What’s in a name? - Residence, citizenship and domicile

Residence, citizenship and domicile are technical terms used to describe aspects of a person’s legal status. Changes in legal status can have significant consequences, both good and bad. Understanding the legal concepts surrounding these terms can help clients avoid confusion about their rights and responsibilities.

Residence

No matter who you are or where you live, you are a resident of at least one country in the world. Canada, like most countries, imposes tax on its residents' world-wide incomes. Since most people equate residency with physical presence, it comes as a surprise to them to learn that you can be a resident of more than one country, and that you may have income tax obligations to each country that deems you to be a resident of their country.

You may have this result because it is possible to maintain “residential ties” with a country that are strong enough for you to be treated as a resident even if you are not physically present in that country. Here are some factors that the Canada Revenue Agency (CRA) considers in determining whether you are a resident of Canada (this is only a partial list, and no one factor is determinative).¹ As you read this list, think of how a client could answer yes to any of these questions even if he or she actually lived and worked in a different country.

- Do you have a home in Canada (owned or rented, even if you don’t actually live in that home)?
- Do you have a spouse (or common-law partner) and/or dependants living in Canada?
- Do you own personal property located in Canada, such as a car or furniture?
- Do you maintain any social ties in Canada (like club and church memberships)?
- Do you have any economic ties to Canada (like a Canadian employer)?
- Do you have a driver’s licence issued by a Canadian province or territory?
- Do you have any Canadian bank accounts or credit cards?
- Do you have health insurance provided through a Canadian province or territory?

If your client answers yes to some or all of the above questions, Canada could treat him or her as a Canadian resident for income tax purposes. But if during the same year your client also spent at least 183 days or partial days in the United States, the Internal

¹ See the CRA’s website, [http://www.cra-arc.gc.ca/tx/nrnsdnts/cmmn/rsdncy-eng.html](http://www.cra-arc.gc.ca/tx/nrnsdnts/cmmn/rsdncy-eng.html). See also CRA’s Interpretation Bulletin IT221, Determination of an Individual’s Residence Status.
Revenue Service (IRS) would consider him or her to be a resident of the United States for U.S. income tax purposes. Your client would then have to file tax returns for Canada and the United States.

Were it not for the Canada – United States Tax Treaty, your client would have to pay income tax to both countries on the same income – double taxation. However, the treaty generally says that if you have to pay tax on the same income to both countries, you may deduct the tax you owe to one country from the tax you owe to the other. But how do you decide which country you have to pay tax to and which country you don’t?

Under the treaty, Canada and the United States have agreed to a set of rules that helps them decide which country collects the tax and which country must offer a tax credit to offset the tax paid to the other country. The rules are closely related to the residency rules, and are incorporated into each country’s income tax laws:

- If you have a permanent home in one country but not in the other you are a resident of the country where you have a permanent home.
- If you have permanent homes in both countries (or in neither) then you are a resident of the country where you have the closer personal and economic ties.
- If you can’t tell which country you have the closer personal and economic ties with, you are a resident of the country where you have an habitual abode.
- If you have an habitual abode in both countries (or in neither), then you are a resident of the country of which you are a citizen.
- If you are a citizen of both countries (or of neither) then the two countries will agree on which country imposes tax.

For example, suppose your client earned $100,000 in salary for the year, was a resident of both countries for income tax purposes, and, under the rules above, was treated under the treaty as more of a resident of the United States than of Canada. Your client would have to file a tax return with the IRS and with the CRA. If your client owed $15,000 in income tax to the IRS, and $20,000 to the CRA, he or she would have to pay the $15,000 to the IRS, but would be able to deduct the $15,000 paid to the IRS from whatever amount he or she owed to the CRA. The CRA would get only $5,000 in income tax from your client.

The rules do not always eliminate double taxation because each country taxes some items or transactions differently. For example, if your Canadian client is subject to both countries’ tax regimes, and gives real estate located in the United States to another person, Canada treats the transaction as a disposition that triggers a potential capital gains tax liability for your client. However, the United States treats the same transaction as a gift, triggering a potential gift tax liability for your client. The United States also defers capital gains tax liability until the person receiving the gift sells or disposes of the property (other than by way of a bequest or gift). Your client will not have to worry about U.S. capital gains tax consequences, but when the donee sells or disposes of the property he or she will have to report a capital gain that includes all the capital gains from when your client first acquired the property.

