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Tax Planning for New Immigrants Working and Living in Canada

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Three Levels of Planning



- A. Pre-Immigration Planning
- B. Immigration Planning
- C. Post-Immigration Planning

A. Pre-Immigration Planning



Pre-immigration planning involves:

1. Obtaining expert advice in departing as well as welcoming jurisdiction
2. Expatriation considerations
3. Cost base determination/record-keeping
4. Timing considerations

A. Pre-Immigration Planning



1. Expert Advice

- U.S. emigration may involve expatriation, resulting in deemed disposition of worldwide assets
- U.K. emigration may involve exposure to inheritance tax on value of assets transferred on emigration

2. Expatriation Considerations

- What income/gain is considered to be realized in home jurisdiction?
- Consider the following:
 - a) Timing
 - b) Rules and requirements for expatriation in home jurisdiction
 - c) Non-tax consequences
 - d) Tax consequences

A. Pre-Immigration Planning



3. Cost Base Determination

- Is there a tax treaty between Canada and the immigrant's home jurisdiction?
- If so, does the treaty permit a step-up in the cost base of assets owned by the immigrant?
- If so, it is important to obtain and maintain appropriate records to support the basis bump to FMV for every asset to which the bump may apply

A. Pre-Immigration Planning



4. Timing Considerations

a) *Sale of Shares*

- May wish to become a Canadian resident before sale of shares of a corporation resident in the immigrant's home jurisdiction

b) *Transfer of Assets Offshore*

- The timing of transfers of assets to offshore entities may be restricted under laws of home jurisdiction

c) *Other Practicalities*

- Selling/buying a home, moving, schools, jobs, bank accounts, insurance, vehicle registrations, etc.

B. Immigration Planning



When immigrating to Canada consider:

1. Acquiring “residence” in Canada for tax purposes
2. Five-year immigration trust
3. Taxation of immigrant’s foreign-source income

B. Immigration Planning



1. Acquiring “Residence” in Canada

a) Implications of Acquiring Canadian Residence

- Immigrant becomes taxable on worldwide income regardless of citizenship

b) Residential Ties to Canada

- Immigrant establishes “residence” in Canada for tax purposes, which is determined by looking at a person’s primary and secondary ties to Canada
- Primary ties are key indicators of where a person is ordinarily resident and hold the most weight
- The primary indicators of residence are the locations of the person’s:
 - permanent home
 - spouse/common law partner
 - dependants

B. Immigration Planning



1. Acquiring “Residence” in Canada *(continued)*

b) Residential Ties to Canada

- While secondary ties are also indicative of residence, they have less weight than primary ties and are examined collectively
- The secondary indicators of residence include the locations of the person’s:
 - Bank accounts, RRSPs, credit cards, securities accounts
 - Healthcare coverage
 - Social club memberships, professional organizations
 - Driver’s licence, vehicle registration
 - Cottage, personal property

B. Immigration Planning



1. Acquiring “Residence” in Canada (*continued*)

b) Tie-Breaker Rules

- If an immigrant acquires residence in Canada and retains residence in her home country (with which Canada has a tax treaty), the treaty will provide tie-breaker rules to determine the immigrant's residence for treaty purposes

B. Immigration Planning



2. Five-Year Immigration Trust

- By establishing a five-year trust, an immigrant to Canada can avoid tax on investment income and capital gains from trust assets for up to 60 months after immigration
- Considerations in setting up an immigration trust include:
 - a) Timing
 - b) Structure
 - c) Trust residence
 - d) Assets
 - e) Reporting requirements
 - f) Protective measures
 - g) GAAR

B. Immigration Planning



2. Five-Year Immigration Trust (*continued*)

a) Timing

- It is advantageous to immigrate early in the year to maximize the 5-year exemption period (the trust becomes taxable in the calendar year in which the 5-year exemption period ends)
- Have to weigh such timing against foreign tax, immigration issues and practical issues
- The 5-year period includes any time the immigrant was previously resident in Canada

