

THE NAVIGATOR



FOREIGN REPORTING REQUIREMENTS IN CANADA FOR INDIVIDUALS

Annual reporting required if you own foreign assets over \$100,000

Since the 1998 tax year, the Canada Revenue Agency (CRA) has required all Canadian resident individuals to report their foreign assets if the assets' cumulative cost exceeded C\$100,000 at any time in the calendar year.

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WHY DOES THE CRA HAVE THIS SET OF REPORTING RULES?

According to the CRA, the foreign reporting requirements were introduced in an effort to address the aggressive marketing of offshore tax havens in Canada and to ensure that residents of Canada pay taxes on all of their income, including income earned from non-Canadian sources. The CRA believes that these measures will help it to better detect and audit transactions that may result in tax avoidance and improve the targeting of its audit efforts.

It is very important to note that these rules require only the disclosure of

information about the ownership of foreign assets. The purpose of requiring disclosure of these foreign assets is to try to combat the use of tax avoidance and tax evasion schemes that involve the use of foreign-based financial arrangements. These rules do not impose any taxes. The CRA's ultimate goal in implementing the disclosure requirements is to increase compliance with existing rules that require individuals to report their world-wide income each year.

The foreign reporting requirements for corporations and trusts have also been implemented. The addition of the requirement for individuals to report their foreign assets for 1998 and

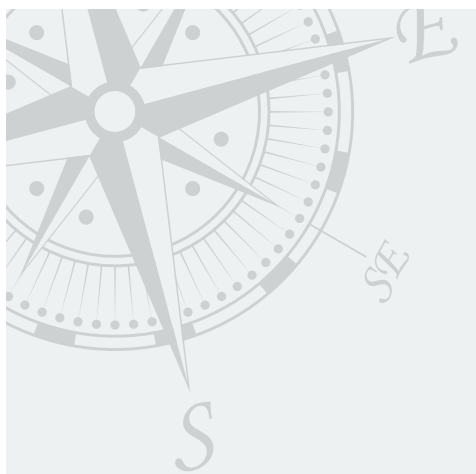
onwards completed a plan that had been in process for a number of years. The rules affecting corporations and trusts are similar to the rules pertaining to individuals that are discussed below.

WHO HAS TO REPORT TO THE CRA?

If you are a Canadian resident and, in any calendar year, you had an interest in "specified foreign property" and at any time during the year the total cumulative cost of this property was more than C\$100,000, the existence of these assets must be reported to the CRA. These assets should be reported on CRA form T1135, which is to be included with your personal tax return for the year. The T1135 is



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due on the same date as your income tax return. The disclosure of the ownership of foreign assets that meet these requirements are required on an annual basis.

WHAT HAS TO BE REPORTED TO THE CRA?

The list of “specified foreign property” includes (but is not limited to) the following items:

- Foreign bank accounts,
- Property (other than personal use property) located outside of Canada (i.e. rental property),
- Canadian securities held outside of Canada,
- Investments in foreign corporations, foreign trusts, foreign partnerships and in other foreign entities (whether held in an account in Canada or outside of Canada), and
- Other real, tangible and intangible property situated outside of Canada.

Items excluded from the list of “specified foreign property”, which means that these assets do not have to be reported, include (but is not limited to):

- Foreign assets held in tax-deferred accounts such as RPPs, RRSPs, RRIFs, RESPs, RDSPs and TFSA's;
- Units of Canadian mutual funds that invest in foreign securities,
- Any property used mainly for personal purposes (e.g. a Florida vacation condominium), and
- Property used exclusively in the course of carrying on an active business

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must be considered, not the cost of each asset individually.

The following example demonstrates this concept.

Consider an individual who in the year owns shares of a U.S. public corporation, in a non-registered Canadian investment account, that have a cost of \$75,000 (expressed in Canadian dollars converted at an exchange rate applicable at the time of purchase) and a bank account in the U.K. with an equivalent of C\$35,000 on deposit (highest value in the year). As the total specified foreign property exceeded C\$100,000, this individual would be required to file form T1135 for the tax year.

Further, even if the cost price of the assets did not exceed the C\$100,000 threshold at year-end, the fact that the total cost of the assets at any point in the year exceeded the threshold will require compliance with the foreign reporting rules. The previous example illustrates the point that fluctuations in foreign asset values during the year could result in a reporting requirement.

HOW TO REPORT FOREIGN ASSETS

In order to make compliance with these rules relatively simple, a “check-the-box” form, form T1135, has been devised by the CRA. The form will allow you, a Canadian resident, to report the following information about your foreign assets:

- The type of asset (by broad category as indicated above not by individual asset),
- The location of these assets (by country not by institution or account),
- The cost of the assets (reported within a range, not the exact amount), and

In the case of jointly owned foreign property, each person should consider their proportionate share of the property, which is based on the amount that they have contributed to the acquisition of the property.

- The amount of any income/loss that the foreign assets generated in the year including any taxable capital gain/loss on the disposition of the foreign assets.

In the case of jointly owned foreign property, each person should consider their proportionate share of the property, which is based on the amount that they have contributed to the acquisition of the property.

INFORMATION YOU CAN USE TO AID IN COMPLYING WITH THE FOREIGN REPORTING REQUIREMENTS

You can review your monthly non-registered account statements to determine which of your investment assets might be affected by these reporting requirements. Canadian mutual funds that invest in foreign securities are not considered foreign for this purpose.

As the reporting on the T1135 is expressed in Canadian dollars, all amounts in foreign currency (i.e., cost of the foreign property and income received on that property) have to be translated. The exchange rate that is to be used for the conversion should be the rate in effect at the time of the transaction. Alternatively, if income is received throughout the year, the annual average rate can be used to translate the income earned on the

foreign property. This annual average rate is available from the Bank of Canada at the beginning of each year for many of the most frequently used foreign currencies for the year just passed.

WHAT IF YOU DON'T REPORT YOUR FOREIGN ASSETS?

The penalties imposed by the CRA for not filing the required foreign assets disclosure form can be quite onerous. Penalties are based on the time period over which the reporting was late, as well as the circumstances under which the reporting was not done. For instance, the penalties will be harsher in a situation where the failure to file was done knowingly or through gross negligence. An additional penalty, which is based on the cost of assets not reported, can also be assessed by the CRA for the intentional non-reporting of specific foreign assets.

Of course the CRA also will penalize you if you under-report your income from foreign sources, just as it has always done.

For further information about the CRA's Foreign Income Verification Statement form or the Canadian foreign reporting requirements contact your qualified tax advisor.

Please contact us for more information about the topics discussed in this article.

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