The treaty provides an imperfect remedy. The Canadian donor still has to include half the capital gain in income and pay tax to the CRA, but the transaction will also be deemed to trigger a capital gain in the United States (with a foreign tax credit for the capital gains tax paid to the CRA). If the gifted asset appreciates in value, the donee will pay U.S. capital gains tax only on the appreciation in value that occurred from the time he or she acquired the property. That helps eliminate the double taxation on the capital gains, but does nothing about the fact that your Canadian client may also have had to pay gift tax, a form of double taxation. However, the treaty provides no relief. There is some relief under U.S. gift tax law. If the property was worth less than US$13,000 (2009 limit, indexed to inflation) there is no obligation to file a gift tax return or pay gift taxes. If the donee was your client’s spouse, and was a U.S. citizen, there is no limit on the amount your client can give to him or her. On the other hand, if your client’s spouse was not a U.S. citizen, there is an exclusion that allows your client to transfer up to $133,000 per year (2009 limit, indexed to inflation) without having to pay gift tax, though a gift tax return will have to be filed.

The residency rules apply only at the federal level. At the state, provincial and territorial level taxpayers are residents of the state, province or territory where they lived at the end of the calendar year. As a result, although your client may have tax obligations to more than one country, he or she will never have tax obligations to more than one state, province or territory. For example, consider a client who lives year round in New York State, but who has residential ties to Canada that are strong enough for Canada to treat him or her as a Canadian resident for tax purposes. Your client would have tax obligations to Canada, the United States and New York State. But even if your client’s Canadian residential ties were all found in the province of Nova Scotia, for example, he or she still would not have a tax obligation to Nova Scotia (because your client did not live in that province at the end of the calendar year).

If you find the residency rules confusing, you’re in good company. Many accountants (who deal with these rules every day) also find the rules confusing. As a result, it can be a good idea to consult with a tax professional, and as part of that consultation obtain a determination of residency status from CRA if you leave Canada or if you return.

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2 See our bulletin, “U.S. income taxes: Stay too long in the U.S. and you may have to file a U.S. income tax return” for more information on residency for U.S. income tax purposes.
Citizenship

Citizenship is very different from residency. It is a personal status that is only granted to selected individuals, and is not lost by simply changing your physical location. Corporations and trusts may be tax residents in Canada, but they cannot hold Canadian citizenship.

Canadian citizens may move anywhere in Canada, may freely leave the country and return, may work, and have a right to a Canadian passport. If they are of age, they may vote in elections, and may hold political office. Access to social benefits like health insurance, welfare benefits and pensions are tangible financial rights that may flow from being a citizen. Citizenship also is often part of a person’s sense of identity.

The rules for acquiring and losing citizenship are complex and change from time to time. Different countries have different rules.

Canadians and Americans may acquire citizenship in their respective countries in similar ways:

- By birth in the country of citizenship (i.e. those born in the United States are U.S. citizens; those born in Canada are Canadian citizens).
- By birth other than in the country of citizenship, but to parents who were citizens of that country at the time of birth. For example, anyone born in the United States to Canadian citizen parents is both a U.S. and Canadian citizen – American by virtue of having been born in the United States, and Canadian by virtue of having been born to Canadian parents. The same rule applies to those born in Canada to U.S. citizen parents.
- By immigrating to the country, becoming a permanent resident, and by then applying for citizenship and becoming a naturalized citizen.

In some countries, being born in that country confers no citizenship rights if your parents are also not citizens of that country. Other countries allow you to trace citizenship through your parents and grandparents even if you were not born in that country.

Like tax residency, many countries acknowledge that their citizens may also be citizens of a second country: “dual nationality” or “dual citizenship.” Giving up citizenship may also be subject to stringent rules, especially if it is done to avoid tax responsibilities. Under the rules that allow you to claim citizenship if your parents (and if you are old enough, your grandparents) were citizens, it is also possible to be a citizen and not know it. See our bulletin, “Unique estate risks of ‘U.S. person’ clients” for more information.

