US Tax Reform For Canadian Companies
Agenda

Domestic Changes
- Income Tax Rate Reduction
- Update for Certain Deductions
  - NOL, Interest, Depreciation, DPAD (Section 199)
- Credits and Incentives

International Changes
- Migration to Territorial System
  - Transition Tax – Sec. 965
  - Subpart F & Sec. 1248
  - Foreign Tax Credits
- New: GILTI, FDII, BEAT

Potential State Impact
- Approach to Conformity

Canada vs USA Tax Planning
Federal Income Tax Changes

- Corporate rate lowered to 21%
  - Pass-through rate of 29.6% for most businesses

- Interest Deduction
  - Limited to 30% of adjusted taxable income/EBITDA
  - Real Estate Company Election

- Repeal of Alternative Minimum Tax ("AMT")

- NOL’s
  - Indefinite carryforward, limited to 80% of adjusted taxable income

- Repeal of deduction for entertainment expenses

- Capital Investment
  - 100% Expensing of Qualified Property placed in service after September 27, 2017, and before Jan. 1, 2023.
  - Does not include real estate, but does include most personal property attached to buildings
Federal Income Tax Changes

- Domestic Production Activities Deduction (Section 199)
  - Repealed for tax years beginning after 12/31/2017

- R&D Credit Preserved

- New Markets Tax Credits - NMTC
  - NMTC Maintained through 2019 allocation

- Historic Tax Credit - HTC
  - Repeal of the 10% non-historic tax credit
  - Modification to 20% HTC to be taken over 5 years

- Work Opportunity Tax Credit - WOTC
  - Maintained through 2019

- Opportunity Zones
  - Deferral of gains reinvested in a qualified opportunity fund and
  - Excludes post-acquisition capital gains on investments in opportunity zone funds that are held for at least 10 years
International Income Tax

- Worldwide Tax System
- Indirect Foreign Tax Credits
- APB 23 – Accounting election to avoid recognizing residual US tax on foreign earnings due to “Permanent Reinvestment”
- Inversions
- Outbound IP Migrations
- Simplification
International Income Tax

Transition Tax

– Sec. 965 requires MANDATORY Toll Charge on Foreign Earnings for DFIC’s
  – “DFIC” = Deferred Foreign Income Corporation

  ▪ Under the new system, there is a one-time toll charge on unrepatriated foreign earnings for every US person – including individuals

  ▪ No actual repatriation required!
    » Toll charge creates a “PTI” account

  ▪ Foreign Earnings measured at November 2, 2017 and December 31, 2017
    » Toll charge computed based on the higher of the two earnings amounts
    » Calendar or Fiscal Year not relevant

  ▪ Effective in 2017, requiring financial statement recognition for the first fiscal period ending after the legislation was enacted on December 22, 2017
International Income Tax

Transition Tax (continued)

- Bifurcated Rate of Tax:
  - 15.5% - Earnings held in cash and other liquid assets
    - Net Accounts Receivable
    - Marketable Securities
    - Timing issue for fiscal year companies
  - 8% - Earnings held in illiquid assets
    - Everything else

- Eight Year Payment Plan is Available

- Basis adjustment applies to the extent the earnings that generate the toll charge remain unrepatriated
  - This is only relevant when a DFIC is sold in the future
International Income Tax

Transaction Tax (Continued)

- Tax Mitigation Opportunities
  - Loss companies can offset companies with positive earnings
    » Applies on an affiliated basis or offshore parent-sub relationships
  - FTC’s are available but the legislation keeps the effective rate of tax on the Transition Tax at 15.5% / 8% (as applicable)
  - FTC carryforwards can be used to offset the toll charge.
  - Carefully and conscientiously prepare and review E&P calculations
    » Focus on “Pre-87” Amounts, from years where the foreign corporation did not have a US Shareholder
    » Focus on transactions where book & tax did not treat items the same
**International Income Tax**

**Territorial System: New Foreign DRD**

- New Sec. 245A provides a 100% Dividends Received Deduction (“DRD”) for dividends received by US Corporations from Foreign Corporations in which it is a US Shareholder
  - 10% Ownership Requirement
  - Holding Period Requirement
  - The dividend can’t be deductible by the Foreign Corporation for local tax purposes

- New DRD does NOT apply to dividends received by:
  - S-Corporation’s or
  - Pass-through entities (LLC, LP, LLP, etc.) owned by non C-Corporation partners

- No more indirect FTC’s allowed if dividend qualifies for DRD
International Income Tax

- **Subpart F** – US version of FAPI
- **Sec. 1248** – Converts capital gain to dividend income
- **Sec. 960** – Indirect credits with Subpart F income
- **PFIC** – Passive companies with no operations
- **Complexity**
- **Acronyms**
International Income Tax

Territorial System: Subpart F (FAPI)

- Subpart F: Survivor!
  - Expansions of certain pain points:
    - Holding Period
      - 30 day ownership rule eliminated
    - Ownership Attribution Rule
      - New: attribution to US corporation from foreign parent
    - CFC Look-through Rule NOT made Permanent
      - This will always, however, be renewed for payments between related parties
  - Repeal of FBC Oil Related Income
  - FTC’s Remain Available via Sec. 960 Retention, but the pooling concept of prior law has been eliminated
    - For Canadian subs of US companies, this presents a new dynamic as the Canadian rate is now higher than the US rate. Accordingly, new planning should be considered to treat Canada as a branch for US purposes or adjust transfer pricing to increase profits in the US
**International Income Tax**

**Foreign Tax Credits**

- Indirect FTC’s under Sec. 902 will be eliminated prospectively
  - May be partially used to offset impact of Transition Tax, but not to reduce it below the 15.5% / 8.5% thresholds

- Indirect FTC’s under Sec. 960 may still be used to offset Subpart F income
  - Under the new regime, foreign tax credits will not pool and may only be used in the year that those credits arose.

