Newcomer Tax Issues and Opportunities

Foreign asset and income reporting

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Who am I and what do I do?

Christopher Sullivan Inc
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- Chartered Professional Accountant, specialized in income tax
- Help business owners, professionals, and newcomers pay less tax
- Services include tax compliance and creating or using tax planning to save or defer tax

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Agenda

- Residency and tax treaties
- Reporting of foreign income and assets
- Taxation of foreign income and foreign tax credits
- Functional currency, foreign exchange, and cost
- Becoming compliant

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Residency and tax treaties

- When do you become a resident of Canada under domestic law?
- Tax treaties – eliminating double taxation

When do you become a resident of Canada under domestic law?

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- Significant residential ties: your home, your spouse or common-law partner, dependants
- Secondary residential ties: “your stuff”, social ties, economic ties, driver’s license, passport, health insurance
- Deemed residents – stayed 183 days or more in Canada

Tax treaties – eliminating double taxation

- What if another country also considers you resident there under their domestic law? Are you taxed in both countries?
- Tax treaties:
  - Help determine residency and the jurisdiction to tax
  - A person may be determined to be resident under the domestic law of a country, but a treaty may over-rule this determination
  - Limit the extent to which each country can tax residents of the other country
  - Often reduce withholding tax normally imposed on non-residents under a country's domestic law

Reporting of foreign income and assets

- T1134 - Information Return Relating to Controlled and Not Controlled Foreign Affiliates
- T1135 Foreign Income Verification Statement
- T1141 Information Return in Respect of Transfers or Loans to a Non-Resident Trust
- T1142 Information Return in Respect of Distributions from and Indebtedness to a Non-Resident Trust

T1134 - Information Return Relating to Controlled and Not Controlled Foreign Affiliates

- Filed by Canadian resident who owns a controlled or not controlled foreign affiliate
- A foreign affiliate is a non-resident corporation in which a Canadian resident taxpayer's equity percentage is not less than 1% and the total of the equity percentages of the taxpayer and each related person is not less than 10%
- Includes general information about assets, but very detailed information about the nature of the income earned
- Provide full financial statements if available
- Due 15 months after year end
- Limited exceptions for small and dormant corporations
- Significant penalties for failure to file

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T1135 Foreign Income Verification Statement

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- Newcomers do not have to file in their first year of Canadian residence
- Filed by Canadian residents owning specified foreign property with cost > $100,000
- Reports cost, value, and income by type of asset and country
- Generally investment property, not personal use property
- Due on the same date as the taxpayer's tax return
- Some simplified reporting methods are available
- Significant penalties for failure to file

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T1141 Information Return in Respect of Transfers or Loans to a Non-Resident Trust

- Newcomers do not have to file in their first year of Canadian residence
- Filed by Canadian residents who transfer money or make loans to a “specified foreign trust” and have some kind of non-arm’s length connection
- A specified foreign trust generally has some kind of connection (directly or indirectly) to a beneficiary who is a Canadian resident
- Pension trusts usually exempt
- Due on the same date as the taxpayer’s tax return
- Significant penalties for failure to file

T1142 Information Return in Respect of Distributions from and Indebtedness to a Non-Resident Trust

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- Newcomers do not have to file in their first year of Canadian residence
- Filed by Canadian residents who are a beneficiary of a non-resident trust and received a distribution from or was indebted to that non-resident trust in the tax year.
- Pension trusts usually exempt
- Due on the same date as the taxpayer’s tax return
- Significant penalties for failure to file

Taxation of foreign income and foreign tax credits

- Worldwide income
- Foreign accrual property income
- Loans from a corporation
- Withholding tax
- Foreign business tax credits, foreign non-business tax credits, and foreign tax deductions

Worldwide income

- Canadian residents are taxable on their worldwide income
- Broad interpretation of income
  - Passive income not distributed yet
  - Foreign exchange gains
  - Loans from corporations
  - Distributions from foreign trusts

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Worldwide income – how does CRA catch this?

- Do not play this game – you will lose: CRA resources are heavily focused on international tax and the underground economy
- Tax information exchange agreements and tax treaties
- Small business audits
  - Risk assessment based on advanced data analytics
  - Tips provided from within CRA and the public
  - Routine review of business and family's personal banking information for revenue completeness testing
  - Net worth assessments

Foreign Accrual Property Income (FAPI)

- At its most basic, FAPI is foreign passive (i.e. investment) income that has not been distributed yet
- Policy objective is to prevent taxpayers from sheltering income from tax by simply keeping it in a foreign corporation
- You are not happy if you have FAPI!
- Deductions often available for foreign tax paid
- Deductions often available once the income is distributed; timing is important
- Active business income might be okay; but this can get complicated

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Loans from a corporation

- A loan from a corporation to an individual is generally included in an individual's income in the year received if it is not repaid within one year after the balance sheet date of the year end of the corporation in which the loan was made. Exceptions are very limited.
- A loan from a foreign affiliate of a taxpayer ("upstream loans") are also included in the income of the debtor if it is not repaid within one year after the balance sheet date of the year end of the lending corporation in which the loan was made. Loans outstanding before August 19, 2011 have some transitional rules. Exceptions are very limited.
- Policy objective of these provisions is to prevent indefinite deferral of taxation simply by lending money to a taxpayer instead of paying it out as a dividend or bonus.

