

Residency Under the Income Tax Act and Other Legislation

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Agenda

- Residency Issues under the Income Tax Act and Tax Treaties
 - Determination of Residency
 - Income Tax Issues Related to Becoming a Resident
 - Income Tax Issues Related to Ceasing to be a Resident
- Property Transfer Tax – 15% Surtax
- Principal Residence Exemption
- Miscellaneous Issues
- Questions

Residency Under the Income Tax Act and Other Legislation

- Residency is the basis of taxation in Canada
- “Every person resident in Canada at any time in the year” is liable to tax on their worldwide income – *Income Tax Act, s. 2(1)*
- Non-residents pay tax only on certain Canadian source income:
 - Employment in Canada
 - Business carried on in Canada
 - Disposition of “taxable Canadian property”
 - Income from property in Canada (rents, royalties, interest, dividends etc.)

Income Tax Act, s. 2(3)

Residency Under the Income Tax Act and Other Legislation

- No definition of “resident” in the *Income Tax Act*:
 - Immigration status not determinative
 - Common-law factual determination
 - Deeming provisions in the *Income Tax Act*:
 - Sojourning test
 - Ordinarily resident
 - Treaty tiebreaker rules
 - NR73 and NR74

Residency Under the Income Tax Act and Other Legislation

- Sojourning test – s. 250(1):
 - Deemed residency throughout the year if the taxpayer sojourned in Canada for a period of, or periods totaling, 183 days or more in the year:
 - Temporary stay, as opposed to ordinary residence
 - Days need not be consecutive
 - Any part of a 24-hour period
 - Only works one way – failing test does not necessarily mean taxpayer is non-resident

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- Ordinary Residence – s. 250(3):
 - Resident includes person who is ordinarily resident in Canada
 - *Thomson v. MNR* (1946) (SCC)
 - Whether the taxpayer, in the settled routine of his life, regularly, normally or customarily lives
 - Determination of Fact
 - Numerous factors
 - Taxpayer may be ordinarily resident in more than one place

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Dual Residence

- Individual may be resident in more than one country in the same year
- *Income Tax Act*, s. 250(5) – Person is deemed not to be resident in Canada if they tie-break to another jurisdiction under a tax treaty

Residency Under the Income Tax Act and Other Legislation

Tie-breaker rules in Article IV of the China-Canada Tax Treaty and Canada-Hong Kong Tax Agreement:

- Permanent Home
- Centre of Vital Interests
- Habitual Abode
- Nationality (HK: Right of Abode)
- Competent Authority

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Permanent Home

- Any form of residence available to the individual (rented, owned, room in spouse or parent's home etc.)
- Consider:
 - Availability
 - Permanence vs. transient or temporary

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Centre of Vital Interests

- In which country are the taxpayer's personal and economic relations closer?
- Consider:
 - Family (nuclear and extended) and social relations
 - Place of business / employment
 - Property and other assets
 - Sources of income
 - Political, cultural etc.

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Habitual Abode

- Where the individual stays most often – *Yoon v. The Queen* (2005) (TCC)

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Example:

- Husband, wife, and children immigrated to Canada from China
- All became citizens of Canada, and all of them currently hold Canadian passports
- The husband returned to China in order to run his business
- The husband spends most of his time outside Canada, returning for 2 week periods to visit his family
- **Issue:** Is the husband a resident or non-resident of Canada for purposes of the *Income Tax Act*?

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Becoming a Resident – Tax Issues

- Deemed disposition and reacquisition of most property at fair market value (FMV) immediately before becoming resident – reset of cost base for Canadian income tax purposes
- Exceptions:
 - taxable Canadian property (e.g. CDN real estate, resource properties)
 - Inventory and class 14.1 property used in a business carried on in Canada
 - an “excluded right or interest” (e.g. RRSP)

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Becoming a Resident – Tax Issues (cont'd)

- Reporting forms:
 - T1135 – Foreign Income Verification Statement
 - T1134 – Information Return Relating To Controlled and Not-Controlled Foreign Affiliates
 - T1141 – Information Return in Respect of Contributions to Non-Resident Trusts, Arrangements or Entities
 - T1142 – Information Return in Respect of Distributions from and Indebtedness to a Non-Resident Trust

