Taxpayer Migration

COLIN CAMPBELL
2011 TAX LAW FOR LAWYERS
May 31, 2011
EMIGRATION
Objective of Rules

• Tax gains that have accrued while resident in Canada
• Deemed disposition and reacquisition of property at FMV on both immigration and emigration
• Deferral only for non-treaty-protected property
• Special rules for trusts and corporations
EMIGRATING FROM CANADA

• Deemed disposition and reacquisition of all property at FMV (s.128.1(4)(b) and (c))

• Exceptions for
  – Canadian real property, Canadian resource property, timber resource property
  – business property of Canadian PE
  – excluded rights or interests
  – certain property of short-term resident
EMIGRATING FROM CANADA

• Election available in year of migration for individual to have FMV disposition rule apply to Canadian real property, Canadian resource property, timber resource property and Canadian PE business property (s.128.1(4)(d))

• Allows accrued loss on such property to offset gain on deemed disposition of other property
EXCLUDED RIGHTS OR INTERESTS

• Rights to future benefits under various plans or arrangements e.g. retirement plans, compensation plans, education savings plan, employee stock options, annuity contracts, government social security (s.128.1(10))
EXCLUDED RIGHTS OR INTERESTS

• An interest in a personal trust (inter vivos or testamentary) resident in Canada (not acquired for consideration)

• An interest in a non-resident testamentary trust (not acquired for consideration)

• An interest in a life insurance policy in Canada
ADDITIONAL RELIEVING MEASURES

• Deferral of tax (and interest) by providing security
• Post-emigration loss on taxable Canadian property
• Tax treaty step-up in tax cost
• Foreign tax credit
• Returning former resident
DEFERRAL OF TAX PROVIDING SECURITY

- Election available in year of migration for individual to defer payment of departure tax by providing “adequate security” (s.220(4.5))
- Interest does not accrue until tax becomes unsecured
- Security must be posted by April 30 of year after emigration year
DEFERRAL OF TAX PROVIDING SECURITY

• Security deemed to be posted for amount equal to tax on capital gain of $100,000 at highest marginal rate (federal tax of $14,500; in Quebec $12,107.50) (s.220(4.51))

• As property disposed of, amount of tax that can be deferred by posting security decreases
DEFERRAL OF TAX PROVIDING SECURITY

• Adequacy of security evaluated annually (s.220(4.53))

• CRA can determine at any time that posted security not adequate and additional security must be provided within 90 days
DEFERRAL OF TAX PROVIDING SECURITY

• CRA may accept reduced security in a case of undue hardship (s.220(4.7))
• CRA has discretion to extend time for making election or posting security where just and equitable to do so (s.220 (4.54))
POST EMIGRATION LOSS

• Election made in return for year of actual disposition available for individual, in effect, to use a post-emigration loss on TCP to reduce departure gain (s.128.1(8))

• Portion of departure proceeds equal to least of specified amount, gain on emigration and loss on sale can be shifted to time of actual disposition and sheltered by high ACB

• Stop-loss rule in s. 40(3.7) may reduce loss on shares or interest in partnership or trust
POST EMIGRATION LOSS

• Election under s. 128.1(8) only applies to TCP - broader relief than ordinary 3 year capital loss carry back (s. 111(1) and (9))

• Loss in year of emigration from post-departure disposition of TCP in emigration year will offset pre-departure gains - s. 114

• No relief provided for post-departure loss on non-TCP
FOREIGN TAX CREDIT

• Double taxation concern
• New country of residence
  – no step-up in tax cost of property
  – no credit for Canadian departure tax from
    disposition at a time when resident in Canada
FOREIGN TAX CREDIT

• Canada’s preferred approach is to modify its tax treaties to have the foreign country recognize the Canadian departure tax – where possible

• Treaty changes take considerable time – As of April 15, 2011, 35 signed treaties (31 in effect) now require the new country of residence to allow a step-up in tax cost (Appendix B)

• Step-up incorporated in Fifth Canada – U.S. protocol

• S.126(2.21) added as interim measure to provide limited credit to non-resident individual for foreign taxes
FOREIGN TAX CREDIT

- Real property situated in a country outside Canada
  - tax must be paid to that country
  - does not apply to shares or partnership or trust interests that derive their value principally from real property
FOREIGN TAX CREDIT

• For any other property
  – Tax must be paid to government or political subdivision of a treaty country
  – Individual must be resident in that treaty country at time of disposition
FOREIGN TAX CREDIT

• Three stage calculation (property by property)
  ▶ determine Canadian tax on pre-departure gain for a particular property
  ▶ reduce foreign tax attributable to that gain by any entitlement to credit for Canadian tax (s.126(2.23))
  ▶ remaining foreign tax creditable against the Canadian tax

• Amend return for emigration year to claim credit
RETURNING FORMER RESIDENT

• Individual former resident who returns to Canada may elect in year of return to unwind effect of departure dispositions (s.128.1(6))
• One election for all TCP
• Another election for all other property
• Can make one election and not the other
• For emigration pre March 5, 2010, old TCP definition continued
RETURNING FORMER RESIDENT

• TCP election (s.128.1(6)(a) and (b))
  – for properties owned since departure
  – no deemed disposition at departure
  – anti-surplus stripping rule may apply to deem gain at emigration or reduce ACB at immigration where property has declined in value since departure and s.40(3.7) would grind loss
RETURNING FORMER RESIDENT

• Non-TCP election (s.128.1(6)(c))
  – for property owned since departure
  – no effect on value increases post-departure
  – reduction of proceeds of disposition at emigration by amount up to the gain
  – specify amount to defer gain at emigration and reduce ACB that would otherwise be established on immigration
ANTI-SURPLUS STRIPPING RULE

