
FineAnswers

Answers to questions on tax and finance

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SHOULD YOU USE AN OFFSHORE CORPORATION IN A TAX HAVEN?

Q1. If a Canadian resident - whether a corporation, a trust or an individual - transfers investments overseas and does not bring into Canada income earned on such investments, is this income subject to tax in Canada?

Canadian residents pay tax on their world income and whether such income is kept outside Canada or not is irrelevant.

Q2. Is a corporation incorporated in Canada; but not resident in Canada, subject to Canadian Income Tax?

Residence of a corporation normally is where its management resides. However, all corporations incorporated in Canada after 27th April 1965 are resident in Canada for tax purposes, regardless as to where the mind and management resides.

Q3. Is a corporation a separate entity from its shareholders for tax purposes?

Yes, this is generally true in Canada.

Q4. Is the income of Canadian Corporations taxed separately from its (shareholders) owners?

Yes. However, when a corporation pays dividend to its shareholders then it is included in the shareholders' taxable income.

Q5. If a Canadian shareholder has a controlling interest in an offshore corporation (Controlled

Foreign Affiliate); but the corporation is managed by a person not resident in Canada, is the corporation considered non-resident for Canadian tax purposes?

If the mind and management of the corporation resides offshore it is not taxed in Canada. However, its income may be included in that of the shareholder. (See Q.7)

Q6. What is a Controlled Foreign Affiliate?

To be a **Foreign Affiliate** a Canadian taxpayer must have at least 1% equity in the foreign corporation and the taxpayer alone or together with related parties, should also have at least 10% equity in it. A **Controlled Foreign Affiliate (CFA)** is a **Foreign Affiliate** which is controlled by:

- the taxpayer - has more than 50% of the shares.
- a person or persons which the taxpayer does not deal at arms length (related parties are assumed not to deal at arms length).
- the taxpayer together with related parties.
- any four Canadian residents collectively.
- the taxpayer together with four other Canadian residents collectively.

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Q7. If a Canadian resident has a controlling interest in an offshore corporation and transfers investments to that corporation, is the subsequent income from such investments subject to Canadian tax?

Assuming that the corporation is a Controlled Foreign Affiliate; but managed in the offshore jurisdiction the answer should be “no!”; because the corporation is neither incorporated nor resident in Canada. However, the Income Tax Act makes such an income subject to tax as if it was personally received by the Canadian taxpayer. Such income is called Foreign Accrual Property Income -**FAPI**

Q8. If a Canadian resident does NOT have a controlling interest in an offshore corporation would the corporation’s income from investment be subject to Canadian tax?

Having established that a Canadian resident does not have a controlling interest you also have to be certain that the income is not derived from portfolio investments . If the income is derived from portfolio investment you should be able to demonstrate that the main purpose of using the offshore structure was not to reduce Canadian taxes. Otherwise income is imputed at a rate prescribed by Revenue Canada applied on the cost of the investment.

Q9. Can Canadian businesses, structure their affairs in such a way that part of their income is earned and taxed in an offshore corporation (in a Tax Haven) subject to no tax or very little tax?

In some cases this can be done. Such as an offshore sales and marketing corporation, offshore purchasing agency, a captive insurance company (one that would insure your own risks and you pay it premiums), a captive leasing company, a captive factoring company etc. The question is whether the income of such companies would be added to the income of the Canadian entity. That is to say would it be **FAPI**-(see # 7 above)

Under what circumstances income earned by a Controlled Foreign Affiliate, would be added to the income of the Canadian controlling entity?

When it is income from property:

- An adventure in the nature of trade (a one time deal),
- An investment business the purpose of which is to derive income from property. Such as interest, dividend, rent, royalty, insurance, factoring and sale of investment property.

When it is income from non-active business:

- Non-active business is defined by the Income Tax Act. Such as a controlled foreign affiliate acting as an intermediary for importing goods into Canada, or acting as a commission agent for its Canadian controlling shareholder if the agency work is done by a Canadian Taxpayer, insurance of Canadian Risks, loans to Canadian businesses or persons, leases to Canadian businesses or persons.

Q11. When is the income of a Controlled Foreign Affiliate of a Canadian resident shareholder taxed in the country of its incorporation (not Canada) and is not included in the Canadian entity’s income? i.e. not FAPI (see Q.7 above)

The income of the controlled foreign affiliate is taxed only in its country of incorporation when:

- The corporation is managed outside Canada. The technical term is that its mind and management are outside Canada.
- The income it earns is active income as defined by the relevant sections of the Income Tax Act . In other words the income should not be “*income other than active*” or income from “*property*”. See Q.10 above.
- Income from a qualified investment business which employs more than five full time employees.

Q12. Under what circumstances is the income of a Controlled Foreign Affiliate EXEMPT and therefore escape Canadian tax even after it is paid to a Canadian Corporate shareholder as dividend?

The conditions in the immediately above answer should be present and also the offshore corporation

should be resident and incorporated in a country that is among the listed treaty countries.

Q13. Is there a tax haven that has a tax treaty with Canada?

Yes!! Barbados is the only tax haven that has a tax treaty with Canada. Barbados Income Tax on a Barbados International Corporation is only 2.5%!!

*Before taking any steps seek professional advice.
The above comments are only general in nature.*