

New Canadian Tax Legislation

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Introduction

- Trusts - Old rules
- New rules
- Case Studies
- Foreign Investment Entity rules
- What can you do?

Old Rules

- Deemed a Canadian resident trust if two conditions met
- 1) Must have Canadian resident beneficiary
- 2) Property acquired from connected Canadian resident

Beneficially Interest

- “a person or partnership that has any right (whether immediate or future whether absolute or contingent or whether conditional on or subject to the exercise of any discretionary power by any person or persons) as a beneficiary under a trust to receive any of the income or capital of the particular trust either directly from the particular trust or indirectly through one or more other trusts.”

Section 94 - Old planning opportunities

- No Canadian resident beneficiary
 - Purpose trusts
 - Charitable trusts
 - Non-resident beneficiaries
 - Power to add beneficiaries
 - Power to change trust
- No Canadian resident transferor
 - Estate Freezes

1998 changes

- If beneficiaries can be added - transferor or non-arm's length to transferor will be beneficially interested
- Filing required
- Back taxes payable
- Late filing penalties
- Penalties on transferor
- Over \$100K, trust should file
- Possible tax on payments to beneficiaries
- Trustee responsible for unpaid taxes

New Non-Resident Trust Legislation - Overview

- New Section 94
 - Applies to non-resident trust if trust has:
 - Resident contributor
 - Or
 - Resident beneficiary
 - Exclusion for “exempt foreign trust”

Resident Contributor

- Trust has resident contributor if Canadian resident makes “contribution” to non-resident trust
- Contribution definition essentially unchanged and includes any transfers or loans of property to non-resident trust
- “transfer” includes back to back transfer (still using “enabling” language) and deemed transfers
- No general requirement that Canadian resident be related to beneficiaries of trust

Resident Contributor - Cont'd

- Exclusion for “immigration trusts”
- Exclusion for arm’s length transfer – not considered a “contribution”

Resident Beneficiary

- Resident Beneficiary
 - Any entity that is a beneficiary
 - Is a resident in Canada
 - Has a connected contributor

New Legislation – Cont'd

- Connected contributor definition essentially unchanged but with separate definition of “non-resident time”
 - Individual who has not been resident of Canada for more than 60 months and made contribution at non-resident time
 - Any entity that made contribution during a non-resident time

New Legislation – Non-resident time

- Non-resident time is
 - Entity: either not in existence or not resident in Canada within 60 months of contribution
 - Individual: if individual was not resident in Canada at time of contribution and
 - Within 60 months if transfer made after June 22, 2000
 - Within 18 months if transfer made before June 23, 2000 or
 - Within 18 months if trust arises on death of individual

New Legislation - Exclusions

- Specified charity:
 - Certain arm's length charities
- Testamentary beneficiary:
 - Beneficiary under trust solely because of right to receive income or capital of trust
 - Right arises only on or after death of a specified individual

New Legislation – Specified Individuals

- Specified individual is individual who is alive and contributor to trust or related to contributor
- Therefore existing inter vivos trusts where interest postponed to death of contribution is ok; or testamentary spousal trust with residual gift over is okay until death of contributor or related person

