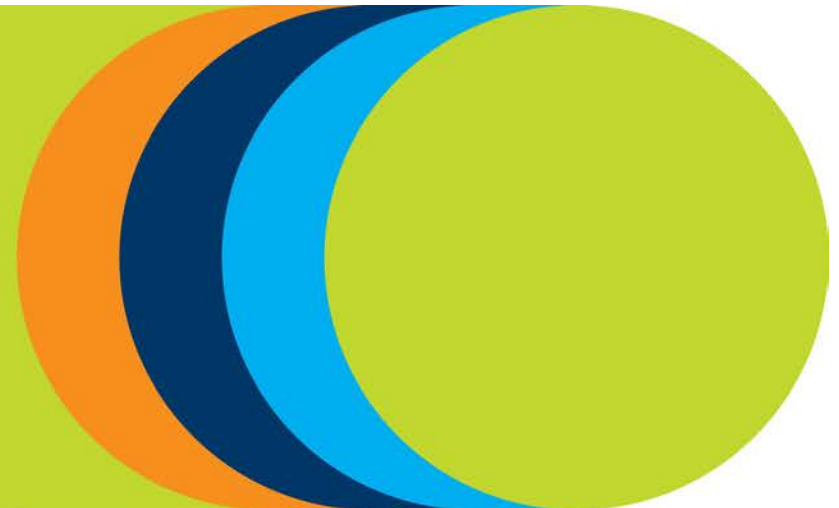


Taxation of Foreign Trusts

A Canadian Perspective

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Date





Taxation of Non-Resident Trusts

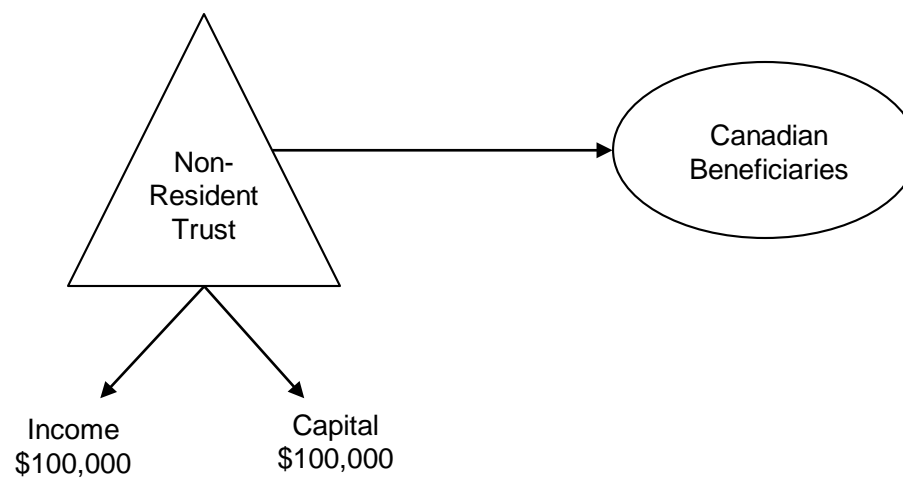
- Starting Point – Canada adopts a very different approach to dealing with the taxation of foreign trusts (trusts that may otherwise not be factually resident in Canada). Why we have chosen to adopt this different approach to the taxation of non-resident trusts is subject to debate and better left for discussion at the bar after the conference.



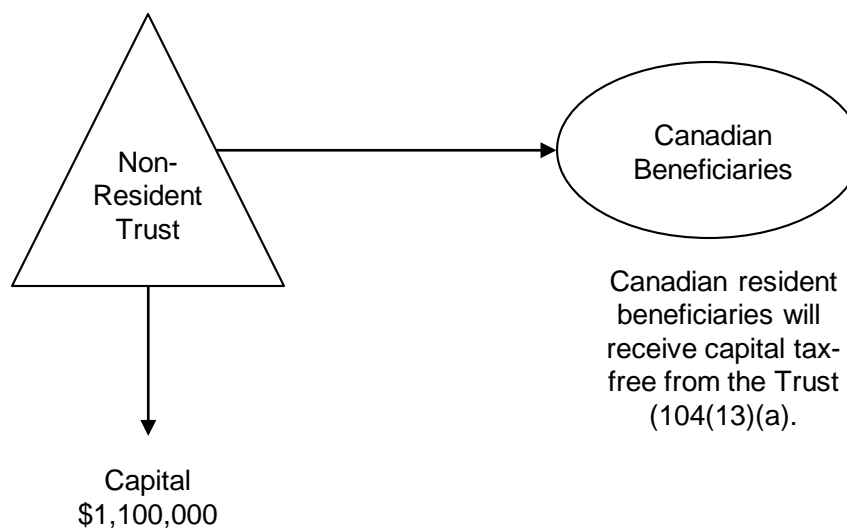
Trust Distributions – Income vs. Capital

- Trust Distribution:
 - Distributions of income from a non-resident trust to Canadian resident beneficiaries fully taxable in hands of beneficiary (paragraph 104 (13)(a)).
 - Distributions of capital from a non-resident trust to Canadian resident beneficiaries tax free (paragraph 104(13)(a)) (Note: Subject to “foreign reporting rules”, section 233.6).