B. Immigration Planning



2. Five-Year Immigration Trust (*continued*)

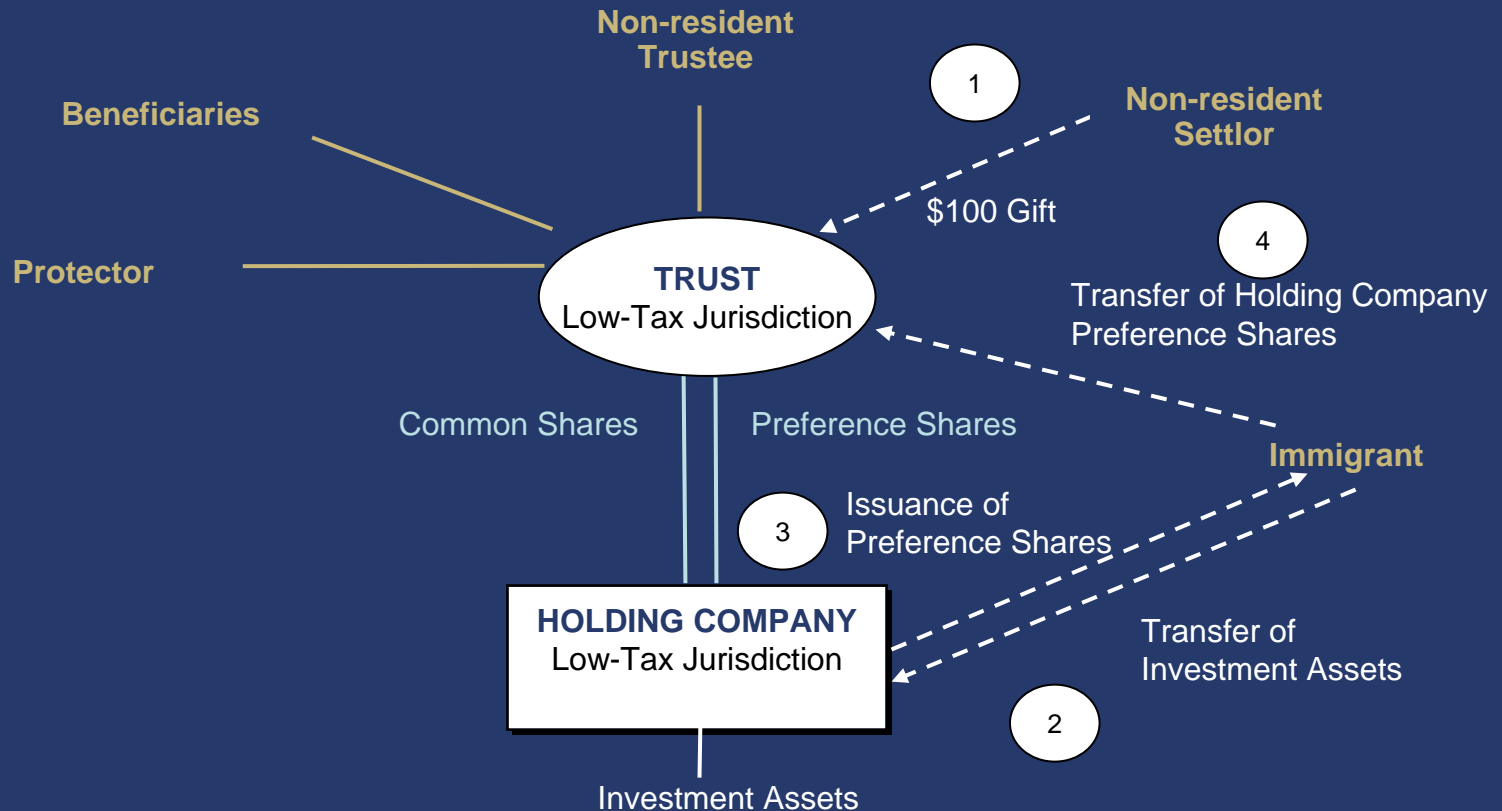
b) Structure

- There are different ways to structure an immigration trust, though the typical structures involves a trust and a corporation

B. Immigration Planning

2. Five-Year Immigration Trust (continued)

b) Structure (continued)



B. Immigration Planning



2. Five-Year Immigration Trust (*continued*)

c) Trust residence

- Immigration trusts are established in low tax jurisdictions
- An immigration trust is a non-resident trust and must be non-resident for tax purposes
- *Thibodeau Family Trust v. The Queen, 78 DTC 6376*
 - Based on the *Thibodeau* decision, residence of a trust was determined primarily by the residence of the trustee(s)
 - Where there was more than one trustee and residence was uncertain, the location of the trust assets and where the trust was administered were to be considered

B. Immigration Planning



2. Five-Year Immigration Trust (*continued*)

c) Trust residence (*continued*)