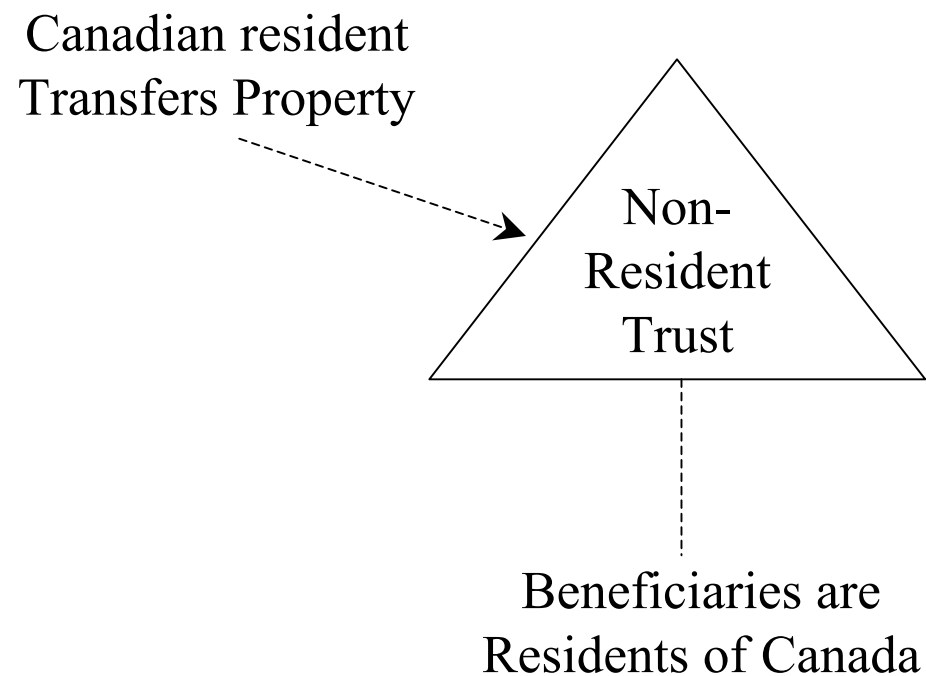
Section 94 - General Implications

- Trust is a person resident in Canada and must file Canadian tax returns and pay Canadian tax
- First & foremost – the trust is the taxable entity
- Liability for the tax flows only if the trust is first liable
- Non-resident for Part XIII purposes – withholding tax – on payments made to beneficiaries

Section 94(3) Implications

- Treated as resident
- Must withhold 25% on payments to non-Canadians
- No withholding on payments to Canadians
- But, Canadians should withhold on payments to trust – trust may get refund

Example 1: A Canadian resident individual settles property on a non-resident trust with Canadian resident beneficiaries



Example 1: A Canadian resident individual settles property on a non-resident trust with Canadian resident beneficiaries

- Current section 94 applies
- New subsection 94(3) applies
- Under new subsection 94(3), non-resident trust deemed to be resident of Canada for certain purposes:
 - Trust taxable in Canada on world-wide income and has corresponding reporting and filing obligations

Example 1: A Canadian resident individual settles property on a non-resident trust with Canadian resident beneficiaries - Cont'd

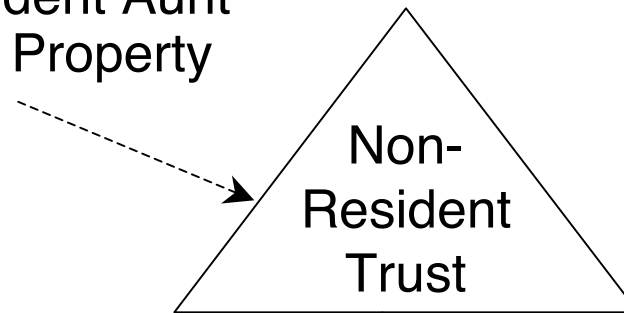
- Trust required to report its foreign property and its foreign affiliates
- Trust entitled to foreign tax credit, if election filed; and
- Trust will be subject to deemed disposition on becoming or ceasing to be resident in Canada

Example 1: A Canadian resident individual settles property on a non-resident trust with Canadian resident beneficiaries - Cont'd

- Trust not liable to withhold Part XIII tax
- Canadians still liable to Part XIII withholding on amounts paid to deemed resident trusts
- Subject to certain restrictions, the contributor and the beneficiaries have joint and several liability for the trust's Canadian tax

Example 2: A non-resident settles property on a non-resident trust with Canadian resident beneficiaries

