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Proceed with caution: Continuation of foreign companies to the BVI

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Sophisticated international families are more than familiar with the need to structure their affairs using vehicles that are modern, flexible, and – ideally – mobile. The ability to migrate vehicles between jurisdictions has always been a priority for UHNWIs and family offices who might anticipate a need to be nimble as their family evolves and their business interests expand. And, with many families choosing to move to "safe havens" around the world in the fact of economic uncertainty and political upheaval in their home country in recent years, this type of flexibility has become increasingly more important.

On this front, there have always been strong links between North America and the Caribbean. It is common for private clients to establish vehicles offshore for multiple business and succession reasons. The link between Canada and the British Virgin Islands is a particularly strong one and is only growing as many Canadians look to migrate their businesses (and their families) offshore in the light of fiscal challenges at home. Whilst "continuing" an existing company to the BVI can be a simple and effective option for changing its tax residence as part of an exercise such as this, it should not be done without first taking tax advice in tandem with local structuring advice to avoid falling foul of increasingly complex and ever-changing tax codes.

Moving offshore

The uncertainty faced by those who seek to move their business offshore was highlighted in the recent decision of the Tax Court of Canada[1] in which the judge found in favour of the taxpayer, notwithstanding the taxpayer's admission that the company's continuance into the BVI was carried out specifically with the intention of taking the company outside of the Canadian-controlled private company ("**CCPC**") tax regime. The Canadian Minister of National Revenue challenged this finding, on the basis that it breached Canada's general anti-avoidance rule ("**GAAR**").[2] The GAAR is applied in cases where the relevant tax authority assesses that tax planning measures have surpassed being simply 'tax efficient' and go far enough to be considered avoidant. In this instance the effect of the GAAR would be to tax the company as if it remained a CCPC despite the continuance to the BVI.

Change in company status

By way of very brief background[3], Canadian corporations are divided into several categories, each with their own tax regime, CCPCs being one such category. The central point in the case was whether moving between categories constituted illegal avoidance.

1 DAC Investment Holdings Inc v the King (2024 TCC 63)
2 Many countries have similar anti-avoidance provisions in their tax codes.
3 The purpose of this note is not to provide any form of Canadian tax advice, and Canadian tax laws are referenced by way of commentary only.

The appellant company was incorporated in Ontario in September 2001 and continued into the BVI in April 2015. The reason for continuation was to change the company's status from a CCPC category company to a company that fell outside this classification, in preparation for a sale of shares in a subsidiary (shares which had seen a considerable accrued gain in excess of CAD $1 million). Following its continuance to the BVI, the company was considered to have been incorporated outside of Canada, which meant that certain tax provisions referring to place of incorporation applied differently or fell away. The shares in the subsidiary were sold in May 2015 and the sale was reported in the taxpayer's 2016 Canadian tax return.

The judge noted that in deciding whether to change the company's status, the directors would have considered the pros and cons of each. The judgment identified those pros and cons to be the following. On the plus side, the company was no longer subject to the 10 2/3% refundable tax on aggregate investment income. However, on the minus side, the company lost access to the low Eligible Small Business Tax Rate for its business income, and to a number of benefits that are only available to CCPCs.

Dismissing the application of the GAAR, the judge noted that the relevant legislation operating in Canada allows companies to change their status between these categories. Therefore, it was held that taking the company outside of the specific CCPC regime meant that it should not be taxed following the CCPC regime, but in such other category. Interestingly, the judge found that the fact that the central management of the company remained in Canada did not change the object, spirit or purpose of the rule in question (and indeed it was noted that this was the result anticipated by the government at the time).

Effect of the judgment

Private clients with an interest in migrating their companies out of Canada to the BVI should take note of this judgment. It is the first judicial ruling in Canada to examine this specific point, and it is understood that several other cases have been held in abeyance anxiously waiting on the ruling of the Tax Court in this case. Whilst the decision will be welcomed by those who have continued companies to the BVI in a similar context, this may not be the end of the matter: Canadian commentators note that it is very likely this decision will be appealed given the revenue at stake.

Unfortunately, and at least for the time being, there will likely be ongoing uncertainty for those who have legitimately continued companies into the BVI from Canada where this appeared to be permitted on the face of the relevant legislation. Despite the taxpayer's success in these proceedings, it will has been a costly exercise and they will have to await the outcome of an appeal by the tax authority. Furthermore, it is understood that proposed legislative changes in Canada would deny the tax benefits realized by the company in this case to similarly situated taxpayers for taxation years ending after April 7, 2022.

Given that these changes would appear to have retrospective effect these companies may find the net closes on them after all, even years later. It is a situation worth monitoring closely in conjunction with both BVI and Canadian attorneys in order to identify swift and sensible solutions to issues arising from historic planning.

Continued

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