BY SONJA CHONG

# Canadian tax planning

## an ounce of prevention

**Most immigrants to Canada are aware of its high tax rates. But what most do not realize is the extent of the Canadian tax net and the extent to which Revenue Canada will sometimes go. Fortunately, with a little pre-arrival planning, these concerns can be eliminated. Without appropriate tax planning, you enter Canada at your financial peril.**

The situation described below is a real case where an immigrant became the target of a "net worth" assessment by Revenue Canada. The names and circumstances have been altered slightly for confidentiality.

### As it unfolds

Kathy emigrated to Canada from Hong Kong in 1988. At the time of her arrival and thereafter, Kathy owned one-third of a Vancouver company ("Canco") and a Hong Kong company ("HKCo"). These companies did business together in importing and trading. The other shareholders are Kathy's brothers and sisters.

Revenue Canada audited Canco in 1991. As the audit progressed, Revenue Canada became concerned over how the shareholders' loan account had grown in the last few years. Most of the increase was attributed to loans and advances to Kathy. There was also concern over Canco's business dealing with HKCo.

Revenue Canada had a long interview with Kathy. Here is a sample of the questions they asked:

1. *How much money do you carry in your purse?*
2. *What is your position in HKCo?*
3. *Do you receive any fees from HKCo?*
4. *Where do you keep your savings?*
5. *What do you do in your spare time?*
6. *Where do you spend most of your time?*
7. *Who is managing HKCo?*
8. *Did you review the financial statements of Canco and HKCo?*

After the interview, Revenue Canada embarked upon a full scale audit of Kathy, they examined everything they could find, including all banking records (deposit slips, cancelled cheques, bank statements, wire transfers, etc.).

The following are some of the major issues that subsequently arose.

**Mind & Management of HKCo**

Revenue Canada visited a number of banks with which Kathy had dealings. One of the banks's files indicated that she held the position of managing director of HKCo. As a result, Revenue Canada proposed to treat HKCo as "managed and effectively controlled" by Kathy, who was now a resident of Canada. This meant that HKCo would also be deemed to be a resident of Canada, and would be subject to Canadian tax on its worldwide income.

**Loans from HKCo**

The financial statements of HKCo indicated that Kathy owed a large sum of money to this company. The loans were non-interest bearing and had been outstanding from one to five years.

Revenue Canada proposed to treat the shareholder loans as a benefit that has been conferred on Kathy. If successful, the entire amount of the loans would be taxed as income to Kathy. No deduction can be claimed when the loans are eventually repaid. This would have been disastrous.

**Loans to Relative & Friends**

Prior to leaving Hong Kong, Kathy had made loans to her brother and to certain close friends. These loans were repaid after Kathy became a resident of Canada and the repayments were picked up by Revenue Canada as deposits to her Canadian bank accounts.

Revenue Canada said that the loan repayments were unreported income of Kathy, since she was not able to substantiate all of the details to their satisfaction.

### Conclusion

Kathy's nightmarish experience will not happen to most new residents. But, for those who prefer to exercise a little caution rather than trust to chance, here are some practical tips:

- *Consider resigning from directorships of foreign companies and dilute the management and control of such companies prior to coming to Canada.*
- *Ensure that information disclosed on the financial statements and financial records of foreign companies is consistent with your personal financial information.*
- *Document loans made to and from friends and relatives.*
- *Provide consistent financial and personal information to all government agencies and banking authorities.*
- *Compile a personal net worth statement prior to moving to Canada.*
- *Consult professional tax advisers prior to and after moving to Canada.*

Canada offers tremendous tax planning opportunities for immigrants. The incentives are among the most generous in the world. Take advantage of them with proper advance tax planning. For those of you who prefer to adopt a wait-and-see attitude, I would caution that planning in hindsight is risky, costly, and, for the most part, ineffective.◆

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