

The Canadian and US Tax Issues of Doing Business in the US as a Canadian



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US AND CANADIAN ATTORNEYS & NOTARIES



THE CANADIAN AND US TAX ISSUES OF DOING BUSINESS IN THE UNITED STATES AS A CANADIAN

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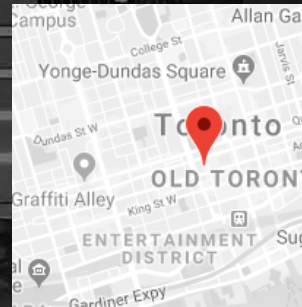
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US AND CANADIAN ATTORNEYS & NOTARIES

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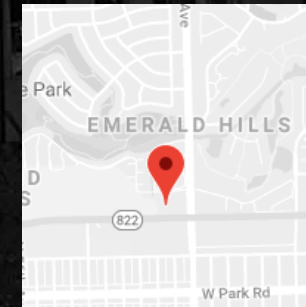
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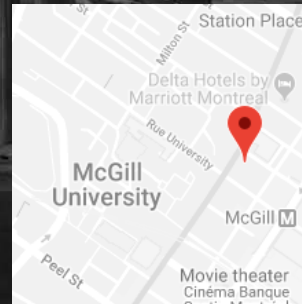
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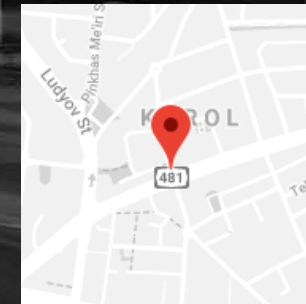
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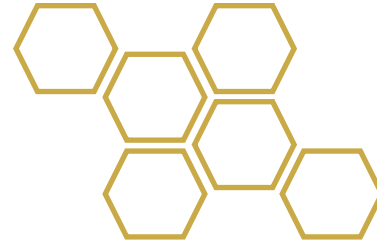
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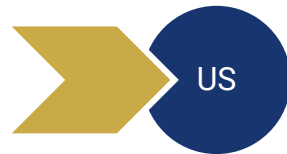
US and
Canadian Tax
Treatment



Structures for Operating in
the US and their Cross
Border Tax Treatment



US
Estate
Tax



US
Immigration
Options



Canadians
Owning
US Real Estate

US TAXATION OF CANADIAN BUSINESSES IN THE UNITED STATES

- ▶ When is a Canadian business operating in the US subject to federal income tax?
- ▶ **US tax law:** recognizes two general types of income
 - US trade or business with Effectively Connected Income (ECI)
 - Fixed, Determinable, Annual or Periodic Income (FDAP)
- ▶ **ECI:** primarily active income
 - Taxed at marginal tax rates
- ▶ **FDAP:** primarily passive income
 - Subject to 30% withholding unless ECI election is made
- ▶ No US federal sales tax



US TAXATION OF CANADIAN BUSINESSES IN THE UNITED STATES

- ▶ Canada-US Tax Treaty
- ▶ Permanent Establishment under the Treaty
 - Fixed place of business in the US
 - US resident agent who can act on behalf of a Canadian business
- ▶ Taxation under the Treaty is also determined by other factors
 - Situs of incorporation of corporations vs Central control and management
 - Characterization as income, capital gains or dividend and source



US INCOME TAX SUMMARY BY OWNERSHIP STRUCTURE

TRUSTS	LIMITED PARTNERSHIPS	PERSONALLY	CORPORATIONS *(US OR CDN)	LLC – DOUBLE TAXATION
IRS – Tax Rates of Beneficiaries*	IRS – Tax Rates of Partners*	IRS – 10 to 37%*	IRS – 21%	IRS – Personal Income Tax Rates
			FL – 4.458% (reverts back to 5.5% in 2022)	CRA – 26%
			Total Tax Liability: 26.5%	Total Tax Liability: Personal Income Tax PLUS 26%*
*US Federal Rates			*+ Canadian Dividend Tax and US withholding considerations	

