Changing US Tax Rules

The Trump Effect and its Considerations for Canadian Corporations

Investment Canada vs USA – Tax Model Consideration

- Canadian company deciding to invest for expansion and planning for taxation of resulting profit.
- 15% or 20% US corporate rate versus 26%-31% Canadian corporate rate (non M&P)
  - Transfer Pricing considerations?
    - Tax models shifting profit from US to Canada may need to be reconsidered
    - How will CRA and IRS react?
  - State Tax Considerations
    - Will they follow federal changes? Will they also reduce rates with broader tax base?
- Higher potential U.S. effective tax rate on income where traditional deductions denied (interest expense and border adjustments)
- Immediate U.S. tax depreciation (potential of 100%) versus declining balance in Canada (M&P Class 53 at 50%)
- Tax free U.S. royalty export revenue versus Canadian SR&ED program (up to 68% recovery of eligible costs)
- Canadian government grants – Over 500 available grants exceeding $37 Billion

Border Adjustment Planning

- "Products, services, and intangibles that are imported to the US will be subject to US tax" – Therefore no tax deduction provided in USA for such expenditure
  - This is a very controversial issue proposal, but still has full support of House leadership due to massive revenue impact needed to offset rate reduction
  - Chairman Brady proposed this week that this could be spread over 5 years
- US is otherwise attempting to implement a VAT through the corporate tax system.
- Where no corporate tax deduction available for goods consider a distributor model where product is supplied to an individual end user:
  - Product shipped to U.S. either directly to customer or stored in warehouse
  - Product sold to U.S. customer through third party distributor network or through U.S. sales subsidiary.
  - U.S. sales service to a non-resident may be exempt from U.S. tax
  - Permanent establishment ("PE") considerations – Access to Canada US International Tax Treaty required to negate nexus for the Canadian company.
- In theory, this would allow Canadian companies to supply the Canadian market tax-free from their US subsidiaries
  - Export of goods or services to Canada would be exempt from US tax and profits could be distributed back to Canada in theory as exempt surplus

Canada USA – International Tax Treaty

- **Does your existing tax structure qualify for Treaty Benefits?**

- **Limitation of Benefits of Article 29 (XXIX-A)**
  - Individuals/Trusts
  - Public Companies
  - Ownership & Base Erosion

- **Fifth Protocol (December 15, 2008) – Fiscally Transparent Entities**
  - Article 1 (I) – Treaty generally applies to "residents … of the contracting states"
  - Article 4 (IV) – Defines residency
  - Article 4 Paragraph 7 (IV 7) – Defines income/profit as not derived by a resident of a contracting state for fiscally transparent entities.

Other Considerations for Canadian Corporations

- Impact on Branch operations:
  - Full foreign tax credit may not be available as effective US tax rate could be higher than Canadian rate where deductions are eliminated for Canadian expenses.
  - Impact on branch tax?
- Impact on Canadian multi-national financing structures
  - Finance U.S. cap-ex through international financing structures.
  - Such structures generally rely on interest income earned offshore not otherwise classified as FAPI due to deductibility of interest expense against ABI of US sub.
  - If net interest expense is no longer deductible, what will impact be on Foreign Affiliate regime?
  - Should US now be considered a viable group financing location if interest income could be sheltered by otherwise disallowed interest expense?
- In theory, U.S. products, services, and intangibles that are *exported* to Canada will not be subject to US tax.
  - Incentive is to shift profit to US as export profit in US is tax exempt
  - Dividends of US profit would also be tax-free?
  - How will CRA react?

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