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Dual Tax Residency in a Canadian Context

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Navigating Dual Tax Residency: Implications and Strategies for Canadians

Dual tax residency, or having more than one country in which one is considered a resident for tax purposes, is not uncommon. In Canada, individuals such as high-net-worth individuals with a second home in a warmer location, landed immigrants who have maintained ties to their country of origin, and employees on extended foreign assignments may all find themselves in this dual-resident situation. The COVID-19 pandemic has also led to a new group of dual residents, due to decisions they made to extend their stay in Canada or abroad based on travel restrictions or health and safety considerations. Similarly, the trend for employees to work remotely (even across borders) has also increased the number of dual residents.

The Canada Revenue Agency (CRA) has traditionally engaged in increased audit activity on high-net-worth individuals and certain landed immigrants with multiple residences. Due to the pandemic, it can be expected that the CRA will have even more focus on residence issues. That's because many individuals unexpectedly spent more time in Canada during the 2020 to 2022 taxation years, and now may have significant Canadian tax issues.

Understanding Canadian Tax Compliance for Dual Residents: Navigating Residency and Worldwide Income

Dual residents should be aware of their Canadian tax compliance requirements before filing their Canadian tax returns. They should also carefully respond to any CRA inquiries, requests, and demands for tax returns. Proactively consulting a tax advisor may be beneficial.

The Canadian tax system is based on residence, and Canadian residents are taxable on their worldwide income. In the year of immigration or emigration, they are subject to tax on their worldwide income earned during the part of the year when they were Canadian residents. The concept of “residence” is not defined in Canada’s Income Tax Act, but the courts have defined it as the degree to which a person has settled into or maintains a central location for their ordinary mode of living.

The CRA provides guidance in the form of [Income Tax Folio S5-F1-C1,] which lists the most important factors (known as primary residential ties) as well as secondary factors used in determining whether or not an individual is a Canadian resident for tax purposes. Individuals can file an NR73 or NR74 form to request a determination of their residency status, but there is a risk that this could trigger a review or audit and that the determination may not be in their best interest. There is no legal obligation to file these forms unless they are requested by the CRA.

Understanding Canada's Tax Treaty Tie-Breaker Rules and Their Influence on Your Tax Responsibilities

Dual residency, or having more than one country in which one is considered a tax resident, can happen when an individual is a tax resident of Canada as well as a tax resident of another jurisdiction that has a tax treaty with Canada. In these cases, the individual's residence status for Canadian tax purposes may be determined through the application of subsection 250(5) of the Income Tax Act (ITA).

When subsection 250(5) applies, it can deem an individual who is otherwise a factual resident of Canada to be a non-resident of Canada if the tie-breaker rules of the applicable tax treaty identify the individual as a resident of the other country. Being a non-resident of Canada means that the individual is generally only taxable in Canada on certain Canadian-sourced income and would only be required to file a Canadian tax return under specific scenarios.

This provision, therefore, is crucial for individuals with residential ties in Canada and another treaty country, who have significant sources of income earned outside Canada, such as through business, employment, or investment income.

The tie-breaker rules in most of Canada's tax treaties utilize internationally recognized tests such as the permanent home test, center of vital interest test, place of habitual abode test, and the citizenship test. But before these tie-breaker rules can be applied, the individual must be considered a resident of both contracting nations for the purposes of the treaty. To be considered a resident of a contracting nation for treaty purposes, a person must be "liable to tax" in that nation, per the terms of the treaty. The CRA has provided guidance on the meaning of "liable to tax" in its publication, Income Tax Folio S5-F1-C1, paragraphs 1.41 to 1.45.

Individuals relying on subsection 250(5) of the ITA should expect to provide support to the CRA regarding their tax status in the other jurisdiction, such as copies of foreign tax returns and assessments. The first tie-breaker test is always the country in which the individual has a permanent home, either owned or rented, available to them. This is why proper tax planning can often ensure that the tie-breaker rules will apply in the desired way.

However, in cases where the individual has a permanent home available to them in both countries during the dual resident period, the first test will not resolve the tie. Consequently, the second and third tie-breaker tests, center of vital interest and place of habitual abode, are often the tie-breaker rules that determine the individual's residence status for purposes of the treaty.

As these tests are highly subjective, it's recommended that the individual consult a tax advisor for an opinion on the matter. In cases where the individual relies on the CRA to make the determination, the CRA may err on the side of caution and determine the individual to be a resident of Canada, when in fact they may have a valid and defendable tax filing position as a non-resident of Canada due to subsection 250(5) of the ITA and the treaty tie-breaker rules.

Dual Residency Dilemmas: Amending Tax Classifications and Mitigating Double Taxation in Canada

Taxpayers may not be bound by their initial classification as a resident of Canada if they have mistakenly filed their tax returns as such. If an individual is a dual resident and ITA subsection 250(5) applies to deem them a non-resident, they may be able to amend their prior tax returns – as long as the taxation years are not statute barred and the CRA agrees with the analysis of the tie-breaker rules. There is Canadian legal precedent supporting the idea that taxpayers are not bound by their initial mistaken tax classification as residents of Canada. This can be beneficial for taxpayers, particularly those who have significant non-Canadian sources of income and lower tax rates in their other country of residence. However, amending tax returns to identify oneself as a non-resident can also trigger negative tax implications, such as departure taxes. It's advisable to consult with a tax advisor to understand all possible ramifications that may arise in both jurisdictions before considering amendment of tax returns.

It's important to note that every dual resident case is unique and can trigger numerous tax issues in both countries. If an individual is a resident of Canada with significant ties to a country that has a tax treaty with Canada, they should not be subject to double taxation. If a double taxation arises, there will be a tax dispute process (Mutual Agreement Procedure) available to resolve the issue. The objective of this article is to raise awareness of Canada's tax system and specifically, subsection 250(5) of the ITA. With an increase in dual residency cases as a result of the pandemic and the trend of remote work it's important for taxpayers to be aware of the rules that may impact their tax situation. For more information, please consult Cardinal Point's Canadian tax residency blog post, or if you would like to discuss your tax situation, please reach out to Cardinal Point.

Contact Cardinal Point for more information

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