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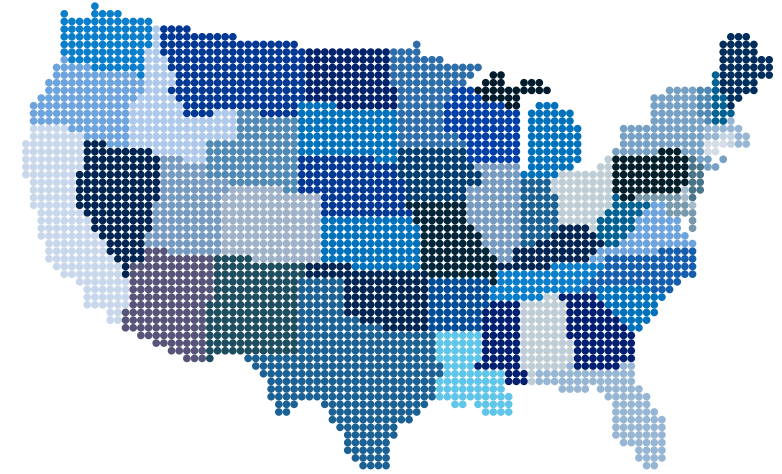
US CAPITAL GAINS TAX SUMMARY BY OWNERSHIP STRUCTURE

TRUSTS	LIMITED PARTNERSHIPS	PERSONALLY	CORPORATIONS *(US OR CDN)	LLC – DOUBLE TAXATION
IRS – 15 to 20%*	IRS – 15 to 20%*	IRS – 15 to 20%*	IRS – 21%	IRS – 15 to 20%
			FL – 4.458% (reverts back to 5.5% in 2022)	CRA – 26%
			Total Tax Liability: 26.5%	Total Tax Liability: 41% to 46%*
*US Federal Rates			*+ Canadian Dividend Tax and US withholding considerations	



STATE INCOME TAX AND SALES TAX

- ▶ Depending the States in which a Canadian based business operates, State income tax and/or State sales tax may apply
- ▶ Economic Nexus Test: No need for a physical presence or connection in the State
 - Facts and circumstances: sales revenue and/or transaction volume
- ▶ Some States have adopted a “Bright Line” amount or percentage threshold
 - Receipts threshold
 - Property threshold
 - Payroll threshold



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STATE INCOME TAX AND SALES TAX

State “Bright Line” Economic Nexus Rule

STATE	EFFECTIVE YEAR	RECEIPTS THRESHOLD	PROPERTY THRESHOLD	PAYROLL THRESHOLD
California	2011	\$536,446 (or + 25% of sales)	\$53,644	\$53,644
Michigan	2008	\$350,000	N/A	N/A
Ohio	2005	\$500,000	\$50,000	\$50,000
New York	2015	\$1,000,000	N/A	N/A

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STATE INCOME TAX AND SALES TAX

- ▶ State Income Taxation
 - Percentage of the entire net income of an entity
 - Proportionate level of activity **WITHIN** the state vs. **OUTSIDE** the state
- ▶ State Indirect Taxes
 - Sales Tax, Use Tax, Franchise Tax, etc.
 - Registration with the State
- ▶ Certain cities also level their own income tax and indirect tax



