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INVESTMENT, TAX AND LIFESTYLE PERSPECTIVES FROM RBC FAMILY OFFICE SERVICES

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## U.S. residency – Canadians travelling to the U.S.

U.S. income tax residency rules may affect you

If you're a Canadian who spends substantial time in the U.S., you may be considered to be a U.S. tax resident (i.e. a U.S. resident alien) for U.S. income tax purposes. As a result, you may be required to file a U.S. resident income tax return and make other U.S. filings. However, there are options to qualify for relief from U.S. tax residency and the tax filing requirements. Being aware of the U.S. income tax laws, including the U.S. tax filing requirements and options for relief that are available if you're considered to be a U.S. resident alien, may help prevent unpleasant tax surprises and costly penalties.

This article applies to Canadian residents who are not U.S. citizens or U.S. green card holders for U.S. income tax purposes.

### U.S. residency and U.S. tax obligations

For U.S. income tax purposes, the taxation of individuals is based on U.S. citizenship and U.S. tax residency. If you're a Canadian resident who is not a U.S. citizen, you may become a U.S. income tax resident if you obtain a U.S. green card or become a U.S. resident alien by meeting the U.S. substantial presence test.

If you're considered a U.S. resident alien under the U.S. substantial presence test, you may be subject to U.S. income tax and have other

U.S. reporting obligations, like a U.S. citizen and green card holder. This may include having to file a U.S. income tax return (IRS Form 1040) as an income tax resident of the U.S. and paying tax on your worldwide income (including Canadian source income). In addition, you may have to file other U.S. forms that require you to disclose information such as financial accounts you own that are located outside of the U.S.

Canadians who meet the substantial presence test have options under U.S. income tax rules and under the Canada-U.S. Income Tax Convention

(Treaty), described later, to qualify for various forms of relief from the obligations of U.S. residency status. However, when you claim relief under the Treaty, you may still have to continue to file certain U.S. forms generally required by U.S. citizens and residents.

If you're not considered to be a U.S. income tax resident, you're a non-resident alien of the U.S. A non-resident alien is only subject to U.S. income tax on income from U.S. sources. Generally, you do not need to file a U.S. income tax return if you simply earn U.S. investment income, such as U.S. dividend income, since your U.S. tax obligation is generally met through the withholding tax applied to your U.S.-sourced income. However, if you sell or earn rental income from U.S. real estate, you may need to file or elect to file a U.S. non-resident tax return (IRS 1040NR).

### Determining U.S. residency status under the substantial presence test

If you're not a U.S. citizen or green card holder, the substantial presence test may deem you to be a U.S. resident alien and therefore a U.S. income tax resident. The following two conditions must be satisfied to meet the substantial presence test for a calendar year:

**Condition 1:** You were physically present in the U.S. for at least 31 days in the current year.

If you were not present in the U.S. for at least 31 days in the current year, you automatically do not meet the substantial presence test for this year and are not a U.S. resident alien. Therefore, you are not a U.S. income tax resident for this year.

**Condition 2:** The total number of days you spent in the U.S. over the last three calendar years equals or exceeds 183 days based on the following formula:

#### Formula:

Add all the days you spent in the U.S. in the current calendar year;

*plus*

1/3 of the days you spent in the U.S. in the previous calendar year (i.e. first year before the current year);

*plus*

1/6 of the days you spent in the U.S. in the calendar year before the previous year (i.e. the second year before the current year).

If you were present in the U.S. for 183 days or more in the current year, or the total number of days using this

If you were present in the U.S. for 183 days or more in the current year, you automatically meet both conditions of the test and would be a U.S. income tax resident for U.S. tax purposes.

formula amounts to 183 days or more, you meet the substantial presence test. You're a U.S. income tax resident for U.S. tax purposes for the current year.

If the total number of days using this formula amounts to fewer than 183, you do not meet the substantial presence test. You're not a U.S. income tax resident for U.S. tax purposes for the current year.

### Counting the number of days in the U.S.

When counting the number of days present in the U.S., even if you're present for part of a day, you must count that day as a full day. For example, a 10-minute trip across the border counts as a full day. However, there are certain exceptions. For example, you can exclude days you regularly commute to work in the U.S. from Canada, days you are unable to leave the U.S. due to a medical condition that arose in the U.S., and days you are in transit in the U.S. for less than 24 hours while travelling between two places outside of the U.S. (e.g., you have a layover in Chicago on your way to Uruguay). Also, certain exempt individuals, such as foreign government officials, students and teachers or trainees who are temporarily present in the U.S. under certain visas and comply with the requirements of that visa, may exclude the days they are present in the U.S.