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Ceasing to be a Resident – Tax Issues

- Deemed disposition and reacquisition of most property immediately prior to departure at fair value
- Exceptions (\neq immigration exceptions):
 - Real/immovable property in Canada, Canadian resource property, timber resource property
 - Inventory, capital property and class 14.1 property used in a business carried on through a PE in Canada
 - an “excluded right or interest” (e.g. RRSP)
 - Property owned by taxpayer resident in Canada \leq 60 months before emigration

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Ceasing to be a Resident – Tax Issues

- Planning Considerations:
 - Election to defer tax
 - Preserve exclusion for property owned by short term (≤ 60 months) resident
 - Important not to overlook the question of valuation of assets subject to the deemed disposition rules

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Ceasing to be a Resident – Tax Issues (cont'd)

- Reporting forms:
 - T1263 – Deemed Disposition of Property by an Emigrant of Canada
 - T1161 – List of Properties by an Emigrant of Canada
 - T1244 – Election to Defer the Payment of Tax on Income Relating to the Deemed Disposition of Property

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Dealing with Incorrect Filings

- Residents who have not filed Canadian tax returns
- Residents who have filed as non-residents
- Non-residents who have filed as residents

Property Transfer Tax (“PTT”)

BC Property Transfer Tax:

- Historically:
 - 1% on first \$200,000
 - 2% on value > \$200,000
- February 17, 2016 - New third tier PTT rate of 3% for FMV of property exceeding \$2 million
- August 2, 2016 - New 15% additional PTT applicable to certain transfers if:
 - The property is residential property;
 - The property is in a specified area (generally the GVRD); and
 - The transferee is a “foreign entity” or “taxable trustee”.

Property Transfer Tax (“PTT”)

What is a “foreign entity”?

- A foreign national or a foreign corporation
- Foreign national: An individual who is not a citizen or permanent resident under the IRPA – Test is based on immigration status, not tax residency
- Foreign corporation: A corporation that:
 - is not incorporated in Canada or
 - is not listed on a Canadian stock exchange and is “controlled” by one or more non-residents
- “Controlled”: directly or indirectly in any manner whatever within the meaning of s. 256 *Income Tax Act*

Property Transfer Tax (“PTT”)

What is a “taxable trustee”? - A trustee of a trust in respect of which:

- Any trustee is a foreign entity, or
- No trustee is a foreign entity but, immediately after the registration of the taxable transaction, a beneficiary of the trust who is a foreign entity holds a beneficial interest in the residential property to which the taxable transaction relates

Property Transfer Tax (“PTT”)

Miscellaneous Details

- Where there are multiple transferees, the tax applies only to the portion transferred to a foreign entity or a taxable trustee
- Each transferee is jointly and severally liable to pay the tax
 - What if a transferee receives a 1% interest and is liable to 15% tax on the other 99%?
 - Is this “direct taxation”?

Property Transfer Tax (“PTT”)

Miscellaneous Details (cont’d)

- Most exemptions in s. 14 are still applicable, but:
 - Exemptions for transfers of residential and recreational property to related individuals require the individuals to be citizens or permanent residents
 - Some exemptions do not apply:
 - transfers to joint owner by right of survivorship
 - transfers on change of trustee
 - transfers on amalgamation

Property Transfer Tax (“PTT”)

Miscellaneous Details (cont’d)

- 6 year limitation period for assessment (beginning at date of transfer)
- Anti-Avoidance Rule
 - Applies to any transaction or series of transactions that would result directly or indirectly in a tax benefit, but do not include transactions undertaken or arranged primarily for bona fide purposes other than obtaining a tax benefit
 - No exception for transactions or arrangements that are not a misuse or abuse
- Monetary penalties for offences w.r.t. 15% tax are quadruple the regular penalties (\$200,000 for corps; \$100,000 for individuals)

Principal Residence Exemption

October 3, 2016 Proposals re Principal Residence Exemption:

