Why snowbirds who spend significant time in the U.S. face major tax repercussions

DALE JACKSON
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Many Canadians are unaware that the IRS has access to their personal information including the location of their permanent home, family members, driver's licence and business activities.

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A growing number of Canadians have been blindsided by unexpected tax bills, penalties, or worse from the U.S. Internal Revenue Service (IRS) since an

information-sharing agreement between the two countries was implemented almost a decade ago.

In fact, the Canada-United States Enhanced Tax Information Exchange Agreement Implementation Act came into effect in 2014 with the aim of collecting untapped tax revenue from Canadians who spend a significant amount of time in the U.S.

“There are a lot of people who don’t understand the data transfer, the day count rules, and they don’t understand the immigration issues,” says Kim Moody, chief executive officer of Calgary-based Moodys Private Client Law LLP.

Mr. Moody, who specializes in cross-border tax issues, has been sounding the alarm since the Canada Revenue Agency (CRA) and IRS first cozied up. He says advisors and even some accountants are often not qualified to file properly on behalf of cross-border clients.

“A lot of people who use accountants mistakenly think they know what they’re doing,” he says. “Anybody can call themselves a tax person.”

The tax treaty attempts to determine which side of the border Canadians fall on for tax purposes through a complicated “substantial presence” formula put forward for the IRS. If snowbirds spend more than 182 days in the U.S. based on a three-year rolling average, they can be taxed as U.S. citizens.

“You count your current year days in the U.S. at 100 per cent,” he says. “In the preceding year, you count one-third of those days, and the second previous years you count one-sixth.”

Any number of days less than 183 days makes Canadians not “substantially present” in the U.S. and not obliged to pay taxes.

“You have to be in the U.S. less than 183 days, and you factually have to be closely connected to Canada,” says Mr. Moody, adding the consequences for Canadians who get it wrong can be dire.

"If you spend too much time in the States without proper immigration status, you're considered to be illegal," he says. "If you're caught, you could be banned permanently from the U.S."

He says other unwanted consequences from both sides of the border could include:

- Being deemed a U.S. resident and subject to U.S. taxes on income from any country.
- Facing a departure tax from the CRA. If a Canadian is no longer considered a resident, they're deemed to have disposed of all their assets and must pay taxes on any gains from those assets.
- Losing provincial health care.

"If you do things badly on your tax returns, you could end up paying more taxes in the U.S. than in Canada," he says. "Worse, if you die, you could be subject to U.S. estate taxes."

Those who fall under the IRS 183-day count and are deemed not "substantially present" would not be obliged to pay U.S. taxes, but they must file a Closer Connection Exception Statement for Aliens (Form 8840) with the IRS to establish they are more closely connected to Canada.

Protecting personal information

Mr. Moody also suspects many Canadians are unaware that the IRS has access to their personal information including the location of their permanent home, family members, driver's licence and business activities. Personal information available to U.S. tax authorities also includes where they vote and social, political, cultural or religious affiliations.

In 2016, then privacy commissioner of Canada Daniel Therrien – whose office provides advice for individuals on protecting personal information under the Federal Privacy Act – expressed concern. The privacy watchdog recommended that the CRA notify affected individuals about when and why their data are provided to the IRS.

In a statement sent to Globe Advisor via e-mail, Privacy Commissioner Phillipe Dufresne stated that "important public interests, such as ensuring an effective international tax enforcement regime, can and must be achieved while protecting the fundamental privacy rights of Canadians."

Under the Privacy Act, general consent is required for the disclosure of personal information but also includes exemptions that allow for disclosures of personal information without consent.

However, the CRA stated in an e-mail that the onus is on individuals to contact the agency or their financial institution to find out if their personal information has been shared with the IRS.

Canadians buying properties in the U.S.

Paul Ferrara, wealth counsellor and client relationship manager at Avenue Investment Management in Toronto, as well as a tax and estate planning specialist, says the tax treaty has affected many clients with cross-border connections.

"They end up learning the lesson in the end when it comes time for selling or transferring [properties]," he says.

Mr. Ferrara suspects the information-sharing agreement was prompted by an influx of Canadians buying U.S. rental properties in the wake of the 2008 real estate crash when high oil prices pushed the buying power of the Canadian dollar to more than US$1.10.

"There are a lot of folks who bought around that time, whether it was in Arizona or Florida," he says. "That's why the CRA is working closely with the IRS. It has to do with some of that rental income."

He says he understands why the IRS would want that information, but questions whether personal information about Canadians with no U.S. income should be shared with a foreign government.

"If a snowbird has no intent to rent out their property … there should be no information sharing at all," he says.

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