THE CANADA REVENUE AGENCY CONTINUES TO CHASE DEPARTING RESIDENTS

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A review of Canadian tax cases published over the last two-and-a-half years (since my last article published in the Tax Notes International issue dated October 24, 2005) indicates that the Canada Revenue Agency (CRA) has continued its policy of claiming that individuals who leave Canada are still Canadian residents for tax purposes. The result has been a number of reported tax cases where the taxpayer has challenged the CRA's consequential tax reassessments.

Below, I discuss key cases and suggest action that a departing Canadian resident might take to minimize the risk of having to litigate. Cases where a non-resident claimed to be a Canadian resident are also discussed, as is a decision relating to Canadian provincial residence.

RESIDENCE CASES

Hauser v R [2006] 4 CTC 193 affirming [2005] 4 CTC 2260

This was a judgement of the Federal Court of Appeal (FCA), affirming the decision of the Tax Court of Canada (TCC) relating to the 1997 – 2001 tax years. Mr. Hauser lost.

Mr. Hauser was a Canadian airline pilot, claiming to be a resident of the Bahamas. The Court agreed that he was resident there. The TCC held, however, that he was a dual resident and that he continued to be a Canadian resident, despite having established residence in the Bahamas.

Mr. Hauser's employment with Air Canada was Toronto-based. He frequently stayed in his mother-in-law's apartment in Canada, where he kept his uniforms and clothing. One of Mr. Hauser's arguments was that when he was sleeping at the apartment, he was not living there! He used her address as his mailing address. He used dental services in Canada. He was in Canada for more than one-third of each of the years under appeal.

The TCC held that he "never divorced himself from Canada. There were just too many attachments". These also included his Ontario Health Insurance coverage, which he never cancelled, and which is only available to residents of the Province of Ontario. Other attachments were his banking arrangements, particularly the continued extensive use of his Canadian bank account, which carried his mother-in-law's address. The Court held that Mr. Hauser's presence in Canada "… was not occasional, casual, deviatory, intermittent or transitory", and dismissed his appeal.

The FCA could "detect no error" in the Tax Court Judge's decision, and the appeal was dismissed with costs.

Laurin v R [2007] 2 CTC 2048 and [2008] FCA 58

In this case, decisions of the TCC and the FCA were both in favour of the taxpayer, who appealed reassessments for years 1996 through 2000, whereby the CRA claimed that he remained a Canadian resident.

Mr. Laurin was also an airline pilot employed by Air Canada, based in various Canadian cities. He moved to Belize in 1993, and in 1996 he moved to the Turks & Caicos Islands (TCI). He took most of the steps expected of a departing resident. For example, he cancelled his health insurance and car insurance; exchanged his driver's license for a US one; sold his car and closed all his Canadian bank accounts except the one required to deposit his Air Canada paycheques.

He opened a bank account in the TCI and set up a company there. He opened an investment account in Florida and had his mail redirected to Florida because of mail problems in the TCI. When in Canada for work, or while on vacation, he stayed with three different friends, "never establishing himself at any one of these homes". His ex-partner's home in Canada was not available to him, as his relationship with her had broken down earlier. He did not spend 183 days in Canada in any of the years under appeal, so he was not a deemed resident "sojourning" in Canada for 183 days.

The Chief Justice of the TCC specifically distinguished the *Hauser* case (above) "with regard to the material facts", noting that Mr. Laurin "did not have any investments or business activities in Canada, unlike Mr. Hauser", and determined that Mr. Laurin was a non-resident of Canada during the years under appeal. He wrote that: "It is certainly possible for an employee of a Canadian company to be a non-resident of Canada for tax purposes".

The Crown appealed to the FCA. The appeal was dismissed from the bench. The CRA's argument was described as "… an attack on Chief Justice Bowman's assessment of the facts. In our view, the attack is unwarranted". Findings of fact by a trial judge cannot normally be overturned on appeal in Canada.

The two cases discussed above provide an important if obvious lesson for would-be expatriates – do it right! Two Canadian airline pilots; both left Canada for residence in a country without a tax treaty with Canada. (The terms treaty and convention are used interchangeably.) One cut his Canadian ties to the maximum possible extent and the other did not. Both Court decisions make sense.

Salt v R [2007] 3 CTC 2255

This TCC decision was another win for the taxpayer. Mr. Salt was reassessed as a resident of Canada by the CRA for the years 1998, 1999 and 2000 and successfully appealed the reassessments.

Mr. Salt, born in the UK and a UK citizen, left the UK in 1964 and worked in Jamaica for ten years. He moved to Canada, where he worked for two years, thence to Spain and worked there for five years, followed by three years working in Ireland. He returned to Canada and bought a home in 1984. He stayed until 1998, when he accepted a job in Australia, effective August 1, 1998. After 18 months, his Australian employment was terminated and he returned to Canada with his wife.

