

THE POTENTIAL BENEFITS OF OFFSHORE TRUSTS

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Masters Series

This is one of a series of articles prepared for CIBC Private Wealth Management™. The series is written by professionals in such fields as taxation, trusts, and estates.

While the immediate tax advantages of using offshore trusts have been significantly reduced in recent years, they can still play a key role in estate and financial planning to help you preserve and enhance your wealth.

You may benefit from using an offshore trust if you are a Canadian resident and:

- you have assets in various locations throughout the world;
- you intend to distribute assets, either while you are alive or through your will, to individuals living outside Canada; or
- you intend to leave Canada.

If you are not a Canadian resident, an offshore trust can help you distribute assets to Canadian residents tax effectively, either while you are alive or through your will, or provide significant tax benefits if you plan to immigrate to Canada.

How offshore trusts work

An offshore trust is established under the laws of another country and administered by a non-Canadian trustee (generally a financial institution). Like a regular trust, an offshore trust has a settlor, trustee, and beneficiaries. If you are the settlor of the trust, you will fund the trust by either giving or lending property to it.

The trustee becomes the legal owner of the trust property and is required to manage it as directed by you in the

trust deed. The trustee is also responsible for distributing trust assets to the beneficiaries you've named in the trust deed. The trustee has full decision making powers over trust assets, and it's essential that you have complete confidence in your choice of trustee.

A trust is a relationship among the trustee, the trust beneficiaries, and you, and is governed by the laws of the country in which the trustee is resident.

To maximize their effectiveness, offshore trusts are generally established in jurisdictions with little or no income, capital gains, or estate taxes, such as Barbados, The Bahamas, and The Cayman Islands. Those countries generally have local financial institutions or local offices of Canadian financial institutions that are experienced in acting as trustees, and have the legal and regulatory systems designed to manage offshore trusts.

Why use an offshore trust?

There are a number of potential benefits to offshore trusts. You can use them to:

- facilitate the smooth transfer of wealth from you to your dependants while you are alive or after your death;
- protect assets from potential creditors;
- take advantage of lower rates of taxation than would apply to resident Canadian trusts in certain circumstances;

- prevent the imposition of “forced heirship” rules, which dictate how assets are to be distributed on death in certain jurisdictions;
- reduce probate¹ and other estate fees; and
- preserve confidentiality with respect to your assets and business affairs.

The structure that is appropriate for you will depend on your circumstances and your financial goals. Here are some typical situations in which offshore trusts may offer significant potential benefits.

You are planning to immigrate (or have recently immigrated) to Canada. The assets in an immigration trust earn income and capital gains from foreign sources free from Canadian income tax for up to the first five years of the immigrant’s Canadian residency.

Because the tax holiday expires five years after the person has moved to Canada, setting up the trust prior to the move to Canada maximizes the benefits. However, setting up such a trust within five years of immigration will still provide some benefits.

You are a Canadian resident with non-resident beneficiaries. An offshore trust can be an effective way to distribute assets to family members who are not Canadian residents. The income earned in the trust and distributed to beneficiaries who are not resident in Canada should not be taxable in Canada, and will instead be taxed by the jurisdiction where the beneficiaries live. If they live in a

country with lower tax rates than Canada, this type of trust will be advantageous.

There is also a narrow class of trusts, called “exempt foreign trusts,” that are exempt from Canadian tax. Exempt foreign trusts include offshore trusts set up for non-resident dependants who are mentally or physically infirm, and trusts set up to support non-resident children in the event of the breakdown of a marriage or common-law relationship.

You are not a Canadian resident but you have relatives who are. A trust set up and funded by a non-resident for the benefit of Canadian residents can accumulate income tax-free offshore, and distribute capital tax-free to Canadian residents. However, income earned by the trust and allocated to a Canadian beneficiary within the year that it is earned will be subject to Canadian tax.

The same rules apply to trusts established in the wills of non-residents of Canada, or former residents of Canada who have been non-residents for at least 18 months prior to their death.

Obtain expert advice

Because of the complexity of the rules governing offshore trusts, you should obtain expert advice from experienced Canadian professionals who are familiar with your particular situation. You will need tax, legal, and investment advice to ensure that the trust is structured for your maximum advantage. Your Canadian advisors will also need to consult with reputable advisors in the jurisdiction where the trust will be established to ensure familiarity and compliance with local laws.

Your advisors can also keep you updated as to the current status of Canadian law concerning the use of offshore trusts, an area subject to change. It is important that any trusts you set up be reviewed periodically to ensure that they provide you with the maximum benefits available under the applicable laws.

This article is intended to provide general information only and should not be construed as specific advice suitable for individuals. Since a consideration of individual circumstances and current events is critical, anyone wishing to act on information in this article should consult a professional. This article reviews Canadian federal tax laws only, unless otherwise stated. Provincial tax laws may also apply and may differ.

Canadian reporting requirements

Offshore trusts are governed by complex Canadian tax rules designed to limit the ability to accumulate offshore income without paying tax in Canada.

For example, Canadian residents who receive distributions from a non-resident trust are required to file Form T1142, Information Return in Respect of Distributions from and Indebtedness to a Non-Resident Trust, annually with the Canada Revenue Agency. The recipient must identify the trust and trustee, describe any distributions received from the trust and estimate their fair market value, and report any indebtedness to the trust.

¹ Probate fees are not applicable in the province of Quebec.

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