- Plus one element of PRE formula (previously available even to non-residents) will no longer be applicable for an individual who was not resident in Canada in the year the property was acquired
- PRE eliminated for years after 2016 for trusts other than:
 - Spousal trusts, alter ego and joint partner trusts and self benefit trusts (“life interest trusts”)
 - Qualified Disability Trusts
 - Trusts for Orphaned Minors

Principal Residence Exemption

Transitional Rule for properties held by a non-qualifying trust at the end of 2016:

- Upon disposition, gain for purposes of s. 40(2)(b) will be calculated in two parts:
 - Gain from acquisition to end of 2016 (deemed disposition at FMV), with PRE available; plus
 - Gain from January 1, 2017 (cost = deemed POD from end of 2016) to actual disposition
- Post 2016 decline in value will be deducted from gain calculated for this purpose.

Principal Residence Exemption

Some good news / relief:

- Costs of disposition for post 2016 dispositions by non-eligible trusts will be applied to reduce post 2016 gain
- S. 107(4.1) rollout denial for s. 75(2) trusts n/a to non-qualifying trusts that hold principal residence at end of 2016 – can roll property out to non contributor who can then claim PRE (only effective on royal assent)
- S. 108(4) amended to provide that a life interest trust will not be disqualified from a rollover only because a child, spouse or common-law partner or former spouse or common-law partner of relevant person inhabits the property

Principal Residence Exemption

- Designating Property as a Principal Residence:
 - S. 152(4) amended to permit reassessment at any time if, inter alia, an individual taxpayer fails to report a disposition of real or immovable property (effective to taxation years ending after October 3, 2016)
 - S. 220(3.21) amended to deem principal residence designation to be an election that the Minister can extend the time for making
 - Starting with the 2016 tax year, taxpayers must report basic information (date of acquisition, proceeds of disposition and description of the property) in their tax returns to claim the full principal residence exemption

Principal Residence Exemption

PRE for Trusts – Options for Existing Principal Residence Trusts:

- Roll property out in 2017 (s. 107(4.1) n/a – however this only applies after Royal Assent)
- Wait until shortly before sale / 21 year deemed disposition of property and roll out then (beware death of specified beneficiary/ies in the meantime)

Miscellaneous Issues (Tax and Non-Tax)

Some Other Things To Consider

- Inbound (granny) Trusts
- Canadian and International Wills
- Wills Variation under the *Wills, Estates and Succession Act*
- Tax Issues in Breakdown of a Relationship
- Clearance Certificates
- Flipping Presale Contracts
- Vacancy Tax

Miscellaneous Issues (Tax and Non-Tax)

Inbound (granny) Trusts

- Immigration Trusts eliminated in 2014
- Inbound “Granny” Trusts with no resident contributor or connected contributor can still be used with no Canadian tax liability

Miscellaneous Issues (Tax and Non-Tax)

Canadian and International Wills

- Intestacy provisions in WESA
- Consider use of Will restricted to property situated in Canada vs. worldwide Will
- Choice of executor
- Planning for minors

Miscellaneous Issues (Tax and Non-Tax)

WESA, s. 60:

“...if a will-maker dies leaving a will that does not, in the court’s opinion, make adequate provision for the proper maintenance and support of the will-maker’s spouse or children, the court may ... order that the provision that it thinks adequate, just and equitable in the circumstances be made out of the will-maker’s estate for the spouse or children.”

- BC law governs devolution of real property in British Columbia and worldwide personal property, if deceased was domiciled in BC at death
- BC law governs devolution of real property in British Columbia even if deceased was not resident or domiciled in BC at death

Miscellaneous Issues

Breakdown of Family Relationship

- Consider:
 - Ability to carry out butterfly divisions – may not be possible after divorce
 - Rollovers - may not be possible after divorce
 - Attribution – typically ends on divorce
 - Spousal support considerations
 - S. 160 joint and several liability – if one spouse has unresolved tax liabilities
 - Complications arising from family trusts
 - Family law agreements

Miscellaneous Issues

Clearance Certificates

- S. 116 withholding and compliance certificates
- S. 159 clearance certificates
- When to apply
- When not to apply
- *Mao v. Liu*, 2017 BCSC 226

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Questions?

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