For citizens of the United States, one price of citizenship is taxation on their worldwide income – regardless of their residency. But the most significant implications of citizenship arise when civic responsibilities exist. For example, citizens of some countries are subject to a period of mandatory military service, potentially for several years. In some circumstances, individuals born abroad but considered citizens under local rules may be detained and subjected to enforced military service if they enter the country. The price of citizenship can be very high indeed.

Domicile

Domicile is often mistaken for residence or citizenship. While there is an overlap between these concepts, there are important differences.

Like residence, everyone must have a domicile. However, unlike residence, you may have only one domicile, and also unlike residence, you may choose your domicile. Your choice need not be explicit, and there are no forms to complete and submit to any authority; rather, your choice becomes clear through your actions (and therefore it is possible for a court to find that you have chosen a particular domicile even if that choice comes as a surprise to you). Minors take the domicile of their parents until they

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4 You may download the form to complete and send to CRA from the CRA website: http://www.cra-arc.gc.ca/E/pbg/tf/nr73/README.html for those leaving Canada, and http://www.cra-arc.gc.ca/E/pbg/tf/nr74/README.html for those entering Canada. But obtain professional advice on the tax aspects of leaving or returning to Canada or the United States.
7 For example, Canada, the United States, France, Italy, Mexico, Switzerland and the United Kingdom all permit dual citizenship. See http://dsp-psd.tpsgc.gc.ca/Collection-R/LoPBdP/BP/bp445-e.htm.
are old enough to make their own choices. Those who are not competent to decide take the domicile of the person on whom they depend for support. In contrast, a person may be a resident of a country without intending to or wanting to be a resident.

In general, a person’s domicile is the place where he or she has his or her permanent home, and to where, if that person is absent from that home, he or she intends to return after the purpose for being absent has been accomplished. There is a psychological aspect to domicile. For example, someone with a vacation home may return to his or her permanent home when vacation ends. He or she would consider the permanent home as his or her domicile even while physically present at the vacation home.

It is also possible to be domiciled at a place where you have not lived for many years. For example, guest workers may live and work in a foreign country, sometimes for years, but still consider their country of origin as their home. Their country of origin would be their domicile. To take a more familiar example, many university students may study and work in cities far from their parents’ homes, but may still think of their parents’ homes as “home”, even if they maintain a year-round address away from their parents’ home, are of legal age and are no longer dependent on their parents. The student’s domicile in that case would be his or her parents’ home. Only after graduating and getting a job might a person begin to think of his or her new address as his or her home, and therefore his or her domicile.

Domicile is distinct from citizenship in that it is possible to change your domicile through your own actions without obtaining the permission of any government or other authority. However, you must take positive steps to change your citizenship, either to renounce citizenship through a formal declaration to a lawful authority (like a consular official outside your country of citizenship), or to acquire citizenship in a new country through that country’s naturalization process.

Many governments use the concept of domicile for different legal purposes. For example, the United States uses domicile to determine estate tax liability. If your client is a non-citizen/non-resident, his or her estate may still be subject to estate tax on his or her U.S. assets if he or she were domiciled in the United States at his or her death. At the same time, though, it would be legally possible for a court in Ontario to find that your client was domiciled in Ontario at his or her death, and to assume jurisdiction over your client’s world-wide estate (including your client’s U.S. assets) in order to administer the terms of his or her will.

While this result appears to contradict the rule that you may have only one domicile, it does not. Each jurisdiction or court will reach its own decision on your client’s domicile for its own purposes (and may completely ignore what any other jurisdictions or courts may have decided about your client’s domicile). No jurisdiction or court will decide that your client had more than one domicile, although the practical effect of their decisions may be that your client did have more than one domicile for different legal purposes.

**Advising clients**

Knowing the differences between residence, citizenship and domicile helps you ask important questions that may reveal unanticipated – yet critical – information about your clients. This is especially true when it comes to uncovering connections to the United States.

- Develop questions about your client’s place of birth, place of marriage, what citizenships they carry, etc. Questions like these offer clues that may signify the increased importance of one or more of these concepts.
- Keep in mind that mailing address is often for convenience. Residence is what is important for Canadian purposes, especially tax.

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