

MONTHLY NEWSLETTER

Snowbirds: Implications of Enhanced Cross Border Information Sharing



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Our goal is to provide updates on topical tax issues. Information contained in the newsletters is not meant to be a comprehensive summary of the issues raised. Rather, we wish to bring what we believe to be important issues to the attention of our valued clients. We would be pleased to discuss any questions that you, the reader, might have in greater detail.

SUMMARY OF CHANGES

June 30, 2014 marked the start of big changes in border crossing procedures between Canada and the U.S. as part of the Entry-Exit Initiative and the Perimeter Security and Competitiveness Action Plan. Travellers are now required to swipe passports both when they enter and when they depart each country and Canada and the U.S. now share this information. For the first time, both countries will know, in real time, which country travellers have been in and for how long. These changes will be particularly relevant to Canadian "Snowbirds" who travel south each year to escape the harsh Canadian winter. So what do the changes mean for Snowbirds?

IMPLICATIONS TO SNOWBIRDS

Non-residents of the U.S. are subject to U.S. federal income tax only on income that is considered to be effectively connected with a business in the U.S. and any fixed annual or periodical income that has a U.S. source and does not constitute effectively connected income. By contrast, U.S. residents are subject to U.S. federal income tax on their worldwide income and are subject to the detailed reporting requirements in the U.S. which require a number of forms to be filed annually to report foreign assets. Some of the filing requirements are duplicative and the penalties for non-compliance can be severe; up to \$10,000 per form per year. The penalties apply even in cases where there is no unreported income.

An individual is considered to be a resident of the U.S. for U.S. federal income tax purposes if he or she:

- 1) is a U.S. citizen,
- 2) is a lawful permanent resident of the U.S. (commonly referred to as a green-card holder),
or
- 3) satisfies the substantial presence test.

Most snowbirds are aware of the 183 day substantial presence test and carefully monitor the number of days they spend in the U.S. However, the individual will satisfy the substantial

presence test in a tax year where the individual is physically in the U.S. for at least 31 days in the year and the total number of days spent in the U.S. during the 3 year period is equal to or greater than 183. For the purposes of the 183 day test, each day in the year being tested counts as a full day; each day in the preceding year counts as one-third of a day; and each day in the second preceding year counts as one sixth of a day.

For example, suppose that an individual is present in the U.S. for 126 days in each of the preceding 3 years. The 31 day test in the current year is clearly met. The total number of days spent in the U.S. for the purposes of the 183 day test is:

$$\begin{aligned} &= 126 + (126 \times 1/3) + (126 \times 1/6) \\ &= 126 + 42 + 21 \\ &= 189 \text{ days} \end{aligned}$$

Based on these facts, the individual would meet the substantial presence test and thus be classified as a U.S. resident in the year. As a result, in the absence of any exceptions, the individual would be required to file a U.S. return to report their worldwide income and file any requisite forms related to foreign assets.

An exception to the substantial presence test applies in the case of a snowbird who has spent fewer than 183 days in the U.S. in the year, is more closely connected with Canada, has not applied for a U.S. green-card, and files form 8840, "Closer Connection Exception Statement for Aliens". Factors to be considered for the purposes of the closer connection determination are: the location of the snowbird's home, family, personal belongings, bank accounts, investments, etc. The filing of form 8840 establishes that a U.S. income tax return is not required even though the substantial presence test is met. Form 8840 is due June 15.

In addition to the income tax considerations, being in the U.S. for too long may create the following additional issues for Canadian snowbirds:

- 1) Potential liability for US estate tax on the fair market value of their worldwide assets on death
- 2) Liability for Canadian departure tax on any accrued gains on capital property owned at the time of ceasing to be Canadian resident
- 3) Loss of provincial health care status
- 4) Travel restrictions to the U.S. for being unlawfully present in the U.S.

CONCLUSION

The consequences of overstaying in the U.S. can be quite punitive. Given the recent changes to the border information sharing between Canada and the U.S. related to the number of days individuals are present in each country, it would be prudent for snowbirds to carefully monitor the number of days they are in the U.S. for each 3 year period and to file form 8840 as necessary to avoid U.S. reporting requirements.