International Tax Commentary - 2018 Federal Budget

Cross-Border Surplus Stripping Using Partnerships and Trusts

The current cross-border surplus stripping rules are designed to prevent a non-resident shareholder from extracting amounts from a Canadian corporation in excess of the paid-up capital (this is generally the amount invested in the corporation) without being taxed on a dividend. In order to capture transactions using partnerships and trusts that are designed to achieve the same outcome, Budget 2018 proposes to implement a series of "look-through" rules for transactions that occur on or after Budget Day. These look-through rules will allocate the assets, liabilities and transactions of a partnership or trust to its members or beneficiaries, as the case may be, based on the relative fair market value of their interests.

Foreign Affiliates

The *Income Tax Act* contains special rules for the taxation of Canadian resident shareholders of controlled foreign affiliates. Shareholders are generally taxed on their share of corporately retained passive earnings. In some situations, taxpayers may pool their investment assets in one corporation in order to avoid this tax. Commonly, they would track their specific assets held within the corporation separately (a tracking arrangement).

Control Test

Often these arrangements are set up to avoid meeting the definition of controlled foreign affiliate. Budget 2018 proposes to deem such a corporation to be a controlled foreign affiliate of the taxpayer where such a tracking arrangement exists.

Employee Test

Another reason that such a corporation may be set up is to meet the exception for businesses with more than five full-time employees.

Budget 2018 proposes to deem such a corporation to have separate businesses where tracking arrangements exist. As such, more than five employees would be required for each business in order to meet the exception.

These measures will apply to taxation years of a taxpayer's foreign affiliate that begin on or after Budget Day.

Filing Due Dates

Budget 2018 proposes to bring the information return deadline in respect of a taxpayer's foreign affiliates in line with the taxpayer's income tax return deadline by requiring the information returns to be filed within six months after the end of the taxpayer's taxation year. This will accelerate the deadline for filing Form T1134 from its current due date, fifteen months after year end.

In order to give taxpayers time to adjust to this change, the measure will apply to taxation years of a taxpayer that begin after 2019.

Also, the reassessment period for tax matters related to foreign affiliates will be extended by three years (generally a total of six years for individuals and CCPCs).