

Avoiding the astronaut's tax trap

By William Thomson

Do you qualify as a resident of Canada for tax purposes?

The Government of Canada imposes income tax on the net worldwide income of each individual resident of Canada. By way of illumination, the Canadian Income Tax Act (ITA) provides that a person is a resident of Canada if that person resides in Canada or is ordinarily a resident of the country.

It has been left to the Canadian courts to put some substance into this tautological statutory definition. The courts have concluded that the determination of a person's residence status is one of fact and degree. No single factor under this definition will, in itself, establish a person as a resident of Canada for ITA purposes. However, a number of factors considered together can establish that a person is a resident of Canada in the eyes of Canadian tax authorities.

Factors considered important for purposes of this deliberation include: past and present habits of life; regularity and lengths of visits to Canada; ties to Canada or elsewhere; ownership of a home available for that person's use while in Canada; residence of the person's spouse, children and other dependent family members in a dwelling maintained by that person in Canada; maintaining a mailing address in Canada; maintaining Canadian bank accounts (other than non-resident bank accounts) or active securities accounts; holding a Canadian drivers' licence; frequent visits to Canada for business or social purposes; maintenance or storage in Canada of personal belongings including clothing, furniture, etc; and obtaining landed immigrant status in Canada.

An individual can be a resident of Canada for tax purposes even though that person is a resident of another country at the same time.

In addition, in cases where this residence definition would not cover an individual, the ITA also provides that a non-resident individual will be deemed to have been a resident in Canada throughout the tax year (which in Canada is a calendar year) if that person sojourned in Canada for a period totalling 183 days or more.

This can be a continuous or intermittent period of 183 days and, to compute time for this purpose, add up the number of hours the person was physically present in Canada to determine whether they equal 183 24-hour periods. Fortunately, this sojourning rule does not apply to an immigrant who takes up Canadian residence part way through a year (providing that person has not sojourned in Canada for 183 days before taking up residence.)

Someone from Hong Kong who unwittingly acquires Canadian tax residence can be in for a nasty shock. As a resident of Canada, all of that person's income from every source and location will be subject to Canadian tax at marginal rates of up to about 50 per cent.

Since the Hong Kong salaries tax system is source-based, that is to say Hong Kong taxes salaries, wages and other compensation arising from an office or employment in Hong Kong, it is entirely possible that a person could have a job in Hong Kong, thus pay Hong Kong tax, and also be a resident of Canada for ITA purposes and be subject to Canadian tax as well.

This scenario might arise, for example, where a person buys a home in Canada and takes his family to live there. That person then returns to Hong Kong to perform services for a Hong Kong employer. This unfortunate soul could find himself paying Canadian tax on his Canadian and his Hong Kong salary, as well as Canadian tax on his investment income and capital gains. Although both Canada and Hong Kong have a tax credit system

to eliminate double taxation of salaries earned in foreign countries, they have different tax years and filing systems, guaranteeing tax filing and payment timing differences. Not only would the person in our example bear the higher Canadian tax rate on his worldwide income, he would be filing and paying Canadian and Hong Kong taxes at different times, so would often be financing some double taxation.

Someone from Hong Kong who acquires Canadian residence will be surprised to learn that Canada taxes individuals not only on salaries and wages, but also on income stemming from investments, interest, dividends, and capital gains accruing to the individual during the tax year.

Specifically with respect to capital gains tax, a non-resident is deemed to acquire all their capital property, excluding property defined as taxable Canadian property, wherever it is situated (whether inside of or outside of Canada) at a cost equal to its fair market value as of the date that person becomes a tax resident.

As a Canadian tax resident, a person will pay tax (3/4 of the gain being included in taxable income) on any gain in value accruing during his residence in Canada when he sells the asset.

There is some relief available to alleviate the effects of capital gains tax in the form of a cumulative C\$100,000 lifetime capital gains exemption, the provisions of which are too cumbersome to detail here.

In summary, anyone from Hong Kong who has any connections with Canada should seriously consider the provisions of the ITA. Failure to do so could result in some surprising, unfortunate and costly consequences. ♦

William Thomson is a tax manager at Deloitte Touche Tohmatsu in Hong Kong. He is also secretary of the 1992/3 Chamber executive committee and a member of the Legal & Taxation Committee.