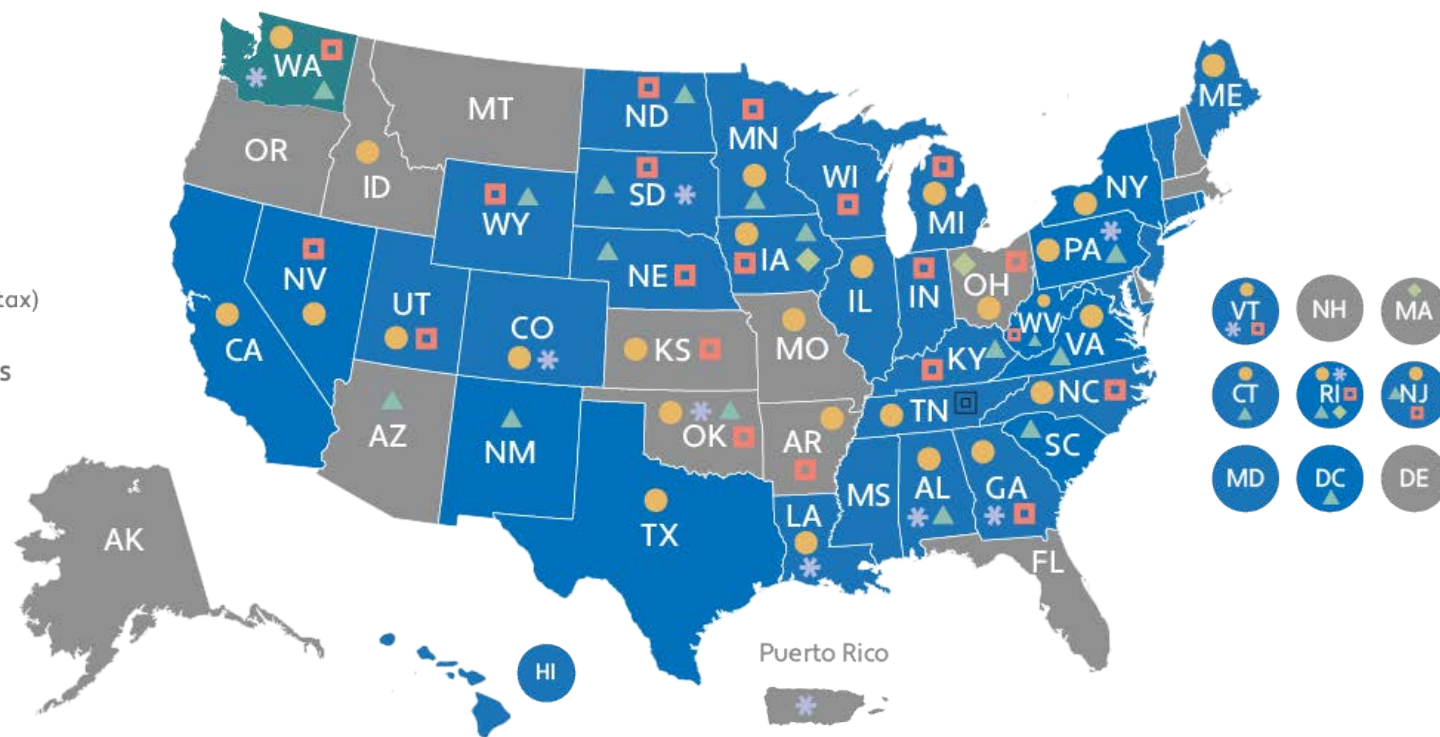
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STATE INCOME TAX AND SALES TAX

Remote Seller Nexus by State

- States with economic nexus (remote transactions)
- States with economic nexus (remote transactions and B&O tax)
- States with affiliate or click-through nexus
- ✳ States with use tax reporting for non-collecting sellers

- Streamlined Sales Tax (SST) state
- SST associate member state
- ▲ States that tax marketplace sales
- ◆ States with cookie/software nexus



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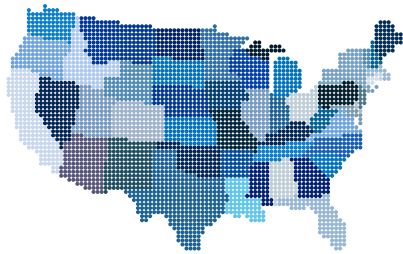
Source: <https://www.avalara.com/us/en/learn/sales-tax/south-dakota-wayfair.html>

STATE INCOME TAX AND SALES TAX

REMOTE SELLER NEXUS	
Affiliate Nexus	In-State Affiliate / Subsidiary Relationship
Click-through Nexus	Commission / Referral through website link
Cookies Nexus	Physical Presence through software / Internet cookies
Tax on Marketplace	Facilitator held liable
Non-Collecting Tax on Marketplace Reporting	Non-collecting sellers share consumers' tax information

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US TAXATION OF CANADIAN BUSINESSES IN THE UNITED STATES



There are other State level considerations



Not all States follow the Canada-US Tax Treaty

Limits access to foreign tax credits (FTCs)

Exposure to double taxation



Canadian business carrying on business in a US State **must** generally register with the States in which it carries on business

