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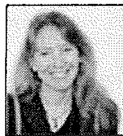
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Tax Implications of Employees Traveling Between the United States and Canada

By Alan R. Sasserath, CPA, MS; Michael D. O'Brien, EA; and Richard Weber, CA

The global economy has produced a growing need for individuals flexible enough to work outside of their home countries, especially among companies with operations in both Canada and the United States. Proper tax planning is essential in minimizing the potential tax liability that can be associated with a work-related transfer between these two countries.

Several important tax policies exist for U.S. resident employees of U.S. corporations and for Canadian resident employees of Canadian corporations who render employment services in the other country. In both the United States and Canada, penalties that might be significant in amount may be imposed on employer corporations and their employees for failure to comply with the tax requirements of each country.

The two scenarios below can act as a general guide to help CPAs prepare for work relocation, although professional advice should be sought for real-life client situations. For simplicity, the two scenarios assume that the country of residence of the individual's employer corporation is the same as the individual's home country. These scenarios do not cover state, provincial or Social Security taxes.

U.S. Residents Travelling to Canada to Perform Employment Duties

Canadian (Host Country) Tax Implications

Liability of Employee to Tax in Canada. Nonresidents of Canada who earn income from employment rendered in Canada are typically subject to taxes on that income according to the domestic tax laws of Canada. But the Canada/U.S. Tax Treaty ("the Treaty") provides the following two helpful and distinct exemptions from such liability for Canadian tax:

- First, employment income earned by a U.S. resident that is attributable to employment carried out in Canada will generally be exempt from tax in Canada if such remuneration for the calendar year is not more than $10,000 (measured in the currency of the host country—in this case, Canada).
- A second exemption from Canadian tax may also be available if the individual is not physically present in Canada for more than 183 days in any 12-month period beginning or ending in the fiscal year in question and if the remuneration is not paid by or on behalf of a person who is a resident of Canada or borne by a "permanent establishment" in Canada. In the latter exemption, "borne by" means allowable as a deduction in computing taxable income.

For example, assume that an individual is a resident of the United States and is employed by a U.S. company. Assume also that the individual performs employment duties in Canada (for less than 183 days) at a Canadian branch office of the U.S. company. The Canadian source employment income earned by the individual for the calendar year exceeds $10,000 (Canadian). The amount of the individual's Canadian source employment income is charged by the head office of the U.S. company to its Canadian branch office, which deducts the charge in computing its income for Canadian tax purposes. In this case, the individual would be subject to tax in Canada on the Canadian source employment income because the Canadian employment income is borne by the permanent establishment in Canada.

Tax Return Filing Requirement. Canada's domestic tax laws contain an exemption from the requirement for individuals to file a Canadian tax return where "no tax is payable… for the year." The Canada Revenue Agency (CRA) restricts the requirement to file a tax return to situations where an individual has to pay tax for the year or if the

CRA requests the individual to file a tax return (for example, if a T4 slip has been filed by the employer). Also, an individual may want to file a tax return voluntarily to facilitate the claim for a refund due, such as for Canadian taxes withheld at source related to Canadian source employment income that is not subject to tax in Canada due to the Treaty.

U.S. (Home Country) Tax Implications

Employees working in Canada may be on a short-term (fewer than 12 months) or a long-term (more than 12 months) work assignment or may even be commuters who travel back and forth on a regular basis. U.S. citizens and residents remain taxable on their worldwide income and so all income earned will continue to be reported on the U.S. individual income tax return.

Short-term assignees may deduct away-from-home living expenses to the extent that they maintain their tax home in the United States and satisfy certain additional requirements. Long-term assignees will seek to meet the criteria enabling them to qualify for the foreign earned income and housing exclusions as applicable.

A U.S. person could qualify for up to $92,900 of foreign earned income exclusion in 2011 ($95,100 in 2012), in addition to claiming specified housing exclusions that vary by location. To qualify for these exclusions, taxpayers must satisfy one of two tests: they must maintain taxed homes outside the United States for a period that includes a complete U.S. tax year or they must maintain a taxed home outside the United States and be present outside the country for at least 330 days in any 365-day period. If they can satisfy one of these tests, the U.S. employee can reduce U.S. tax withheld in anticipation of claiming these exclusions on the U.S. tax return when filed.

Employees will also wish to ensure that they can utilize the maximum amount of foreign tax credit available on their U.S. tax return for Canadian taxes paid or accrued. To this end, income taxed by both the United States and Canada should ultimately be taxed only once—at the higher prevailing tax rate. Where the U.S. employer is obliged to withhold Canadian taxes on wages paid for work performed in Canada, the corresponding U.S. tax withholding can be suspended to avoid an undue withholding burden on the employee.

U.S. employees living and working in Canada for extended periods may face additional U.S. information reporting requirements in relation to interests that they acquire in foreign corporations, foreign trusts or foreign bank accounts.

Canadian Residents Travelling to the United States to Perform Employment Duties

U.S. (Host Country) Tax Implications

Liability of Employee to Tax in the United States. A foreign national working in the United States is likely to be engaged in a U.S. trade or business and therefore subject to U.S. tax at normal graduated tax rates, unless such person qualifies as exempt under the Treaty.

Broadly speaking, Article XV of the Treaty permits taxation only in the country of residence for services rendered in the other country when—

- remuneration does not exceed $10,000 (in the currency of the other country) or
- the recipient is present in the other country for less than 183 days and the remuneration is not borne by an employer with a presence in the other country.

Tax Return Filing Requirement. The first consideration for any Canadian employee on U.S. work assignment is often whether the amount of time spent by that employee in the United States will give rise to a U.S. tax filing requirement and what (if any) provisions of Treaty will prevail. As mentioned above, for those individuals on short-term business trips, spending less than 183 days per year in the United States or earning less than $10,000 per year from U.S. sources, the Treaty may permit taxation only in Canada. A treaty-based nonresident tax return will confirm this position.

Individuals will normally become U.S. residents for tax purposes if they obtain permanent residence status (green card holder) or if they meet the substantial presence test, which is met in any year that an individual spends at least 31 days in the United States during the current year and 183 days in the United States when counting

all of the current-year U.S. days, one third of the prior-year U.S. days and one sixth of the U.S. days in the second prior year. A foreign national may end up filing Form 1040, Form 1040NR or a combination of both—known as a dual-status tax return—all depending on the actual residency start date, as well as on any elections that might be entered into for the year of arrival.

Canadian nationals working in the United States who become U.S. residents are subject to additional U.S. information reporting requirements in relation to interests they may have in foreign corporations, foreign trusts and foreign bank accounts (including registered retirement savings plan accounts).

Canadian (Home Country) Tax Implications

Foreign Tax Credit Related to U.S. Taxes Incurred. In order to avoid what would otherwise constitute double taxation, Canada permits a foreign tax credit in respect of U.S. source employment income earned by a Canadian resident that is first subject to taxation in the United States. To ensure that no undue hardship would arise, an application to the CRA may be made by the individual to request a reduction in the amount of Canadian tax withheld at source that relates to U.S. source employment income that is subject to U.S. tax withholding.

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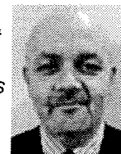

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