Tax Free Savings Account (TFSA) & U.S. TAX

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Description

- Introduced in February 26, 2008 Federal Budget
- Registered investment account
- Designed to encourage savings by Canadians (high & low income earners)
- Income and capital gains earned within plan are 100% tax-free when earned or when withdrawn.

Registration Requirements

- Must be 18 years of age; however, no max. age limit to contribute
- Canadian resident
- SIN required
- Effective January 2, 2009

Taxation

- No taxes within the plan
- Contributions are not tax deductible
- Withdrawals are not taxable
- Income-tested benefits or credits unaffected*

* *OAS, CTB & Guaranteed Income Supplements*

Contribution Rules

- Plan holders can contribute up to $5,000 annually to TFSA
- Unused contribution can be carried forward indefinitely
- Withdrawals from TFSA will increase contribution room for future years
- Contributions to a spouse or common-law partner's TFSA will be allowed
- Annual contribution rate will be indexed to inflation in $500 increment
- CRA will assess 1% per month penalty for excess contributions to TFSA
- CRA will advise individual's TFSA contribution limits on an annual basis

Qualified Investments

- Same as RRSP rules; however, a TFSA will be prohibited from holding investments in any entity which the account holder does not deal at arm's length

TFSA – Death of Registrant

- Received by estate tax-free
- Tax-free rollover to spouse or common-law partner (FMV of TFSA @ date of death); IFSA will continue to be tax-free
- The ITA allows a TFSA trust to continue to maintain its tax free status until end of next year following the year in which the TFSA holder dies; if TFSA still exists after this, the trust becomes taxable.
- Cumulative earnings subject to tax after the end of the taxation year following the year of death*