If you qualify as an exempt individual or are unable to leave the U.S. because of a medical condition, you may need to file IRS Form 8843 – *Statement for Exempt Individuals and Individuals With a Medical Condition* (Form 8843) to claim an exclusion for the days you're present in the U.S.

Talk to a qualified tax advisor for more information on how to count your days of presence in the U.S. and to confirm if you need to file Form 8843.

### Substantial presence test example

Assume you spent 130 days in the U.S. in each of the last three years. Let's see if you meet the two conditions under the substantial presence test for the current year:

Since you spent at least 31 days in the U.S. in the current year, you meet the requirements of condition 1. Because you spent fewer than 183 days in the U.S. in the current year, you must determine if you meet the requirements of condition 2, which looks at the days of presence over the

last three years. For condition 2, the formula results in 195 days of presence in the U.S. over the last three years, calculated as follows:

- 130 days in the current year, plus
- 43 days in the previous year (130 days multiplied by 1/3), plus
- 22 days in the year before the previous year (130 days multiplied by 1/6)

Since 195 days (130 days + 43 days + 22 days) is equal to or greater than the 183-days guideline, in this example, you meet the substantial presence test for the current year.

As a general rule, if you spend more than four months (122 days) every year in the U.S., you will meet the substantial presence test after the third year, and annually thereafter, and you will be a U.S. resident alien and U.S. income tax resident.

The quick-reference box summarizes the substantial presence test and may assist you in determining your U.S. residency status.

### Are you a U.S. income tax resident?

You're considered a U.S. income tax resident (other than a green card holder) if you spend:

- At least 183 days in the current year in the U.S.;

#### OR

- You spend at least 31 days in the current year in the U.S., and you will have to do the following calculation using the substantial presence test formula:

Add all the days you spent in the U.S. in the current calendar year;

*plus*

1/3 of the days you spent in the U.S. last year;

*plus*

1/6 of the days you spent in the U.S. in the year prior to last year.

## U.S. immigration versus income tax laws

It's important to recognize that there are differences in U.S. immigration laws versus U.S. income tax laws for Canadians visiting the U.S. From an immigration perspective, the U.S. Customs and Border Protection (CBP) generally limits your presence in the U.S. to six months in

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a rolling 12-month period, or 180 days in a rolling year. Also, the way in which your days of stay in the U.S. are counted for U.S. immigration purposes may be different. Speak to a qualified legal professional with expertise in U.S. immigration laws for further information.

## The U.S. tracks your days of presence in the U.S.

Canada and the U.S. share information about when you enter and leave your respective country. As a result, the U.S. can track your days of presence in the U.S. This information could potentially be used by the U.S. to enforce both U.S. immigration and income tax laws.

The CBP provides online access to a report of your border crossings. To access the 10-year history, visit the CBP webpage. You will be required to enter several pieces of information found on your passport, including country of issuance, passport number, full name, and date of birth.

## Options for U.S. income tax residents under the substantial presence test

There are two options to qualify for relief if you're considered to be a U.S. resident alien and U.S. income tax resident under the substantial presence test. Under U.S. income tax rules, you may be able to claim the "closer connection exception" or under the Treaty, you may be able to claim a "treaty exemption."

### Closer connection exception

If you spend fewer than 183 days in the U.S. in the current year (and you have not applied for or already have a U.S. green card), you may claim the closer connection exception to be considered a U.S. non-resident for U.S. income tax purposes. If you successfully claim this exception, you are not a U.S. income tax resident. You will not have to file a U.S. resident income tax return reporting your worldwide income or other U.S. filings (discussed later). However, if you earn certain U.S. source income, you may have to file a 1040NR, as discussed earlier.

To claim the closer connection exception, you must demonstrate on IRS Form 8840 – *Closer Connection Exception Statement for Aliens* (Form 8840) that you have a closer connection with Canada. The following factors will indicate you have a closer connection with Canada:

- Your permanent home is in Canada;
- Your family is located in Canada;
- Your business activities are carried on in Canada;
- You own personal property in Canada such as a car, furniture or jewellery;
- You hold a Canadian driver's licence;
- You have memberships in social organizations in Canada;
- You are registered and vote in Canada;
- You belong to religious, political or cultural organizations in Canada; and
- You have a bank account in Canada.

Speak to a qualified tax advisor regarding how to complete Form 8840 and how to file it with the U.S. tax authorities by the appropriate filing due date. The due date depends on your tax filing situation.

