Travelling south again this winter? Here are the residency tax rules snowbirds need to know.

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After two years of COVID-19, Canadian snowbirds are no doubt eager to head back to the U.S. and its warmer weather. Before you start relaxing by the pool, though, it's important to become acquainted – or reacquainted, if you haven't travelled past the 49th parallel in a while – with the potential tax consequences of staying south for an extended period of time.

Conventional wisdom among snowbirds is that if you spend fewer than 183 days in the U.S., the Internal Revenue Service (IRS) will leave you alone. The reality is more complicated. Visitors to the U.S. are subjected to what the IRS calls a "substantial presence" test to see if they will be deemed to be U.S. residents for tax purposes. And if they are considered residents, they may have to pay up to Uncle Sam.

What makes a U.S. resident?

While the IRS test does come down to days spent in the U.S., the tax agency has its own definition of what constitutes a day, and it isn't necessarily 24 hours. Instead, a day can be any part of a 24-hour-period in which an individual is physically on U.S. soil. So, for example, an early morning trip to the airport for a flight back to Canada would count as a full day, and not a partial day, in the calculation.

Given this caveat, you qualify as a resident for tax purposes if you have been physically present in the U.S. for 31 days during the current year, and for 183 days on a weighted average basis in the three years that include the current year and the two preceding years.

Here's where the calculation becomes a bit more complicated (and allows a bit of leniency for taxpayers). To arrive at that three-year total, the IRS allows visitors to add the number of days they were in the U.S. during the current year to one-third of their total U.S. days in the previous year and one-sixth of their U.S. days the year before that. If the total is less than 183 days, generally, residency isn't established. If it's 183 days or more, you could have a problem.

As an example, let's assume that Sam and Nic, two Winnipeggers who love escaping to Palm Springs every year, spent 120 days in the U.S. in 2022, and spent the same number of days there in each of the preceding two years. (For the sake of this example, we'll pretend COVID-19 travel restrictions in 2020 and 2021 never existed.) Sam and Nic's calculation under the substantial presence test for the three years will then be 120 plus 40 (1/3 of 120) plus 20 (1/6 of 120), for a total of 180 days. So they won't qualify as U.S. residents.

Now, let's say Sam spent an extra ten days in the U.S. last year. He would have incurred an extra three days under the formula. That would have pushed him to the 183-day threshold, making him a U.S. resident for tax purposes.

Closer connection exception.

Even if Sam meets the substantial presence test, he can still avoid being labelled a U.S. resident by filing IRS Form 8840 with the IRS. This form has the coldly cumbersome name of "Closer Connection Exception Statement for Aliens." Sam can complete this form if he was present in the U.S. for fewer than 183 days in the current year, can establish a "tax home" in Canada in the current year and can establish a closer connection to the tax home in Canada than to the U.S. By filing this form, Sam would still be considered a non-resident of the U.S.

Form 8840 asks Sam a barrage of questions to support his claims that his personal, social and economic ties in the latest tax year are closer to Canada than to the U.S. The IRS will want to know the location of his permanent home, where his family resides, where his automobile is registered and where he keeps his personal belongings.

Among other things, the form also asks where he conducts his banking relationships, where his driver's licence was issued, where he is registered to vote, and the locations of personal, financial and legal documents. The form even requests the location of investments and whether Sam qualifies for any type of national health plan sponsored by a foreign government. About the only thing it doesn't want to know is the location of his birthmarks.

As intrusive as it may sound, Form 8840 must be filed with the IRS by June 15 in the year following the year in which the substantial presence test is met. If Sam doesn't file on time, he may not be eligible to claim the closer connection exception, and may be treated as a U.S. resident. He could potentially face other penalties as well.

The tax treaty "tie breaker".

If Sam spent 183 days or more in the U.S., then he cannot complete Form 8840. However, Sam may still be able to avoid being considered a U.S. resident under the *Canada-U.S. Tax Treaty*.

To avail himself of what is commonly known as the "tie breaker" rule under the treaty, Sam will have to fill out IRS Form 8833, "Treaty-Based Return Position Disclosure." The disclosure required in this case is much more rigorous and complicated than on the "Closer Connection" form.

In fact, Sam would be well advised to seek out a tax expert who specializes in this area. Like the "Closer Connection" form, the "Treaty Position" form must be filed with the IRS by June 15 in the year following the year the substantial presence test is met. Failure to file on time could make Sam ineligible to claim the treaty position, and he might then be treated as a U.S. resident. And again, other penalties could be assessed.

Enjoy the benefit.

It's very likely that there are many Sam and Nics out there in Canada's snowbird community. If you are among them, it's a good idea to talk to a professional and to be aware of U.S. residency requirements for tax purposes. You don't want to inadvertently fall offside. But once you understand the potential pitfalls, you'll be grateful that you've avoided a U.S. tax filing, or worse, a U.S. tax liability.

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