The CRA claimed that Mr. Salt remained a Canadian resident for tax purposes while working in Australia, but conceded that he was a resident of Australia during the period at issue.

Though reference was made by the Court to the fact that Mr. Salt had severed most of his ties with Canada while he was in Australia, the decision turned on Article 4 of the Canada-Australia Tax Convention and subsection 250(5) of the Canadian Income Tax Act.

Article 4(3) of the Convention provides that a dual resident (resident in both Canada and Australia) is deemed a resident of the country in which he has a permanent home available to him.

Subsection 250(5) of the Act provides that a person is deemed not to be a resident of Canada if he is resident in another country under the terms of Canada's tax treaty with that country.

Evidence was presented that Mr. Salt's former Canadian residence had been leased to an unrelated third party for a 22 month term, on conditions that prevented Mr. & Mrs. Salt taking back possession when they returned to Canada, and that they were provided with a furnished house by their Australian employer. This was sufficient for the Court to find that Mr. Salt had a permanent home available in Australia during the period and that he did not have a permanent home available in Canada. Accordingly, Article 4(3) of the Convention applied and so Mr. Salt was deemed to be a resident of Australia and a non-resident of Canada during the period under appeal.

Although the Court made passing reference to Mr. Salt's continuing ties with Canada (real estate investment, other Canadian investments, bank account, credit card, health insurance and driver's licence in Canada), these were not determinative; the Convention prevailed.

By comparing this decision with the two "pilot" cases described above, we see the significant difference between a move to a country with which Canada has a tax treaty and a move to non-treaty countries such as the Turks & Caicos Islands or the Bahamas.

Barton v R [2007] 4 CTC 2125

This case was heard by the TCC in October 2005, but judgement was not rendered until May 2007. The taxpayer lost. Mr. Barton was assessed by the CRA for the years 1995 through 1998 on the basis that he remained a Canadian resident, and the Court agreed.

Mr. Barton, a Canadian citizen, moved from Canada to the US in August 1994 on a three-month assignment, working in Texas. He then took a one-year contract in New York City, followed by a job in New Jersey until November 1997. At that time he moved to another New Jersey employer. Mr. Barton had an annual "TN visa" (work permit), and there is no mention of his applying for a US green card. He returned to Canada at the beginning of 1999.

Mr. Barton's wife was held by the Court to have remained resident in Canada. Mr. Barton returned to Canada at least 64 times from 1995 through 1998 – a ten hour drive each way.

Although Mr. Barton took out private medical coverage in the US, he did not cancel his Ontario medical insurance.

He opened two US bank accounts with small balances, but kept his Canadian bank account and credit cards with substantial balances. He used his wife's Canadian address as his mailing address.

The Court noted that Mr. Barton filed his US federal tax returns as a non-resident, giving his wife's residence in Canada as his permanent address. In his non-resident US returns, he indicated that he was a Canadian resident, entering and leaving the US at frequent intervals. Mrs. Barton claimed her husband as a dependent in her 1996 and 1997 Canadian tax returns, indicating that his net income in those years was "zero".

The Court noted that Mr. Barton "recognized that he was in the USA for work only and that he did not have any other ties there".

The Court was of the view that Mr. Barton maintained his ordinary mode of living in Canada – family, social relations, interests and conveniences – and found that he never ceased to reside in Canada during the period. Thus he remained a Canadian resident.

There was neither reference to, nor consideration of, the Canada-US Tax Convention; Article IV(2) deals with dual residence of an individual.

However, I do not believe that applying Article IV(2) of the Convention would have made any difference to the outcome. By implication, it seems that the Court decided that Mr. Barton was not a dual resident, which is consistent with the fact that he claimed in his US tax return not to be a US resident for tax purposes. That would be sufficient reason not to refer to the Convention. However, one would have expected at least some reference to the point in the Court's judgement.

Had Mr. Barton obtained a US green card, earlier jurisprudence suggests that this would have made him a dual resident, so the Convention would have had to be addressed in the judgement.

My view is that, while Mr. Barton had little chance of success in any event, his filing US returns as a non-resident, thereby effectively claiming to be resident "nowhere", must have affected the Court's decision, even though this point was not specifically included in the reasons for judgement.

Johnson v R [2007] 4 CTC 2359

Mr. Johnson was assessed for 2001 and 2002 by the CRA as ordinarily resident in Canada in both years. He lost.

He moved to Dubai, United Arab Emirates (UAE)) with his wife in March 2001 to take up employment there for a 36-month renewable term. Either party could revoke the employment agreement after two years with 90 days' notice. In due course, his employer terminated the agreement and he returned to Canada in June 2003.

