Tax Implications for Canadians: Investing in U.S. Equities

When it comes to investing in U.S. equities, there are a number of tax considerations that Canadians should be aware of. Although not all encompassing, this article highlights five areas for consideration for a Canadian resident that wishes to invest in U.S. equities.

*Note: This article assumes that the taxpayer is a Canadian resident who is not a U.S. citizen, U.S. resident or green card holder.*

1. Taxes Payable

**Canadian Personal Income Tax** – For Canadian tax purposes, dividends received from Canadian corporations generally enjoy preferential tax treatment in the form of a dividend tax credit. The dividend tax credit is a non-refundable tax credit which applies when Canadian dividends are included in income. On the other hand, dividends from U.S. corporations are taxed at the individual’s marginal rate and do not qualify for a dividend tax credit.

For example, assuming a Canadian resident in Ontario receives a dividend from a U.S. corporation, the top tax rate that can be applied for 2014 is 49.53%. In comparison, depending on the type of Canadian dividend received by the same individual, the top tax rate applied to Canadian dividends ranges from 33.85% to 40.13%.

Capital gains or losses realized on the sale of U.S. equities receive the same tax treatment as Canadian equities and are taxed at a 50% inclusion rate (i.e. 50% of the gain is to be included into income).

**U.S. Non-Resident Tax** - Generally, a foreign person is subject to U.S. tax on U.S. source income. When a Canadian receives a dividend from a U.S. equity, taxes may be withheld prior to the payment of the dividend, depending on which account the U.S. equity is held in (discussed later in this article). TD Wealth is a Qualified Intermediary (QI) and will withhold the U.S. taxes for its clients at the time of payment. Under the Canada-U.S. Tax Convention (the Treaty), where an investor has less than a 10% interest in a corporation, the withholding tax rate applicable on the U.S. dividend income received will be 15%i. This rate generally applies to clients whose accounts have been QI-designated.

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i Department of Finance Canada, Convention Between Canada & the United States of America With Respect to Taxes on Income and on Capital, Article X.
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To avoid double taxation, a foreign tax credit may be available to reduce the amount of Canadian taxes payable on the U.S. income received. If taxes are withheld, they may be recoverable by claiming a foreign tax credit to the extent that there are Canadian taxes payable on the U.S. income earned.

On the other hand, capital gains/losses realized from U.S. equities are generally not subject to withholding taxes².

2. U.S. Equities Held in Registered Plans

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

Registered Plans (i.e. RSPs, RIFs, LIRAs, LIFs, LRIFs): Under the Treaty, certain income earned in registered plans that are held for pension or retirement purposes is exempt from non-resident withholding tax³. Therefore, dividend income earned from U.S. sources in the account is generally not subject to withholding tax. For Canadian tax purposes, the income is taxable at marginal tax rates when it is withdrawn from the registered account.

Tax Free Savings Account (TFSA): On the other hand, the Treaty does not recognize a TFSA as a pension or retirement account. Therefore, withholding tax may apply to any U.S. dividends earned in a TFSA. The U.S taxes paid may not be recoverable through the foreign tax credit for Canadian tax purposes.

Registered Education Savings Plan (RESP): Similarly, the Treaty does not recognize an RESP as a pension or retirement account. Therefore, any income earned from U.S. investments held in an RESP would not be exempt from U.S. withholding tax.

3. Underlying Source of Income

When receiving dividends from a U.S. equity, the underlying source of income must be taken into account. Provisions under the Treaty apply to income earned in the U.S. and do not apply to foreign-sourced income; therefore, foreign non-resident withholding taxes may apply depending on the country of origin. For example, if a foreign dividend is received in an RSP account and an exemption in that country’s tax treaty is not available, taxes will be withheld and would not be recoverable.

4. Canadian Reporting of Foreign Property Held

In general, Canadians are required to report income (foreign and non-foreign) from all sources on their personal Canadian 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. Canadians who fail to file this form may be subject to interest and penalties.

² Department of Finance Canada, Convention Between Canada & the United States of America With Respect to Taxes on Income and on Capital, Article XIII.
³ Department of Finance Canada, Convention Between Canada & the United States of America With Respect to Taxes on Income and on Capital, Article XXI.
5. U.S. Estate Tax

For Canadians that are not U.S. persons for U.S. tax purposes, U.S. estate taxes will only apply to the portion of their assets deemed to be situated in the United States (U.S. situs assets) if the cumulative amount of these assets, and their worldwide assets, exceed certain thresholds.

For 2014, Canadians will be subject to U.S. estate taxes if, at the time of their death, the value of their U.S. property exceeds US$60,000 and the value of their worldwide assets is more than US$5.34 million. 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. property 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.

The above information is provided for general information purposes only. Readers should consult a qualified tax advisor to identify the income tax considerations specific to their situation.