DAVIES

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CANADIAN TAX UPDATE

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MULTILATERAL CONVENTION

- On May 28, 2018, Canada tabled a *Notice of Ways and Means Motion* in the House of Commons to enact the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting into Canadian law (MLI).
- The MLI is intended to allow participating countries to modify their existing bilateral tax treaties to include measures in the MLI without having to renegotiate those treaties individually.
- By adopting the MLI, Canada adopts the MLI's mandatory provisions and has agreed to adopt certain optional provisions.

MANDATORY PROVISIONS

- Adoption of a new treaty preamble that is a statement confirming that the purpose of a treaty is to eliminate double taxation without creating opportunities for non-taxation or reduced taxation (MLI Part III, Article 6, paragraph 1).

MULTILATERAL CONVENTION

- Adoption of a principal purpose anti-abuse rule. This rule denies a benefit under a treaty where one of the principal purposes of an arrangement or transaction is to obtain that benefit, UNLESS, the benefit is in accordance with the purpose and object of the relevant provision of the treaty (MLI Part III, Article 7, paragraph 1).
- Canada also announced that over time, it will seek to include a limitation on benefits article in its treaties, where appropriate.
- Canada has also announced its commitment to adopt mandatory binding arbitration as a mechanism to resolve treaty-based disputes – this involves submitting disputes to an independent and impartial arbitration panel whose decision is binding (MLI Part VI, Article 19).

MULTILATERAL CONVENTION

OPTIONAL PROVISIONS OF MLI ADOPTED BY CANADA

–Canada will initially adopt the following optional provisions for the purposes of Canada's tax treaties to which they apply:

- lower Canadian withholding tax rates on dividends paid by Canadian companies are only available in respect of shares held by non-resident companies for at least 365 days (MLI Part III, Article 8, paragraph 1);
- impose a 365-day test period for non-residents claiming treaty relief on capital gains on dispositions of shares or other interests that derive their value from Canadian immovable property (MLI Part III, Article 9, paragraph 1);
- incorporate the MLI provision for resolving dual resident entity cases in the case of persons other than individuals, to prevent potential double taxation while protecting against the manipulation by companies and other entities of their residence to avoid or reduce taxes (MLI Part II, Article 4, paragraph 1).

NEW FEDERAL VOLUNTARY DISCLOSURE PROGRAM

- Canada adopted a revised Voluntary Disclosure Program (“**VDP**”) effective March 1, 2018.
- The revised program is set out in *Information Circular* IC00-1R6 published by the Canada Revenue Agency (“**CRA**”).
- The purpose of both the previous and revised program is to provide relief from penalties and interest to taxpayers who are non-compliant with their obligations under the *Income Tax Act*, the *Excise Tax Act* for GST/HST taxes (i.e., VAT), as well as other federal statutes that impose taxes or duties.
- Taxes are not relieved or forgiven under the program.
- Since penalties and interest on unpaid taxes are not deductible, the relief offered to qualifying taxpayers under the program is significant.
- The program also provides protection against criminal prosecution in cases of tax evasion.

NEW FEDERAL VOLUNTARY DISCLOSURE PROGRAM

- The relief for penalties and interest is limited to the 10 years prior to the year of disclosure.

REVISIONS TO THE PROGRAM

- The revisions to the program substantially restrict its ability to attract non-compliant taxpayers.
- There are 2 new tracks instead of 1 track – a General Program and a Limited Program.

GENERAL PROGRAM

Positive Factors

- Taxpayers who qualify for the General Program are eligible for relief from all penalties and partial interest relief and will not be referred for criminal prosecution.
- Interest relief is 50% of interest accrued for the 7 years preceding the most recent 3 years – no interest relief for the most recent 3 years.

NEW FEDERAL VOLUNTARY DISCLOSURE PROGRAM

Limited Program

Positive Factors

- No criminal prosecution.
- Relief from gross negligence penalties (i.e., 50% of unpaid taxes).

Negative Factors

- No relief from penalties other than gross negligence penalties.
- No interest relief.

Qualification For General Program

- Not clear – admission to the General Program is discretionary.
- Admission to be based on “merit” and in “good faith”.
- No admission to General Program if taxpayer qualifies for Limited Program.

NEW FEDERAL VOLUNTARY DISCLOSURE PROGRAM

QUALIFICATION FOR LIMITED PROGRAM

– Taxpayers whose non-compliance has an element of intentional conduct either by the taxpayer or by a closely related party.

– Corporations whose gross revenue in 2 out of the last 5 years together with related entities, exceeds Cdn.$250 million.

– Intentional conduct factors:

  i. efforts to avoid detection through offshore vehicles;
  ii. size of dollar amount;
  iii. number of years of non-compliance;
  iv. sophistication of the taxpayer; and
  v. disclosure is made after CRA announces a compliance project or campaign.

FAINT HOPE

– The existence of a single factor will not necessarily force a taxpayer into the Limited Program. A sophisticated taxpayer may be eligible to correct a reasonable error under the General Program.