Registration fee and other legal or administrative requirements

CANADIAN TAXATION OF CANADIAN BUSINESSES IN THE UNITED STATES

OWNERSHIP BY A CANADIAN INDIVIDUAL OR A CANADIAN ENTITY

Must declare income and pay tax in Canada

Canada-US Tax Treaty

- ▶ Availability of Foreign Tax Credits in Canada for US tax paid
- ▶ Possible mismatch on depreciation: mandatory in the United States – optional in Canada

Form T1134

- ▶ Must declare ownership of shares in a foreign affiliate with a value in excess of \$100,000 CAD or which is active

Form T1135

- ▶ Must declare ownership of foreign investment property with a value in excess of \$100,000 CAD

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US ESTATE TAX FOR CANADIANS


US ESTATE TAX FOR CANADIANS



Does it apply to
Canadians owning US
assets?

Are your US assets >
\$60,000 USD?


Is the value of your
worldwide estate >
\$11,400,000 USD?



US **situs**
assets

What is in?

What is out?



Worldwide
estate

Everything counts!

Specific rules (joint
tenancy, life insurance
policies, etc.)

US ESTATE TAX

	100,000 \$ US Taxable Estate Value	1,000,000 \$ Worldwide Taxable Estate Value
YEAR		2019
ESTIMATED TAXABLE AMOUNT		100,000 \$
ESTIMATED MARGINAL TAX RATE		30 %
ESTIMATED ESTATE TAX AMOUNT		23,800 \$
ESTIMATED UNIFIED CREDIT		450,580 \$
ESTIMATED ESTATE TAX PAYABLE		0 \$

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US ESTATE TAX

	\$950,000 US Taxable Estate Value	\$20,000,000 Worldwide Taxable Estate Value
YEAR		2019
ESTIMATED TAXABLE AMOUNT		950,000 \$
ESTIMATED TAX MARGINAL RATE		39 %
ESTIMATED ESTATE TAX AMOUNT		326,300 \$
UNIFIED CREDIT AMOUNT		214,025.50 \$
ESTIMATED ESTATE TAX		112,274.50 \$

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STRUCTURES FOR OPERATING IN THE UNITED STATES

Growth and expansion of your business may result in a need of a real presence in the United States.



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STRUCTURE & CROSS BORDER TAX TREATMENT

1.

Branch: CanCo
operating
directly in the US

▶ Conduct business as a **foreign corporation**

▶ Authorization needed for each State in which it operates

▶ Source income to be reported in both US and Canadian Tax returns

▶ Tax to be paid on the ECI at graduated rates / FDAP: 30% withholding

▶ Liable for branch profits tax: 5% for CanCo

▶ Application of Canada-US Tax Treaty for corporate tax

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STRUCTURE & CROSS BORDER TAX TREATMENT

2. US LLC

▶ Default: IRS solely taxes LLC profits in the hands of the members

▶ Election to be taxed as Corporation in the US

▶ CRA does not recognize pass-through nature of LLCs

▶ CRA taxes LLC earnings paid to CDN members as dividends

- ▶ Canada-US Tax Treaty not applicable: **Double taxation problem**
- Mismatch on characterization of the nature of LLC income
 - Mismatch on timing of LLC income distribution

STRUCTURE & CROSS BORDER TAX TREATMENT

3.

US Limited Partnership

▶ Taxed on a pass-through basis in both the US and Canada

▶ Partners bear their own income tax burden on profits allocated to them under the partnership agreement

▶ Canada-US Tax Treaty applies: US tax paid will generate foreign tax credits against Canadian tax

▶ Only the remaining Canadian tax will be owed in Canada

▶ If you cease to be Canadian tax residents, only the US personal income tax treatment will apply

STRUCTURE & CROSS BORDER TAX TREATMENT

4.