(Note: Canada is one of the only jurisdictions that allows the tax free distribution of capital in this manner without any deferral penalty or ordering rule).



- Income earned by the trust will not be distributed at year end but will be added to the capital account of the trust.



- The trust will distribute proceeds to the Canadian resident beneficiaries from the capital account. Canadian resident beneficiaries will receive distributions tax free.



February 1999 Budget Proposals

- Changes announced in the February 1999 Budget Proposals provided that all distributions (including capital distributions) to Canadian beneficiaries should be subject to tax, except to the extent that tax has previously been paid on the income of a non-resident trust, in which case some form of a credit or deduction would be given.
- This proposal was abruptly abolished by Finance in a Press Release dated November 30, 1999.



- It is this ability to capitalize the income and distribute capital tax free to a Canadian resident beneficiary that has led to:

The need to introduce very complex and onerous “foreign trust legislation”;

- A review and revisions to Canadas double tax treaties and the application of these treaties;
- An expansion of the common law doctrine on trust residency; and
- A more aggressive stance on whether a trust actually exists.



Statutory Residency



The CRA gets more aggressive!



Statutory Residency – Cont'd

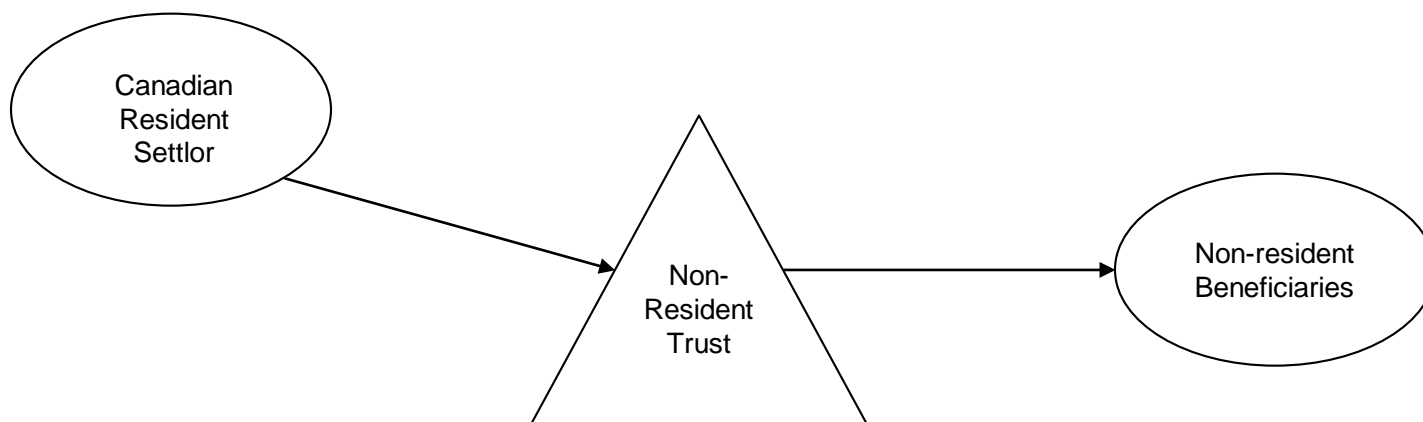
- Section 94 deems an otherwise non-resident trust to be resident in Canada (“**Deeming Rule**”).
- Apart from section 94, there is no statutory definition of the residence of a trust in the Act.



This is Now..

New NRT Rules

- Amendments to Canada's NRT rules, which had been in proposal form for many years, were finally enacted on June 26, 2013, generally with application to taxation years that end after 2006. A nonresident trust to which these rules apply will be deemed to be resident in Canada for certain purposes and taxed on its worldwide income and gains.
- Under the new NRT rules, a non-resident trust that acquires property or receives loans from a Canadian resident would be deemed to be resident in Canada and would be taxed on all of its undistributed income (regardless of having a Canadian resident beneficiary). Transferor, the Trust and certain beneficiaries (subject to certain recovery limits [94 (7) –(9)]) would be jointly liable for the tax (would be entitled to credit for foreign taxes paid on undistributed income).