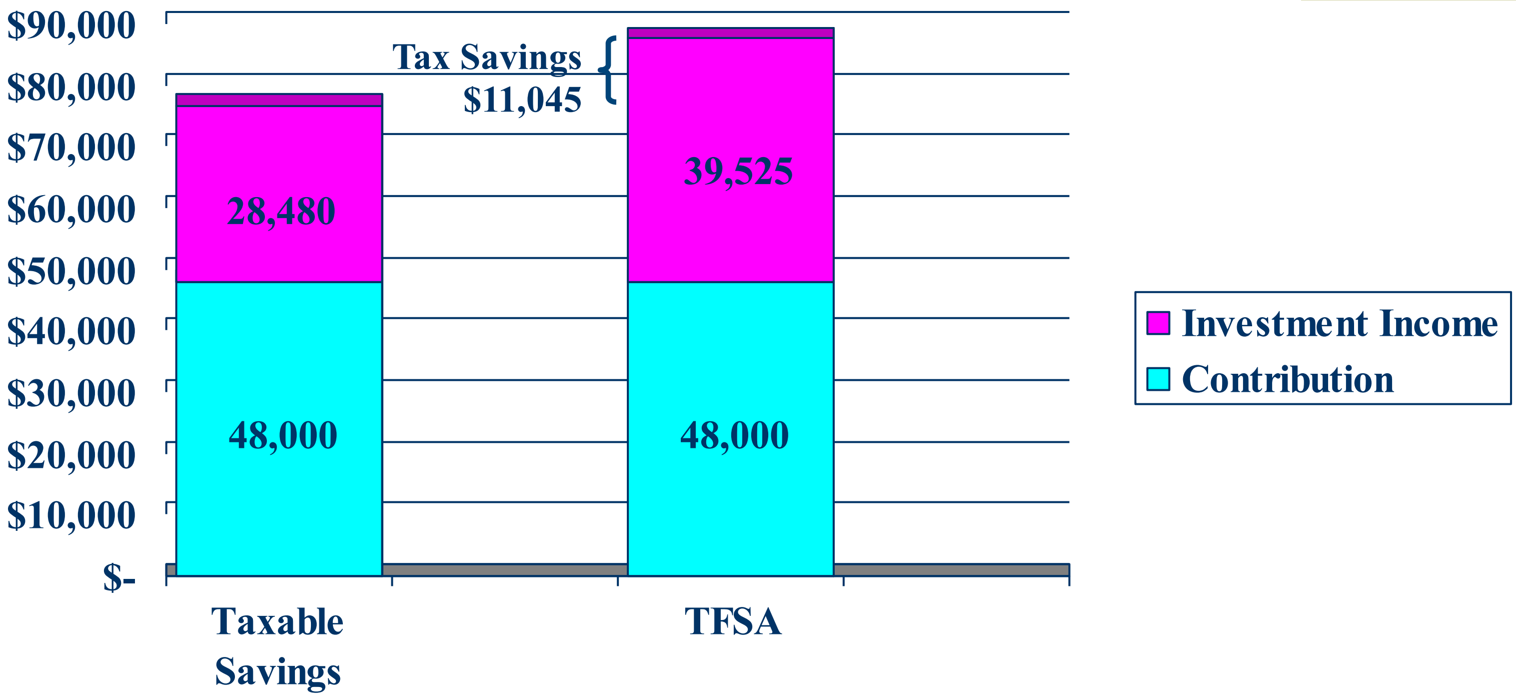
Marriage/Relationship Breakdown

- Tax-free rollover permitted to spouse or common-law partner (FMV at date of death)
- Transfer of TFSA assets do not result in adjustment to contribution room of parties involved

TFSA
Comparison to RRSP - Differences

	TFSA	**RRSP**
Contribution Limits	Fixed – Annual Limit	Determined by earned income and Pension Adjustment
Contribution to Plan	Not deductible from income	Deductible from income subject to contribution limit
Withdrawal from Plan	Not taxable	Taxable income
Earnings within plan	Not taxable	Tax deferred until withdrawn – taxable on withdrawal
Withdrawals – contribution room	Withdrawals restore contribution room	Withdrawals do not restore contribution room
Plan conversion	No conversion of TFSA to another plan at any time	RRSP must be converted to RIF at age 71
Contribution to Spousal Plan	No income attribution on contribution to spouse's TFSA	Can contribute to spousal RRSP to extent of contribution room

Returns from Saving in a TFSA Compared to Taxable Savings



Notes: Combined federal-provincial tax savings, based on a $200 monthly contribution for 20 years, and a 5.5 per cent rate of return. For unregistered savings, a 21 per cent average tax rate on investment income is assumed (based on 40 per cent interest, 30 per cent dividends and 30 per cent capital gains, and a middle-income earning account holder).

U.S. Issues for U.S. Citizens Living in Canada

- Filing requirements & Due dates
- Principal residence
- Estate taxation
- Taxation differences
- Charitable donations
- Capital gains
- Social security
- Pension income

Filing Requirements & Due Dates

- All U.S. citizens and residents must file each year
- Personal tax returns & tax payments are due April 15th each year
- Automatic 2 month extension to file is granted if you live outside of the U.S.; however, taxes are still due by April 15th
- You can file a form to receive a longer filing extension (6 months)

Principal Residence Issue

- Full gain on sale is exempt in Canada if you meet certain criteria
- Only $250,000 is exempt from tax in the U.S. if you meet certain criteria; rest of the gain is taxed at long term capital gains rates
- Exemption can be increased to $500,000 for married filing jointly taxpayers and certain criteria are met
- Exemption can be used every 2 years
- Loss from sale of principal residence is not deductible

Estate Taxation

- Each U.S. citizen is entitled to the estate exemption equaling $2,000,000 at present (may be changing in the future)
- Canadian citizens/resident holding assets in the U.S. are also required to file a U.S. estate return but they are also eligible for an estate exemption but it depends on the value of the estate held in the U.S. compared to that held within Canada (using the tax treaty)

Difference in Taxation between Countries

- Canada taxes individuals based on residency
- U.S. taxes individuals based on citizenship (i.e. it doesn't matter if you live in the country or not)
- Both countries have time tests to determine residency status; however, you can escape ling a tax return in the U.S. if you qualify under the closer connection election or under the Tax Treaty
- Each taxpayer or dependant of a taxpayer must have a social security number or a tax identifier number (i.e. to claim a dependant credit, the dependant must have a number; unlike Canada where a SIN is not required for dependant children)

