



THE VIEW FROM NORTH OF THE 49TH PARALLEL

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Outline

- Canadian perspective on Treaty changes
- Structuring considerations for business expansion into the US
 - Canadian parent issues
 - BC International Financial Activity Program
- International tax developments
 - Section 116 Clearance Certificates
 - Advisory Panel on International Tax System



Canadian Perspective on US Treaty Changes

Canadian Perspective on US Treaty Changes

-- The Hot List

- Corporations on either side of the border with a foreign parent (from another country) must review the continued existence of treaty exemptions, e.g.,
 - Carrying on business in the other country but not through a permanent establishment
 - A very big deal for American performing services in Canada, but also important going the other way
 - Capital gains exemptions on non-real property transactions
- Review all foreign cross-border interest payments for exemptions and reductions
 - Able to unwind 5 year debt arrangements
- Consider the exposure to deemed permanent establishment based on the new time-based “temporal” approaches – two separate 183 day tests

Canadian Perspective on US Treaty -- The Hot List (cont'd)

- Review Hybrid entities before January 1, 2010 effective date
 - LLCs
 - ULCs
- Longstanding issue relating to CRA's position that a US Limited Limited Company (LLC) is not generally entitled to treaty benefits
- Unexpected changes that, as worded, impact shareholders of a Canadian Unlimited Liability Company (ULC)
- Changes on financing structures

