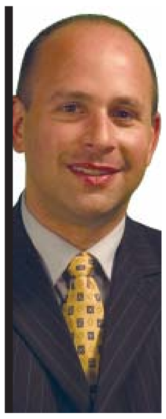
A complex formula for U.S. residency



MERRICK WEALTH

By Peter Merrick

In American history books, "no taxation without representation" was the battle cry of colonists in the North American British colonies in 1776. The grievance sparked the American Revolution. According to the colonists, having no direct representation in the British Parliament meant that any laws passed by London that taxed the colonists was illegal and grounds for slashing their umbilical cord to imperialistic Great Britain.

As I write this article I can't help but think of one of my favourite quotes from essayist George Santayana: "Those who cannot remember the past are condemned to repeat it." In this month's column I wish for all of us to reflect on Santayana's keen observation as it applies to the American Revolution's battle cry and now, how our neighbour to the south applies its imperialistic tax code on non-U.S. citizens of the world.

For those who spend a fair amount of time in the U.S., counting the number of days you were in that country should be one of your most important tax-related tasks.

"As far as U.S. tax is concerned, one single day could make the difference between you being a U.S. resident and a non-U.S. resident for U.S. tax purposes," says Veronika Chang, a tax lawyer with Morris Kepes Winters in Toronto, and a tax specialist with extensive experience working in the United States in the areas of the Canada-U.S. tax treaty and the *Internal Revenue Code*.

Starting June 30, Canada and the U.S. implemented the final phase of the Entry/Exit Initiative of the "Beyond the Border Action Plan for Perimeter Security and Economic Competitiveness," and started sharing information on people entering and leaving each country. This means the U.S. has the ability to identify visitors and the duration of their stay. The main objective of collecting and sharing travel information to and from the U.S. and Canada is for immigration purposes. However, "it is also possible that the information will be shared with other government players, most notably the IRS," says Chang.

Knowing the number of days you spend south of the border is important because the U.S. taxes American residents on their worldwide income. I learned from Chang that the definition of a U.S. person includes not only American citizens and permanent residents (green cardholders), but also U.S. tax residents. That means you, your family, your clients and I can all be deemed a U.S. resident for tax purposes, regardless of our immigration status.

So who is a U.S. resident for U.S. tax purposes? You would pass the "substantial presence test" and be deemed a U.S. tax resident if these two conditions are met: You were in the U.S. at least 31 days during this year, and the sum of all the days you are in the U.S. this year, plus one-third of the days you were there last year, plus one-sixth of the days you were there two years ago, totals 183 days or more.

"So for the purposes of the substantial presence test, you count all the days in which your feet were touching U.S. soil, except for days when you were commuting to your workplace in the U.S. from Canada, when you were in transit passing through the U.S. for less than 24 hours, when you were working as a crew member on a (non-U.S.) ship, or when you were an exempt individual (i.e., diplomats, teachers, students and athletes meeting certain requirements)," says Chang.

Using the substantial presence formula, if you spend 122 days, or about four months each year, in the U.S., you could well be a U.S. resident for U.S. tax purposes.

"Bear in mind that those who spend only 31 days there this year, but who have lived full-time in the U.S. for the previous two years, could still be considered U.S. tax-resident," adds Chang.

"If you are not a U.S. citizen but a U.S. resident (either by holding a green card or by being substantially present in the U.S.), you may have a way out," she says. You can avail yourself of the Canada-U.S. tax treaty and "tie-break" to Canada — "This means you claim to be a Canadian resident under the treaty because you have a permanent home in Canada, and your personal and economic relations are closer to Canada," she says. However, the treaty benefit is not bestowed on you automatically; you must file a tax form (Form 8833), which must be attached to a U.S. income tax return for non-residents (Form 1040NR) in order to claim a treaty exemption.

"But a big caution should be noted," she says. "The treaty only makes you non-U.S. tax resident for the purpose of computing your U.S. income tax liability. Thus, you continue to be treated as a U.S. resident for other purposes, most importantly for the purpose of filing an information return related to your non-U.S. bank and financial accounts (better known as FBAR). Failing to file an FBAR comes with a hefty minimum penalty of $10,000."

If you are not a green card-holder and have spent 183 days or less in the U.S. in a year, then you can claim the "closer connection exception" under the *Internal Revenue Code*. The closer connection exception can be claimed by filing a Form 8840, which says that you are more closely connected to Canada than the U.S. Unlike the exemption under the treaty, the closer connection exception will get you out of the U.S. tax regime completely, including the need to file the FBAR.

As my lesson came to a close, Chang left me with this thought: "Coupled with the FATCA (*Foreign Account Tax Compliance Act*), which took effect on July 1, the U.S. is now in a better position to determine and find those who are subject to the U.S. tax regime. So, if you are a U.S. person, the U.S. will now have better access to your financial information, and will know where you've been and how long you've been in the U.S., even if they don't know exactly where you are right now."

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Detective sees courts hardening

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The stress of being a fraud victim is palpable, he said, and goes beyond just the money.

Three in 10 Canadians have been approached with a potential investment fraud and as many as one in 20 Canadians have been a defrauded in an investment scheme.

"Thirty-five per cent of fraud victims have been approached by more than one fraud scam," he said. "It has a huge impact on mental and physical health and relationships, which can end up in divorce or with parenting issues."

Aside from inside employee fraud, he said, typical external investment frauds are often based on personal referrals, either through local churches or groups or cultural connections.

DeBoer

Often, they offer a rate of return much higher than other investment options. Given the relationship connection and apparent community standing, victims often think they're on to a good investment. In the interim the money flows, though since most are variations on a Ponzi scheme, the scammer eventually runs out of new victims to keep the ruse going.

More recently, however, he said, the courts have taken a harder line. Last May, Ronald Fast, 71, of Saskatoon, was sentenced to seven years in jail for scamming 250 elderly investors out of $17 million. The Crown had asked for 10 years, the defence for 2.5. His daughter, accountant Danielle Fast-Carlson, received 30 months.

"It's changing," said DeBoer. "But the public doesn't really know what's going on here still."