Canadian Tax FOCUS

Investing with a Foreign Broker and Buying Canadian Shares

Foreign brokers can attract Canadian investors, perhaps because of low management fees. The foreign broker may purchase some Canadian shares (either on a foreign exchange or on the TSX). These shares should be treated as Canadian for the purposes of dividend tax credits and foreign tax credits (FTCs), but as foreign for the purpose of form T1135 filings; this counterintuitive treatment can lead to errors.

Consider first form T1135, because this form has large penalties for missed filings, and possibly for errors as well. The **CRA's view** (question 19 on the website) is that shares in Canadian companies held through a foreign broker are subject to the T1135 filing, like all specified foreign property, because they are "situated, deposited or held outside Canada" (subsection 233.3(1)). The issue is that the brokerage account is foreign, even though the shares are not. (Interestingly, the location of the stock exchange on which the shares were purchased is not relevant; thus, even if the foreign broker bought the Canadian shares on the TSX, form T1135 would still have to be filed.)

Dividend tax credits are available for dividends on these Canadian shares because the dividends are from Canadian corporations (section 121). It is easy to forget to claim these credits because the foreign broker would not likely issue a T5 slip to the Canadian investor.

As for FTCs, there is no definition of foreign-source income in the Act. The closest reference to a definition of income from a source can be found in section 4, but that section does not specifically address income from a foreign source. Therefore, one must look at the CRA FTC folio (S5-F2-C1).

For dividends, paragraph 1.59 of the folio states that dividends received from a company that is not resident in Canada would normally be considered as foreign-source. Presumably, one could make the negative inference that foreign-source income would not include dividends received from a Canadian-resident corporation, and therefore this income should not be included in the calculation of foreign tax credits.

For capital gains, the situation is more complicated. The general treaty rule is that capital gains on stocks and bonds are taxed only in the jurisdiction of the taxpayer's residence (see article XIII(4) of the Canada-US tax treaty). Thus, the gains would be tax-exempt income, according to the definition in subsection 126(7). Tax-exempt incomes are not qualifying incomes (subparagraph 126(9)(a)(iii)) and are not eligible for FTCs (subparagraph 126(1)(b)(i)).

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