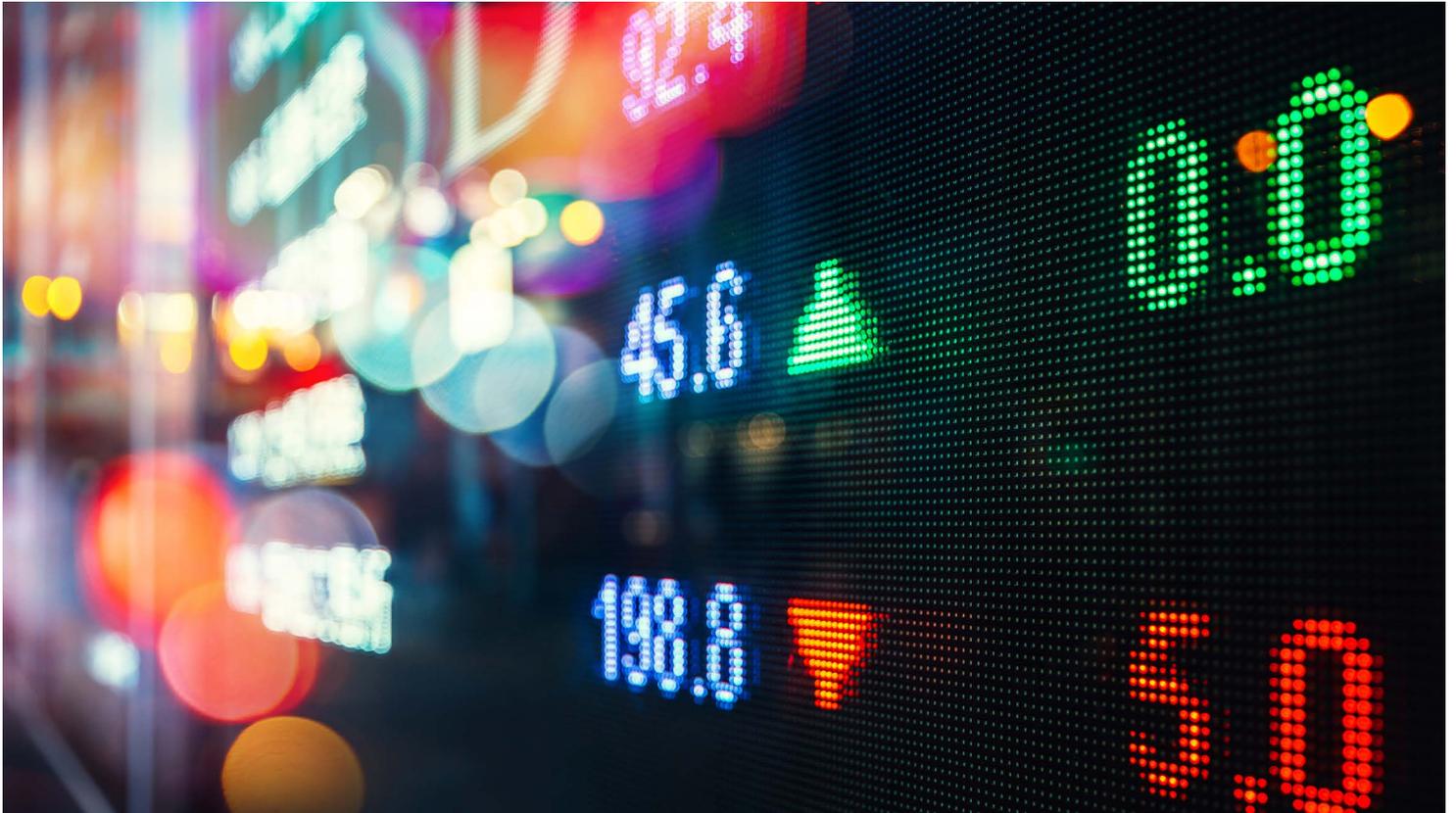


## Canadians Investing in U.S. Equities



Canadian residents who are not U.S. citizens, green card holders or U.S. residents (collectively referred to as U.S. persons), should consider the Canadian and U.S. tax implications of owning U.S. equities, including potential relief from the *United States-Canada Income Tax Convention* (the *Treaty*).

### Taxes payable

#### Canadian Personal Income Tax

Under Canada's tax laws, dividends received from Canadian corporations generally receive preferential tax treatment in the form of the **dividend tax credit**. This credit is a non-refundable tax credit, which applies when Canadian resident investors receive taxable Canadian dividends through a non-registered account.

However, foreign dividends, including those received from U.S. corporations do not qualify for a dividend tax credit and are taxed at an individual's marginal tax rate.

For example, Gurleen is a Canadian resident who is not a U.S. person, living in Ontario, who receives a dividend from a U.S. corporation. For 2020, the top marginal tax rate that may apply to her dividend is 53.53%. Comparably, if she were to receive a taxable Canadian dividend, depending on the type of dividend (eligible versus non-eligible), the top tax rate that could be applied will range from 39.34% to 47.74%.

If she sells the U.S. equity and realizes a capital gain or loss, it will receive the same tax treatment as Canadian equities, that is, 50% of the gain will be included in her income and taxed at her marginal tax rate.