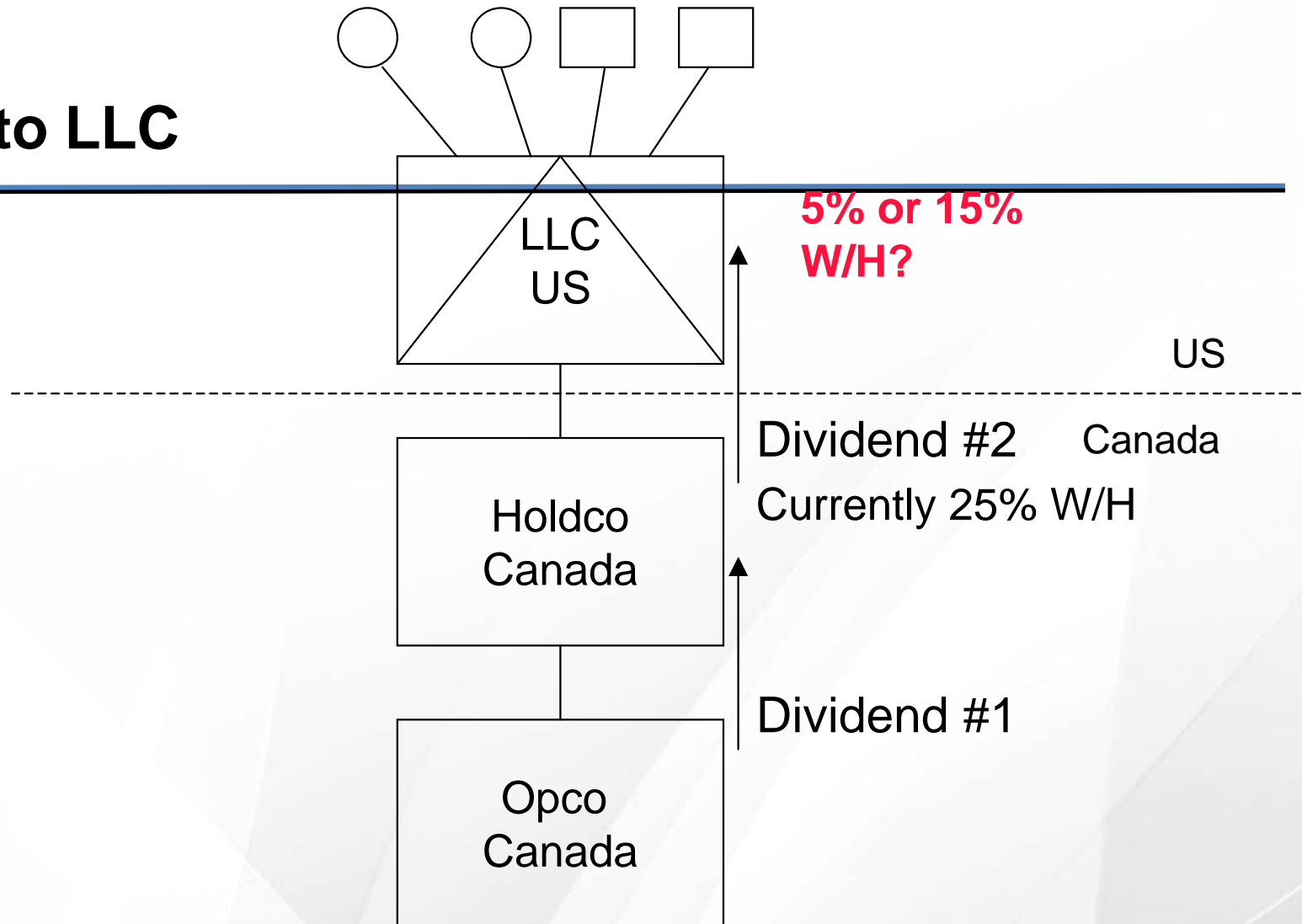


Positive Change for LLC Investors into Canada

- Income, profit or gain will be consider derived directly by the owner
- LLC members access to
 - Capital gains exemption
 - Carrying on business but no PE exemption
 - Reduced withholding tax rates, etc.
- Consider challenges
 - Payer's determination of residency of individual members re: W/H rate, etc.
 - Filing of tax returns by LLC members?
 - Section 116 compliance by LLC re its members
 - S corporation treatment?

