

Partners Across Borders

Canada and U.S. are best friends when it comes to tax collecting

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(August 1, 2019, 11:26 AM EDT) -- Despite the rhetoric of current protectionist measures, we still live in an interconnected world. Not only do people, goods and services cross the border, but so do taxes. A good example of this interconnectedness is the Canada-U.S. Income Tax Treaty. Because they are friends who do for each other, Article 26A of the treaty allows the two countries to assist each other in the collection of taxes.

A recent case from the United States Court of Appeals for the 4th circuit reminds us that the U.S. and Canada are truly BFFs or best friends forever. In this case — *Paul Retfalvi v. United States* 18-2158 (4th Cir. 2019) — the second-highest court in the U.S. ruled that the treaty allowing the IRS to collect taxes for Canada is constitutional. The case involved a Canadian citizen and a U.S. permanent resident with an outstanding CRA bill.

In 1993, Paul Retfalvi, who is a Canadian citizen, went to the U.S. to participate in a medical residency program. He returned to Canada in 1997, but a year later decided to move back to the U.S. He became a permanent resident there in 2005.

Here is where it gets interesting. In 2006, Retfalvi sold two condominiums in Canada that he had purchased eight years earlier, in 1998. Both Retfalvi and his wife filed Canadian income tax returns; each of them reported one-half of the proceeds of the sale of the condominiums. However, the CRA had an issue with how he had reported the sale and decided to reassess him.

Retfalvi became a U.S. citizen in 2010, but by late 2011, his Canadian tax liability became final and all his rights of appeal were exhausted.

In 2015, the CRA referred the assessment to the U.S. for collection, pursuant to Article 26A of the Canada-U.S. Income Tax Treaty. In turn, the IRS sent Retfalvi a bill for US\$125,000. He eventually paid the amount, but filed a refund claim with the IRS. When his refund claim was denied, he filed a lawsuit.

Retfalvi challenged the constitutionality of the treaty authorizing the U.S. to collect unpaid income taxes on behalf of Canada and he also challenged the legal authority of the IRS to collect a foreign assessment on behalf of Canada. Needless to say, the court rejected these arguments.

There is one important caveat regarding Article 26A. The two BFFs will not help each other collect if the person owing the tax was a citizen of the country, whose assistance is requested, when the tax became due. As that applies to this particular case, Retfalvi was a U.S. citizen when Canada sought the United States' help to collect what it felt was its due. But because Retfalvi was not a U.S. citizen when the tax became due, the U.S. had no issue in helping Canada collect.

Had Retfalvi been a U.S. citizen and not a green card holder when the tax became due, the IRS would not have assisted the CRA in the collection of Canadian tax. In that scenario, the CRA would have had to explore other options to try to collect the tax, which would have been a very difficult task for the CRA without the assistance of the IRS.

As a U.S. permanent resident, Retfalvi was subject to the U.S. tax regime in the same way that a U.S. citizen would have been, but clearly he was not entitled to the same protection from the IRS when the protection was needed, even though he was a U.S. citizen.

With the IRS involved, Retfalvi had no choice but to pay the CRA bill. If he had not done so, the IRS could have legally seized his property to satisfy the CRA debt. That could have meant garnishing his wages, freezing his and his wife's bank accounts and seizing and selling their cars, house and other assets.

The reverse is also true when it comes to BFFs helping each other under the treaty. If the IRS looks to Canada for assistance and the tax debtor is a dual citizen of the U.S. and Canada, the CRA will not assist and the Canadian courts will not enforce U.S. judgments for tax owed against assets in Canada.

Unlike the immigration border, the tax border between the U.S. and Canada is, more or less, invisible and fluid. The moral of the story? If you owe taxes to the IRS or the CRA, it is always best to go to them first rather than have them chase you. And as always when it concerns tax matters, it is wise to consult the services of a tax professional who is familiar with the tax regimes in both countries.

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