NEW FEDERAL VOLUNTARY DISCLOSURE PROGRAM

OTHER REVISIONS

- Transfer pricing issues no longer qualify for the program.
- Application on a “no-names” basis has been eliminated.
- Where the taxpayer had received advice relating to the non-disclosure, the application generally should include the name of that advisor.
- Previously, the VDP did not require disclosure beyond the period for which books and records are available – accordingly, since most banks do not keep records beyond a 10-year period, taxpayers were not required to determine income earned prior to the beginning of that 10-year period if they did not have books and records for that prior period.
- The revised program requires the taxpayer to estimate the income for the time prior to the beginning of the 10-year period in order for the application to be accepted.
- Requirement to now pay estimated taxes with the VDP application unless the taxpayer is unable to pay immediately, in which case, the taxpayer may enter into a payment schedule with the CRA.

CANADIAN RULES ON OFFSHORE TRUSTS

FACTUAL RESIDENCE OF A TRUST

***St. Michael Trust Corp. (Garron Family Trust) v. The Queen*, 2012 DTC 5063 (Supreme Court of Canada)**

– Central management and control test used to determine the residence of a corporation is the test to be used to determine the residence of a trust.

– The residence of the trustee will not determine the residence of a trust unless the central management and control of the trust is carried out in the jurisdiction of residence of the trustee.

CANADIAN RULES ON OFFSHORE TRUSTS

DEEMED CANADIAN RESIDENCE OF OFFSHORE TRUSTS

–Trusts that are not resident in Canada under the central management and control test may, in the circumstances described below, be deemed to be resident in Canada under Canada's non-resident trust rules.

WHEN DO THE NON-RESIDENT TRUST (NRT) RULES APPLY TO AN OTHERWISE OFFSHORE TRUST?

–NRT rules apply to an offshore trust for a taxation year of that trust, if, at the end of that year either:

- the trust has a "resident contributor"; or
- the trust has a "resident beneficiary".

–If the trust has a resident contributor or a resident beneficiary at the end of a taxation year, the trust is deemed to have been resident in Canada throughout that taxation year and is subject to Canadian tax on its worldwide income.

CANADIAN RULES ON OFFSHORE TRUSTS

DEFINITION OF A RESIDENT CONTRIBUTOR

– A person who has made a "contribution" to the trust at any time is a resident contributor to the trust for a taxation year of the trust ending after the contribution is made, if the contributor is resident in Canada at the end of that taxation year.

– Where there is a resident contributor to a trust at the end of a taxation year of the trust, the trust is deemed to be resident in Canada throughout that year regardless of whether there are any beneficiaries of the trust who are resident in Canada at the end of that year.

– This is a remarkable change from Canada's previous offshore trust regime which deemed discretionary offshore trusts to be resident in Canada for a taxation year only if the trust had Canadian resident beneficiaries.

WHAT IS A CONTRIBUTION TO A TRUST?

- Definition of a "contribution" is extremely broad and includes both direct and indirect transfers of property and loans to trusts.
- Guarantees of loans as well as the provision of other kinds of financial assistance to a trust are deemed to be transfers of property to the trust.
- Includes back-to-back transfers or loans.
- In limited circumstances, transfers of property and loans are not "contributions" if certain arm's length terms are satisfied.
- However, even if a transfer or loan is made on arm's length terms, it will nevertheless be a "contribution" unless "none of the reasons for the transfer is the acquisition at any time by any entity of an interest as a beneficiary under the trust".

CANADIAN RULES ON OFFSHORE TRUSTS

- In summary, where a contributor to an offshore trust is resident in Canada at the end of a taxation year of the trust, the trust is deemed to be resident in Canada throughout that year even if, for example, the contribution was made when the contributor was not a resident of Canada.
- For example, if a contribution to an offshore trust is made by a non-resident who subsequently immigrates to Canada, the trust will be deemed to be resident in Canada for every taxation year ending subsequent to that immigration, as long as the contributor is resident in Canada at the end of that subsequent taxation year.

CANADIAN RULES ON OFFSHORE TRUSTS

RESIDENT BENEFICIARIES

– An offshore trust will also be deemed to be resident in Canada for a taxation year of the trust and subject to tax on its worldwide income, if, at the end of that taxation year, there is a “resident beneficiary” under the trust.

– An offshore trust has a resident beneficiary at the end of a taxation year of the trust only if there is a beneficiary under the trust who is resident in Canada at that year-end and the trust has a “connected contributor” at that year-end.

CONNECTED CONTRIBUTOR

– “Connected” in the context of “connected contributor” means “connected” to Canada, not “connected” to the beneficiary.

– Every person who has made a contribution to the trust before the end of a taxation year of the trust is a “connected contributor” to the trust at that time UNLESS:

> all of the person’s contributions to the trust made at or before that taxation year-end were made at a time that is a “non-resident time” of the person.

