

On April 12, 2012, the Supreme Court of Canada released its much anticipated decision in *Fundy Settlement v. Canada* (also known as the *Garron Family Trust* appeals). The *Fundy Settlement* case dealt with residency of a trust for Canadian tax purposes.

Background

The two trusts were settled (established) by an individual resident in St. Vincent, in the Caribbean. The trustee of both trusts was a corporation resident in Barbados, and the beneficiaries of the trusts were residents of Canada.

When the trusts sold shares they owned in Ontario corporations, the purchaser of the shares remitted a significant sum (\$152 million) to the Ministry of National Revenue as a withholding tax on the capital gains realized by the trusts. The trustee of the trusts requested the return of this sum on the basis of an exemption from Canadian capital gains tax under an international tax agreement between Canada and Barbados. Under this agreement, tax would only be payable in the country in which the seller of the capital assets was resident. Since the trustee was resident in Barbados, it argued that the trusts were also resident in Barbados and that Canadian taxes should not apply. However, the Minister of National Revenue argued that the trusts were actually resident in Canada, and that Canadian taxes were properly payable.

Court decision

The Court unanimously upheld the earlier decisions of the Tax Court of Canada and the Federal Court of Appeal. The Court confirmed that, as with corporations, the residency of a trust should be determined by where the “central management and control” of the trust actually takes place. Put another way, one should look at where the “real business” of the trust is carried on. If the trustee is not the person actually managing and controlling the property of the trust, then the trust will not necessarily have the same residency as the trustee.

In their decisions, the lower courts were particularly persuaded by the following facts in determining the “central management and control”:

- The trustee merely “[executed] documents as required, and [provided] incidental administrative services” and it did not have “responsibility for decision-making beyond that”;
- Rather than exercising its powers and discretions under the trust deeds, the trustee defaulted automatically to the recommendations and decisions of two of the principal beneficiaries, both of whom were resident in Canada;
- The principal beneficiaries had the authority to replace the “protector” of the trust (a role not commonly found in Canada), who in turn had the authority to replace the trustee;
- The trusts and beneficiaries had the same tax and investment advisors; and
- The trustee was actually an offshoot of an accounting firm, and had accounting and tax expertise, but it was less specialized in trust management.

Weighing the above-noted facts, the courts all agreed that the “central management and control” rested with the beneficiaries in Canada. The trustee only provided administrative services and had little responsibility. As such, the trusts were actually resident in Canada for tax purposes, and subject to Canadian taxes. The residence of the trustee is not conclusive of the residence of the trust, if the real management and control of the trust rests in the hands of Canadian residents.

Key takeaway – avoid confusion and unintended tax consequences

The *Fundy Settlement* case serves as a reminder of the perils of high value, offshore tax planning. However, having a non-resident trustee or a non-resident beneficiary generally can have unintended tax consequences. Individuals need to determine who has true control over any trusts, and to consult with a tax specialist in the country of the person with control so that any potentially adverse tax issues can be dealt with.

If you are seeking to set up a foreign-resident trust (e.g. a Barbados-resident trust) and a trustee or beneficiary of the trust is a resident of Canada, you should seek the advice of a Canadian tax specialist. The *Fundy Settlement* decision confirms that the Ministry of National Revenue may actively pursue taxes from a trust it believes to be controlled by a resident of Canada.

If you would like more information on this topic, please contact Roger Nainby at 416.860.8017 or rnainby@houserhenry.com.

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