Tiered Corporate Structure

▶ Incorporation of a subsidiary in the US

▶ US tax treatment similar as operating a branch

- ▶ Dividend distributions to Canadian shareholders subject to US withholding tax
- 15% for Canadian individual shareholders
 - 5% for Canadian corporate shareholders

▶ Foreign affiliate rules

▶ Canadian dividend tax

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US IMMIGRATION OPTIONS

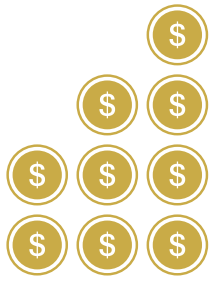
Business-wise and/or for lifestyle preferences, if you wish to be physically present in the US for potentially more than 50% of the year, here are some US immigration options:

1



**E-1 Treaty
Trader Visa**

2



**E-2 Treaty
Investor Visa**

3



**L-1A Visa
for Intracompany
Transferee Executive
or Manager**

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US IMMIGRATION OPTIONS

1



**E-1 Treaty
Trader Visa**

Nonimmigrant visa for treaty nation citizen to carry out substantial trade in the US



Eligibility:

Executive, manager or specialist, or 50% owner of business



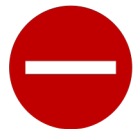
Benefits:

- Travel freely in and out of the US
- Bring your minor dependents to the US, and your spouse can also work



Duration:

Initial stay of two (2) years and renewal in increments of two (2) years



Main limitation:

Limited to the employer or business on which the visa is based

US IMMIGRATION OPTIONS

2



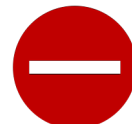
**E-2 Treaty
Investor Visa**

Nonimmigrant visa for treaty nation citizen investing substantially in a US enterprise



Eligibility:

- ▶ **Substantial** investment;
- ▶ In a **real operating commercial enterprise**;
- ▶ With potential to generate **significant income**;
- ▶ You must have **control of funds**; and
- ▶ The investment must be **at risk**.



Benefits, Duration, Main limitation:

Same as E-1 visa holder

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US IMMIGRATION OPTIONS

3



**L-1A Visa
for Intracompany
Transferee Executive
or Manager**

Nonimmigrant visa for individuals being sent by a foreign employer to open or continue a US branch, affiliate or subsidiary



Allows for **dual intent**: path for Green Card & Permanent residency



Eligibility:

- ▶ “Qualifying Relationship” between the US and foreign employer
- ▶ Additional requirements for “new office”
- ▶ Employee worked minimum one (1) year for the foreign company
- ▶ Executive or managerial role in the US



Duration:

Initial stay of one (1) year, if the US business shows growth, possibility of increments of two (2) years – up to maximum of seven (7) years

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CANADIANS OWNING US REAL ESTATE

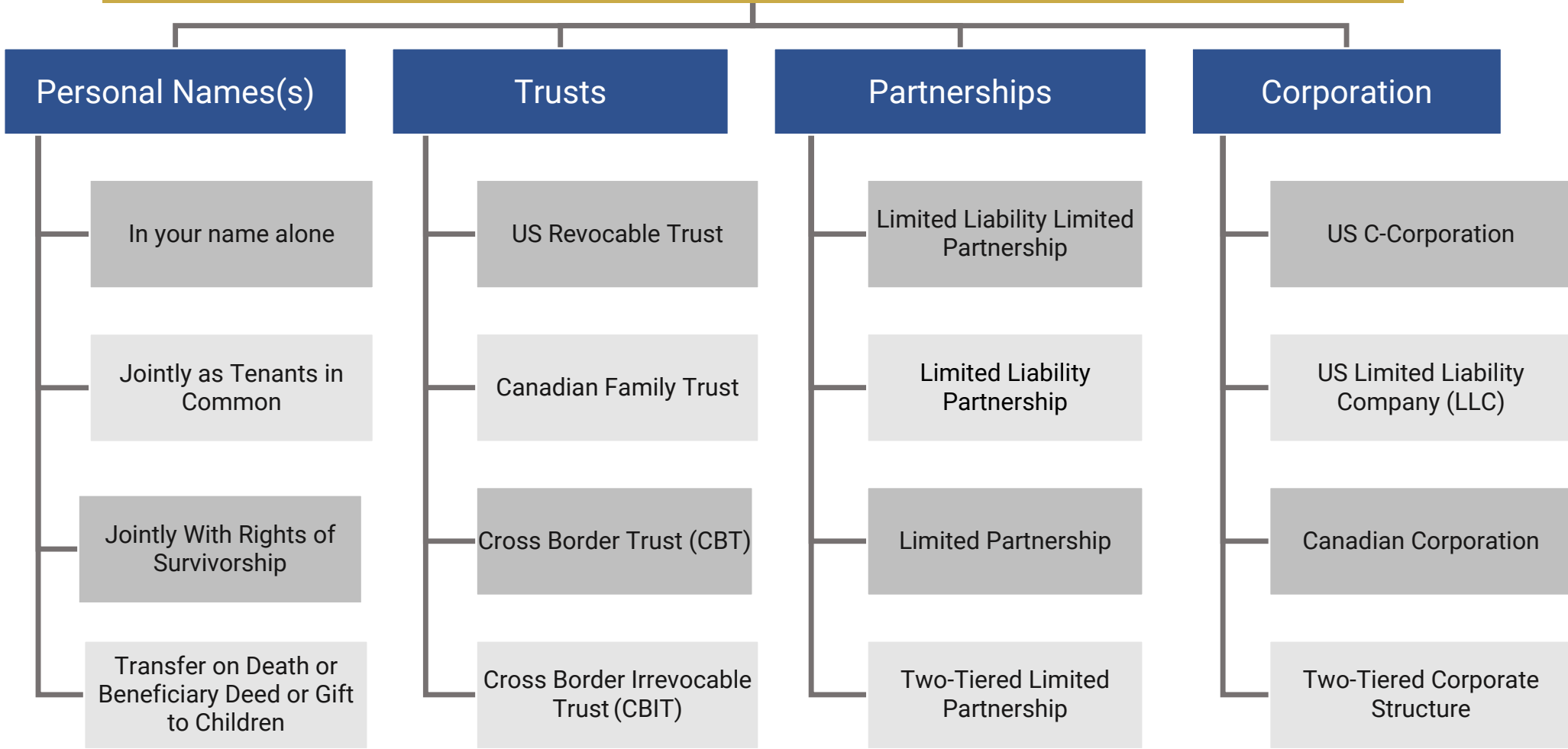
If you are a Canadian that owns a property in the US, or if you are currently looking to purchase a US property, be aware of the following ownership issues:



