United States-Canada Tax Issues

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Outline

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Introduction

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Canada is the largest trading partner for the United States for the following reasons:

- Proximity of jurisdictions
- Ease of doing business
- Similar cultures and business practices
- Tendency for businesses to focus on North America as one market
- Many customers operate cross border

Introduction

Often businesses don’t understand the tax filing obligations they may be creating as a result of:

- Agreeing to be importer of record
- Soliciting for sales in Canada
- Providing services in Canada
- Leasing or Licensing to Canadian residents
- Owning real or personal property in Canada
- Obtaining a Canadian Business Number (“BN”)

International Tax

Largest issues faced by middle market companies and executives in the international arena are:

- Residency
- Domicile
- Tax treaties
- Permanent establishment
- Transfer Pricing
- FATCA

Residency

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- – Relates to tax home for individuals
- – Can be difficult due to globalization
  - Multiple residences
  - Work in multiple countries
- – Can be determined based on number of days (183 or more)
- – Can be determined based on facts and circumstances
- – Dual residency is possible

Domicile

- Relates to tax home for businesses or trusts
- Can also be difficult due to globalization
  - Place of incorporation
  - Corporate headquarters
  - Employee base
  - Majority of business activity
- Generally determined based on facts and circumstances

Tax Treaties

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- Local country law could subject companies or individuals doing business across borders to double taxation.
- Tax treaties are negotiated between countries to define when companies or individuals can be taxed in order to keep them from being double taxed.
- Treaties define Permanent Establishment which is a term used for when a business becomes taxable in another country.
- Countries that do not have bi-lateral tax treaties can create uncertain tax results for companies and individuals doing business across borders.

Permanent Establishment

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- The threshold for when a company becomes subject to income tax if a tax treaty applies to their business operations, similar to nexus for state income tax purposes
- Often defined as a fixed place of business
- Can be created when services are rendered for over half a year or when a construction contract exceeds one year
- Can also be created when an employee or contractor has the ability to bind a company via a contract in the foreign country

Transfer Pricing

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– Term that describes pricing between related parties doing business in different tax jurisdictions
– Can be associated with prices charged for goods, services or use of intangibles
– Governments worldwide are concerned that companies may manipulate pricing when there is common control in order to move income from one taxing jurisdiction to another
– Especially a concern when there is a low tax jurisdiction involved

FATCA

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- Foreign Account Tax Compliance Act
- Effort by US to ensure that US citizens and residents report and pay taxes on foreign assets and earnings
- Requires banks in foreign countries to report to the US government (directly or indirectly) certain information on US account holders
- Designed to combat tax evasion and for Treasury to monitor funds due to money laundering and terrorism finance concerns

Canadian Taxes

The following taxes may apply when doing business in Canada:

- Income tax
- Withholding and Branch Taxes
- Goods and Services Tax (“GST”) and Provincial Sales Tax
- Payroll Taxes
- Property Taxes
- Land Transfer Taxes

Canadian Income Taxes

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– Jurisdictions include Federal, 10 provinces and 3 territories.
– Quebec and Alberta have their own corporate tax returns and administration, but other jurisdictions are filed with Federal.
– Combined Federal and Provincial corporate rates range from approximately 26-31% and individual rates range from approximately 39-50% at the top marginal tax rate.

Canadian Withholding Taxes

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- Resident companies that receive services from nonresidents must withhold 15% of the payment and remit to the Federal government.
- Quebec has additional 9% withholding.
- A waiver can be applied for to remove this withholding in some cases.
- General withholding required on payments of interest, dividends, royalties, rents and management fees to nonresidents is 25%.
- US-Canada Treaty reduces that to 0% for interest, 5 or 15% for dividends and 10% for royalties.
- Branch profits tax is equal to dividend withholding rate.

Goods and Services Tax (“GST”)

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- The Federal government charges a 5% GST on most goods and services.
- 4 Provinces have agreed to Harmonize with the federal government so HST was created. This increases the HST rate to 13%-15% depending on the province.
- Exemptions for basic foods, healthcare and education.
- British Columbia, Manitoba, Saskatchewan and Quebec have their own provincial sales tax system. Quebec calls it’s tax QST. The rates are 7% - 9.975%.

Canadian Payroll Taxes

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- Employers are required to withhold income tax, Canadian Pension Plan (“CPP”) contributions and Employment Insurance (“EI”) premiums from wages of employees working in Canada.

- There is a totalization agreement between the US and Canada that exempts employees from CPP and EI for short term employment in Canada.

Doing Business in Canada

Q: What does it take to be considered doing business in Canada by the Canadian Revenue Agency ("CRA")?

A: Very little. Becoming importer of record, having a person in Canada soliciting sales, providing any services or leasing property would all be considered doing business. This very low threshold can create significant filing requirements.

Doing Business in Canada

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Q: Our customer has asked us to be responsible for importing goods, to provide services to them or to lease them property. What should we do?

A: It depends upon the specific circumstances. If the customer is large you may not have a choice. What are total costs and benefits associated with the decision? Can you employ independent contractors to handle the services or take title to property in Canada?

Doing Business in Canada

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The following activities do not, on their own, create Canadian filing requirements:

- Sales to Canadian customers with title transfer in US
- Use of a customs broker
- Hiring of Canadian independent contractor who is not soliciting for sales in Canada

Doing Business in Canada

The following activities may create Canadian filing requirements, but will not create Permanent Establishment ("PE"):

- Services performed on contracts less than 183 days
- Construction contracts less than 1 year
- Acting as importer of record with title transferring outside the US
- Hiring someone to solicit sales in Canada

Doing Business in Canada

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The following activities may create Permanent Establishment (“PE”) in Canada:

- Services performed on contracts more than 183 days
- Construction contracts more than 1 year
- Server
- Maintaining inventory or other business property
- Establishment of office or fixed place of business
- Agent with authority to close contract

Canadian Entities

- Branch – Not advantageous if owned directly by individual or LLC.
- Canadian Corporation – Not advantageous if owned directly by individual, S Corporation or LLC.
- Unlimited Liability Company (“ULC”) – Not advantageous if owned directly by individual or LLC.
- Partnership and/or Trusts – Similar issues with individuals and LLCs.

Tax Planning

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- Structure – Choice of structure is the first and often the most important way to do tax planning. Don't move forward without getting competent tax and legal advice.
- Transfer Pricing – By analyzing worldwide corporate rates a company with multiple tax jurisdictions may find ways to reduce worldwide taxation by setting intercompany charges at reasonable, but favorable amounts.
- US Export Incentive – Interest Charge – Domestic International Sales Corporation ("IC-DISC").

US Informational Requirements

- Forms 5471, 8865 and 8858 – Report activity in foreign owned corporations, partnerships or disregarded entities.
- Form FinCen 114 – Report on direct or indirect ownership of or signature authority over foreign financial accounts in excess of $10,000.
- Form 8938 – Report direct ownership of foreign assets valued in excess of $50,000.
- Penalties for each of these forms are $10,000 per form at a minimum for non-filing.

US Investment from Canada

- LLC ownership typically will not work for Canadians.
- Ownership of a US Partnership will create US tax filing requirements for Canadian.
- Working in US creates a US filing requirement.
- US citizens residing in Canada or US residents who are Canadian citizens are both taxed in the US on their worldwide income.