Report All Your Foreign Income

Arnold Sherman

As most people know, there is a difference between tax avoidance and tax evasion. Everyone has the right to plan to pay the least amount of income tax permitted under the law. Minimizing your tax liability by taking advantage of a particular provision of the law is (in principle) perfectly okay and is known as tax avoidance or sometimes called using a tax loophole. However, I have more to say below about taking advantage of loopholes. Cheating on your taxes is tax evasion. The difference between tax avoidance and tax evasion is sometimes said to be the thickness of a prison wall. That leads me to the question of taxpayers who attempt to minimize their tax liability by moving their investments offshore.

As an international tax adviser, I find that the most frequent source of questions from potential clients relates to the possibility of moving their investments offshore to "avoid Canadian taxation". They often do not believe me when I tell them that it is generally impossible to do so, and that failure to report all their foreign income would be tax evasion.

Many enquirers suffer from what I call the "man-in-the-pub syndrome". They met a man in a pub who told them that he has moved his investments offshore and that he no longer pays tax on his foreign income or on his capital gains. It is hard to convince them that their informant is guilty of tax evasion, a criminal offence.

I must stress that Canada is a free country with no restrictions whatever on the free movement of your cash or investments anywhere in the world. However, moving your investments offshore – to a jurisdiction which charges little or no tax on income or capital gains – does not affect the Canadian taxation of that income or capital gains.

Canadian residents are taxable on their world-wide income, so moving your investments out of Canada does not affect your Canadian tax liability.

Setting up a foreign company, perhaps in a tax haven, and transferring your investments to that company does not work either. The income of the foreign company is taxable to you personally, whether you leave it offshore or bring it back to Canada. That foreign company income is technically known as foreign accrual property income – FAPI for short.

Setting up a foreign trust to hold your investments does not work either – again, the trust income is taxed just as though you earned it yourself.

There are many reasons why a Canadian resident may decide to move his or her investments offshore, but saving Canadian tax is not one of them.

Professionals and others who are afraid of being sued by their clients often move their savings out of Canada to make it harder for a litigant to reach his or her assets. As long as there were no existing or contingent claims on the assets transferred at the date of the transfer, this is an acceptable way of safeguarding one's savings. It is called "asset protection" and often involves the creation of an offshore trust (an asset protection trust), again with no effect on the individual's Canadian tax liability.

Recently, a potential client explained to me that he was turning his investment portfolio into gold bullion. He planned to carry the bullion to Panama and deposit it in a Panamanian bank. His reason? He didn't trust Canadian banks!

I am currently helping a Canadian client to move his investments to a foreign company which he will set up and own in a zero tax jurisdiction. The reason? He wants to invest overseas and believes he will be better served by offshore investment advisers. He is certain that he will have more flexibility in the selection of world-wide investments. He knows the rules and will report his world-wide income on his T1.

I have often assisted Canadians to move their investments offshore – as long as I am satisfied that

there is a valid reason for the move, and am sure that they understand that income and capital gains must be reported to the Canadian tax authorities. In my view, I am morally responsible for ensuring that the Canadian tax adviser who prepares the client's T1 return is made aware of what he or she has done.

The T1 tax return includes a question: Did you own or hold foreign property at any time in the year with a total cost of more than CAN $100,000? An incorrect answer means that you will have filed a false income tax return, which can have dire consequences.

If you answer "yes", Form T1135 "Foreign Income Verification Statement" has to be attached, giving details. It is a one-page form with three pages of instructions and explanations. Six categories of foreign property are listed: funds, shares, indebtedness, real property, interests in non-resident trusts and other property. The total cost of each category has to be reported, as well as location. Total income from the reported assets, as shown on the T1 return, is required to be included on the form.

That is not the only way the CRA can get information. Canada's extensive network of international income tax treaties and agreements to exchange information give them many ways to identify investments outside Canada which are owned by Canadian residents.

It is true that there are some legitimate ways (loopholes) to move investments offshore without the need to report future investment income in Canada. However, the CRA closes loopholes as soon as they are discovered. In any event, they are not for the average person. They are expensive, need help from skilled tax professionals and may often result in litigation. As the CRA does not like people to use loopholes, they tend to take the taxpayer to court – an expensive proposition, whether you win or lose. Two recent court cases, involving the use of Barbados trusts, have proven to be very costly to the taxpayer.

The bottom line? Offshore tax savings for Canadian taxpayers are a myth. Listen to the man in the pub, smile, and wonder when they will catch him.

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