

NON-RESIDENCY: MOVING FROM CANADA

Ceasing Canadian residence

Generally, Canada imposes tax on the worldwide income of its residents but only on the Canadian-source income of non-residents. So whether you are considered resident in Canada can make significant difference to your potential Canadian tax liability after you move.

If you move to another country, you may still be considered a Canadian resident for tax purposes if you keep certain ties with Canada such as maintaining a home, club memberships, credit cards or medical plans or if your spouse or dependants remain in Canada. If you're moving to another country permanently or for an extended period, you may want to take steps to cease Canadian residency.

The CRA has no hard and fast rules for determining residency. Each situation is assessed on its own merits. Generally, you will be considered a non-resident of Canada if your stay abroad has a degree of permanence, you sever your residential ties to Canada and establish new ties elsewhere, you are considered a resident of another country, your visits to Canada after your departure are occasional and sporadic.

Starting in the year of your departure, you should spend significantly less than 183 days in Canada per year. Days during any portion of which you are physically present in Canada counts as full days.

Other steps that will show you have ceased Canadian residency include:

- Selling your personal property such as furniture or cars or taking it with you to your new country;
- Canceling or suspending club memberships;
- Canceling your Canadian driver's licence and plate (you may want to obtain a driver's licence in your new country before you give up your Canadian licence);
- Closing your Canadian bank accounts or putting them on non-resident status;
- Canceling credit cards issued in Canada and having them re-issued in your new country;
- Changing your mailing address for all correspondence;
- Canceling your Canadian medical plans and taking out new ones in your new country;
- Situating your primary place of business outside Canada;

As a non-resident of Canada, you will still be subject to Canadian tax if at any time during a calendar year you:

- Are employed or perform services in Canada;
- Carry on business in Canada;
- Dispose of property not subject to Canadian departure tax such as rental real estate;
- Receive Canadian sourced dividend or interest income; or receive rental income from rental properties in Canada.

A tax treaty between Canada and your new country will reduce or eliminate your Canadian tax liability in many circumstances.

Canadian departure tax

If you leave Canada and become non-resident, you are deemed to have sold most of your assets at fair market value, and will have to recognize any resulting income or capital gains. The range of assets treated as having been sold for fair market value on emigration includes all property, except for:

- Canadian real estate property that you already owned when you became resident in Canada, if your residence in Canada totaled no more than five years out of the last 10
- Pension entitlements, including RRSPs and RIFs
- Property used in a business in Canada
- Certain stock options
- Certain interests in Canadian trusts

For other property, the deemed disposition will result in an immediate tax liability on the resulting departure tax on income or gains, although the CRA will allow you to defer paying the tax on gains as long as you post acceptable security. Acceptable security could be a letter of credit, a mortgage or a bank guarantee. You will not have to post security for departure tax on the first \$100,000 in capital gains. The tax will still be due but not until the assets are sold. If you decide to post the security, interest will not be charged for the period up to the actual disposition of the property or death of the owner (whichever occurs first). If the security subsequently becomes deficient (e.g., due to a decline in value of the assets posted), you will have 90 days after you're notified by the CRA to make up the deficiency.

Security for private Canadian company shares

If you are a private Canadian company shareholder and you give up your Canadian residency status but retain your shares, the new rules may create valuation and financing problems if your shares have significantly appreciated in value. For example, determining the fair market value of your shares will generally require professional assistance, possibly resulting in significant valuation costs. If you don't have your shares valued, the CRA will fix the value. Financing your tax liability may also pose a problem if it is not advisable or possible to use the business's banking facilities and you do not have other liquid resources available to satisfy the debt.

In the past, the CRA has not normally accepted non-liquid assets such as shares of private corporations as security for future tax liabilities. However, recognizing the dilemma many taxpayers will face, the CRA officials say that they may accept such shares as security for the debt. The CRA will act as any other commercial lender and expect the normal representations, warranties and covenants to ensure that the shares retain their value. To satisfy the CRA, you may have to change existing collateral arrangements and shareholder agreements.

Capital gains exemption on emigration

Once you are non-resident, you cannot use the \$500,000 capital gains exemption. If you still have room in your exemption, and you own qualifying farm property (which includes Canadian real estate), you may wish to take steps to "crystallize" your gain before you emigrate. That way, you will trigger a gain that is absorbed by the \$500,000 exemption which would not otherwise be available after you have emigrated, and only the increase from the current fair market value will be taxed in Canada when you, as a non-resident, eventually dispose of the property.

