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Canada edition

Forecast Partly Sunny – Offshore Trusts for Canadians

By James Bowden |25 October 2021

As most tax-minded Canadians will know, the opportunities to realise tax efficiencies by moving money offshore have become very few indeed. If you invest in overseas investments using a foreign investment vehicle (offshore investment/holding company) in the hopes of deferring tax on income or capital gains until you eventually repatriate the funds, the foreign accrual property income (FAPI) rules set out in the Income Tax Act (ITA) will operate to attribute any such income and capital gains to you every year on an accrual basis, even if not (or never) actually paid to you. If you establish an offshore trust with similar hopes, the trust will be deemed Canadian resident for tax purposes because you, as a Canadian resident, contributed assets to it. The idea of an offshore tax utopia is usually a mirage, much sought after but rarely ever real. Nevertheless, for those whose circumstances support it, offshore vehicles still retain their usefulness for both tax and non-tax reasons.

One such tax-focused opportunity is colloquially known as a "granny trust". This is where a non-resident of Canada (such as a relative or friend, or a benevolent grandparent who lives abroad) establishes a trust in a no-tax jurisdiction, which includes Canadian beneficiaries. In that case, the trust is not deemed Canadian resident because the settlor (or any other contributor of assets to the trust) is not a Canadian resident, and the fact that Canadian residents are beneficiaries is not on its own sufficient to cause the foreign trust to be deemed Canadian resident. It is critical that no Canadian resident (or anyone who was a Canadian resident within the last 5 years or who becomes a Canadian resident within the next 5 years) contributes any funds or assets to the trust, or it will be deemed Canadian resident.[1] The trust can make payments to the Canadian beneficiary(ies) on a tax-free basis, provided the payments are out of trust capital (not trust income), which is not a difficult rule for the trustees to follow. Had the same funds been gifted to a Canadian

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James is an experienced transactional and corporate and commercial practitioner, having trained in both Ontario and with Afridi & Angell in Dubai for many years. He has developed significant expertise in a number of specialisations, most notably commercial advisory and transactional work, onshore and offshore trusts structures, asset protection, and tax and estate planning. James spearheaded the firm's initiative to establish its Toronto office (Afridi & Angell Professional Corporation), which he now heads, taking advantage of the firm's many Canadian ties and bringing the Afridi & Angell service standard to Canadian clientele. James is a member of the Ontario bar and received his L.L.B., from Queens University, Canada, in 2004.

[1] If the trust is created in the settlor's will as a testamentary trust, they need only have been non-resident for 18 months, not 5 years.

resident directly, the gift would be tax-free, but any capital growth and income earned on the gift would be taxed.

Making the gift by way of the offshore trust allows both the gift and all growth to be realized and paid to a Canadian resident tax-free, indefinitely. If the quantum of the gift is sufficient that it will generate income and gains that exceed the cost of maintaining the trust then it is an attractive solution.

What about Canadian residents who are considering a change in residency, or recently changed their residency? Can you establish a granny trust for beneficiaries in Canada then? Perhaps surprisingly given that very many of your Canadian tax and filing obligations fall away when you cease to be Canadian resident, the answer is that the analysis does not change at all until you have been continuously non-resident for 5 years.[2] If you are non-resident and not filing Canadian tax returns, and you make a gift to another third party non-resident who settles an offshore trust using those funds, the CRA will want to know if there are any Canadian beneficiaries of the trust (and if there are, they will tax the trust as though it was Canadian resident). However, the moment you become non-resident, you can establish offshore trusts that do not include any Canadian resident beneficiaries (or only include Canadian beneficiaries whose rights arise after your death) and those trusts will not be deemed resident in Canada. Alternatively, you can explore structures other than trusts, which are not subject to the same attribution and deemed residency rules as trusts (at least for the first 5 years of your non-residency). There are many safe and tax-efficient structures available to you once you are no longer a Canadian resident.[3]

It must be noted that there are other good reasons, tax considerations aside, to consider establishing a trust in other jurisdictions. The laws of the well-developed offshore jurisdictions like Jersey, Guernsey, Cayman Islands, British Virgin Islands, Bermuda, Barbados, Bahamas, the Cook Islands, and several up-and-coming jurisdictions like the United Arab Emirates, offer various features that can be attractive depending on what you wish to achieve with the trust. These features include, for instance:

- Privacy: strong privacy rules whereby beneficiaries need not be informed of their interest, for example.
- Legacy trusts: where limits on the lifespan of a trust do not apply or are very long (i.e. the so-called rule against perpetuities does not apply), and for Canadians, there are no deemed dispositions for tax purposes every 21 years as there is for a Canadian trust.
- Asset protection: many offshore jurisdictions maintain strong firewall legislation which prevents certain foreign judgments from being enforced against the trust, and some have relatively short limitations periods during which creditors must bring their claims, which can be useful for forced heirship situations and for asset protection generally.
- No probate: the probate process (and taxes) is avoided if property is transferred to a trust during one's lifetime rather than passing on death under a will. This is currently true of domestic Canadian trusts too, but Canada regularly adopts new tax policies to expand its tax base and it is a realistic possibility that assets held by an inter vivos trust will be made subject to probate tax at some point.
- Stability: the leading offshore jurisdictions have long histories of well-established trust service providers that have the expertise and professionalism necessary to give you confidence and peace of mind, and strong, reliable judicial systems that will uphold their domestic laws.

The offshore planning landscape may not be for everyone, but for Canadians (including prospective immigrants and emigrants) who fit the mold the benefits are still very attractive and are well worth considering whether for tax reasons, asset protection, or greater freedom in your wealth and estate

[2] Section 94(1) of the Act provides that if a "contribution" was made during a "non-resident time of the person", it still counts as a "connected contributor" for purposes of deeming the trust resident in Canada. A "non-resident time" means 60 months before, and after, a person's Canadian residency commences or ceases, respectively.

[3] These comments are made from the Canadian perspective. You may also need to consider the rules applicable in your new place of residence, if it is not a low-or-no-tax jurisdiction.

planning. If you wish to explore these or other offshore planning opportunities, please -do not hesitate to contact us. ■

Afridi & Angell

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