Non-Resident Aunt
Transfer Property

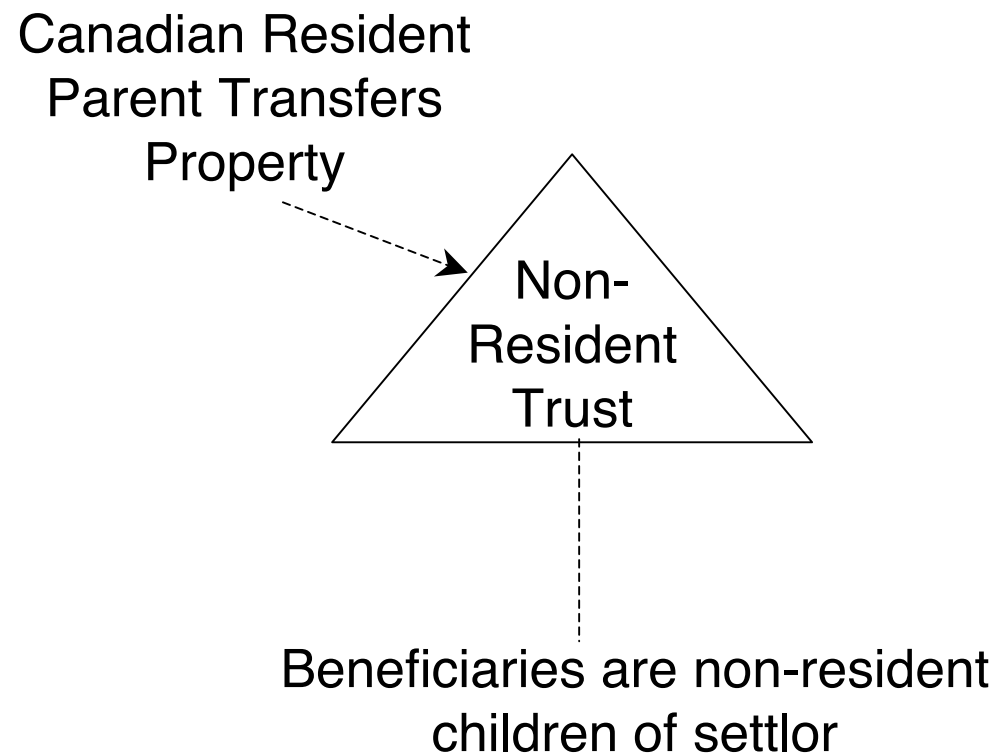


Beneficiaries are nephews and
nieces who are all residents
of Canada

Example 2: A non-resident settles property on a non-resident trust with Canadian resident beneficiaries

- Current section 94 does not apply
- Assuming that the non-resident Aunt was never a resident of Canada, new subsection 94(3) will not apply either
- What if Aunt left Canada and after four years settled trust?
- What if Aunt dies 20 months after leaving Canada and creates testamentary trust for Canadian beneficiaries?

Example 3: A Canadian resident individual settles property on a non-resident trust for the individual's non-resident children