• Designed to prevent gain on departure being replaced by post-departure dividend subject to lower withholding tax

• Gain at departure on TCP could be offset by subsequent loss carried back that resulted from disposition at reduced value due to post-emigration dividend
ANTI-SURPLUS STRIPPING RULE

• Rule contained in s. 40(3.7)
• Operates by reducing loss from disposition where taxable dividends received (directly or through a partnership or trust) after emigration and while non-resident
• Applies to actual dividends and deemed dividends
ANTI-SURPLUS STRIPPING RULE

• No distinction between ordinary course dividends and special dividends
• Applies to dispositions after Dec. 23, 1998 by individuals who cease to be resident after October 1, 1996
• If Part XIII tax paid on dividends after emigration and before disposition, credit may be available under s.119 for emigration year to offset departure tax on gain on the property (amend emigration year return)
• Finance comfort letter proposes amendment so credit will also reduce AMT
REPORTING REQUIREMENTS
YEAR OF EMIGRATION

• T-1 tax return to be filed for emigration year which will include world wide income for resident period (including deemed gains on departure) and income earned in Canada for non-resident period (s.114)

• Elections re security (T1244) and excepted property (T2061A)

• T-1161 list of properties to be filed for emigration year if FMV of all reportable properties exceeds $25,000 (s.128.1(9))
REPORTING REQUIREMENTS
YEAR OF EMIGRATION

• Reportable property (s.128.1(10)) is any property other than
  – Cdn money and Cdn money on deposit
  – excluded rights or interests (other than employee stock option, resident personal trust interest and life insurance policy in Canada)
  – certain non-TCP of short-term resident
  – an item of personal-use property with FMV of less than $10,000
REPORTING REQUIREMENTS
POST-EMIGRATION

• T-1 tax return to be filed for each year following emigration in which individual disposes of taxable Canadian property other than in an excluded disposition (s.150(1.1)(b))

• Excluded disposition is disposition of TCP which is "excluded property" or where s.116 certificate has been issued

• Excluded property (s.116(6)) includes TCP that is "treaty-protected" property (s.248(1)), disposition of which is exempt under a treaty

• S. 116 notification is required for each disposition of treaty protected property and s.116 certificate required if TCP not treaty-protected

• Elections or adjustment claims re post-emigration losses, s.119 credit, foreign tax credit, returning former resident
TRUST DISTRIBUTIONS

• Apply to distributions of property made after Oct 1, 1996 by resident personal trust to a non-resident beneficiary in satisfaction of all or part of beneficiary’s capital interest
TRUST DISTRIBUTIONS
S.107(5)

• General rule - no rollover to trust where trust property distributed to non-resident beneficiary

• Exceptions
  – Cdn real property, Cdn resource property, timber resource property, business property of Cdn PE, excluded rights or interests (s.128.1(4)(b)(i) to (iii))
TRUST DISTRIBUTIONS
S. 107(2.1)

• On distribution to non-resident beneficiary, trust deemed to dispose of property at FMV
• Beneficiary deemed to acquire property at FMV
• Capital interest (or part thereof) of beneficiary will be disposed of, but generally without gain
• Non-resident beneficiary should obtain s.116 certificate
TRUST DISTRIBUTIONS
PARTS XII.2 AND XIII

• Income arising from deemed disposition should be “payable” to non-resident benef. and deductible by trust under s.104(6)

• For inter vivos trust - Part XII.2 tax at trust level for taxable capital gain on TCP and Part XIII tax on income portion of all distributions to NR beneficiary (net of Part XII.2 tax)

• For testamentary trust - Part XIII tax only
TRUST DISTRIBUTIONS
S. 107(2.11)

• Trust can elect to have income arising from deemed disposition taxed at trust level - useful if trust has losses

• If election made
  – inter vivos trust - Part I tax only
  – testamentary trust - Part I tax only

• Use highest combined federal/provincial rate
TRUST DISTRIBUTIONS
DEFERRAL OF TAX
PROVIDING SECURITY

• Trust can elect under s. 220(4.6) to defer payment of Part I tax arising from distribution of TCP to non-resident beneficiary

• “Adequate security” must be furnished by or on behalf of the trust
TRUST DISTRIBUTIONS
DEFERRAL OF TAX
PROVIDING SECURITY

• Interest does not accrue until tax becomes unsecured
• As property disposed of, the amount of tax that can be deferred decreases
• Unlike individuals, there is no amount of “deemed security”
TRUST DISTRIBUTIONS
DEFERRAL OF TAX PROVIDING SECURITY

• Deferral otherwise operates in a similar manner to deferral for emigrating individual
  – annual evaluation of security
  – inadequate security (s.220(4.62))
  – undue hardship (s.220(4.7))
  – just and equitable time extensions (s.220(4.63))
TRUST DISTRIBUTIONS
FOREIGN TAX CREDIT

• Limited credit available to trust under s. 126 (2.22) where non-resident beneficiary disposes of property previously distributed to beneficiary

• Credit against Part I tax arising from deemed disposition on distribution for foreign tax on subsequent disposition by beneficiary

• Same limitations as foreign tax credit for emigrating individual

• Amend return for distribution year
RETURNING TRUST BENEFICIARY

• Individual trust beneficiary who returns to Canada may make joint election under s. 128.1(7) with the trust to unwind the tax consequences to the trust that occurred because of distributions to non-resident beneficiary
  • One election for TCP - another for non-TCP
  • Operates similarly to s. 128.1(6) for individuals
RETURNING TRUST BENEFICIARY

• If trust ceases to exist before the individual’s filing-due date for the year of immigration, the elections may be made by the individual alone.

• If individual elects alone, trustee and individual will be jointly and severally liable for any tax payable by trust as a result of the election.