inBrief

Canada edition

What is International Tax?

By James Bowden | 6 October 2022

Tax is a jurisdiction-specific subject where each country applies its own system and rules of taxation. Many countries have provincial, state, regional or municipal tax rules in addition to or separate from the federal rules. Despite tax being a jurisdictionally limited concept, you often hear about "international" or "cross-border" tax issues. Those terms generally refer to issues in which more than one country's tax laws have the potential to apply at the same time, or to the ever-expanding body of supra-national rules relating to disclosure, economic substance, minimum tax and anti-avoidance, or the world's network of bilateral tax treaties. This inBrief will give examples of situations in which cross-border tax issues arise.

One common example that many individuals may encounter during their lifetime is undertaking a change in tax residency. If an individual moves from one country to another, it may mean their place of residency for tax purposes changes as well. Indeed, changing one's tax residency is the centerpiece of some of the most effective tax planning strategies. Such a change will have consequences in both the country of departure and the country of arrival. For example, Canadians giving up Canadian tax residency incur a deemed disposition of most of their worldwide capital assets[1] calculated as of the date of departure and an obligation to pay any capital gains tax on such deemed proceeds. At the same time, one's assets may be given a new cost basis in the new country of tax residency, and that new country may require special disclosures relating to one's assets in the initial tax filings. Individuals must also make themselves aware of how they will be taxed on their local and worldwide income and capital gains under their new tax residency status. Several jurisdictions that compete to attract immigration by high-net-worth individuals offer special tax regimes, which may be a flat annual tax irrespective of income levels, or may be zero tax on foreign source income, among other incentives.

Another common example is the ownership of assets in foreign countries, especially income-producing or investment assets such as real estate or interests in public or private companies.

The Author

James Bowden
Managing Director - Toronto
jbowden@afridi-angell.com
Tel: +1 416 601 6815

James is the founder and Managing Director of Afridi & Angell's Toronto office, which primarily services the private client space in local and international estate planning, and creating structures using trusts and foundations.

Areas of expertise include succession planning, the use of trusts locally and internationally, tax planning, asset protection, tax-driven changes in residency, and estate structuring. The Toronto office also continues to provide corporate and commercial support in many instances.

[1] There are some important exclusions to the assets on which a deemed disposition is incurred, such as Canadian real property and registered savings plans.

The asset or its income may be taxed in the foreign jurisdiction, and will likely also be taxed in the home jurisdiction. If there is a double taxation treaty in place between the two countries one may be able to avoid double taxation; however, if there is not, double taxation may result without any relief. All high-tax countries have developed extensive anti-avoidance rules that are aimed at preventing their residents from realising a tax advantage simply by moving assets to a low- or no-tax country or holding them through entities established in such a country. Even for people who hold foreign assets without any intention to obtain a tax advantage it is important to be aware of those rules so as not to inadvertently fall afoul of them, as disclosure or filing failures can result in significant penalties. Determining the detailed tax treatment of foreign holdings, whether held directly or indirectly, in both the country of residence and the foreign jurisdiction(s) is critical and can be complex. Professional advice is essential.

Recently, there has been a strong trend towards increasing transparency and disclosure with respect to tax matters among nations, and introducing economic substance and/or minimum tax rules, particularly in low- or no-tax jurisdictions. With the notable exception of FATCA, these initiatives have been driven by the OECD, which evaluates nations and designates them as white, black, or gray-listed, with serious reputational and practical consequences for being black or gray-listed. As a result, most low- or no-tax jurisdictions have been rapidly introducing new tax and compliance rules to avoid that consequence. These new and fast-evolving changes have significantly constrained previously acceptable international tax planning strategies. Simply establishing a holding company in a zero-tax jurisdiction in order to hold revenue-generating or growth assets to shelter such income or growth, or in order to access treaty benefits, will no longer be sufficient and is no longer good planning. Good planning today requires awareness of the OECD initiatives and how they have been implemented so far. It also requires an understanding of how such initiatives will continue to be implemented over the coming years as more countries implement and enforce economic substance rules, minimum tax levels, and beneficial ownership registries that may or may not be publicly accessible. Finally, treaty networks are undergoing amendments to reduce access to treaty benefits in situations that are now (but have not historically been) viewed as abusive avoidance transactions.

However, these developments have not detracted from the healthy competition among nations to attract an influx of businesses and wealthy individuals, and there are still many opportunities to realise tax advantages with sound international planning. These opportunities include, for example:

- A business that can relocate some of its revenue-generating operations to a subsidiary in a low- or no-tax country, with employees and operations to support a genuine presence that satisfies the economic substance requirements in that country. For Canadian parent companies that have a foreign subsidiary in a country with which Canada has a tax treaty (such as the UAE), the "active business income" (a defined term in Canada's *Income Tax Act*) of the subsidiary can generally be repatriated to the parent on a tax-free basis. This model can result in significant tax savings.
- Changes in one's tax residency generally, as described above in this article.
- Succession planning, particularly where an advantageous place of tax residency has been obtained first. The use of succession planning structures such as trusts, foundations, corporations (and wills) can offer excellent and lasting tax advantages when implemented while the individual is tax-resident in a low- or no-tax jurisdiction. By allowing the "structure" to own or inherit assets, rather than individual heirs who may reside in high-tax jurisdictions, the assets remain sheltered and can continue to grow without successive applications of inheritance tax, for instance.

Understanding and planning for international tax issues has always been complex, and the complexity continues to grow as the international regulatory landscape evolves. However, opportunities for good planning remain for those with the circumstances to support it. If you wish to discuss your circumstances in this regard please do not hesitate to contact us. ■

Afridi & Angell

Founded in 1975, Afridi & Angell is a full-service UAE law firm in its fifth decade at the forefront of the legal community. From the beginning, our hallmarks have been a commitment to quality, unsurpassed knowledge of the law and the legal environment, and crafting of innovative business solutions. Licensed in the three largest Emirates of Abu Dhabi, Dubai and Sharjah as well as the Dubai International Financial Centre, our practice areas include banking and finance; private client advisory; corporate and commercial law; arbitration and litigation; construction; real estate; infrastructure projects; energy; project finance; maritime (wet and dry); and employment. We advise local, regional and global clients ranging in size and sophistication from start-ups, sole proprietorships, family-owned businesses, entrepreneurs and investors to some of the world's largest public and private companies, governments and quasi-government institutions.

Afridi & Angell Professional Corporation, Afridi & Angell's Toronto office which was established in 2021, takes advantage of the firm's many Canadian ties and brings to our Canadian clients, and those with Canadian interests, the highest standards of advice and client service for which Afridi & Angell is known. Our Toronto office, which operates as a separate legal entity from Afridi & Angell's UAE offices, provides legal and advisory services in the following areas: corporate and commercial; mergers and acquisitions; tax planning and advisory; asset protection; private client and estate planning; anti-money laundering and anti-bribery compliance; IT outsourcing and contracting; consulting on Canada-UAE opportunities and cross-border legal issues.

www.afridi-angell.com/toronto/