Alternatively, if you realize gains on the deemed disposition of certain qualified farm property or shares in a qualified small business corporation, you will want to make sure you apply any of your remaining \$500,000 exemption against these gains. For small business shares and certain qualifying farm property, the deemed disposition on emigration will occur automatically. You will not need to make a special election and you can claim the exemption on your return in the year of your emigration.

Reporting rules for emigrants with property worth over \$25,000

If you emigrate from Canada and you own property with a total value of \$25,000 or more, you are required to file an information form (T1161) listing all your significant assets with your final Canadian tax return in the year of emigration. In determining whether your property exceeds the \$25,000 reporting threshold, the following assets are not included:

- Cash, including bank deposits;
- RRSPs, private company pension plans (RPPs), RRIFs, retirement compensation arrangements (RCA), employee benefit plans and deferred profit sharing plans (DPSPs);
- Items for personal use such as household effects, clothing, cars, and collectibles whose fair market value is less than \$10,000.

If you rent or sell your Canadian home after emigration

Real property that you own in Canada will not be subject to the deemed disposition rules discussed above when you emigrate. If you decide to rent your property, you will generally have to remit a 25% non-resident withholding tax on your gross rental income. If you will be incurring expenses to earn your rental income, you can file Form NR6 before your first non-resident tax payment is due and the withholding tax will be assessed on your net rental income. If you file the form, you will have to file annual rental income tax return by June 30 of each following year.

Generally, there is no Canadian income tax levied on the gain from selling a principal residence. If you sell your former principal residence while you are a non-resident of Canada, you must notify the CRA of the disposition and request a clearance certificate. If you don't obtain a clearance certificate before the disposition, the purchaser must withhold and remit one-quarter of the gross proceeds to the CRA. You should file the CRA Form T2062 at least 30 days before the property is sold or within 10 days after the sale to obtain the clearance certificate.

If you sell your former principal residence more than one year after the year of your move, only a portion of the gain would be exempt under the principal residence exemption. The principal residence exemption calculation is based on the fraction of one plus the number of taxation years ending after 1971 for which the property was a principal residence and during which you are a resident of Canada over the total number of years (after 1971) it was owned by you. So for each additional year that you do not sell your principal residence after you cease Canadian residency, the denominator increases while the numerator stays constant and a smaller portion of the gain is exempt from Canadian tax.

If you plan to rent out your former principal residence, the property's use will change from personal to income-producing and will be subject to a deemed disposition at fair market value. Any gain accrued up to the date of the change in use will be taxable but the tax may be reduced or completely eliminated by the principal residence exemption. You may be able to make an election not to deem a change in use of the property. You will not be able to claim depreciation on the property while the election is in effect. However, the election could be beneficial if you expect the property to increase significantly in value since you will be able to shelter some of the resulting capital gain with the principal residence exemption because of the pro-rata calculation.

If you have RRSPs.

Your RRSPs are not subject to the deemed disposition rules when you leave Canada. For Canadian tax purposes, you can continue to make deductible contributions to your RRSP as long as you have contribution room available. Of course, if you have no income subject to Canadian tax, you will not realize any current tax savings from making contributions. If you need to collapse your RRSPs, you may want to wait until you are a non-resident of Canada.

As a non-resident, you will be subject to a 25% withholding tax on the proceeds received from the plan. Any tax treaties reduce the Canadian withholding tax rate if the payments are periodic rather than lump-sum.

If you collapse the plan while you're a resident of Canada, the proceeds will be taxed at your marginal tax rate, which will be about 45% if you are in the top tax bracket, depending on the province you live in.

If you withdrew funds from your RRSP under the Home Buyers' Plan or Lifelong Learning Plan and you become a non-resident, you should repay the entire withdrawal within 60 days of becoming non-resident. To the extent you do not make the repayment within 60 days, the unpaid balance will be included in your income on your Canadian income tax return for the year of your departure.

If you move to the US., your RRSP contributions will not be deductible for U.S. tax purposes and the income earned inside your RRSP is technically subject to U.S. taxation in the year it is earned. However, the Canada-US tax treaty provides an election to defer the US taxation until an actual distribution is made.