Charitable Donations - Deductibility

- If you are a Canadian resident and non-citizen of the U.S. and you donate money to a U.S. charity, you can only use the donation as a credit against U.S. source income
- The same is also true if you are a U.S. citizen donating money to a Canadian charity, you can only use the donation credit in the U.S. against Canadian source income

Capital Gains Taxation

- Only 50% of a capital gain is taxable in Canada at the individual's applicable tax rate
- Capital gains taxation is more difficult in the U.S. because they have various categories of capital gains (i.e. gains resulting from different types of property) which are all taxed at different rates, such as:
  - Capital gain from assets held one year or less is taxed at the taxpayer's regular tax rates; (CONT'D)

Capital Gains Taxation (Cont' d)

- Capital gain from the sale of collectible held more that twelve months (i.e. antiques, metals, gems, stamps, coins) is taxed at a maximum rate of 28%;
- Capital gain attributable to unrecaptured depreciation on business property held more than twelve months is taxed at a maximum rate of 25%; and
- Capital gain from assets held more than twelve months (other than from collectibles and unrecaptured depreciation on business property) is taxed at a rate of 15% (or 5% for individuals in the 10% or 15% tax bracket).

Social Security (SS) Taxation

- Social security in the U.S. is the equivalent of Canada's CPP
- Generally, social security is not taxable in the U.S. until your income reaches a certain threshold:
  - Up to 50% of Social Security benefits may be included in gross income if the taxpayer's provisional income (AGI + tax – exempt income + 50% of the Social Security benefits) exceeds a threshold that is $32,000 for a joint return, $0 for married taxpayers filing separately, and $25,000 for all other taxpayers. The amount to be included in gross income is the lesser of
    1. 50% of the Social Security benefit; or
    2. 50% of the excess of the taxpayer's provisional income over the base amount

Social Security (SS) Taxation

- Up to 85% of Social Security benefits may be taxable to taxpayers with higher income over a second threshold of $44,000 for a joint return, $0 for married filling separately, and $34,000 for all other taxpayers. The amount to be included in gross income is the lesser of
  1. 85% of the Social Security benefit; or
  2. The sum of (a) 85% of the excess of the taxpayer's provisional income over the higher threshold amount plus (b) the smaller of (i) the amount of benefits included under (a) above, or (ii) $4,500 for single taxpayers or $6,000 for joint filers

Social Security (SS) Taxation

- **CPP & OAS** are treated as the same as SS benefits for U.S. tax purposes (i.e. not taxable in U.S. if you reside in Canada)
- **Rule of thumb:** SS benefits are fully excluded by low-income taxpayers with provisional income of less than $25,000; 85% of benefits must be included in gross income by high-income taxpayers with provisional income greater than $60,000

Social Security (SS) Taxation

- **Lump-sum distributions** from qualified pension, profit-sharing, stock bonus and Keogh plans (but not IRAs) may be eligible for special tax treatment
  1. The portion allocable to pre-1974 years is eligible for long-term capital gains treatment
  2. If the employee was born before 1936, they may elect ten-year averaging
  3. The distribution may be rolled over tax-free (within 60 days) to a traditional IRA, but future payments from the IRA will be treated as ordinary income

Social Security (SS) Taxation

- If you live outside the U.S. (i.e. in Canada), under the treaty, SS benefits will only be taxed in the country of residence. Canada has agreed to tax only 85% of the income to maintain the maximum taxable allotment to coincide with U.S. SS tax guidelines. This means that in Canada you will pay tax on 85% of the SS benefits you receive no matter what your income threshold is. On your U.S. return, you will report the SS income but none of it will be taxed in the U.S. because you do not reside there. This eliminates double taxation but eliminates the threshold allocations applicable if you were to reside in the U.S.

Pension Income

- RRSP, RPP, RRIF, etc.
- Contributions to above plans are not a deductible expense in the U.S. (consider foreign pension plans);
- Only income portion and employer contributions are taxable in U.S. *
- Same is true for U.S. pension plans, such as, 401(K) & IRA;
- Detailed calculation each year**

Questions?

Thank-You!

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