His former home in Canada was leased to a third party, but he had the right to reoccupy it on 90 days' notice. He had purchased a second Canadian property in 2000, had it completed while he was in the UAE and leased it to a third party, after completion, in 2002. Mr. Johnson designated the second house as his principal residence, but claimed in Court that this was only "for tax planning purposes". This reason was not accepted by the Court.

Mr. Johnson retained significant ties with Canada. Apart from real estate, these included his Ontario driver's license, investments in Canadian companies, some Canadian credit cards and his Registered Retirement Savings Plan. On the other hand, he testified that he allowed his Ontario Health Insurance and his professional membership to lapse. Most of the family's personal belongings remained in storage in Canada.

Another significant factor noted in the Court's judgement was that the employer agreed to return Mr. & Mrs. Johnson to Canada at the end of the assignment and was obliged to try to find him an equivalent position within its Canadian operations.

The Court held that Mr. Johnson was ordinarily resident in Canada in 2001 and 2002, and that he did not sever his residential ties with Canada. His "move to the UAE with his spouse was a temporary one only". Accordingly, his appeal was dismissed.

During the years under appeal there was no tax treaty in force between Canada and the UAE. A treaty was signed in 2002, but entered into force only in 2004. In any event, it would not have helped Mr. Johnson's appeal, because Article 4(1)(b)(i) of the treaty defines a resident of the UAE as including only a national of the UAE – so even if the treaty had been in effect, Mr. Johnson would not have qualified as a UAE resident.

On the facts, Mr. Johnson had little chance of winning his appeal.

Garcia v. R [2008] 1 CTC 2215

This appeal was in respect of a bonus received by Mr. Garcia in 2003 in respect of his 2002 employment in the US, after he moved to Canada. He was reassessed as a resident of Canada in 2003, and the bonus included in his 2003 employment income. He lost.

Mr. Garcia, a French citizen, moved to the US with his family in 1993 and obtained a green card. At the end of 2002, his employer moved him to Canada. He obtained a US re-entry permit valid for two years to protect his green card.

For 2003, he filed his Canadian tax return as a non-resident and filed a US tax return as a resident. On his Canadian return, he included the bonus as income, but deducted it as foreign source income. The CRA reassessed him, to tax the bonus as employment income received while he was resident in Canada. The question to be decided by the Court was whether Mr. Garcia was resident in Canada in 2003.

The Court noted that "it is not really disputed by the parties that the appellant was ordinarily resident in Canada in 2003. It is also agreed that, because of his green card, the appellant was a resident of the U.S. as well".

Mr. Garcia argued that under Article IV of the Canada/US Income Tax Convention, he was a resident of the US because of the tie-breaker rule in the Convention. This rule provided that he was deemed to be resident where he had a permanent home available to him. He claimed that he did not have a permanent home available to him in Canada, because he purchased his Canadian residence with the idea in mind that his stay in Canada would be only temporary.

In its decision, the Court (among other references) referred to the OECD 2005 commentary on Article 4 of the Model Tax Convention and to CRA Interpretation Bulletin IT-221R3, discussing the tie-breaker rule.

The Court's decision was, not surprisingly, that Mr. Garcia had a permanent home only in Canada in 2003, so he was deemed to be a Canadian resident.

The decision was not unexpected, given the weakness of Mr. Garcia's argument.

NON-RESIDENTS CLAIMING CANADIAN RESIDENCE

Shao v R [2006] 3 CTC 2028

Ms. Shao claimed a deduction for moving expenses in 2003, when she moved back to Canada from the US. Such a deduction would be permitted only if Ms. Shao was "absent from but resident in Canada" when she moved. As a result, the question of where she was resident was the issue before the Court.

This was the reverse of the usual case, where the taxpayer appellant tries to demonstrate non-residence in Canada. Here, Ms. Shao tried to prove Canadian residence, but without success.

Ms. Shao argued that her preparations to return over a period of several months, looking for a job and an apartment and changing her mailing address, resulted in her becoming a Canadian resident before she actually moved back to Canada.

The Court noted that the facts clearly established that, prior to 2003, Ms. Shao's "settled and routine life was in the United States, not Canada". It was held that "She did not become a resident in this country until she actually moved back. Preparation and intent alone are insufficient to establish residency".

Zhan v R [2006] 4 CTC 2349

The facts in this case were the same as in the Shao case discussed above. Mr. Zhan and Ms. Shao were husband and wife. This case was heard later, by a different Tax Court Judge. The decision was the same – Mr. Zhan was not a Canadian resident until the move was completed.

These two cases will comfort immigrants to Canada. The decisions tend to diminish any risk that the CRA might successfully claim that immigrants become Canadian residents when they began planning their move to Canada.

Both cases were decided under the Tax Court's "Informal Procedure", so they are not binding on future decisions, but they have persuasive authority.