- In practice, trust residency has been evolving since *Thibodeau* such that practitioners have not generally been relying on trustee residence alone, and have been looking to give offshore trusts more substance
- In September of this year the evolutionary decision *Garron v. The Queen*, 2009 DTC 1287 was released where the court held that central management and control of the trust determines trust residency

B. Immigration Planning



2. Five-Year Immigration Trust (*continued*)

d) Assets

- Assets that are generally transferred into the immigration trust structure are:
 - Liquid portfolio securities
 - Shares of foreign corporations, including real estate corporations
- Confirm there are no significant income tax or other tax consequences (i.e. land transfer tax if real estate) to such transfers in the home company jurisdiction or any other relevant jurisdiction

B. Immigration Planning



2. Five-Year Immigration Trust (*continued*)

e) Reporting requirements

Property transferred to the trust

- Canadian residents who transfer property to the trust must report such transfers in the year of transfer (Form T1141)

Trust distributions

- First year – no reporting requirements
- Subsequent years – Canadian resident beneficiaries are required to report distributions received from the trust each year (Form T1142)

B. Immigration Planning



2. Five-Year Immigration Trust *(continued)*

f) Protective Measures

- The immigrant may be concerned with losing control over assets and may be more comfortable with some protective measures being put in place:
 - i. Letter of wishes – non-binding letter from settlor explaining settlor's wishes on how the trust is administered; discretion still remains with the trustee
 - ii. Appointing a protector – settlor may appoint a protector with certain powers, such as power to replace the trustee; have to be careful how much power is given to the protector

B. Immigration Planning



2. Five-Year Immigration Trust (*continued*)

f) Protective Measures

- iii. Investment advisory committee – an investment advisory committee of the investment corporation could be appointed to advise the directors and trustee on investing the assets; discretion still remains with the trustee and the board of directors

B. Immigration Planning



2. Five-Year Immigration Trust (*continued*)

g) GAAR

- Arguable that 5-year immigration trusts are contemplated under current and proposed section 94 of the *Income Tax Act*, therefore such trusts are not contrary to the object and spirit of the Act
- GAAR may be a concern for more aggressive structures that try to extend the tax-free period beyond the five years

C. Post-Immigration Planning



After immigrating to Canada consider:

1. Winding-up the holding company before expiration of 5th year
2. Exit strategies from a five-year immigration trust
3. Taxation of immigrant's Canadian-source income
4. Taxation of immigrant's foreign-source income

C. Post-Immigration Planning



1. Wind-up the holding company

- If the immigrant is staying in Canada, the holding company should be wound-up before the end of the five-year period to step-up the cost base in the underlying investments rather than in the shares of the holding company

C. Post-Immigration Planning



2. Exit Strategies - Five-Year Immigration Trust

- In the 4th year of the trust, options should be presented and recommendations should be made to the client regarding exit strategies:
 - a) Emigrate from Canada
 - b) Dissolve the trust
 - c) Migrate the trust to Canada
 - d) Prolong the tax holiday

C. Post-Immigration Planning



2. Exit Strategies - Five-Year Immigration Trust

- a) Emigrate from Canada
 - The client could choose to emigrate from Canada and therefore not be liable to Canadian tax on trust assets
 - If the trust structure in whole or part remained in place, tax implications of the person's home/new jurisdiction would have to be taken into consideration

C. Post-Immigration Planning



2. Exit Strategies - Five-Year Immigration Trust

- b) Dissolve the trust
 - After the 5-year tax holiday, the trust will be taxable in Canada at the highest marginal rate
 - Its assets are deemed to be disposed of for FMV proceeds
 - The trust can be dissolved
 - On dissolution, Canadian resident beneficiaries are deemed to dispose of their capital interests in the trust on a rollover basis, and acquire trust assets at FMV adjusted cost base
 - No rollover applies to non-resident beneficiaries

C. Post-Immigration Planning



2. Exit Strategies - Five-Year Immigration Trust

- c) Migrate the trust to Canada
 - There is a step-up in the adjusted cost base of assets on migration to Canada, other than taxable Canadian property and some other property that is not deemed disposed of under paragraph 128.1(1)(b)
 - Consider migrating to Alberta because it has the lowest top marginal rate, but ensure that central management and control of the trust is in Alberta (*Garron*)

