Determining the tax residence of individuals

accountancydaily.co/determining-tax-residence-individuals

Guillermo Narvaez,Tax partner and technical director, Kreston Global Tax Group 14 Feb 2022

Residency is an important factor when deciding which jurisdiction the taxpayer should pay tax in and rules vary between countries. Guillermo Narvaez, tax partner and technical director, Kreston Global Tax Group, considers the tax traps

Tax residence matters are often misconstrued as being an issue of little practical concern for most people, and for those who never move abroad and conduct only domestic business activities, this may well be the case. However, tax residence matters are important and neglecting them when they arise can be incredibly costly.

Article 4 of the Model Convention of the OECD (Model Convention) is dedicated to defining the tax residence of both individuals and artificial persons.

How do problems arise?

Each state is free to define its own tax framework, and the criteria among states can vary. For instance, one state may consider that citizenship is the basic criterion when defining residence, while a second state may define tax residence through habitually living in that state.

An individual will therefore have a dual tax residence if they satisfy both criteria - if they are a citizen of the first state but live in the second. To solve these matters the MC and double tax agreements (DTAs) have introduced tie-breakers.

Below is a hypothetical case where a person (X) is a tax resident in State A and State B at the same time according to domestic laws.

The relevant features and activities of X in both states to define their dual residence are as follows:

Person X **Facts and activities**	
State A	*State B*
Permanent home	Permanent home
Permanence of 175 days per year	Permanence of 190 days per year
Habitual business activity for many years	Entrepreneur
Nationality	Investments

Ex-spouse with children	New spouse

In our example, State A considers all citizens to be tax residents, while State B automatically considers as tax resident any person whose permanence has been longer than 183 days per year. Hence, X has a dual residence.

The DTA brings in tie-breakers to resolve the question, in this order:

- permanent home;
- habitual abode;
- centre of vital interests;
- nationality; and
- mutual agreement.

X has a permanent home at their disposal in both states, however, considers their 'real' home to be in State B, where they reside with their second spouse. Given that X spends substantial amounts of time in both states - broadly half of the year in each - X may be deemed to have a habitual abode in both.

So far, the assessment of X in both states is tied, so the next step in defining their tax residence is to determine where their centre of vital interests (CVI) is located.

The test to determine an individual’s permanent home or habitual abode is objective, and similarly nationality is usually a matter of fact and easy to confirm. Conversely, the CVI looks at both objective and subjective factors when defining where a person has the stronger attachment. This involves a full interpretation of facts, economic matters, personal matters, and even personal feelings.

Essentially, when applying article 4 it is crucial that we understand the full context of the individual - it is not simply a matter of gathering facts.

In this example, we may say that X is resident of State B according to the corresponding DTA and the article 4 tie-breaker because:

- they spend most of the year in that state;
- they have a business to attend;
- they have their new family (ie, their current spouse); and
- investments have been made in that state.

However, we could also conclude that X is resident of State A given that:

- it is the place where they were born and they are still a citizen
- they do not spend most of the year in State A, but they spend a considerable part of it (almost half);
- in State A, X founded a permanent business before their entrepreneurship activity carried on in State B; and
- X’s children live in State A.

Hence, there exists sufficient evidence to determine that X could be resident of either State A or B. The key to applying a dual residence tie-breaker in circumstances such as this is to look at where the strongest attachment of the individual lies.

In the case of X, if the CVI is deemed to be tied, State A becomes the governing jurisdiction due to the fact that the following tie-breaker is determined by nationality and X is a citizen of State A. However, the context of X has not been comprehensively revised; we have not considered the full scope of X's plans for the future and aims for spending their life in two different countries. These elements may not be definitive but may have a bearing. We need to ask questions such as:

- do they expect to split their time between both countries for the rest of their life? Or is this just a transition?
- will business in State A be carried on permanently or will the new economic activity in State B substitute the activity in State A when the entrepreneurship activity has matured?
- what is the nature and extent of X's attachment to their children?

Tax residence issues are not merely trivial or academic. Individuals who may become liable to double taxation should ensure that their tax residence status is determined accurately through a thorough analysis of facts and context. If the full scope of their circumstances is not properly addressed, the implications could be severe. In the above scenario, for example, it is likely that X is actually a tax resident of State B, despite our initial assumptions to the contrary.

About the author

Guillermo Narvaez is tax partner and technical director, Kreston Global Tax Group

If you think this article would be useful to a friend, click the **'Share with a Friend'** button below

Guillermo Narvaez |Tax partner and technical director, Kreston Global Tax Group

Guillermo Narvaez is a tax partner and technical director at Kreston Global Tax Group...

View profile and articles

Average: 4.7 (3 votes)
Rate this article

Related Articles