

THE ABACUS

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Flying South for the Winter

Every year, thousands of Canadians escape our winter by traveling south, usually to the U.S., for a few weeks or months, or even the whole winter. The thoughts of such snowbirds are typically on improving their golf game or enjoying the sunshine, and not on the tax implications of their whereabouts. There are, however, costs and tax consequences which can follow on spending an extended period of time outside of the country.

Tax 101 for snowbirds

Typically, snowbirds who go south for the winter remain what is called, in tax parlance, "factual residents of Canada". In practical terms, the income of such taxpayers is treated, for Canadian tax purposes, as though they had never left Canada. Factual residence is determined by the Canada Revenue Agency (CRA) on the basis of whether a taxpayer has maintained "residential ties" to Canada. Such residential ties could include continuing to maintain a home in Canada, having a spouse or dependants who remain in Canada while the snowbird is out of the country, having personal property (like a car) in Canada and continuing to hold a Canadian driver's licence and hospitalization insurance.

The vast majority of snowbirds who winter down south do maintain sufficient residential ties to Canada to be considered factual residents. Consequently, when they file their tax returns for the year, they follow all the same rules as year-round Canadian residents. They report all income received during the year from both inside and outside Canada and claim all



available deductions and credits. Income tax is paid to the federal government and to the province with which their residential ties are kept. Finally, snowbirds who remain factual residents of Canada remain eligible for the goods and services tax credit, which may be paid to recipients outside of Canada.

Health care coverage

ONE OF THE BIGGEST CONCERNS OF MANY SNOWBIRDS IS MAINTAINING HEALTH CARE INSURANCE COVERAGE WHILE OUT OF THE COUNTRY. In all cases, the availability and degree of coverage will depend on the health care plan in effect for the province or territory of which the snowbird is a resident, and it's necessary to confirm in advance the coverage which will be made available for out-of-Canada medical expenses. Most snowbirds end up obtaining supplementary health-care coverage, and the premiums paid for such coverage can usually be claimed as a medical expense on the Canada tax return. As well, any out-of-pocket costs incurred for eligible medical expenses while out of Canada (whether for the individual or his or her spouse) can be claimed as a medical expense on that year's tax return.

Application of U.S. tax laws

The application of U.S. tax laws to snowbirds can, unfortunately, be a good deal more complex than the equivalent Canadian laws, and any snowbird who thinks he or she may have a U.S. tax filing or payment obligation should certainly seek professional advice. That said, it is possible to summarize in a general way the basic rules which govern the application of U.S. tax laws to snowbirds.

Canadian residents who spend part of the year in the U.S. are classified as either resident aliens or non-resident aliens. Resident aliens are generally taxed in the U.S. on income from all sources worldwide and non-resident aliens are generally taxed in the U.S. only on income from U.S. sources. The classification depends, in the first instance, on the amount of time the person spends in the U.S. during a given calendar year. A person who was in the U.S. for 183 days or more (i.e. more than half the year) during the calendar year is considered to have met the "substantial presence" test and is classified as a resident alien of the U.S. At the other end of the spectrum, a person who was in the U.S. for less than 31 days during the calendar year is considered a non-resident alien. Those who fall in the middle (which would include most snowbirds who spend, for instance, the months of January and February in Florida) may meet the substantial presence test, depending on the application of a complex formula which uses a weighted average of the number of days of residence in the current and two previous calendar years.

Even this brief summary is sufficient to illustrate the complexity of the U.S. tax laws as they may apply to snowbirds. The best advice for those whose plans include an extended stay south of the border, particularly if they are contemplating repeat visits on an annual basis, is to obtain professional advice in advance on the U.S. and Canadian tax consequences. Doing so can ensure that what is intended as a relaxing vacation doesn't end up causing a major tax headache.

Retirement Savings Gap Continues To Grow

A recent Statistics Canada report indicates that the retirement savings gap among Canadian families continues to widen. The study, which examined the retirement savings patterns of Canadian families over the period running from 1986 to 2003, was the first since the mid-80s to focus on family, rather than individual, preparedness for retirement.