C. Post-Immigration Planning



2. Exit Strategies - Five-Year Immigration Trust

- d) Prolong the tax holiday
 - Trust funds could be invested in an *exempt insurance policy* to extend the tax holiday
 - An *exempt insurance policy* is a life insurance policy that is not subject to accrual taxation on its investment income
 - Exempt policies are meant to be policies obtained primarily for insurance protection rather than investment accumulation

C. Post-Immigration Planning



2. Exit Strategies - Five-Year Immigration Trust

- d) Prolong the tax holiday (*continued*)
- This may be an aggressive plan if not strictly compliant; GAAR may be a concern
 - There are strict requirements that must be met on an ongoing basis to make sure the policy qualifies for exempt policy status and tax treatment
 - If the requirements are not met, all investment income is fully taxable
 - There are institutions offering such products, but due diligence of such institutions and products is required due to the strictness of the requirements and the downside risk

C. Post-Immigration Planning



3. Taxation of Immigrant's Canadian-Source Income

- While the immigrant lives in Canada, his/her Canadian-source income will be taxed under Canadian rules
- The immigrant should become familiar with Canadian rules, and seek opportunities to minimize tax lawfully, for example:
 - Small business deduction
 - Scientific Research and Experimental Development Expenditures
 - Tax shelters, including RRSPs, flow-through shares
 - Estate freeze with discretionary, Canadian trust

C. Post-Immigration Planning



3. Taxation of Immigrant's Canadian-Source Income

Some key tax considerations for an immigrant while he/she lives in Canada are:

- a) There will be a deemed acquisition of assets on acquiring Canadian residence – this resets the cost of assets for Canadian tax purposes
- b) Canadian-controlled private corporations may qualify for the small business deduction – a low rate of tax on the first \$500,000 of annual active business income
- c) The taxation of investment income is integrated for Canadian-controlled private corporations through a refundable dividend tax system (RDTOH)

C. Post-Immigration Planning



3. Taxation of Immigrant's Canadian-Source Income

- d) U.S. Citizens living in Canada may generate Subpart F income by using a Canadian holding company - have to find structuring alternatives which also take into account the treatment of ULCs under the Fifth Protocol to the Treaty
- e) Foreign tax credits can be used to avoid double tax
- f) The immigrant will have reporting requirements in both the U.S. and Canada
- g) The taxation of existing pension plans, retirement plans, and stock options

C. Post-Immigration Planning



4. Taxation of Immigrant's Foreign-Source Income

- While the immigrant lives in Canada, his/her foreign-source income will be taxed under Canadian rules subject to foreign tax credit and relief under tax treaties with countries where the income arises (source countries)
- Immigrant should:
 - a) Plan to maximize *exempt surplus*
 - b) Plan to minimize *FAPI*
 - c) Seek opportunities for Inheritance-In Trust

C. Post-Immigration Planning



4. Taxation of Immigrant's Foreign-Source Income

- a) Plan to maximize exempt surplus
- Exempt surplus is active business income earned in a designated treaty country, or a country with which Canada has a Tax Information Exchange Agreement
 - Exempt surplus can be repatriated back to a Canadian-resident, corporate shareholder free from Canadian tax
 - Immigrants should be educated about the Canadian foreign affiliate system and plan to maximize their exempt surplus in order to minimize their Canadian tax exposure

C. Post-Immigration Planning



4. Taxation of Immigrant's Foreign-Source Income

b) Plan to minimize FAPI

- FAPI is foreign accrual property income
- It is generally investment income earned outside Canada
- FAPI earned through a controlled foreign affiliate of a Canadian resident shareholder is taxable to the shareholder on an accrual basis, regardless of whether the shareholder has received a distribution to fund such tax
- FAPI should be minimized as much as possible

C. Post-Immigration Planning



4. Taxation of Immigrant's Foreign-Source Income

c) Seek Opportunities for Inheritance-In Trust

- Provided Settlor of discretionary *inter vivos* or testamentary trust is not, and has not been, a resident of Canada for 60 months, consider transfer to trustee in tax-favoured jurisdiction of investment assets that would have been gifted eventually to Canadian beneficiary,
- Income can be accumulated tax-free and distributed as tax-free capital to Canadian beneficiaries



4. Taxation of Immigrant's Foreign-Source Income

- d) Proposed Non-Resident Trust and Foreign Investment Entity Rules
 - Not applicable for new immigrant's first 60 months of residence in Canada



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