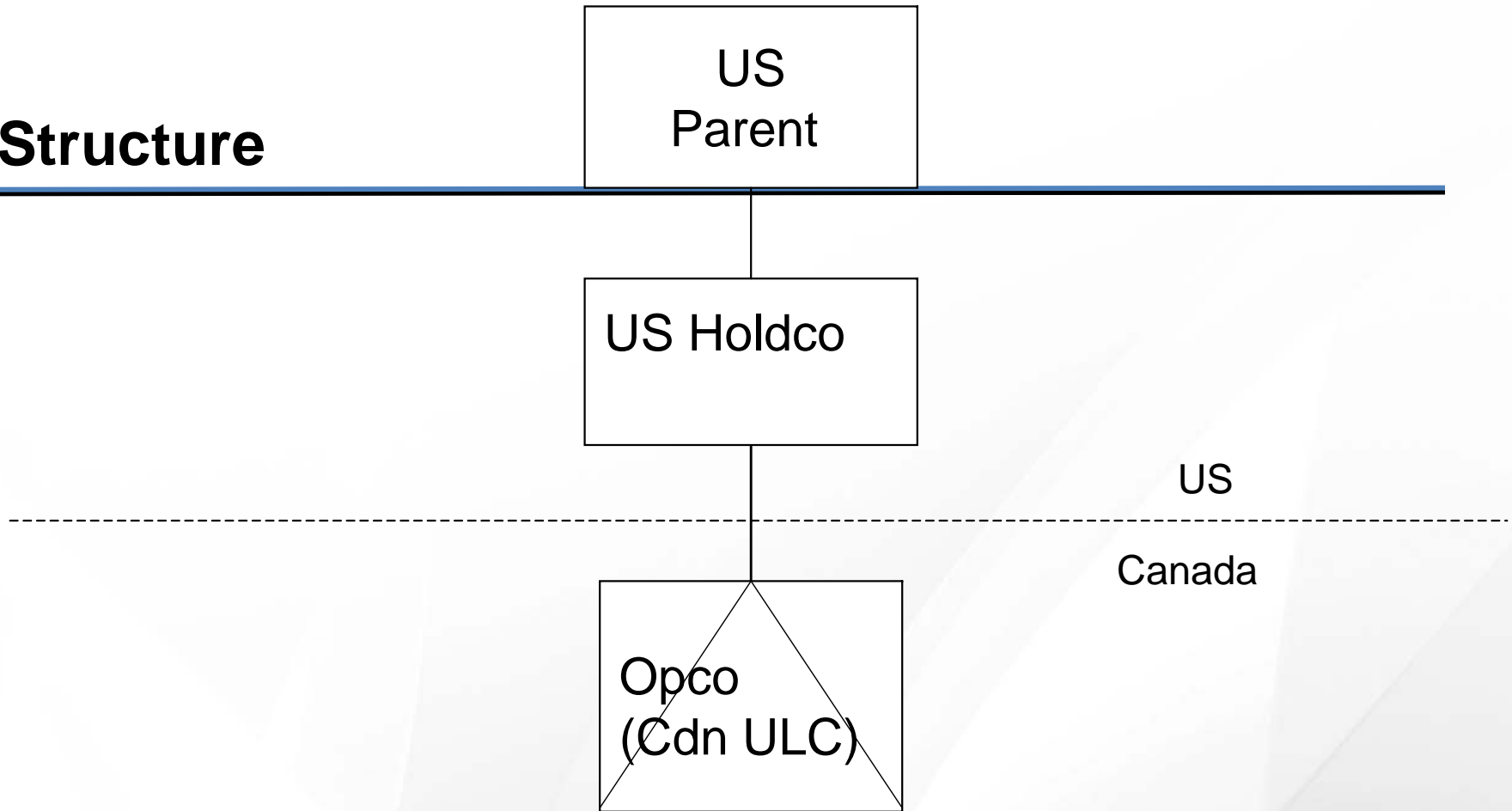


Dividend to LLC

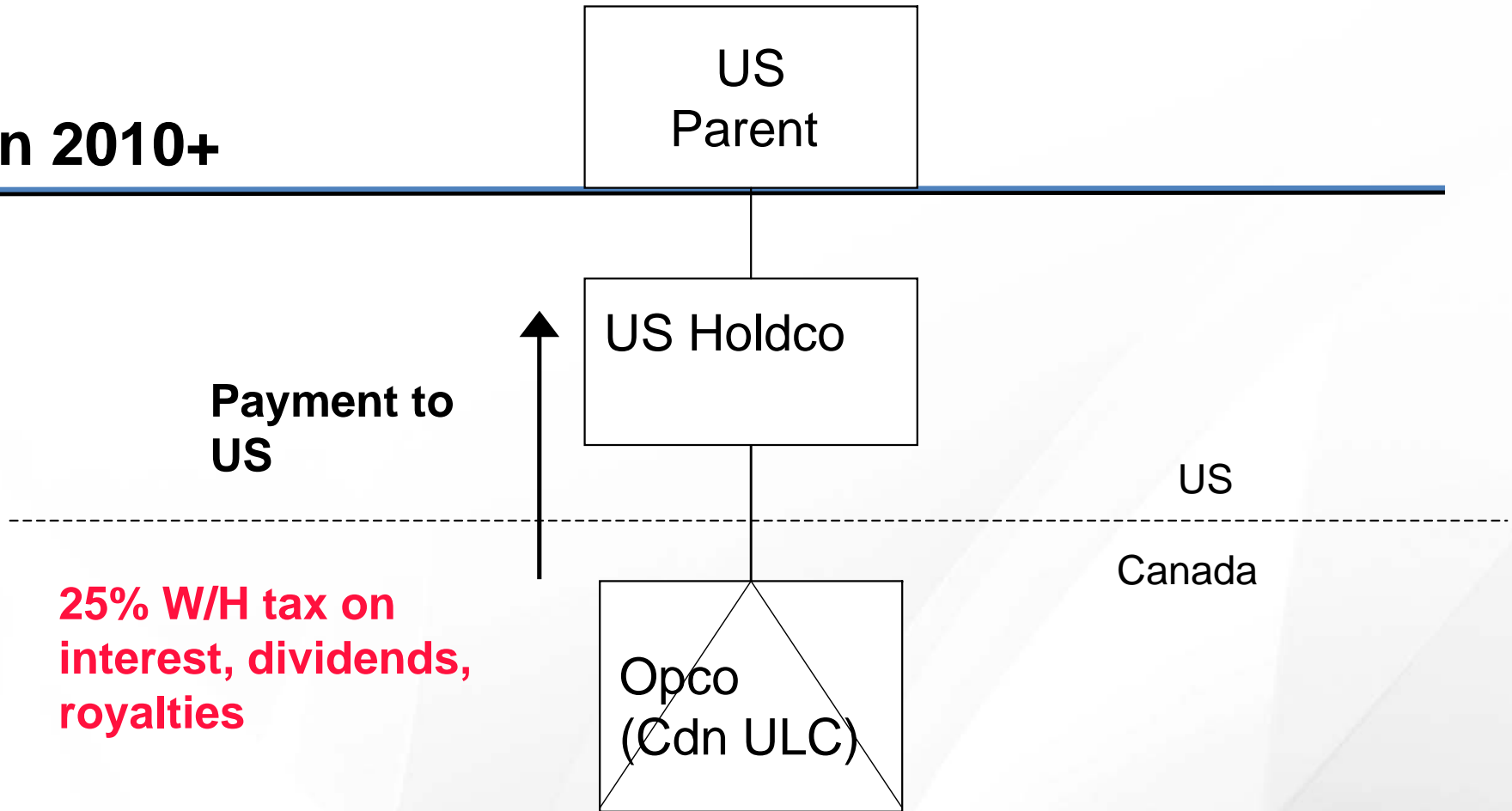




ULC Structure



ULC in 2010+



The ULC Problem

- Both Canadian and US officials have commented that the broad effects of the treaty provision were not intended
- Both sides have commented publicly that another protocol to amend the treaty may be necessary to “fix” this issue
- Fifth Protocol took 10 years to negotiate
- A number of possible solutions – choice of restructuring dependent upon a variety of factors
- Interesting alternative – insert Luxembourg SARL
- Recent discussions with CRA indicate some reluctance to confirm “GAAR N/A”



Structuring Canadian Business Expansion into the US



Considerations for the Canadian Parent

- Deductibility of interest expense on funds borrowed and loaned into the Canadian parent company
 - Canadian parent company needs to consider charging interest
 - In these challenging economic times, may help with deductibility of a capital loss on the funds loaned to the Canadian parent company
- Impact of US expansion on the “Small Business Corporation” status of the Canadian corporation
 - Lifetime capital gains exemption
 - Corporate attribution
 - Allowable business investment losses
 - Therefore, consider a sister corporation

BC International Financial Activity Program

- IFA provides eligible corporations with a refund of corporate taxes (11% as of July 2008) paid on income from a qualifying international business
- In most cases, non-arm's length arrangements also qualify
- For non-residents transferred to BC to work in an International Financial Business, 75% of BC personal tax is refunded
- By 2012, the tax rate will be down to 15%
 - Competitive with Singapore and Hong Kong
- Not just financial activities



