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  - Repealed for tax years beginning after 12/31/2017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:

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

  - 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

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Tax Planning – Canada vs USA

- **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 stragegy

QUESTIONS & ANSWERS

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