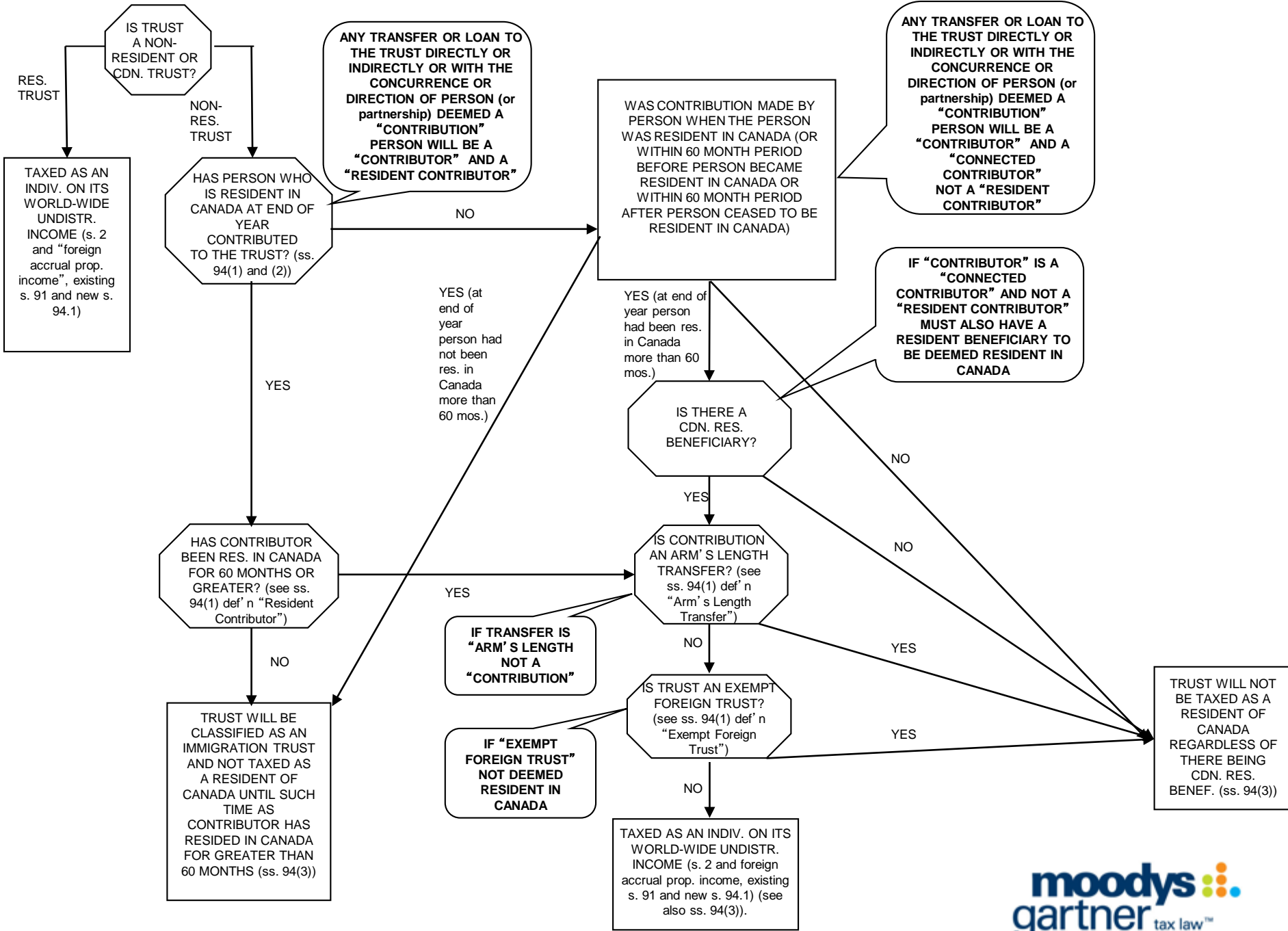


- Under the new NRT rules the Trust, the Settlor and certain beneficiaries will be jointly liable for Canadian tax on all undistributed income of the Trust (regardless of residence of beneficiaries).



Subsection 94(3) Charging Section

- Subsection 94(3) is the main charging section. The Trust (otherwise non-resident) is deemed to be resident in Canada throughout the year for the purposes of an extensive list of items (Note: specific exclusions set out in subsection 94(4):
 - Trust deemed resident for computing income under Part I of the Act;
 - Foreign disclosure reporting (also covers reporting of Trust's foreign property);
 - Trust deemed resident for purposes of tax filing, administration and enforcement;
 - Trust deemed resident for Part XIII (withholding); and
 - Trust deemed resident for purposes of 21-Year Rule.





Treaty Over-ride

- The Income Tax Conventions Interpretation Act was amended in 2013 to "clarify" that a trust that is deemed resident in Canada under the NRT rules will be considered resident and subject to tax in Canada for tax treaty purposes. It is unclear how this proposal will affect treaty tiebreaker rules in cases of dual residence, or trusts with contributions by residents and non-residents.
- It is important to note that there is no "tie-breaker" provision in any of Canada's Tax Treaties when it comes to determining the residency of a Trust.



Determining Residence from a Common Law Perspective

- Common Law position was well established in that a trust deemed to be resident where the majority of the trustees are located (see *Thibodeau Family Trust v. The Queen*).
- The Common Law position has been changed to follow the corporate concept of “residence”. The SCC in Garron (*Fundy Settlement v. Canada*, 2012 SCC 14) held that the residence of a trust should be determined by reference to the “central management and control” of the trust.



Do We Even Have a Trust? Time to Review Old Principles

- Do we even have a Trust?
 - Three Certainties
 - Certainty of Intention
 - Certainty of Subject Matter
 - Certainty of Objects
 - Trust vs. Agency
 - Sham Trust
 - Bare Trust



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