Practice Notes and Comments

This regular feature is edited by Gregory J. Winfield of McCarthy Tétrault LLP. It discusses tax developments affecting the taxation of compensation and retirement and focuses on Canada Revenue Agency policies and practices.

DUAL RESIDENCY

When Subsection 250(5) of the Income Tax Act Does Not Apply: Black v. The Queen

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Introduction

The ongoing legal battles of Lord Conrad Black continue. This time, the issues involved are of relevance to many "dual-resident" Canadians who rely on relief under Canada's various taxation treaties in order to avoid Canadian taxation on foreign-source employment and other income.

In the circumstances described in *Black v. The Queen*,[1] Lord Black earned, in 2002, significant non-Canadian income, including U.S.-source employment income. The issue before the Tax Court of Canada was whether Canadian income tax was exigible on such income by virtue of Black having been a resident of Canada in the taxation year in question and hence being subject to Canadian tax on his worldwide income.

The case raises novel issues relating to the interaction between domestic tax residency rules and corresponding rules under Canada's tax treaties.

[1] 2014 TCC 12.

Factually, in the year in question, Black was resident both in Canada and in the United Kingdom, but, under the tie-breaker rules in Article 4(2) of the *Canada-United Kingdom Tax Convention* (the "Treaty"), he was deemed to be resident only in the United Kingdom for the purposes of the Treaty. Under the non-domiciliary rules in the United Kingdom, because Black was resident, but not domiciled, in the United Kingdom, he was not taxable in the United Kingdom on the income in question, as it neither arose in, nor was remitted to or received in the U.K.

The legal issue before the Tax Court was, accordingly, whether Black's deemed Treaty residency in the United Kingdom precluded the Minister of National Revenue from assessing on the basis that Black was a resident of Canada.

Ordinarily, in similar factual circumstances, the taxpayer could be expected to rely on subsection 250(5) of the Income Tax Act,[2] which provision treats a person who is resident in Canada but who is deemed to be resident in another country under a tax treaty to be a non-resident of Canada for the purposes of the Act. If applicable, the provision should have been dispositive of the case in Black's favour. In the circumstances, however, because Black became a resident of the United Kingdom in 1992 and remained a resident thereof through 2002, the provision did not apply due to the transitional rules, which preclude its application to a Canadian resident individual who was a treaty resident of another country at the time the provision came into force on February 28, 1998 for so long as the person continues to be resident in the same treaty country.

While the Tax Court made only a passing reference to subsection 250(5) (which both the taxpayer and Minister agreed did not apply), the Court did go so far as to note that the rule in subsection 250(5) likely represented a substantive change in law, implying that, in circumstances where the provision does not apply, a person can be a resident of Canada even while being a resident, for the purposes of a particular tax treaty, of another treaty

[2] R.S.C. 1985, c. 1 (5th Supplement), as amended, hereinafter referred to as the "Act." Unless otherwise stated, statutory references in this article are to the Act.

country. This in fact was the outcome of the *Black* decision.

Decision of the Tax Court of Canada

Before the Tax Court, Black's argument was that the Treaty should prevail over the provisions of the Act, such that Black should not be considered a resident of Canada in the year in question. In contrast, the Minister contended that Black's deemed residence in the United Kingdom under the Treaty applied only for the purposes of the Treaty and that, since Black was a factual resident of Canada in 2002, he was subject to Canadian tax on his worldwide income unless a particular item of income or gain is provided for in the Treaty.

The Tax Court adopted a liberal and purposive approach to interpreting the Treaty. Its analysis began with the fact that the definition of "resident of a Contracting State" in Article 4 of the Treaty was "for the purposes of the [Treaty]," and then reviewed commentary to the effect that the Treaty was not meant to override Canada's domestic law in the absence of "conflict or contradiction." Such an inconsistency only arises, in the view of the Tax Court, where the result of the application of the Act is in contradiction with the purpose of the Treaty of providing relief from double taxation. In the case before it, since Black was unable to point to any provision of the Treaty that would result in double taxation if he were held to be a resident of Canada for the purposes of the Act, no inconsistency existed. Rather, the Tax Court held that the tie-breaker rules in Article 4(2) of the Treaty merely provided a preference to the taxing authority of the United Kingdom, but did not extinguish Canada's claim to tax. In the result, the Tax Court held that Black's deemed Treaty residency in the United Kingdom did not impact his tax residency in Canada for non-Treaty purposes.

Although not necessary to dispose of the case, the Tax Court also addressed the position of the parties in relation to Article 27(2) of the Treaty, which provision addresses the U.K. tax treatment of non-domiciled residents of the U.K. who are required to pay tax on foreign income only when such income enters the U.K. The provision provides that, where a U.K. resident is relieved from Canadian tax under the Treaty on income by reference to the amount thereof which is remitted to the U.K., the relief allowed in Canada shall apply only to the amount of the income subject to tax in the U.K.

Black argued that the provision permits the Minister to assess tax only under Part XIII of the Act (being withholding tax on payments made to non-residents of Canada). Notwithstanding commentary suggesting that Article 27(2) is intended to allow the state of source (in this case, the United States, not Canada) to tax income that has not been remitted to the state of residence, the Tax Court rejected Black's position, noting that Article 27(2) did not itself refer to the source of income or the state in which it arises.

Conclusion

The *Black* decision highlights the importance of subsection 250(5) to dual residents. Provided that the provision applies, dual-resident individuals who are resident in the U.K. or another tax treaty jurisdiction under the rules of the applicable tax treaty can continue to be assured that Canadian income tax will not be levied on non-Canadian source income. It follows from *Black* that, where subsection 250(5) applies to deem a person to be a non-resident of Canada, Article 27(2) can only restrict Treaty benefits insofar as Canadian source income is concerned. As such, the direct impact of the *Black* case to other taxpayers may be less than initially anticipated.

That said, the decision remains important as authority on treaty interpretation and the circumstances in which an "inconsistency" between a tax treaty and the Act will be considered to arise. The result of the Tax Court's analysis is, in some sense, intuitively appealing – since Black was not subject to U.K. tax on the income in question, Treaty relief was not available, which is consistent with the purpose of tax treaties to avoid double tax (but not to allow a taxpayer to avoid tax altogether). On the other hand, it is interesting that the Treaty operates such that the application of the U.K.'s tax laws (which did not tax the income in question) would impact whether or not Canadian tax would apply. For example, if Black's U.S.-source employment income had been remitted to the U.K., U.K. tax would presumably have applied and Canadian tax would not. It seems

a strange result that the incidence of U.K. tax should impact the Minister's ability to assess Canadian tax, but this is the result of the Tax Court's analysis.

The *Black* decision has been appealed to the Federal Court of Appeal and thus, the validity of the approach remains an open issue. Stay tuned!