INTRODUCTION

- 1982 Section 94 broadened to catch purchased/appointed interests
- 1984 Section 94.1 introduced to counter offshore investment funds
- 1995 FAPI definition broadened
- 1996 Foreign asset reporting
- 1996 *Beneficially interested* definition broadened
- 1998 Section 94 broadened to catch foreign affiliate dividends/capital gains
BACKGROUND

- 1999 Federal Budget
- June 22, 2000 draft legislation
- August 2, 2001 draft legislation
- October 11, 2002 draft legislation
- October 30, 2003 draft legislation
- July 18, 2005 draft legislation
- November 9, 2006 draft legislation
- Bill C-10 – 1st Reading Senate - December 4, 2007
- 2010 Budget
NON-RESIDENT TRUSTS (NRTs)
Residency of a Trust

- Different taxing regime for resident vs. non-resident trusts
- Starting point is determining where a trust is resident
- Traditional Test – the jurisdiction where the majority of trustees that make decisions reside: *Thibodeau Family Trust v. The Queen*
Residency of a Trust

- However, recent TCC decision in *Garron et al v. The Queen* casts doubt on this test.
- In *Garron*, the TCC adopted the “central management and control” test for trusts
- *Garron* is currently under appeal to the FCA
EXISTING RULES – Section 94

- Only applies if both of the following conditions met:
  - Beneficiary Resident in Canada
    - Definition of “beneficially interested” in 248(25) very broad
    - Includes a person who may become a beneficiary under a discretionary power
  - Canadian Resident Contributor
    - Must be beneficiary of trust or related to beneficiary of trust
EFFECT OF SECTION 94

- Discretionary Trust:
  - deemed resident in Canada with income equal to Canadian-source income and FAPI
  - beneficiaries jointly and severally liable for reporting obligations, and for tax obligations to extent of distributions/proceeds for sale

- Non-discretionary (Fixed Interest) Trust:
  - deemed to be a corporation, interests >10% deemed to be shares in the corporation
  - FAPI rules apply
2010 budget proposes that generally the amendments outlined in Bill C-10 will apply with certain amendments.

Elimination of requirement for resident beneficiary. Trust can be caught even if no Canadian resident beneficiary.

Expansion of concept of contribution to a trust.

Trust deemed to be a resident of Canada and all income of the trust is taxable.
NEW OFFSHORE TRUST RULES
- OVERVIEW

- Trust property will be divided into resident portion and non-resident portion.
- Income from resident portion will be attributed to resident contributors in proportion to relative contributions to the trust.
- Income from non-resident portion will not be taxable in Canada.
NEW RULES – s.94(3)

- New subsection 94(3) applies if either of the following conditions satisfied:
  - resident contributor; or
  - resident beneficiary and connected contributor

- Exemption for exempt foreign trust
  - New expanded carve out for interests in commercial trusts
RESIDENT CONTRIBUTOR

- Resident of Canada
  - if an individual, must be resident in Canada for more than 60 months
- Has made a *contribution* to the trust at any time
  - expansive rules in new subsection 94(2)
  - excludes *arm’s length transfers*
RESIDENT BENEFICIARY

- Resident in Canada
  - Not a successor *beneficiary*
  - Not a *specified charity*
  and

- Trust has a *connected contributor*
  - Any *contributor* other than:
    - Individual who has not been resident in Canada for more than 60 months, or
    - A person whose only contribution is during a *non-resident time*
KEY DEFINITIONS

**Contribution**

- Transfer or loan to trust
- Extensive deeming rules in s.94(2)
  - Back-to-back loans or transfers
  - Provision of services to trust
  - Issuance of shares, partnership units, debt
KEY DEFINITIONS

Arm’s length transfer

- Loan or transfer where:
  - Reasonable to conclude that none of the reasons for transfer is acquisition by any entity of interest at any time under a non-resident trust; and
  - Specific circumstances one would expect in arm’s length relationship (i.e., payment of dividends, interest, rent)
CONSEQUENCES IF NEW RULES APPLY

- All income subject to tax
- Canadian withholding obligation on payments to trust, however trust entitled to refund
- Flow-through of trust income to beneficiaries same as domestic trusts – subject to restriction in subsection 104(7.01)
CONSEQUENCES IF NEW RULES APPLY (Con’t)

- Deemed disposition of trust assets if cease deemed residence

- Trust property divided into resident portion and non-resident portion – resident portion will consist of property acquired from residents and certain former residents; non-resident property, everything else
CONSEQUENCES IF NEW RULES APPLY (Con’t)

- New attribution rules will attribute trust income back to resident contributors in proportion to relative contributions
- There will be a deduction to trust for distributions payable to beneficiaries and income attributed to resident contributors
- If income is not distributed, the accumulated income will be considered a contribution by resident contributors and will form part of resident portion
CONSEQUENCES IF NEW RULES APPLY (Con’t)

- If income earned on non-resident portion is not distributed and kept separate, it will not form part of resident portion.

- An ordering rule will apply to distributions: to resident beneficiaries, distributions will be first out of resident portion, then non-resident portion. The rules will be reversed for non-resident beneficiaries.

- Distributions out of resident portion to non-resident beneficiaries will be subject to Part XIII.
A deemed resident trust will be entitled to claim a foreign tax credit for income tax paid to a foreign country that treats the trust as resident of that country. The amount of the foreign tax credit will be limited to the Canadian tax rate.

Trust will be able to attribute foreign tax credits to resident contributors to which the attribution rules apply.

Reassessment period for trusts subject to the 2010 NRT rules will be extended by 3 years.
Coming into Force

- Effective date for 2010 NRT rules will be as of January 1, 2007. An election will be available to have new rules apply as of January 1, 2001. The attribution rules will only apply starting with the 2010 taxation year
JOINT AND SEVERAL LIABILITY

- As a consequence of attribution rule, no more joint and several liability for resident contributors to the trust – resident contributors will be primarily liable for the tax.
- Resident beneficiaries will be jointly and severally liable for tax and reporting obligations of trust.
- Liability may be limited to recovery limit.
What Still Works?

- Immigration trust
- Inbound trust (granny)
- Outbound trust
OFFSHORE INVESTMENT FUND PROPERTY (OIFP)
CURRENT RULES – s.94.1

- Offshore investment fund property rules apply where:
  - Taxpayer holds an interest in a property that is a shares in, interest in, or debt of a non-resident entity
  - The interest may reasonable be considered to derive its value primarily from *portfolio investments*
  - One of the main reasons for holding the interest is that the taxes would be significantly less than if held the investment directly
    - Walton v. The Queen, 98 DTC 1780
If all three conditions met then taxpayer will have a deemed income inclusion equal to “designated cost” multiplied by prescribed interest rate.

“Designated Cost” includes cost amount plus amounts transferred by 3rd parties that it is reasonable to assume increased the value of the taxpayer’s interest in the property plus prior year’s section 94.1 income inclusions.
Proposed Changes – s.94.1

- The outstanding FIE rules will be replaced with the existing OIFP rules with the following enhancements:
  - the deemed inclusion rate will be increased to the prescribed rate plus 2%
  - the definition of an interest in a fixed-entitlement trust currently in section 94 that is not otherwise caught by section 94 will be expanded
  - Reassessment period will be extended to 6 years