lived or worked in Canada and in another country, you may be eligible for pensions and benefits from Canada and/or from the other country. If you don't qualify for benefits from Canada and/or the other country, a social security agreement may help you qualify for some benefits.

You may have moved to Canada with a Will and powers of attorney that were drafted and executed in a foreign country.

To receive Canadian benefits, you'll need to meet certain contributory or residency requirements. If you've lived and/or worked in Canada and in another country and don't meet the requirements for CPP or Old Age Security benefits, a social security agreement may help you qualify.

To confirm whether there's a social security agreement in place with Canada and another country and for information regarding applying for benefits from Canada or the other country, please contact Service Canada.

Gift, estate or inheritance taxes

Canada does not have a gift, estate or inheritance tax system. However, during your lifetime, for Canadian income tax purposes, if you make a gift of appreciated assets to someone other than a spouse, you're deemed to have disposed of these assets at their FMV and will be taxed on the accrued gains and losses realized on the transfer in the year the gift is made. In addition, the income attribution rules referenced earlier may apply to attribute future income earned on the transferred assets back to you, so care must be taken when considering such gifts or transfers of property.

Upon your death, you're deemed to have disposed of your assets at FMV, unless the assets are left to your surviving spouse. As such, income tax on the accrued gains on your assets may be payable at that time.

Canada doesn't generally allow foreign tax credits for gift, estate or inheritance tax that you may incur in a foreign country on foreign source assets. You should speak with a qualified tax advisor in the country you moved from to determine if you're subject to gift, estate or inheritance tax in that foreign jurisdiction.

Will and powers of attorney

You may have moved to Canada with a Will and powers of attorney that were drafted and executed in a foreign country. The laws of the country and/or jurisdiction where your documents were prepared and executed may differ from those of the provincial or territorial jurisdiction within which you reside presently. As a result, the validity of these documents may be uncertain.

Your Will

After you move to Canada, it's important to ensure you have a valid Will that properly addresses your wishes for how your assets are to be distributed on your death. You should

review your current Will with a qualified legal advisor to determine whether your Will is valid in accordance with the laws of the province or territory in which you're now living. You may need to update your Will or draft a new Will. You may also want to consider who you've named as your executor(s) (or liquidator(s) in Quebec) or trustee(s) in your Will. If they're non-residents of Canada, they may no longer be suitable candidates for a number of reasons, including tax, legal and compliance issues.

If you have assets located in different parts of the world, such as real property, you should review the laws in each country to determine whether it makes sense to have a separate Will in each country, or whether an international Will (where possible) is more appropriate. It's important when you have separate Wills that they're drafted properly so one does not revoke the other, and they deal with both Canadian and foreign assets separately as coexisting legal documents.

Your powers of attorney

After your move to Canada, you may want to consider having powers of attorney executed in accordance with the provincial or territorial law that appoints someone to manage your financial and personal affairs should you become incapable. With the legal requirements for valid powers of attorney documents differing from country to country, if you already have powers of attorney, you may need to execute new ones. If your attorney resides in a different country, you should consider whether they may face practical challenges in carrying out their duties.

If you own property in other countries, such as real estate, it may be prudent to have a separate power of attorney for the jurisdiction where the property is located to ensure these properties can be properly managed. It's important when you require a separate power of attorney for assets located in Canada and in a foreign country that one does not revoke the other, and they deal with Canadian and foreign assets separately as coexisting legal documents.

Ceasing Canadian residency

If your stay in Canada is not permanent and you later decide to move from Canada, it will be important to consider the tax implications of ceasing Canadian residency. When you cease Canadian residency, you're deemed to dispose of your assets at FMV (with certain exceptions). This will trigger the accrued gains and losses on your assets, which will be subject to Canadian tax. If you were resident in Canada for not more than 60 months out of the prior 10 years, any assets you owned when you became a Canadian resident will not be subject to the deemed disposition rules when you cease residency.

For more information, ask your RBC advisor for a separate article on moving from Canada.

You made your move

Now that you're a resident of Canada, it's important to understand the Canadian tax system and the effects it may have on your income tax and estate planning.

Speak with a qualified tax and legal advisor who may be able to provide tax planning strategies and help you ensure your estate planning wishes and intentions can still be executed.

This article may contain strategies, not all of which will apply to your particular financial circumstances. The information in this article is not intended to provide legal, tax or insurance advice. To ensure that your own circumstances have been properly considered and that action is taken based on the latest information available, you should obtain professional advice from a qualified tax, legal and/or insurance advisor before acting on any of the information in this article.



Wealth Management

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