Manulife Investment Management

THANK YOU to all health care heroes Learn more | A message regarding COVID-19 Learn more

April 20, 2020

Form T1135 - What is all the fuss about?

Investment Insight

Form T1135 is designed to help the Canada Revenue Agency ("CRA") obtain information on the amount of certain types of assets held by Canadian residents outside Canada.

The form went through a number of changes over time. The ability to EFILE it continues to expand with this option now available to partnerships along with individuals. Trusts must still file a paper version with electronic filing coming in the future. Given the form's current stable state, we'll review key requirements, definitions and challenges related to its completion.

Who is required to file form T1135?

All Canadian resident taxpayers who, at any time in the year, owned "specified foreign property" (SFP) with a total cost amount of more than $100,000 (Canadian) even if some or all of the SFP was sold before the end of the year. This requirement applies to individuals, trusts, corporations and partnerships, subject to a few exceptions[1].

What is SFP?

Specified foreign property is defined in subsection 233.3(1) of the *Income Tax Act* and includes:

- amounts in foreign bank accounts
- shares in foreign companies, even if held in a Canadian brokerage or through a separately managed account (SMA)

- shares of Canadian corporations held outside Canada (e.g., in a brokerage account in another country)
- interests in non-resident trusts
- debts owed by non-residents including bonds and debentures issued by foreign governments or foreign corporations
- life insurance policies issued by a foreign issuer[2]
- a property that is convertible into, exchangeable for, or confers a right to acquire a property that is specified foreign property (e.g., a call option or stock options or restricted stock units to acquire shares in a foreign corporation[3])
- interests in foreign mutual funds
- real estate situated outside Canada (unless mainly held for personal use and enjoyment)
- other tangible and intangible property situated outside Canada such as patents, copyrights, precious metals, gold certificates and futures contracts

Specified foreign property does ***not*** include:

- a property used or held exclusively in carrying on an active business;
- property held in a registered Canadian plan (e.g. RRSP, RRIF, RPP, RESP, RDSP, TFSA)
- personal use property (e.g. car, vacation property, jewelry, art work etc.)
- assets in certain foreign retirement accounts (e.g. U.S. 401(k) or IRA)
- an interest in, or a right to acquire, any of the above-noted excluded foreign property
- interests in Canadian registered mutual funds and segregated funds regardless of the underlying fund assets

What has changed on the form T1135

There has been no change as to who has to file the form, what property must be reported or to the $100,000 cost threshold. Furthermore, Form T1135 remains purely a disclosure form and does not calculate one's tax liability.

Prior to 2013, completing Form T1135 was a relatively simple exercise. A taxpayer only had to indicate the type of SFP owned, tick a box for a range of the total cost, country of location and total the amount of income reported in the income tax return related to these properties.

For years after 2014 if the total cost of the SFP is less than $250,000 throughout the year, Form T1135 provides for a simplified reporting method. This reporting method allows taxpayers to simply check a box for each type of property held, indicate in which countries most of the SFP is held and total the income from all SFP as well as the gains or losses from any disposition of SFP.

However, if the total cost of the SFP is $250,000 or more at any time during the year, detailed information is required for each SFP and includes:

- the name of the foreign entity holding the funds, foreign corporation, or foreign trust, or description of the foreign property
- the country where the foreign asset is located
- the highest cost amount of each property during the year and the cost amount at year end

- the amount of income or loss and capital gain or capital loss realized from the SFP during the year

Depending on the amount of foreign assets and the information available, this can be a time consuming and challenging exercise and one that can result in significant fees if paying someone to prepare the form.

Aggregate reporting method

Recognizing the challenges in completing the revised Form T1135, the CRA allows for the aggregate reporting method. For 2015 and later taxation years, an investor who held SFP in an account with a Canadian registered securities dealer may now report the aggregate value of all such properties on a country-by-country basis instead of reporting the details of each property. In addition, the total value of all such qualifying foreign property to be reported is the highest fair market value (FMV) at the end of any month during the year in addition to the FMV at year-end as opposed to reporting the highest cost amount of each property during the year and the cost amount at year end.

A taxpayer still also has to report the total income (loss) earned in the year and the gain (loss) realized from all dispositions during the tax year of all such property.

This aggregate reporting is reported in category 7 on Form T1135, “Property held in an account with a Canadian registered securities dealer or a Canadian trust company”.