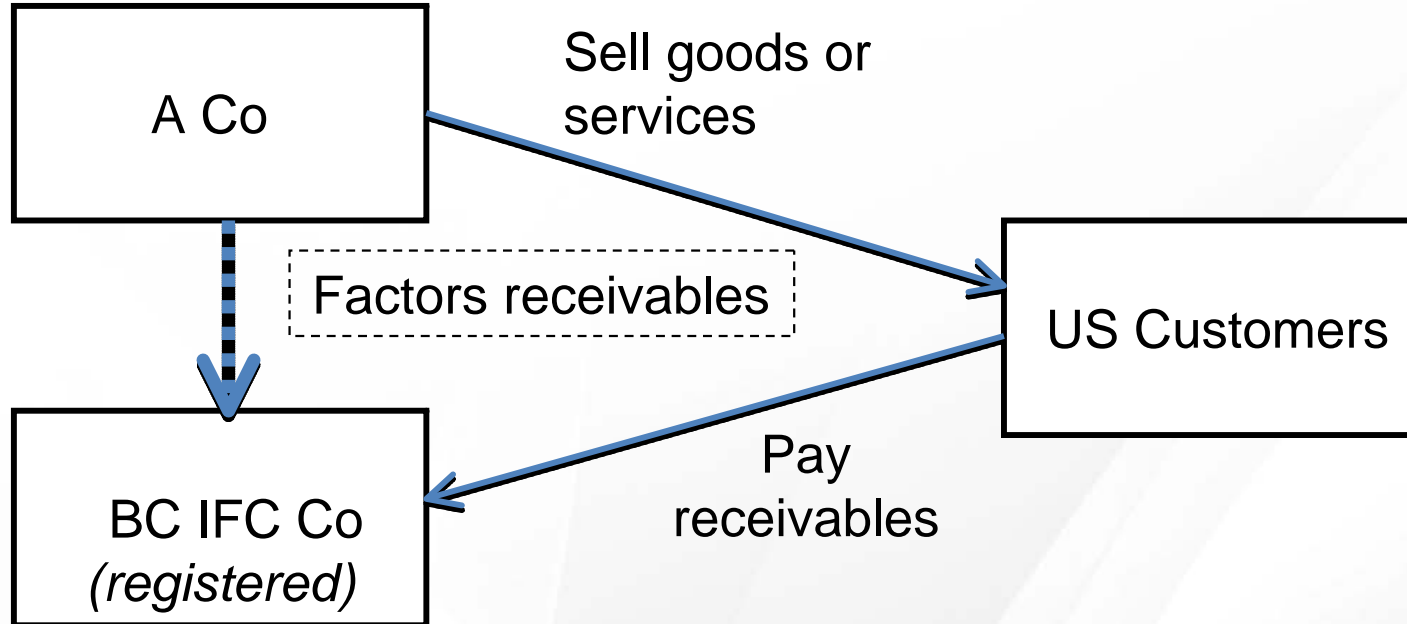
Enhancements to the Program

- In 2008, qualifying activities under the IFA Program were expanded to include
 - Head office activities
 - Short-term financial instruments for non-securities corporations
 - Hedging activities
 - Exploitation of green-related patents

Qualifying IFA activities

- Financial activities (loans, deposits, dealing in securities, providing financial advice, managing foreign exchange, factoring, leasing and insurance)
- Distributing film and television outside of Canada
- Providing administrative support services
- Selling, assigning or licensing to a non-resident
 - Life science patent
 - Green-related patent
- Selling to a non-resident a good or service whose sales revenue is derived from above-listed patented technologies

Illustration of factoring





International Tax Developments

Dispositions of Taxable Canadian Property by Non-Residents

- Changes to the Section 116 Clearance Certificate provisions for dispositions after 2008 for “treaty-protected property”
 - (i.e., capital gain exempt under a tax treaty)
- Where the purchaser and the vendor are related, the purchaser must provide notice under new s. 116(5.02)
- Purchaser is not required to withhold 25% of the purchase price if
 - a) after reasonable enquiry, the vendor is resident in a treaty country
 - b) the property is “treaty-protected property”
 - c) the purchaser provides notice under s. 116(5.02)

Dispositions of Taxable Canadian Property by Non-Residents

- Risk to purchaser that property would not be treaty-protected property
(e.g., perhaps Limitation of Benefits rules apply or individual is a former resident of Canada and the treaty exemption does not apply)
- Experience is showing that few arm's length purchasers will take this risk
- In Vancouver, the clearance certificate log jam seems to have been cleared nonetheless
- Also special rules to exempt the non-resident from having to file a tax return to report the "excluded disposition"



Advisory Panel on Canada's System of International Taxation

- December 2008 report recommending changes to improve Canada's competitiveness
 - Maintain the existing system for foreign-source income of Canadian companies and extend the existing exemption system to all active business income earned outside Canada by foreign affiliates
 - Maintain the existing system for the taxation of inbound investment and adopt targeted measures to ensure Canadian-source income is properly measured and taxed
 - Recommendations affecting "outbound" investments are generally favourable
 - Recommendations affecting "inbound" investment are mixed

Advisory Panel on Canada's System of International Taxation

- **Outbound**
 - Broaden the existing exemption system to cover all foreign active business income
 - Impose no additional rules to restrict the deductibility of interest expense of Canadian companies where the borrowed funds are used to invest in foreign affiliates and repeal section 18.2 (2012) restrictions on double-dip interest
 - Other technical changes

Advisory Panel on Canada's System of International Taxation

- **Inbound**
 - Reduce maximum Thin Capitalization ratio from 2:1 to 1.5:1 (used to be 3:1)
 - Extend Thin Capitalization rules to partnerships, trusts and branches
 - Curtail tax-motivated debt-dumping transactions
- **Withholding taxes**
 - Reduce non-resident withholding taxes bilaterally
 - Eliminate the 15% withholding tax on services rendered in Canada by non-residents
 - Eliminate the 25%/50% withholding tax on sale of taxable Canadian property where non-resident certifies the gain is exempt and exclude all sales of public company shares



QUESTIONS

Moderator for Q&A Session

Tom Morton, Tax Partner, Smythe Ratcliffe, Vancouver

Panel

Eddie Goldsberry, PKF of Texas, Houston

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