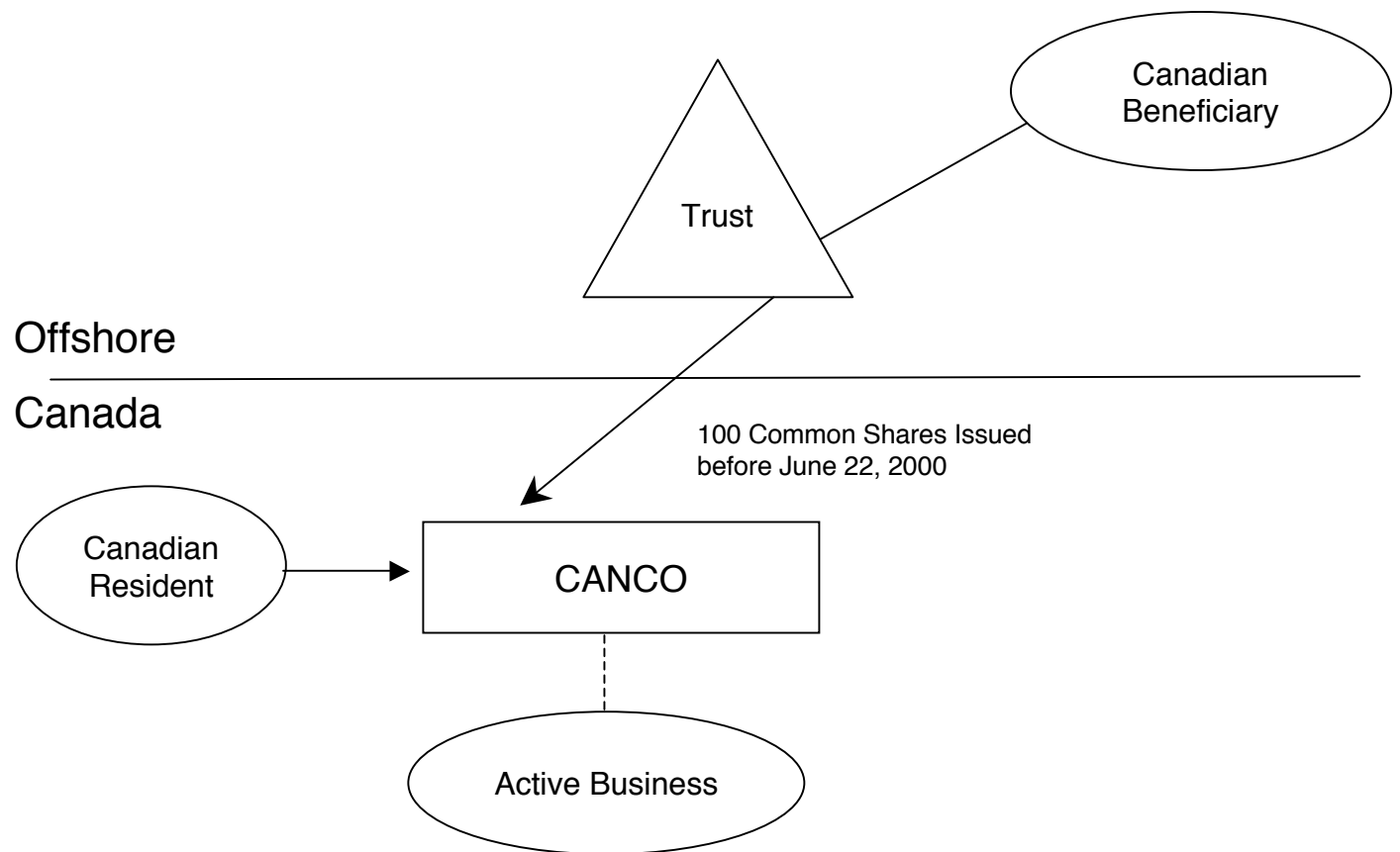
Example 3: A Canadian resident individual settles property on a non-resident trust for the individual's non-resident children

- Current section 94 does not apply
- However new subsection 94(3) will apply and deem the trust to be resident in Canada for certain purposes, as described earlier

Example 3: A Canadian resident individual settles property on a non-resident trust for the individual's non-resident children

- If the trust distributes any of its income for a year to one of the non-resident beneficiaries, new subsection 104(7.01) will also apply and restrict the trust's ability, in calculating its income for the year, to claim a deduction in respect of any Canadian-source income distributed to a non-resident beneficiary
- What if Canadian settlor leaves Canada: 94(5) FMV disposition

Example 4: International Estate Freeze – An individual who holds all the common shares of a corporation exchanges them for preferred shares after which a non-resident trust subscribes for common shares



Example 4 (cont'd)

- Paragraph 94(2)(g) deems the issuance of common shares to the non-resident trust to be a transfer of property from the corporation to the trust
- There is no exception for international estate freezes set up before the application of the new trust rules
- The deemed transfer from the corporation to the trust may not be a “contribution” if it qualifies as an arm’s length transfer. However, transfers of “restricted property” cannot be arm’s length transfers
- Consider purchase of existing shares by trust from third party
- Any subscription of preference shares private Canadian company by offshore trust can be a problem even where common shares are issued

Foreign Investment Entity rules

- FAPI – Foreign Accrual Property Income
- CFA – Controlled Foreign Affiliate
- Large groups of investors – deferral
- Old rules – taxable if intention of structure to reduce Canadian tax
- New rules – remove motive test
- Taxpayer can elect to pay tax on amounts received and share in gain – “market to market approach” or share of income
- Onus on Canadian taxpayer – not FIE

What can you do?

- Inbound trusts
- Immigration trusts
- Returning Canadians
- Non-tax – asset protection
- IBCs – FIES – report and pay your tax
- Active businesses
- Life insurance
- P & C Insurance – including captives
- Foundations
- Companies limited by guarantee