Challenges in preparation

The increased level of disclosure and changes generally has created a number of challenges in completing the form. These relate to:

The cost amount

The cost amount is defined in subsection 248(1) of the *Income Tax Act* and generally means the adjusted cost base (ACB) of the property. Calculating the ACB can be difficult and the ACB of a property may change over time. Partial sales or redemptions, subsequent deposits, distributions of return of capital, dividend reinvestments, capital improvements to real estate and the application of the superficial loss rules to name a few examples can all impact the ACB.

If two people are joint owners of SFP they would need to include their share of the cost amount of the property. For new immigrants the cost amount is the fair market value (“FMV”) of property at time of immigration. For a gift or inheritance, the cost amount is the FMV on date of receipt.

Determining the country of residence of a corporation

Remember it is the country of residence of the corporation which is relevant, and this is not necessarily the same as the stock exchange the security is listed on. For example, consider American Depositary Receipts (ADRs). These are stocks that trade on a U.S. stock exchange but represent shares of a foreign corporation. One must look at where the corporation actually resides and not the fact that it is listed on a U.S. stock exchange. Keep in mind that there are foreign corporations listed on Canadian stock exchanges which are considered SFP. There are also some Canadian companies that are traded on foreign stock exchanges, but they are not reported on Form T1135 because they are usually considered Canadian property. However, shares of a Canadian corporation (wherever listed) held in a brokerage account outside of Canada are considered SFP. Many people are often surprised by this.

Complications with the aggregate reporting method

The aggregate reporting method requires disclosure on a country-by-country basis and eliminates the need to supply cost amounts. While this provides some relief in simplifying the reporting process, it raises a few challenges. The investment statements may not be presented on a country-by-country basis. For example, the investments may be listed by currency denomination. In that case the taxpayer would need to sort through all of the investments and identify the country of residence.

Filing deadline

Form T1135 is due on the same date as the income tax return for individuals, corporations and trusts.

Penalties

Failure to file Form T1135 by the due date results in a penalty of $25 per day (subject to a minimum penalty of $100) to a maximum of $2,500. Additional penalties may result if the failure to file was done knowingly or under circumstances amounting to gross negligence or persisted after 24 months. More significant penalties apply to people who knowingly or under circumstances amounting to gross negligence make false statements or omissions.

As well, the period within which the CRA can reassess a taxpayer's tax return is extended by an additional 3 years (from 3 years to 6 years) if a taxpayer fails to report income from a SFP on their income tax return and either Form T1135 is filed late or income from a SFP is reported incorrectly on the form. It is important to point out that this extended limitation period allows the CRA to review the entire tax return for the year and does not restrict their review to just the income related to the foreign property.

Conclusion

Form T1135 has evolved over time which caused some growing pains. As a result, CRA has created a robust Question and Answer section on their website to help taxfilers. Still, keeping good records of all foreign holdings will be critical to reducing the time, frustration and potentially the cost of completing this form. Errors or omissions, even if accidental, could result in penalties and could extend the reassessment period. Consequently, it is important that Canadian residents complete the form correctly and file it on time. Speaking to a tax advisor is usually recommended.

Planning opportunities with non-registered assets

For clients who hold shares of Canadian corporations in a brokerage account outside of Canada, consider moving them back to a Canadian account. For those who hold shares of foreign corporations directly (including through an SMA) consider purchasing mutual or segregated funds with a similar investment mandate. In both cases, these assets would no longer be considered SFP and wouldn't have to be included on Form T1135. Furthermore, if the total cost amount of one's SFP now falls below $100,000 the form doesn't have to be filed at all.

Important Disclosure

1 Certain exceptions to this rule include (but are not limited to) individual immigrants to Canada in the first year they become a Canadian resident (unless they were previously a resident in Canada), mutual fund trusts and corporations and non-resident owned corporations. **2** For a foreign life insurance policy, the cost amount would follow the normal rules for determining the “adjusted cost basis” of a life insurance policy for Canadian tax purposes. For more information, see AAMOT June 2014 “Foreign Life Insurance and T1135 Reporting”. 3 The cost amount of the stock options or restricted stock units (RSUs) is frequently nil since they are usually granted at no cost to the employee. If the total cost amount of the employee’s other foreign property is less than $100,000, the threshold is not met and no T1135 reporting is required. However, if the total cost amount of the employee’s other foreign property exceeds the $100,000, then the stock options and RSUs would need to be declared on the T1135 Form even though the cost amount is nil.

MK3114E 04/20