### U.S. Tax for Non-resident Aliens

Generally, when someone is not a U.S. person and is a non-resident alien for U.S. tax purposes, a withholding tax will be applied on any U.S.-source income he or she earns. That means taxes may be withheld prior to the payment of a U.S. dividend, depending on the type of account the U.S. equity is held in. If the investment is held with a Canadian financial institution that is a Qualified Intermediary (QI), it will withhold the U.S. tax when a dividend is paid. Under the *Treaty*, when an investor has less than a 10% interest in a corporation, the withholding tax rate applicable on the U.S. dividend income received will typically be 15%. When U.S. taxes are withheld at source, Canadian-resident investors may reduce Canadian taxes payable on the U.S. income by claiming a foreign tax credit on their Canadian tax return.

Please note that capital gains or losses realized from U.S. equities are generally not subject to withholding taxes. Under the *Treaty*, most capital gains are taxed by the country where the investor is resident.

## U.S. equities held in registered plans

There are special provisions under the *Treaty* that apply to registered plans. As a result, Canadian resident investors may wish to consider the tax implications of holding U.S. equities in non-registered accounts versus registered plans

such as Registered Retirement Savings Plans (RRSPs), Registered Retirement Income Funds (RRIFs), Locked-In Retirement Accounts (LIRAs) and Life Income Funds (LIFs).

### Registered Plans (RRSPs, RRIFs, LIRAs, LIFs)

Under the *Treaty*, some income, such as certain U.S. dividend income, earned in registered plans designed for pension or retirement purposes is exempt from U.S. withholding tax. However, the U.S. withholding tax exemption generally would not apply to any income that is connected with a U.S. trade or business and such income may be subject to U.S. withholding tax. Therefore, careful consideration should be given to the type of U.S. investments held within a registered plan. If U.S. withholding tax is paid on investments in a registered plan, these amounts may not be claimed for a foreign tax credit. For Canadian tax purposes, amounts withdrawn from the registered plan are taxable at marginal tax rates.

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### Tax Free Savings Account (TFSA)

The *Treaty* does not recognize a TFSA as a pension or retirement account, and as a result, U.S. withholding tax may apply to any U.S. dividends or other U.S. income earned in a TFSA. The U.S. taxes paid may not be claimed for a foreign tax credit.

### Registered Education Savings Plan (RESP)

Similarly, the *Treaty* does not recognize an RESP as a pension or retirement account, and any income earned from U.S. investments held in an RESP would not be exempt from U.S. withholding tax.

## Underlying source of income

When receiving dividends from a U.S. equity investment, the underlying source of the income must be taken into

account. As previously noted, while Canadians are typically taxed on income based on residency, income received from outside of Canada may also be taxed in the country where it originated.

Under the *Treaty*, the U.S. tax provisions apply to income sourced in the U.S., and generally do not apply to income sourced from another country. For example, if a non-U.S. domiciled company (e.g., a Japanese company) is listed on a U.S. stock exchange, any source non-resident withholding tax applied on dividend payments from the Japanese company would typically be based on Japan's non-resident withholding tax rules (or a tax treaty between Canada and Japan). The U.S. non-resident withholding rules (including those under the *Treaty*) typically would not apply.

If a foreign dividend is received in an RRSP and an exemption in that country's tax treaty with Canada is not available, taxes may be withheld, and may not be recoverable.

## Canadian reporting of foreign property held

In general, Canadians are required to report income (Canadian and foreign) from all sources on their Canadian personal income tax returns. In addition, Canadian residents who own foreign investment property with a cumulative cost of more than \$100,000 at any time during the year are required to file a *Form T1135, Foreign Income Verification Statement* with the Canada Revenue

Agency (CRA). Canadians who hold **specified foreign property** with a total cost-amount of over \$100,000 but less than \$250,000 throughout the year may report under a simplified reporting method. The CRA will levy substantial penalties for failing to file Form T1135 accurately and on time.

## U.S. estate tax

For Canadian residents who are not U.S. persons, U.S. estate taxes will only apply to the portion of their assets located in or connected to the United States (U.S. situs assets) if the cumulative amount of these assets and their worldwide assets exceed certain thresholds. Canadians will be subject to U.S. estate taxes if, at the time of their death, the value of their U.S. situs assets exceeds US\$60,000 and the value of their worldwide assets is more than US\$11.58 million in 2020 (indexed annually for inflation). The maximum federal estate tax rate is currently 40%. Note that if at the time of death the value of a Canadian's U.S. situs assets is over the US\$60,000 threshold, a U.S. estate tax return is required, whether or not U.S. estate tax is payable. The deadline to file this return is nine months following the date of death and an extension may be requested.

The Tax Reform legislation enacted at the end of 2017 doubled the basic exclusion amount until the end of 2025. However, unless new legislation is enacted, the exemption amount will return to the amount under prior law of US\$5 million adjusted for inflation to 2026.

## Conclusion

Consider speaking with your TD advisor and a cross-border tax advisor when assessing the tax aspects associated with investing in U.S. equities.



This article provides a general overview of some of the U.S. and Canadian tax considerations for Canadian residents around certain types of U.S. retirement accounts. It does not address additional considerations applicable to persons who are U.S. citizens, green card holders or individuals who are otherwise treated as residents of the United States for U.S. tax purposes. The U.S. and Canadian tax rules are complex, and tax consequences can vary depending on your individual circumstances. Be sure to speak with your tax specialist before taking any action with respect to any retirement accounts.

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