- Direct FTC’s under Sec. 901 still permitted – may be beneficial for US Co’s to treat Canada and Mexico as branches
  - Low-taxed Mexican production can provide foreign source income to soak up excess Canadian taxes
International Income Tax

Foreign Tax Credits (continued)

- FTC Limitation Changes:
  - New FTC basket established for foreign branches
  - New FTC basket established for GILTI
  - Elective increase in ODL utilization percentage for ODL’s generated pre-2018
  - Sec. 863(b) sourcing rule changed to rely on place of PRODUCTION
  - Elimination of FMV method for Interest Expense Apportionment

- FTC’s have a 10 year statute so retroactive FTC reviews are now the only way to use excess FTC’s
**International Income Tax**

- **New: Global Intangible Low-Taxed Income (“GILTI”)**
  - GILTI is US attempt at a global minimum tax

  - CFC Shareholders subject to an effective 10.5% tax on Adjusted CFC Net income that:
    - Exceeds a specified return, on
    - Tangible business assets, that is
    - Not otherwise taxed by the US, or
    - Minimally taxed outside the US

  - New Sec. 951A; operates similarly to Subpart F

  - FTC’s can be used to partially offset the tax on GILTI
International Income Tax

New: Deduction for Foreign Derived Intangible Income (“FDII”)

– FDII Deduction is an INCENTIVE to hold intangible property in the US

– Deduction = 37.5% of FDII
  - Results in effective US tax rate of 13.125% on FDII

– Key Formula for FDII:

\[
FDII = \frac{\text{Deemed Intangible Income} \times \text{Foreign Derived Deduction Eligible Income}}{\text{Deduction Eligible Income}}
\]

– Practically, this is an additional incentive for US companies to increase export prices
**International Income Tax**

**Base Erosion Anti-Abuse Tax ("BEAT")**

- BEAT applies to:
  - US C-Corporations, with
  - Gross receipts exceeding $500 million (3 year average), and with
  - Deductible, related party payments that exceed 3% of total deductible payments
    - 2% threshold applies in certain cases for financial service entities

- BEAT does not apply to:
  - RIC’s, REIT’s, S-Corporations
State Income Tax

State Impact - Current Approaches to Conformity

- “Moving” or “rolling” conformity states
  - These states adopt the current IRC for the tax year in question

- “Fixed-date” or “static” conformity states
  - These states conform to the IRC as of a specific date

- “Conform to specific IRC Sections”
  - These states pick specific IRC sections to follow

- “Federal Taxable Income” – No Reference to IRC
  - State taxable income starts with federal taxable income

- Not affected
  - Gross receipts tax states (Nevada, Ohio, Washington) do not follow IRC conformity
Tax Planning – Canada vs USA

U.S. Corporate Tax Rate – 21%

- Comparison to Canada needs to consider full effective U.S. rate
  - State Tax
  - GILTI
  - BEATS

100% Expensing of Qualified Property

- Canadian M&P CCA (50%) allows approx. 90% deduction over 4 years
- Material capital purchases require financing. Consider impact of availability of interest deduction when evaluating Cap-Ex spend
**Interest Deductibility**

- Business interest expense deduction will be limited to 30% of “adjusted taxable income”
- However, such test is now based on all interest (related party and third party financing)
- Deduction for certain related party amounts paid or accrued pursuant to a hybrid transaction or by, or to, a hybrid entity, will be denied.
- Where will you receive the maximum benefit of interest deductibility?
- Lower tax rate on higher base = higher tax rate on lower base?
**Tax Planning – Canada vs USA**

**Transfer Pricing**

- IP Planning
  - Global Intangible Low-Taxed Income (“GILTI”) – 10.5% to consider for traditional international IP safe harbors
  - Deduction for Foreign Derived Intangible Income (“FDII”) – Incentive to hold IP in USA
- Shifting of transfer pricing to goods, services, cost sharing agreements?
  - Base Erosion Anti-Abuse Tax (“BEAT”)
Tax Planning – Canada vs USA

Tax Modelling

– Necessity for tax modelling
  - Too many U.S. tax changes to predict impact for each industry
  - Various thresholds can exempt application of negative tax implications. I.E. – Planning to the Threshold
  - Availability of elections (interest deductibility vs 100% capital deduction)
  - Accelerating tax deduction for high tax periods
  - Revenue deferral to lower tax periods
  - Global capital structure
  - Transfer Pricing strategy
QUESTIONS & ANSWERS
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