



# Am I a U.S. Tax Resident?

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CROSS-BORDER WEALTH MANAGEMENT



Most Canadians who move to the U.S. have a good understanding of their immigration residency status. However, many do struggle to determine their residency status for U.S. income tax purposes.

While it is common knowledge that U.S. citizens and green card holders are responsible for filing U.S. tax returns, most people who move to the U.S. on a non-resident visa – such as a TN, E1 or E2, O-1, L-1 – are unfamiliar with the U.S. tax residency rules that can subject them to U.S. taxation on their worldwide income.

This is not surprising given that the definition of a resident for U.S. tax purposes is mutually exclusive of the definition of a U.S. resident for immigration purposes.

As a result, a non-resident for U.S. immigration purposes, can in fact be a U.S. tax resident who is subject to U.S. taxation on their worldwide income. On the other hand, a non-resident for U.S. tax purposes is subject to U.S. taxation only on their U.S. source income.

To assist our Canadian clients in navigating the complicated U.S. tax residency rules, we have prepared the following summary of the most common questions Canadians have when it comes to preparing a U.S. tax return:





## How Do I Become A U.S. Tax Resident?

Simply put, you become a U.S. tax resident if you are physically present in the U.S. for at least 183 days in one calendar year. You can also be considered a resident under the Substantial Presence Test (SPT) if you spend, based on a special formula, at least 120 days in the U.S. each year, during the past 3 calendar years.

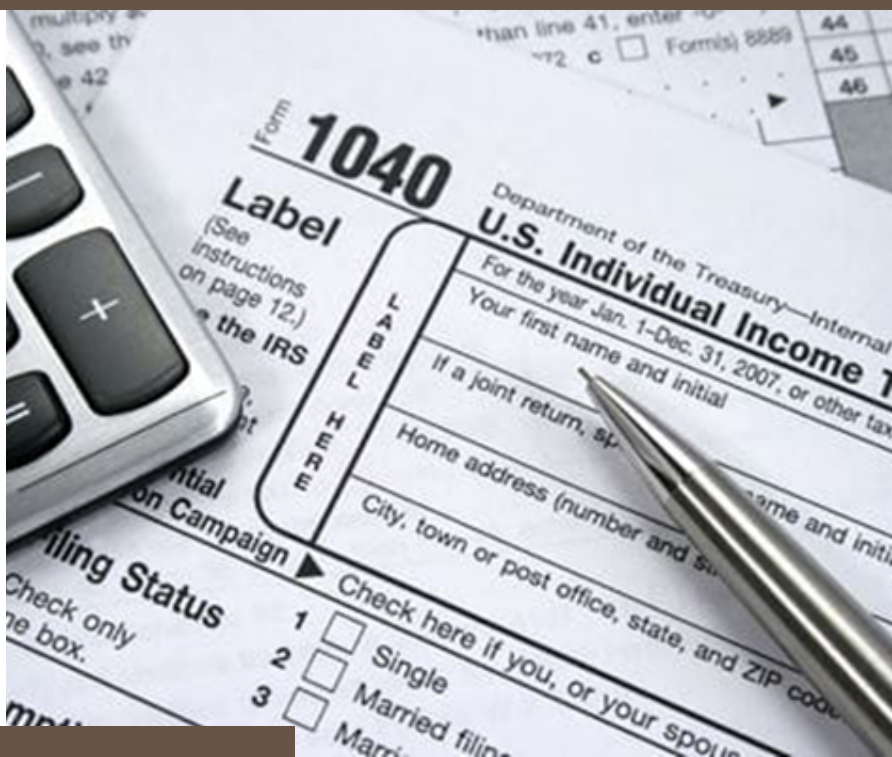
For Canadians who like to visit the U.S. for cross-border shopping, beware because even those short day trips south of the border count as a full day for purposes of the 183 day threshold.

Conversely, a Canadian who is never physically present in the U.S. for more than 120 days in each calendar year will not qualify as a U.S. tax resident.

## What Happens if I Become A U.S. Tax Resident?

Since most Canadians moving to the U.S. for work on temporary visas are unlikely to spend less than 183 days in the U.S., they qualify to be taxed as U.S. residents.

Although special rules beyond the



scope of this ebook apply to a first year U.S. tax resident, a U.S. taxpayer prepares a Form 1040 and reports all their worldwide income, including all investment income, capital gains, rental income from non-U.S. rental properties and foreign pension income.

## Is There A Way To Avoid Being Treated As A U.S. Tax Resident?

If a Canadian working in the U.S. on a temporary visa qualifies as a non-resident taxpayer, then they prepare a Form 1040NR and generally only pay U.S. income tax on wages earned while working in the U.S.

However, if you qualify as a U.S. taxpayer, the following exemptions will allow you to prepare a U.S. tax return as a non-resident.

### 1 Closer Connection Exception (CCE)

A Canadian who meets the SPT may avoid preparing a return as a U.S. resident by filing IRS Form 8840.

To qualify to file the Form 8840, one must meet all the following criteria:

1. Have a “tax home” (usually where your family, permanent home and personal belongings are located) and a closer connection to Canada
2. Be physically present in the U.S. for under 183 days in the current calendar year; and,
3. File Form 8840 to indicate this connection on a timely basis (filing this Form late may cause you to be ineligible to claim the CCE)

### 2 Non-Residency Under The Treaty

In the event a Canadian working in the U.S. on a temporary work visa is physically present in the U.S. for at least 183 days in a single calendar year, it is still possible to avoid U.S. tax residency by filing a Form 1040NR with a Form 8833 treaty election.

Generally, a treaty election is used when a taxpayer is considered a tax resident of both the U.S. and Canada. In the case where a taxpayer is a simultaneous resident of both the U.S. and Canada, the treaty acts as a tiebreaker to determine which country has the right to tax the taxpayer as a resident.





The U.S.-Canada tax treaty contains a provision that allows a U.S. taxpayer to be treated as a Canadian tax resident, and hence a U.S. non-resident, if Canada is their permanent home.

If a taxpayer has a permanent home in the U.S. and Canada, then it's necessary to look at where a taxpayer maintains their center of vital interests, their habitual abode and their citizenship to break the tie.

Nevertheless, a person who uses the treaty to be taxed as a U.S. non-resident is still considered a U.S. tax resident for other filing purposes. As such, Canadians need to report their financial accounts and interests in foreign corporations, trusts and partnerships to the IRS on the following IRS Forms:

- Foreign Bank Accounts (FinCen 114)
- Foreign Corporations (5471)
- Foreign Partnerships (8865)
- Foreign Trusts (3520/A)

Tax filers beware as fees to prepare these foreign compliance Forms can be costly because they are complicated and time consuming.



## Does California Follow The Same Residency Rules As The IRS?

Sadly, if preparing a federal return in the U.S. wasn't complicated enough, a whole set of different rules beyond the scope of this article apply to determine if a Canadian working in California is considered a California tax resident, and hence subject to California tax on their worldwide income. Since California is not a party to the U.S.- Canada tax treaty, no foreign tax credits can be taken for any foreign taxes paid to Canada. In addition, since California is a community property state, special California community property tax rules apply with respect to splitting community income.

### In Closing

Because few tax professionals work with Canadians temporarily working in the U.S., it is important to partner with a firm that understands the tax complexities involved in cross-border employment. At Cardinal Point, we assist Canadians working in the U.S. on temporary visas and are available to assist with properly assessing your U.S. tax residency and preparing the necessary U.S. and Canadian tax filings.

**Contact Cardinal Point for more information**

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