CANADIAN RULES ON OFFSHORE TRUSTS

"NON-RESIDENT TIME"

– A contribution made by a non-resident person to a trust, is made at a "non-resident time" of the person if, when the contribution is made, the person has been a non-resident for at least 5 years before the contribution is made.

– A contribution made by a non-resident person to a trust, is made at a "non-resident time" of the person if the contributor does not become a resident of Canada for at least 5 years after making the contribution.

– Thus, a contribution made by a non-resident person to a trust, is made by the person at a "non-resident time" of the person if the person has not been resident in Canada for at least 5 years before the contribution is made and does not become a resident of Canada for at least 5 years after making the contribution.

CANADIAN RULES ON OFFSHORE TRUSTS

- As stated, where at the end of a taxation year of a trust, there is both a beneficiary of the trust who is a resident of Canada and a “connected contributor” to the trust, the trust is deemed to be resident in Canada for that taxation year and subject to tax by Canada on its world-wide income for that year because the trust will have a resident beneficiary at the end of that taxation year.
- It is noted that a resident contributor who has made contributions to the trust while resident in Canada will always be a “connected contributor”, since not all of his contributions will have been made at a “non-resident time”.
- Accordingly, when a resident contributor emigrates from Canada, the trust will cease to have a resident contributor, but it will nevertheless be deemed to be resident in Canada for each taxation year of the trust in which there is a beneficiary under the trust who is resident in Canada at the end of that year because the former resident contributor will be a “connected contributor” at the end of such year.
- This conclusion is true even after the death of the former resident contributor because the definition of “contributor” defines a person who was a contributor prior to his death to continue to be a contributor after his death.

CANADIAN RULES ON OFFSHORE TRUSTS

- Accordingly, where a resident contributor dies, the offshore trust will not be deemed to be resident in Canada for taxation years of the trust after the contributor’s death because of the resident contributor rule, since the deceased contributor will not be a resident of Canada at the end of those years; however, since the deceased contributor continues to be a “connected contributor” to the trust subsequent to his death, the offshore trust will be deemed to be resident in Canada for each taxation year subsequent to the contributor’s death in which there is a beneficiary of the trust who is resident in Canada at the end of such taxation year because of the resident beneficiary rule.

CANADIAN RULES ON OFFSHORE TRUSTS

- Moreover, where a resident contributor to an offshore trust emigrates from Canada, for example, to Israel, the offshore trust will continue to be deemed to be resident in Canada for every year of the trust in which there is a beneficiary of the trust who is a resident of Canada – even after the death of the contributor.
- Lastly, where a person who has immigrated to Canada has made contributions to an offshore trust in taxation years of the trust that are within the 5-year period preceding his immigration to Canada, those contributions are deemed to have been made by the contributor at a time that is other than a non-resident time such that the trust will be deemed to have been resident in Canada for each of those years ending after the first of such contributions, if, at the end of each of those years, there was a beneficiary under the trust who was resident in Canada. This result obtains because the contributor would have been a connected contributor at the end of each of those preceding years and the trust would have had a "resident beneficiary" at the end of each of those years, if, at the end of those years, the trust had a beneficiary who was a resident of Canada.

CANADA'S DEPARTURE TAX

DEPARTURE TAX

– Canada has a complex set of rules that apply to individuals, corporations and trusts that cease to be resident in Canada.

– This presentation is limited to an outline of the basic rules applicable to individuals only.

– An individual who ceases to be resident in Canada is deemed to have disposed of and reacquired her property for its fair market value at that time, subject to certain exceptions.

– The key exceptions to the general rule are:

  a) Canadian real estate and Canadian resource properties;

  b) capital property and inventory used by the individual in carrying on a business in Canada through a permanent establishment in Canada; and

  c) excluded rights or interests.

CANADA'S DEPARTURE TAX

- An excluded right or interest generally is a right or interest of the emigrant in various registered savings plans, employee profit sharing plans, pension funds, various kinds of trusts, Canada Pension Plan, life insurance and interests in certain personal trusts.
- Where an emigrant has a latent loss in respect of Canadian real estate or property used in carrying on a business in Canada, the individual can elect to trigger a disposition of that property to create a loss not exceeding the income resulting from the application of the deemed disposition rule.
- A departing individual can elect to defer payment of the tax triggered by reason of the deemed disposition without incurring interest or penalty charges by posting adequate security for the unpaid tax with the CRA.

CANADA’S DEPARTURE TAX

- Where security is posted with the CRA, it will assess the adequacy of the security on an annual basis.
- As property is disposed of following emigration, the amount of the tax that can be deferred by providing security, decreases.
- An individual is deemed to have provided adequate security for an amount equal to the taxes payable at the highest marginal tax rate on the first $50,000 of income triggered by the deemed disposition on departure.
- The type of security generally acceptable should be liquid, but the CRA will accept a pledge of shares of a private corporation in certain circumstances.

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