

Global Rewards Update: Canada – Royal Assent received on Non-resident Trust Rules

September 2013

Background

For several years, Canada has proposed rules that would deem foreign trusts to be residents of Canada, and so subject to Canadian tax on their worldwide income, if contributions have been made or are deemed to have been made by Canadian resident entities. 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).

Elections available to mitigate the tax charge

On June 26, 2013, the proposed rules received Royal Assent. They are now enacted into law, effective (retroactively) as of January 1, 2007, and 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; the first should be made by the trust and the second by the Canadian employer.

1. *Resident portion election*

Under the first election, which needs to be filed by the foreign trust, the trust can limit the scope of its tax in Canada by filing an election 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 Canadian tax return filing due date of the trust's first year in which it is deemed to be resident of Canada under the new rules. For trusts affected in the years between 2007 and 2012, they have 365 days from the June 26, 2013 Royal Assent date in which to make such election for those years, so they must make the election by June 25, 2014.

If such an 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 the 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 generally be advantageous where the employer's Canadian tax rate is lower than the trust's (as 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 consider whether the trust is electing to limit the scope of tax to the "resident portion" only.

Action

Companies that have established global employee benefit trusts outside Canada should determine whether any of the beneficiaries of the trust have been employed by a Canadian resident entity between the years 2007 and 2012. They will then need to consider whether to make one or both of the elections.

If there has been at least one such Canadian employee since 2007, the trust should consider whether to file the election with the Canada Revenue Agency to limit its taxability in Canada to the portion of the trust related to contributions made on behalf of employees of the Canadian resident employer. The election needs to be filed by June 25, 2014.

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

People to contact

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