

Cayman Subsidiary Zero Tax Exempt Surplus

On June 1, 2011, the tax information exchange agreement (“TIEA”) between the governments of Canada and the Cayman Islands entered into force. A TIEA is a bilateral agreement that permits an exchange of financial and tax information between the two countries. Most importantly, the Cayman Islands are now considered a designated treaty country for the purposes of the Income Tax Act (Canada) (“ITA”).

With this designation now in place, Canadian-resident corporations may establish or re-domicile a non-resident controlled foreign affiliate corporation (subsidiary) in the Cayman Islands and, provided such subsidiary earns active business income (as determined in the ITA), the subsidiary will be able to take advantage of the “exempt surplus” tax rules for Canadian corporations. Generally, exempt surplus includes active business income of a foreign affiliate that is resident in a country with which Canada has a tax treaty or a TIEA. Active business income (as determined in the ITA) of the Cayman subsidiary is generally not attributed to the Canadian corporate shareholder (parent) and so not taxed in Canada on a current basis. In addition, such exempt surplus can be repatriated to the Canadian-resident parent corporation as a tax-free intercorporate dividend.



Cayman Advantages over Double-Tax Treaty Jurisdictions

Canadian corporations have enjoyed a longstanding relationship with Barbados with which Canada signed a double-tax treaty in 1980. Since the signing of this treaty, Barbados has been a convenient tax saving jurisdiction for many Canadian businesses, whereby foreign affiliates based in Barbados would be subject to local corporate tax of up to 2.5% on active business income without resulting in further tax to the corporate parent. These low-taxed earnings could then be repatriated to the Canadian parent company without incurring further Canadian tax.

As noted above, as a consequence of the TIEA, the Cayman Islands are now considered a “designated treaty country” for Canadian tax purposes and as a consequence, dividends to a Canadian parent resulting from active business income earned by a Cayman-based subsidiary are effectively exempt from Canadian tax.

Whereas the corporate tax rate for International Business Companies in Barbados can be up to 2.5%, in contrast there are NO corporate income, capital gains or withholding taxes levied in the Cayman Islands which presents a significant tax savings for foreign Canadian subsidiaries.



Residency of Subsidiaries

One of the principal concerns of companies considering the establishment of a foreign subsidiary is that of a potential challenge of the actual residency (for tax purposes) by the Canada Revenue Agency (“CRA”).

The determination of residency is question of fact based upon the location of the central management and control of the corporation. This is generally understood to be the place where the company’s board of directors meets. The CRA may challenge the central mind and management of a foreign affiliate particularly in a low-tax jurisdiction.

Cayman has recently set itself apart from other designated treaty countries by establishing a special economic zone where Canadian foreign affiliates can quickly and efficiently establish a definitive corporate presence in the Cayman Islands. With exemptions from work permits, taxes, import duties, and fast-tracked set up of operations in state-of-the-art customized business facilities, Cayman Enterprise City (“CEC”) offers one of the best opportunities available to successfully establish a tax-neutral foreign affiliate presence in a designated treaty country.

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