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Tax

New tax forms burden for private businesses, families investing outside Canada

By **Kenneth Keung**

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(February 1, 2021, 12:36 PM EST) -- Canadians who own interests in a "foreign affiliate" are required by s. 233.4 of the *Income Tax Act* (the Act) to annually file T1134 forms, unless a *de minimis* administrative exception is met. Generally speaking, a foreign affiliate is a non-resident corporation in which the Canadian, along with related persons, owns 10 per cent or more.

Since it is often difficult to gather information from foreign entities, T1134 forms have historically been due 15 months after year end. This due date was shortened to 12 months for taxation years that begin in 2020, and further to 10 months for taxation years that begin after 2020.

Compounding the effect of this shortened filing timeline, the Canada Revenue Agency (CRA) has recently released a preview of its new T1134 Summary and Supplement forms. If anyone needs proof that international tax is a complicated subject, a quick glance at these new forms will clearly settle the matter. The new T1134 forms require a great deal more disclosure and completing them properly will require a decent understanding of (sometimes obscure) Canadian international tax rules. These new T1134 Summary and Supplement forms must be used for taxation years that begin in 2021.

Although completing the T1134 forms have historically been the domain of accountants, legal advisers should be aware of the stringent and extensive requirements that these forms entail when advising clients with or going into cross-border structures. Further, given the technical complexity of these new forms, lawyers specialized in the area of international tax will likely be called upon much more often to assist with their completion.

There are some relieving changes coming out of this overhaul of the T1134 forms. The dormant/inactive administrative exception is expanded so that the $100,000 aggregate cost amount limit applies at a foreign affiliate by foreign affiliate level, and the annual gross receipt threshold is increased from $25,000 to $100,000. However, dormant/inactive foreign affiliates will need to be identified with certain base level information in the new T1134 Summary. Also, a new related group reporting regime is introduced so that a group of Canadian reporting entities may file only one set of consolidated T1134 forms.

The new forms require extensively more disclosure. Below is some of the new information being asked for:

- whether the Canadian reporting entities are themselves involved in reorganization transactions under s. 85, 85.1, 86.1, 87 and 88 of the Act
- adjusted cost base (ACB), rather than book cost of common shares and preferred shares in the foreign affiliate
- unconsolidated financial statements are now required for a foreign affiliate where the reporting entity or a controlled foreign affiliate owns 20 per cent or more voting shares in the foreign affiliate
- extensive questionnaire regarding the applicability of the foreign affiliate dumping rules to any investments made in respect of the foreign affiliate
- extensive questionnaire regarding the foreign affiliate surplus accounts

- extensive questionnaire regarding the upstream loan rules. An upstream loan from a foreign affiliate may have to be included in income if the loan is not repaid within two years (analogous to the s. 15(2) rules in the domestic context) — the taxpayer now must positively identify to the CRA whether these rules apply to their foreign affiliates
- extensive questionnaire regarding foreign affiliate dissolution: s. 88(3), (3.1), (3.3) and (3.5).
- disclosures regarding "equity percentage," "surplus entitlement percentage" and "participating percentage."
- disclosure of number of employees — not just whether the foreign affiliate had more than five full-time employees
- traditional passive-type of revenues now have to be disclosed separately between those earned from an arm's length source versus those earned from a non-arm's length source
- detailed disclosure about foreign accrual property loss (FAPL) and foreign accrual capital losses (FACL). It is no longer good enough to provide a net foreign accrual property income (FAPI) amount
- disclosure of information required on lower-tiered foreign affiliates held by non-controlled foreign affiliates of the reporting entity

CRA's desire for more disclosure and transparency for foreign affiliates is understandable. The new information from the new forms will provide the CRA a powerful database that it can use to better target their audit resources, consistent with its recent emphasis on risk-based auditing.

That said, most taxpayers completing the T1134s are private enterprises who may be just starting to expand outside Canada or are Canadian individuals looking to make modest investments in foreign entities. The extensive information requested by the new T1134 forms is extreme heavy-handedness for such taxpayers.

In my team's experience as advisers to Canadian entrepreneurs and high-net worth families, most investments in foreign affiliates are either: i) real estate investments or ii) organic expansion of their Canadian businesses, and almost all of them are made in the United States and in other jurisdictions with highly developed tax regimes.

One thing that all of these structures have in common is that there are little to no Canadian income taxes arising from them, because the foreign tax regime (again, typically the United States) already imposes income tax on foreign earnings at equal-to-or-higher-than rates that would have been charged in Canada. Because of that, there is generally foreign accrual tax to shelter any FAPI income, or the foreign dividends would have been fully sheltered by the surplus regimes.

For private enterprises investing in countries with highly developed tax regimes like the United States, there are typically no tax "games" being played and sometimes that is simply because the type of cross-border tax mischief in the newspaper headlines are simply not economically feasible to implement for most Canadian private entrepreneurs and families.

The new T1134 forms are much more suitable for large multinational enterprises than for private enterprises and individuals. The CRA should have created a simplified T1134 disclosure form for Canadian individuals and private corporations investing in a "safe" list of high tax rate countries such as the United States, and under a certain dollar threshold. A similar approach has been taken with the Form T1135, where reporting is very streamlined when specified foreign property totals less than $250,000. Why couldn't the same be done for T1134?

A complex annual filing requirement like the new T1134 discourages business expansion outside Canada. Many businesses and individuals cannot afford international tax specialists to help them understand and complete the new T1134 forms, while at the same time, an inaccurate or incomplete filing may lead to potential penalties of up to the greater of $24,000 or five per cent of the investment per form, per year.

Legal advisers involved in cross-border transactions should review the new T1134 forms, and advise their clients of this upcoming change to their annual compliance and that they should start gathering the necessary information to comply.

Kenneth Keung is a director of Moodys Tax Law LLP*. Keung has been a tax adviser to private* *businesses, high worth families and multinationals for almost 20 years.*

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