Are Canadians Living Abroad Required to Pay Income Tax?

Description

A common question many expatriates ask is whether they'll be liable to pay taxes in their home country. It's well known that U.S. citizens can have tax liabilities even after living outside of the country for years and earning their income from foreign sources. Whether Canadians permanently residing and working abroad are liable to pay taxes can be more difficult to determine, however.

When is tax payable?

Many Canadians living abroad may be surprised to find that they are liable to pay Canadian taxes, even after residing outside of Canada for an extended period. The Canada Revenue Agency (CRA) categorizes a Canadian citizen as a non-resident for tax purposes if they normally or routinely reside in another country, do not have significant residential ties to Canada and are abroad for more than 183 days during the tax year.

A non-resident is liable to pay a 25% federal tax on earnings sourced from Canada, including dividends and interest paid by Canadian domiciled companies, pensions and rental payments. There is no requirement to declare income sourced from outside Canada. Canada has tax treaties with over 90 countries, which may reduce the rate of non-resident tax withheld on certain income.

Many Canadians living abroad fail to realize that if they have a spouse or common law partner, dependents or home in Canada, they are considered to have significant residential ties. The determination of whether they are a resident for tax purposes is also influenced by secondary factors, including holding a Canadian passport, driver's licence, health insurance, bank accounts, investments and credit cards.

If any of those conditions apply, even if living abroad permanently, they can be treated by the CRA as a tax resident. They must file an annual tax statement reporting all sources of income. If that income exceeds certain thresholds, they may be liable to pay tax.

Strategy

This has sparked significant interest among Canadians working abroad as to how to minimize Canadian taxes because many jurisdictions outside Canada have substantially lower taxes. Cutting ties to Canada can be a difficult and lengthy process.

A better approach is to reduce their Canadian tax liabilities. Canada has tax treaties with many other countries recognizing the taxes paid in one jurisdiction. This prevents the same income from being taxed twice in different countries, particularly if a Canadian is a resident for tax purposes in more than one jurisdiction.

Canadian tax residents can use a Tax-Free Savings Account (TFSA) to minimize their tax liability. All interest, capital gains and dividends paid from a compliant investment within a TFSA are typically tax-free. The only risk is that if an account tholder becomes a non-resident, then contributions made during that period are subject to a monthly 1% tax until withdrawn or they become a Canadian tax resident.

One alternative is to invest outside of a TFSA in stocks that pay eligible dividends disbursed by a Canadian domiciled public corporation from tax paid profits. These are categorized as eligible dividends and receive favourable tax treatment.

The dividend income is grossed up by the 38% corporate tax rate, then a 15% Federal dividend tax credit and provincial tax credit of between 5.4% and 12% depending on the province, are applied. If the tax payable is negative, it is not refundable, but can be used to offset tax on other income.

Top dividend stock

A top eligible dividend paying stock is **Fortis** (TSX:FTS)(NYSE:FTS). It has hiked payment for an incredible 46 years straight to be yielding 3.6%, with a modest 50% payout ratio that appears sustainable.

Fortis's wide economic moat, steep industry barriers to entry, and the highly regulated nature of the utilities sector protects its earnings. Those attributes coupled with the inelastic demand for electricity makes Fortis's income highly resistant to economic slumps.

This is highlighted by Fortis's first quarter 2020 earnings. Earnings per share, despite the poor economic environment, fell just a modest 7% year over year to $0.67. The utility also possesses considerable liquidity totalling $4.9 billion available from credit facilities.

The predictability of Fortis's earnings and dividend make it an ideal stock for Canadians seeking tax friendly income. When considered that Fortis is trading at around 14-times earnings and 1.4 times its book value, it appears cheap, making now the time to buy.

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