

BY



GENA KATZ, FCA, CFP,
an executive director
with Ernst & Young's National Tax
Practice in Toronto.

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advisorsedge@rmpublishing.com

IS OFFSHORE OFF LIMITS?

New rules make it harder to set up non-resident trusts.

This is the first of **TWO** parts.

We've all heard about wealthy Canadians who move offshore, set up trusts with their investment assets in low- or no-tax jurisdictions, and escape taxation. You too may have clients who have had quite enough of Canada's tax regime, wishing to explore these opportunities.

Be aware, the Canadian tax authorities are wise to most non-resident trust arrangements and have introduced a number of complex tax rules aimed at ensuring that Canadians pay their share of tax on offshore earnings.

Generally, a non-resident trust is one in which the majority of trustees who manage and control the assets reside outside Canada. As a non-resident, the trust's foreign income is not taxable in Canada (although Canadian income may be subject to non-resident withholding tax). If the trust is established in a tax haven, its earnings can potentially grow tax-free and the capital can then be distributed to beneficiaries in Canada or elsewhere, with no additional tax.

While it may not appear too difficult to implement an offshore trust, there are a number of rules that deem an otherwise non-resident trust to be resident and therefore taxable in Canada. And these deeming rules have been casting an even wider net since 2007.

Under the pre-2007 deeming rules, a non-resident trust, which had both a Canadian contributor and a Canadian beneficiary, was determined to be a resident trust. As a result, a Canadian could settle a non-resident trust for beneficiaries living outside Canada, and a non-resident could settle a foreign trust for Canadian beneficiaries, with neither trust, generally, being taxable in Canada.

But beginning in 2007, if an offshore trust has either a Canadian resident contributor or a Canadian resident beneficiary and a contributor with a connection to Canada, the trust is deemed to be resident in Canada and subject to many domestic tax rules. There are some specific exceptions for infirm beneficiaries, marital breakdown and certain charitable trusts.

Now, any offshore trust that receives a contribution from a Canadian is deemed to be a Canadian resident trust even if all the beneficiaries are non-resident family members (with the exception of immigration trusts discussed later). To reduce or eliminate any Canadian tax liability, the trust might distribute its income to the non-resident beneficiaries (if the terms of the trust allow). And if the beneficiaries live in countries that don't tax or have low rates of tax on this income, overall tax savings can still be achieved.

But even when the contributor is a non-resident, it is still possible for the trust to be deemed resident in Canada if there is a resident beneficiary. In the case of a resident beneficiary, the only way to escape the deemed resident trust rules is if:

- a contributor has been a resident of Canada for less than a total of 60 months in his or her lifetime; or
- a contributor doesn't make a contribution to the trust within 60 months of being resident in Canada.

The first exception allows for individuals who have never been residents of Canada to use foreign trusts for the benefit of Canadian family members. And immigrants to Canada can set up foreign trusts before establishing residence and benefit from five years of tax-free accumulation in the trust.

The second exception applies to individuals who were permanent residents of Canada. In this case, if the plan is to have Canadian resident beneficiaries, the foreign trust cannot be established within five years of leaving Canada (18 months for testamentary trusts).

Further, the contributor must remain a non-resident for an additional five years after the contribution to avoid the deemed resident rules from the time the trust was established. This means someone has to be a non-resident for at least 10 years to effectively use a non-resident trust for Canadian beneficiaries. **AE**

KATZ