Not surprisingly, the study showed that families with higher incomes were consistently able to put aside more money for retirement, whether through registered retirement savings plans (RRSPs) or employer sponsored registered pension plans (RPPs). The real news coming from the StatsCan report was that between 1986 and 2003, there has been no increase at all in the amount of money put aside for retirement by lower income families. In some cases, particularly that of lower-income single parents, the average amount of money saved each year for retirement has actually declined over that 17-year period. Consequently, the gap in contributions to RRSPs and RPPs which existed in 1986 between families in the upper income brackets and those in the lower percentiles has grown over the past two decades.

As StatsCan noted, the findings have important implications for Canada's public retirement income system. According to StatsCan, income inequality among retired Canadians was substantially diminished by the "maturation" of the Canada and Quebec Pension Plans during the '80s and mid '90s. However, the growing disparity in private retirement savings between upper and lower income families disclosed by the study suggests that, absent offsetting factors, the gap in income inequality could start increasing again in future years.

No Tax on Bonus Allocated To Health Care Expense Account

It isn't often the case that amounts received by employees from their employer escape the Canadian tax net. Virtually all such amounts received are treated as income from employment, reportable on the annual tax return and taxed at the employee's usual tax rate. However, a recent advance tax ruling issued by the Canada Revenue Agency (CRA) indicates that such a result may be obtainable where credits based on an employee's bonus are allocated to an employee's health care spending account.

The facts considered by the CRA involved a benefits plan set up by the employer for its employees. The plan covered such costs as disability insurance, dental insurance and group sickness and accident insurance, and employees were entitled to enroll in the plan or to make changes to their coverage once each year. Employees enrolled in the plan could have eligible costs paid for to the extent of credits existing in their individual health care expense accounts (HCEA). Compensation paid to employees of the company consisted of a combination of base salary and annual bonuses. The payment of bonuses was determined by both the overall financial results of the company and achievement by a particular employee of individual business goals and contributions to team goals and objectives.

The CRA was asked to consider the tax consequences of an amendment to the HCEA which would permit employees to apply all or part of their annual bonuses toward additional credits in the HCEA. The taxable amount of bonus payable would be reduced by any portion which the employee elected to allocate to HCEA credits, and the amount elected could be a lump-sum amount or a percentage of the bonus received. Any election made would be irrevocable.

After considering the facts and the proposed changes, the

CRA CONCLUDED THAT THE ALLOCATION OF CREDITS TO THE HCEA WOULD NOT BE CONSIDERED INCOME FROM EMPLOYMENT UNDER THE INCOME TAX ACT.

As well, any amount by which a bonus otherwise payable to the employee was reduced as a result of the employee's HCEA election would also not be included in the employee's income. Finally, any payments from the HCEA to an employee to reimburse that employee for medical expenses would not be taxable to the employee. Effectively, the plan amendment proposed by the employer had the effect of turning what would have been a bonus payment taxable as employment income into a non-taxable enhancement to the employee's health care expense account.

The opinion rendered by the CRA was in the form of an advance tax ruling, and such rulings are binding on the Agency only with respect to the specific taxpayer who requested the ruling. However, the type of health care plan involved (that is, a flexible plan in which the employee can allocate extended health care coverage credits in the manner which best suits his or her needs) is a common one in the Canadian workplace. It's reasonable to conclude that, where plan terms are virtually the same or even very similar, the reasoning and conclusions reached by the CRA in this ruling would be very persuasive. And, for an employee, the ability to increase coverage available under an employer-provided health care plan on a tax-free basis is a win-win situation.



FAST FACTS

2006 Federal Tax Rates and Brackets

The 2006 federal tax rates and brackets for individuals are as follows:

- 15.25% of the first \$36,378 of taxable income;
- 22% on taxable income between \$36,379 and \$72,756;
- 26% on taxable income between \$72,757 and \$118,285; and
- 29% on taxable income over \$118,285.

Provincial tax rates are calculated separately.



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