Withholding tax

- Domestic law of most countries applies a withholding tax on payments like dividends, interest, rent, royalties, employment income, pensions, sales of real estate, etc.
- Tax treaties sometimes apply to reduce the withholding tax rate that domestic tax law would normally apply
- The withholding tax you pay is sometimes the final foreign tax paid, but not always
- The final foreign tax paid is often available to reduce the taxes applied by Canada on this foreign income, but not always
- Tax treaties and foreign tax credits are the main mechanisms that prevent double taxation of the same income by two countries

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Foreign non-business tax credits

- The credit with respect to foreign non-business income is calculated on a country by country basis
- Calculation of credit can be complex but on a high level it is:
  - the proportion of “Basic Federal Tax” that “Net Foreign Non-Business Income” is of “Net Income”;
  - i.e. it cannot be higher than the tax you would otherwise pay in Canada
- There is a provincial foreign non-business tax credit
- There is no carry-over to future years of unused foreign non-business tax credits
- Taxes that do not generate a useable credit may sometimes be eligible for a deduction instead

Foreign business tax credits

- The credit with respect to foreign business income is calculated on a country by country basis
- Calculation of credit is similar to the federal non-business foreign tax credit
- There is no provincial foreign business tax credit
- Unused foreign business tax credits may be carried over to future years
- Taxes that do not generate a useable credit may sometimes be eligible for a deduction instead

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What are 2016 NS personal income tax rates?

		Capital	Canadian Dividends	
	Regular	Gains	Eligible	Non-Eligible
first $29,590	23.79%	11.90%	-0.11%	11.43%
over $29,590 up to $45,282	29.95%	14.98%	8.39%	18.64%
over $45,282 up to $59,180	35.45%	17.73%	15.98%	25.07%
over $59,180 up to $90,563	37.17%	18.59%	18.35%	27.08%
over $90,563 up to $93,000	42.67%	21.34%	25.94%	33.52%
over $93,000 up to $140,388	43.50%	21.75%	27.09%	34.49%
over $140,388 up to $150,000	46.50%	23.25%	31.23%	38.00%
over $150,000 up to $200,000	50.00%	25.00%	36.06%	42.09%
over $200,000	54.00%	27.00%	41.58%	46.77%

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Functional currency, foreign exchange, and cost

- Canadian taxable income for individuals is calculated with CAD as the functional currency:

  For example, taxable income on disposal of a capital property

  Proceeds converted to CAD
  Less cost in CAD
  Equals capital gain in CAD

- Foreign currency gains and losses are subject to Canadian income tax

- So what?

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Taxation of foreign exchange

- Gains and losses are either on account of income or on account of capital
- If on account of income they are treated as regular income
- If on account of capital, they are treated like a capital gain
- Gains and losses on account of capital are generally taxable only when realized, for example when an investment is sold, a loan is paid, or cash is converted to another currency
- An example of gains on income account would be working capital used in a business; various methods of accounting for this are acceptable but they must be used consistently from year to year

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Tax cost of newcomers' assets

- The Canadian tax cost of Newcomers' assets (except for taxable Canadian property and certain rights) are the fair market value at the time of establishing Canadian residency
- Taxable Canadian property includes Canadian real or immovable property, capital property used in carrying on a business in Canada, certain shares of Canadian private corporations, certain shares of public companies, and Canadian resource properties.

Becoming compliant:
The voluntary disclosures program

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- A second chance: if taxpayer qualifies, penalties are forgiven but tax and interest still must be paid
- Conditions for a valid voluntary disclosure
  - the disclosure is made before the taxpayer is aware of any compliance action taken by the CRA against them;
  - a penalty applies to it;
  - the information is at least one year overdue;
  - the information is complete;
  - The taxpayer pays any tax and interest owing, if applicable

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Key messages

- The mechanisms of tax treaties and foreign tax credits can often help to eliminate or at least reduce the threat of double taxation
- However, sometimes they do not work as expected. Timing is important.
- Fully complying with reporting worldwide income might not result in additional Canadian tax if income is already taxed at high rates in the foreign country
- There are significant penalties for not complying
- The voluntary disclosure program can reduce penalties for taxpayers who want to become compliant
- I can help!

Thank you for your time

For further information please contact:

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