If you do not file Form 8840 by the due date, you will not be eligible to claim the closer connection exception and may be treated as a U.S. income tax resident, which means you may have to file a U.S. resident income tax return. In this case, you may want to consider whether you should file a U.S. non-resident tax return and attach a treaty statement claiming a treaty exemption, as discussed later. You might be subject to a non-disclosure penalty under the IRS tax laws for failing to disclose a treaty-based position.

### Treaty exemption

If you spend over 183 days in the U.S. in the current year, you are not eligible for the closer connection exception. However, you may claim a treaty exemption to be deemed a resident of Canada and not a U.S. income tax resident. If you can successfully claim the treaty exemption, you will not have to file a U.S. resident income tax return or pay U.S. tax on your worldwide income. However, you will be required to file a U.S. non-resident tax return (Form 1040NR) and attach a treaty exemption statement (IRS Form 8833) and may have other U.S. filings, discussed later. The treaty exemption statement indicates to the IRS that you're a resident of Canada under the Treaty and a non-resident of the U.S. As discussed earlier, if you're non-resident alien, you're only subject to U.S. tax on U.S. source income.

In general, to claim a treaty exemption, you must be deemed to be a resident of Canada under the provisions contained in the Treaty called the "treaty tie-breaker rules." You're considered to be a resident for income tax purposes

If you spent over 183 days in the U.S. in the current year, you may claim a treaty exemption to be deemed a resident of Canada and not a U.S. income tax resident.

by each country's domestic tax rules; however, the treaty tie-breaker rules may be used to ultimately determine which country you're deemed a resident of for income tax purposes. If you're deemed to be a resident of Canada under the treaty tie-breaker rules, you will be deemed not to be a resident of the U.S.

### Treaty tie-breaker rules

Here is some general information about the treaty tie-breaker rules under the Treaty. The first rule considers whether you have a permanent home available for use in one or both countries. If you only have a permanent home available for your use in Canada, you may tie break to Canada. If you have a permanent home available for your use in both Canada and the U.S., then you must look at the second treaty tie-breaker rule, your centre of vital interests. Your centre of vital interests refers to the country in which your personal and economic ties are closer. Factors considered as part of this test include your family and social relations, occupation(s), political or cultural activities, place of business and place from which you administer property. Your ties might be closer to Canada under this test if your family resides in Canada; you're carrying on a business in Canada; your bank accounts, social memberships, religious organizations are located in Canada; and, you're registered and you vote in Canada. Other rules look at your location of "habitual abode" (i.e. the country you spend the most time in) and your citizenship.

If you tie break to Canada under the treaty tie-breaker rules, you can claim a treaty exemption and not pay tax on income from sources outside of the U.S. You should consult with a qualified tax advisor regarding the filing of a U.S. non-resident tax return (1040NR) and treaty exemption statement (Form 8833), including the filing deadline and penalties for failing to file.

### Other U.S. filings

If you meet the substantial presence test and cannot claim the closer connection exception (because you failed to file Form 8840 on time or you spent more than 183 days in the U.S. in the current year), you may be required to complete and file other U.S. tax forms even if you successfully claim the treaty exemption to be treated as a non-resident for U.S. income tax purposes. An example of an IRS form you may need to file is the FinCEN Report 114 – *Report of Foreign Bank and Financial Accounts (FBAR)*. This form must be filed electronically and is required if the aggregate

of the maximum account values (at any time during the year), of all foreign bank and financial accounts you own, have an indirect interest in, or have signing authority over, exceeds US\$10,000. Examples of foreign bank and financial accounts are Canadian bank or brokerage accounts, registered retirement savings plans (RRSPs) and registered education savings plans (RESPs), locked-in retirement plans (LIRAs, LIFs, LRIFs and PRIFs) and tax-free savings accounts (TFSA). In certain instances, foreign bank and financial accounts of a corporation or a trust may need to be included. Speak to a qualified tax advisor for further information about the FBAR, including the filing deadlines and penalties for failing to file the form or disclosing a foreign account. As well, consult with a qualified tax advisor regarding any additional U.S. forms you may be required to file.

### Your length of stay in the U.S. and your provincial/territorial health care coverage

It's important to understand your provincial health care coverage as it pertains to your absence from Canada. The requirements related to how long you can be absent from Canada before coverage is affected varies among the provinces/territories. For more information, please contact the appropriate government branch for provincial/territorial health care coverage in your province or territory of residence.

### Monitor your status

It's important to monitor your presence in the U.S., considering both U.S. immigration and income tax laws. You should consult with a qualified tax advisor who is familiar with Canada-U.S. income tax laws to determine your U.S. residency status. If you become a U.S. tax resident under the substantial presence test, they can help you determine if your situation qualifies for relief under the closer connection exception or the treaty exemption and provide you with assistance in completing the necessary U.S. filings.

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