

## **IT122R2 United States social security taxes and benefits**

INCOME TAX ACT United States Social Security Taxes and Benefits

IT-122R2 March 13, 1989

Subparagraphs 56(1)(a)(i) and 110(1)(f)(i) and Articles XVIII and XXIX of the Canada-U.S. Income Tax Convention (1980).

Application This bulletin replaces and cancels Interpretation Bulletin IT-122R dated January 14, 1980. Current revisions are designated by vertical lines.

Summary This bulletin deals with the taxation of United States social security benefits received by a resident of Canada. It also explains the deduction from tax to which a resident of Canada may be entitled with respect to the taxes paid to the United States which are used to fund social security benefits.

Discussion and Interpretation 1. Of the benefits provided under the United States social security system, retirement, survivors and disability insurance benefits provided under Title II of the Social Security Act or Tier 1 of the Railroad Retirement Act are commonly referred to as "social security benefits". For the 1986 and subsequent taxation years, the portion of Tier 1 benefits considered to be social security benefits is the amount of the social security benefits that a railroad employee or beneficiary would have been entitled to receive if the employee's service had been covered under the social security system rather than the railroad retirement system. In addition, the minimum annuity benefit described in section 3(f)(3) of the Railroad Retirement Act is taxed like social security benefits. To pay for the Title II benefits, taxes are collected from employers, employees and self-employed persons under the Federal Insurance Contributions Act and the Self-Employment Contributions Act which are elements of the Internal Revenue Code. Tier 1 and Tier 2 benefits under the Railroad Retirement Act are funded by the Railroad Retirement Tax Act. Tier 2 benefits and, for the 1986 and subsequent taxation years, the portion of Tier 1 benefits not taxed as social security benefits, while not considered to be social security benefits, are nevertheless superannuation or pension benefits which are included in income under subparagraph 56(1)(a)(i).

2. United States social security benefits which are retirement insurance or survivors insurance benefits paid under the Social Security Act or under the Railroad Retirement Act, as well as disability insurance benefits paid under the latter, are regarded as pension benefits when received by a resident of Canada and are included in income under subparagraph 56(1)(a)(i) of the Act. Disability insurance benefits paid under the Social Security Act up to the age of 65 are not considered to be income and therefore are not subject to tax in Canada. However, upon entitlement to social security benefits at the age of 65, the payments are regular social security benefits which are included in income as noted above. Social security benefits received by a parent on behalf of a dependent child are considered to be income of the child and not of the actual recipient.

3. Subparagraph 110(1)(f)(i) and Article XVIII(5) of the Canada-U.S. Income Tax Convention (1980) allow a taxpayer, in determining taxable income, to deduct one-half of the amount of U.S. social security benefits included in income. The Convention also provides that, except for benefits paid to United States citizens who are resident in Canada, United States social security benefits paid to residents of Canada shall be taxed only in Canada.

4. Ordinarily, payments of social security tax are not allowable as deductions in computing income. However, where an employer in Canada has made payments of social security tax on behalf of an employee without deducting them from salary or wages, those payments are allowable deductions to the employer. The amount so paid in the year that pertains to the employee's portion of the social security tax constitutes a benefit to the employee, which must be included in income under paragraph 6(1)(a). The amount that pertains to the employer's portion does not constitute a taxable benefit to the employee but is nevertheless deductible by the employer.

5. The United States social security tax paid by an employee or on behalf of the employee by an employer (see 4 above) is an income tax and therefore it may qualify as a non-business-income tax under paragraph 126(7)(c) for purposes of the foreign tax credit under paragraph 126(1)(a). A payment which an employee makes as a contribution under the Railroad Retirement Tax Act of the United States may be dealt with, at the employee's option, either as a contribution to a registered pension fund or plan or a payment of a foreign tax (see IT-167R5). Subparagraph 126(7)(c)(iv) will not apply to exclude the social security tax or railroad retirement tax paid by a resident of Canada since such taxes are payable even if the taxpayer is not a citizen of the United States.

6. Where salary or wages are paid by a resident of the United States (including a company incorporated in that country) to an employee resident in Canada and performing services wholly in this country, the income so earned is considered to have its source in Canada. Accordingly, an employee who pays United States social security tax or railroad retirement tax will be allowed a foreign tax credit for such a payment under paragraph 126(1)(b) if the employee has income which has a source in the United States.

7. A corporation resident in the United States may elect to pay the full tax under the Social Security Act on behalf of United States citizens resident in Canada who are employees of a Canadian corporation which is a subsidiary of the United States corporation. Where this election is made the employee's share of the tax is normally withheld from the salary of such an employee by the Canadian subsidiary. The amount so withheld should be regarded as an income tax paid to the United States, in respect of which a foreign tax credit will be allowable if the employee has income in the year from sources in the United States.