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Canadian tax alert

Canada – Royal Assent received on non-resident trust rules

October 1, 2013

Background

For several years, Canada has proposed rules that would deem a foreign trust to be a resident of Canada and, as such, subject to Canadian tax on its worldwide income, if contributions to the trust have been made or are deemed to have been made by a Canadian resident entity. The proposals applied to foreign employee benefit trusts that have beneficiaries who are employed by Canadian companies. The Canadian employer would be jointly liable for the taxes on the trust's income.

For example, a global employee benefit trust that is established by a UK parent company in Jersey for several thousand employees in its worldwide group would be deemed to be resident of Canada as long as there is at least one beneficiary of the trust that is employed by a Canadian employer. The trust would be taxable on all of its worldwide income (for example, on dividends earned on company shares held by the trust, or interest received).

Retroactive application - but elections can mitigate the tax charge

On June 26, 2013, the proposed rules received Royal Assent and are now law, effective (retroactively) as of January 1, 2007. They apply to income earned by the deemed resident trust from January 1, 2007.

There are two elections that can be made to mitigate the Canadian tax exposure: one that would be made by the foreign trust and the other by the Canadian employer.

1. Resident portion election

Under this election, the foreign trust can limit the scope of its tax in Canada by filing an election with the Canada Revenue Agency to be taxed only on its "resident portion" (that is, the portion of the trust that relates to contributions made by, or on behalf of, Canadian residents).

This election must generally be made by the filing due date of the trust's Canadian income tax return for the first year in which it is deemed to be resident of Canada under the new rules.

For foreign trusts that have had Canadian beneficiaries in 2013 only, the deadline for the filing of the election is March 31, 2014.

A transitional provision applicable in respect of years 2007–2012 permits a trust to make the election within 365 days from the June 26, 2013 Royal Assent date; thus, the trust must make the election for those years by June 26, 2014.

If this election is not filed on time, the trust is taxable in Canada on ALL of its worldwide income (that is, including income on contributions made on behalf of non-Canadian employees).

2. Electing contributor

This election allows a Canadian employer to assume the Canadian tax liability of the foreign trust. The trust would then be generally relieved from Canadian taxation. This election would typically be advantageous where the employer's Canadian tax rate is lower than that of the trust (as trusts (other than testamentary trusts) are generally taxable at the highest rate), though there are special foreign tax credit restrictions that must be considered. If making this election, the Canadian employer should ensure that the trust is electing to limit the scope of tax to the "resident portion" only. This election is due on the tax return due date of the employer for the year in which the employer desires the election to take into effect.

Actions to consider

Companies that have established global employee benefit trusts outside of Canada should determine whether any of the trust beneficiaries have been employed by a Canadian resident entity since 2007.

If there has been at least one such Canadian employee since 2007, the trust should consider whether to file the election to limit its taxability in Canada to the "resident portion" of the trust. As noted above, for the years 2007-2012, the election must be filed by June 26, 2014. For foreign trusts that have had Canadian employee beneficiaries in 2013, the election must be filed by March 31, 2014.

Canadian employers should also consider whether it is desirable to file an election as an "electing contributor", to shift the tax liability from the trust. This election can only be made with respect to the Canadian employer's tax years ending after March 4, 2010. For years when the employer would have been required to file a return by October 24, 2013, the contributing employer's election must be made by June 26, 2014. Otherwise, this election is due on the tax return due date of the employer for the relevant year.

For assistance with this matter, or any other issue related to the operation of your compensation policies, please contact your local Deloitte advisor or one of the compensation tax specialists listed on this alert.

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