CANADIAN RESIDENCE IN A PROVINCE

Mandrusiak v. British Columbia [2007] 5 CTC 165

A 2007 decision of the British Columbia Supreme Court is also of interest. Mr. Mandrusiak was assessed by the CRA on the basis that he was resident in British Columbia (BC) for the years 2000 through 2002.

Each Canadian province sets its own personal income tax rates and allowances, but all, except Quebec, have their provincial personal income tax collected on their behalf by the CRA (together with Federal income tax). Rates differ widely. In the years under dispute, BC personal income taxes payable by a resident of that province were significantly higher than those payable by a resident of Alberta (AB) on the same income. The taxpayer was reassessed on the basis that, although he was a dual resident, he was principally resident in BC at year-end and so subject to personal income tax at BC rates.

Below are some salient facts:

- Mr. Mandrusiak (aged 75) was born in AB, grew up and was educated there and raised his family there.
- He and his wife owned a home and farm in AB. His two sons and extended family lived in AB.
- In 1987 he purchased (and in 2000-2002 he still owned) an apartment in BC. He worked for some years in BC as a consultant for the BC office of an AB firm.
- He and his extended family invariably spent Christmas and New Year's Eve at their AB home.
- During the period under appeal (2000-2002), Mr. Mandrusiak's chief source of income was from his AB farm.
- He was held to have spent slightly more time in BC than AB in the years in question. This was not held to be determinative, but was a factor.
- His cars were all AB registered and he held only an AB driver's licence.
- He held a BC Healthcare card.
- He and his wife purchased burial plots in AB in 1996.
- He was the beneficiary of two AB trusts and his Registered Retirement Savings Plan and the family holding company were in AB.

The facts indicated dual residence. The Court had to decide which province was his "principal place of residence" – a difficult decision based on the facts. The decision, in favour of the taxpayer, was primarily based on the AB residence of his family, his social contacts (which were held to be stronger in AB than in BC) and on financial considerations.

The relevant regulations provide that residence on the last day of the year is the determining factor. However, the Court took many other factors into account.

The decision seems reasonable based on the facts; a small change in the facts might have led to a different conclusion.

CONCLUSION - WHAT CAN WE LEARN FROM THESE DECISIONS?

- When moving to a treaty country, the emigrant should pay particular attention to the first tie-breaker rule, which appears in Article 4 of almost every treaty, dealing with the availability of a permanent home. A permanent home available in the destination country and no such home in Canada is the key to a successful claim of non-residence in Canada. The former home in Canada should preferably be sold to an unrelated third party. Alternatively, it should be leased to a third party on terms which prevent the lessor from taking back possession of the property with only a few months' notice. Selling or leasing the property to a family member is dangerous. It may allow the CRA to claim that the taxpayer had retained a permanent home available in Canada.

- It is much easier for a departing Canadian resident to claim non-residence when moving to a country that has a tax treaty with Canada. It may be worth considering a move in two stages – first to a treaty country and then, after an appropriate lapse of time, to the final planned (non-treaty) destination. The tie-breaker Article of the treaty requires careful study before any such action is taken; too fast a departure from the treaty country could cause problems.

- A treaty can be invoked only in the case of dual residence. Consequently, a claim by the CRA that the taxpayer was not "resident" in the new treaty jurisdiction may be anticipated in many cases. That is why, even when a treaty claim is made, cutting ties with Canada and establishing ties to the new country require attention. Filing tax returns as a resident of the "new" country and paying tax there as a resident are prerequisites.

- Don't play games! To file Canadian and US tax returns for the same year, both claiming to be a non-resident, is asking for trouble. The CRA can obtain a copy of the taxpayer's US return by asking the IRS for it, under the exchange of information provision in the Canada-US Tax Convention. The same comment applies to other treaty countries.

- As noted above in my comment on the *Hauser* and *Laurin* cases, do it right! Important points to watch include cancelling Canadian provincial health insurance coverage, closing Canadian bank accounts, and cancelling Canadian credit cards and driver's license. It is unwise to retain a Canadian mailing address after leaving Canada. Investment management should not remain in Canada.

- An immigrant to Canada should try to arrange to receive all income due to him or her for earlier periods before taking up Canadian residence.

- An employment contract requiring the employer to return the employee to Canada at the end of the assignment was held by the Court in *Johnson* to be a relevant factor in determining that the employee remained a Canadian resident during the assignment. The Court had no difficulty in "seeing through" a long term employment contract which could be cancelled at short notice.

- Take your personal belongings with you when you leave Canada. Don't store them in Canada. Otherwise, the implication is that you are coming back.

- It is extremely difficult to claim successfully to be a non-resident of Canada if your spouse remains a Canadian resident.