

UNDERSTANDING THE NEW T1135

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Editor's note: we have updated this article to reflect tax rules as of June 2017. It was originally published in 2015 by François Bernier.

CRA's revised Form T1135 requires taxpayers to provide significantly more information about their foreign property. This article explains the new rules.

WHO HAS TO FILE A T1135?

A T1135 must be filed by:

- Canadian resident individuals, corporations and trusts that, at any time during the year, own specified foreign property costing more than \$100,000; and
- certain partnerships that hold more than \$100,000 of specified foreign property.

An individual does not have to file a T1135 for the first year he or she is a resident of Canada.

Note the \$100,000 threshold isn't based on the fair market value, but on the adjusted cost base of the asset in Canadian currency.

WHAT IS SPECIFIED FOREIGN PROPERTY (SFP)?

Subject to the exceptions noted below, SFP includes:

- Funds in foreign bank accounts;
- Shares of foreign corporations (even if held in Canadian brokerage accounts);
- Interests in foreign mutual funds;
- Shares of Canadian corporations on deposit with a foreign broker;
- Debts owed by non-residents including bonds, debentures, mortgages, and notes receivable;
- Interests in a non-resident trust;
- Interests in a partnership that holds specified foreign property;
- Land and buildings located outside Canada (foreign rental property);
- Tangible and intangible properties located outside Canada;
- Life insurance policies issued by a foreign insurer;
- Precious metals, gold certificates, and futures contracts held outside Canada.

There are many Canadian public corporations whose shares are trading on foreign stock exchanges; the shares of these corporations are not considered SFP if held with a Canadian broker.

What matters is not the currency of the holding, or the stock exchange where the investment is bought or sold. Canadian company bonds denominated in U.S. dollars are still Canadian. Canadian corporation stocks traded on the New York Stock Exchange are still Canadian and are therefore not considered SFP.

SFP does **not** include:

- Foreign property held in a Canadian-based mutual fund;
- Property used or held exclusively in the course of carrying on an active business;
- Foreign property held for personal use and enjoyment, such as a vehicle, vacation property, artwork, etc.;
- Foreign property held within registered plans like RRSPs, LIFs, RRIFs, LIRAs, TFSAs, RESPs and RDSPs;
- Assets held in a foreign registered pension account (IRA, 401K);
- Shares of a foreign affiliate;
- Interests in a non-resident trust that neither the taxpayer nor a relative had to pay for (e.g. an estate);
- Interests in or indebtedness of a non-resident trust that is a foreign affiliate.

WHAT MUST BE REPORTED?

On the earlier version of the T1135, there was no need to identify particular foreign assets, or to give the precise cost.

For 2013 and subsequent years, the revised form requires the following for each foreign asset:

- Name of the entity holding the SFP;
- Name of the foreign corporation, name of the foreign trust or description of the foreign property;
- Country where the SFP is located;
- Maximum cost of the SFP during the year;
- Cost of the SFP at year end;
- Amount of income (or loss) related to the SFP; and
- Amount of any capital gain (or loss) realized on the disposition of the SFP.

THE TWO-TIERED SYSTEM

As of the 2015 tax year, CRA has introduced a two-tier information reporting structure for specified foreign property.

The first tier, known as the simplified reporting method, is for taxpayers who held specified foreign property with a total cost of more than \$100,000, but less than \$250,000, throughout the year. Under the simplified method, taxpayers simply check a box to identify the type of property held during the year (as opposed to providing details of each specific property). Also, taxpayers will need to identify the top three countries where the specified foreign property is held, based on the aggregate maximum cost amount of the properties held during the year. Finally, taxpayers will be required to disclose the total income as well as the combined gain or loss earned on the sale of all specified foreign property during the year.

The second tier, called the detailed reporting method, applies to taxpayers who own total specified foreign property with a cost base of more than \$250,000 at any time during the year. The detailed method of reporting hasn't changed; however, the threshold at which this applies increased to \$250,000 as of 2015. Under the detailed reporting method, taxpayers are required to provide details of each specified foreign property, including the location of the asset (via the country code), the maximum cost amount during the year, the cost amount at year-end, and any income or capital gains/losses recognized from each asset.

Special rules have been implemented for SFPs held in account with a Canadian registered securities dealer (or a Canadian trust company) where taxpayers are permitted to aggregate and report the property on a country-by-country basis. There is no need to segregate the SFPs by categories (shares, debt, etc.) as required under the more detailed method. The amounts that have to be reported are the highest fair market value during the year. This amount may be based on the highest month-end fair market value that appears on the investment statements. The fair market value at the end of the year must also be reported on a country-by-country basis.

In addition, the combined income (or loss) earned on all SFPs held at any time in the year, as well as the total gains or losses realized on the disposition of SFPs during the year, have to be reported on a country-by-country basis.

Detailed reporting on a SFP-by-SFP basis is still required when the SFP is not held in an account of a Canadian registered security dealer (or a Canadian trust company).

Amounts reported on the T1135 form are required to be determined in the applicable foreign currency, and then converted into Canadian dollars. In terms of which exchange rate should be used, taxpayers are required to use the exchange rates in effect at the time of the transaction (e.g., the time the income was received from the property, or the exchange rate on the date the property was purchased). However, if income is received throughout the year, CRA permits using an average exchange rate.

FILING THE FORM

Form T1135 must be filed by the filing due date of the income tax return for the particular year. Individual as well as corporations can file this form electronically for the 2014 tax year and beyond. Trusts and partnerships are still required to paper file. For all taxation years prior to 2014, taxpayers must paper file the T1135.

EXTENSION OF THE NORMAL REASSESSMENT PERIOD

In the past, unless an omission in a tax return was due to negligence, tax authorities were prevented from processing a reassessment for additional tax after the normal reassessment period (generally three years after the day a notice of assessment is sent to a taxpayer).

For 2013 and following tax years, the reassessment period will be extended by three years if a taxpayer has failed to report income from a SFP on his or her income tax return and the T1135 was not filed, was filed late, or included incorrect or incomplete information.

PENALTIES

The penalty for not filing the T1135 is \$25 per day, up to a maximum of \$2,500. Additional penalties are possible if the taxpayer knowingly or negligently fails to comply.

FINAL THOUGHTS

Always keep good records of clients' investment holdings. Trade confirmation slips can be evidence of cost amounts. And, when in doubt, file the T1135. There are no penalties for filing it even if it is not required.

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