

The CRA's Foreign Reporting Requirements for Foreign Affiliates

Canadian residents are taxed on their worldwide income (regardless of source). To ensure that a Canadian resident is properly complying with the rules regarding foreign-based income, there are provisions in the Income Tax Act ("Act") that require Canadian residents to file information returns with respect to their foreign investments. For example, Canadians are required to file an information return (Form T1135) with the Canada Revenue Agency ("CRA") if the aggregate cost of their foreign assets exceeded \$100,000 at any time during the year. This article will focus on the CRA information return relating to foreign affiliates (i.e., Form T1134, "Information Return Relating to Controlled and Not-Controlled Foreign Affiliates") which is required to be reported separately from the T1135 form.

Filing Obligation

A Canadian resident taxpayer (including an individual, corporation, trust, and certain partnerships) who holds an interest in a foreign affiliate or a controlled foreign affiliate at any time in the year must file Form T1134 to report information about the foreign affiliate. Form T1134 consists of a Summary and Supplements. A separate supplement must be filed for each foreign affiliate of the taxpayer.

For a Canadian resident taxpayer who owns shares of a foreign corporation, the first step in ascertaining whether a T1134 filing obligation exists is to determine whether the foreign corporation is a foreign affiliate or a controlled foreign affiliate.

A **foreign affiliate** of a taxpayer is a non-resident corporation in which the taxpayer's ownership (defined as "equity percentage") is not less than 1% and the total of the taxpayer's equity percentage in the corporation (and of each person related to the taxpayer) is not less than 10%. A foreign affiliate is also a **controlled foreign affiliate** where the taxpayer and all related persons (and others not dealing at "arm's length") own a sufficient number of shares to have voting control (i.e., more than 50% of the voting shares) of the foreign affiliate **or** where the taxpayer along with any four or fewer unrelated Canadian resident shareholders together own a sufficient number of shares to have voting control of the foreign affiliate.

If shares of a foreign affiliate or a controlled foreign affiliate are owned at any time in the year, Form T1134 must be filed in respect of the foreign affiliate within 15 months after the end of the reporting taxpayer's taxation year.¹

A paper copy of this form must be filed separately from the taxpayer's income tax return (except for corporations and partnerships, which can now file Form T1134 electronically for the 2015 and 2017 taxation years, respectively, and later taxation years).

Note that an individual (other than a trust) does not have to file Form T1134 for the year in which he/she first became a resident of Canada. A filing exemption is also provided for a "dormant" or "inactive" foreign affiliate if the total cost amount of the shares of all foreign affiliates to the taxpayer at any time in the year is less than \$100,000. For these purposes, a "dormant" or "inactive" foreign affiliate is one that had gross receipts (including proceeds from the disposition of property) of less than \$25,000 in the year and at no time in the year had assets with a total fair market value of more than \$1,000,000.

Information required to be disclosed on Form T1134

The general purpose of Form T1134 is to enable the CRA to determine that appropriate taxable income in respect of the foreign affiliate has been properly included in the shareholder taxpayer's income tax return for the year. This determination is made in light of the relevant Canadian tax legislation which can prevent an investor from deferring Canadian income tax on passive income by investing through a foreign entity.

The T1134 summary form must be completed for each reporting entity and contains information on the reporting entity, and its organizational structure. The required information on the organizational structure includes the

name of the related corporation, its country of residence and the corporation's equity percentage in the foreign affiliate.

The T1134 supplement form must be completed for every foreign affiliate and controlled foreign affiliate of the reporting entity. The required information includes financial information about each foreign affiliate, as well as transactions between the foreign affiliate and the reporting entity. For a controlled foreign affiliate, additional information regarding the nature of its income is required to be disclosed (e.g., its number of employees, composition of revenue, foreign accrual property income ("FAPI"), and capital gains (losses)). The determination of FAPI income is important, as certain types of passive income earned by a controlled foreign affiliate must be included in the Canadian resident's taxable income on a current basis, regardless of whether or not the income was distributed to the Canadian shareholder.

Penalties for failure to file Form T1134

The penalty for failing to file Form T1134 is \$25 per day for up to 100 days (minimum \$100 and maximum \$2,500). Further penalties can apply if failing to file is done knowingly or under circumstances amounting to gross negligence.

Additionally, a taxpayer who fails to provide any information required on the form may be liable to a penalty for each such failure. For example, the form is filed but is incomplete because it is missing information or required information is not attached. Also note that if all or some of the necessary substantive elements on the form are missing or incorrectly stated, the form may be considered invalid by the CRA and is therefore considered not to have been filed.

If you own a foreign affiliate but have not properly completed a T1134 form, you may be able to correct past filing deficiencies under the Voluntary Disclosure Program ("VDP") to avoid penalties and/or potential prosecution. Before you initiate the process, you should contact your tax advisor to find out if you are eligible to make a valid voluntary disclosure, especially in light of recent changes to this program.²

Conclusion

The rules governing the taxation of foreign affiliates are among the most complex set of provisions in the tax legislation. As a Canadian taxpayer owning a foreign affiliate or a controlled foreign affiliate, it is important to understand your reporting obligation in respect of the foreign affiliate and ensure compliance with these rules since the penalties to failure to file Form T1134 (or failure to disclose the relevant information) can be significant. Please consult with your tax advisor to confirm the tax implications and any reporting obligations in respect of any foreign affiliates in your particular situation, and to ensure that your foreign business operations are structured in a tax-efficient manner.

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If you have any questions please consult with your tax advisor for assistance in your particular situation.



July 2020

¹Originally, Form T1134 is due 15 months after the end of the reporting taxpayer's taxation year. Now the filing deadline has been changed from 15 months to 12 months for taxation years that begin in 2020 and 10 months for taxation years that begin after 2020. For example, if an individual owns shares of a foreign affiliate at any time in 2019, Form T1134 is still due 15 months after 2019 (i.e., March 31, 2021). For 2020 and 2021, the filing deadline for Form T1134 is now changed to December 31, 2021 and October 31, 2022 respectively. Note further that as a result of the COVID-19 outbreak, the Federal government announced extensions of most Federal tax filing deadlines to June 1, 2020, including the March 31, 2020 deadline for T1134 forms.

²Note that the CRA has recently made some changes to narrow access to the VDP for applications received after February 2018. Key changes to the VDP include:

- elimination of the no-names disclosure process;
- introduction of two different methodologies (i.e., the general program which qualifies a taxpayer for penalty and partial interest relief and the limited program which provides more limited relief if there is an element of intentional conduct);
- payment of the estimated tax at the time of the VDP application; and
- disclosure of the identity of an advisor who assisted the taxpayer in respect of the non-compliance.

Before making a VDP application, you should contact your tax advisor to assess whether you meet all the conditions of a valid disclosure and the likelihood of acceptance under the general program versus the limited program.

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