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Vern Krishna: Determining tax jurisdiction

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Canadians spend a lot of time in the U.S. Trouble is, Canada and the U.S. have confusing rules on whether taxpayers owe funds to the CRA, the IRS or both Fotolia

Now that the holiday season is over, we can all look forward to filing our tax returns in the spring. Those who spend a lot of time in both Canada and the United States will have to review their calendars to determine whether they need to file returns in both countries.

Be careful. With the governments of both countries facing large deficits and unfunded pension liabilities, the Canada Revenue Agency and the Internal Revenue Service are eager to grab the biggest slice of a taxpayer's income by embracing individuals as their own. Trouble is, tax rules from both countries do not always provide a clear answer as to which government should actually be getting the taxpayer's money.

Canada uses residence as its primary connecting factor to tax individuals on the theory that a person who enjoys the legal, political and economic benefits of association with the country should bear his or her appropriate share of tax on their worldwide income.

We determine an individual's residence under statutory rules, a facts and circumstances test, or international tax treaty rules.

The statutory rule, which is perhaps the easiest to apply, deems individuals who sojourn 183 days or more in Canada in a calendar year to be Canadian residents.

The facts and circumstances tests apply to determine whether an individual has an economic and social nexus with Canada. The CRA looks at three factors: dwelling place, family connections, and personal property and social ties. The most important of these factors is whether the individual maintains a home or dwelling in Canada that is available to him or her.

Tax treaty rules kick in to prevent double taxation of individuals when both Canada and a foreign country with which we have a tax treaty claim taxable jurisdiction over the taxpayer. Tax treaties allocate taxing jurisdiction by applying a series of tiebreaker rules so that only one of the countries will have the primary right to tax the individual as its resident. The other country retains a secondary right to tax income based on its source.

Now for the U.S. Americans are proud of their status as having the most complicated in the world (the U.S. legislation runs about 80,000 pages). To start with, the U.S. taxes all of its citizens, regardless of where they live, and its resident aliens ("green card" holders). However, it can also tax individuals who have a "substantial presence" in the United States, unless they have a "closer connection" with another country.

An individual has a substantial presence in the United States if he or she spends at least 31 days during the current year in the country, and a weighted average of 183 days or more during three years, including the current year and the two years immediately before. To determine the average, we multiply days in the current year by one, days in the immediately preceding year by one-third, and days in the second prior year by one-sixth.

For example, an individual who was in the United States for 120 days in each of 2013, 2012 and 2011 does not have a substantial presence in the US for tax purposes. The 2013 days count as 120, the 2012 days count as 40 days, and the 2011 days count as 20 days. Thus, the weighted average for the three years is only 180 days.

However, an individual who is in the U.S. for fewer than 183 days during the current year, but who has a substantial presence in the country may qualify as a non-resident alien if he or she has a "closer connection" to a foreign country in which they maintain a tax home during the entire year. The IRS will look at family, personal belongings — such as, cars, furniture, clothing, and jewelry — current social, political, cultural, or religious affiliations, business activities, driver's license, and voter registration to determine closer connection. Individuals claiming a closer connection with the U.S. must file Form 8840 with the IRS.

Where both Canada and the U.S. claim taxing jurisdiction over an individual, we look at the tax treaty between the two countries. This is where obscurity trumps certainty for the benefit of tax lawyers. The treaty determines attachment that an individual has with each country by looking at his or her permanent home (if any), centre of vital interests, habitual abode, and nationality.

If, as often happens in tax law, the rules do not provide a decisive answer, the individual must rely on the CRA and the IRS, neither of which are merciful when it comes to determining who gets the biggest piece of the pie.