- ▶ **Probate**
- ▶ **Incapacity**
- ▶ **Protection of your beneficiaries**

CANADIANS OWNING US REAL ESTATE

CHOOSING AN OWNERSHIP STRUCTURE

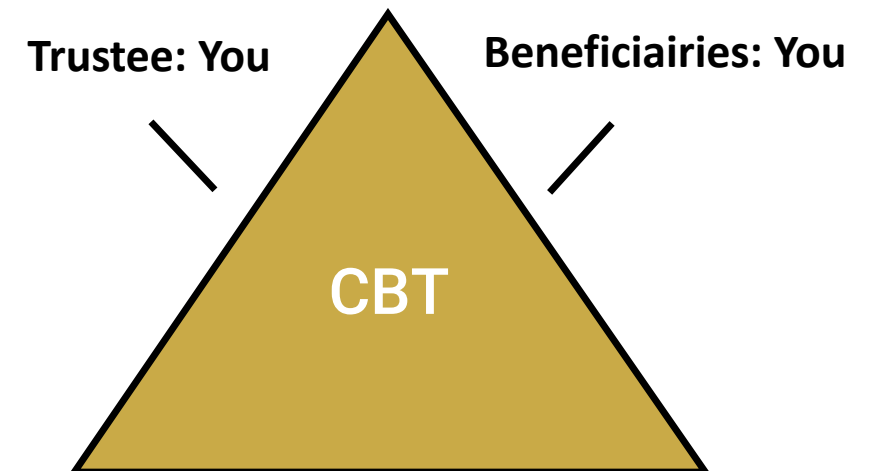


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CANADIANS OWNING US REAL ESTATE

CROSS BORDER TRUST (“CBT”)

- ▶ Avoids probate & incapacity issues
- ▶ Protects inheritance from divorcing spouses/creditors
- ▶ Preserves foreign tax credits
(on sale/death)
- ▶ Reduces and defers US estate
tax (QDOT & discounting)



CANADIANS OWNING US REAL ESTATE

US REAL ESTATE – TERMINOLOGY

Title search	Notice of commencement
Lien search	Special assessments
Open / expired permits	Stamp tax
Estoppel letter	Closing Affidavit



Closing costs: who pays for which specific closing costs?

CANADIANS OWNING US REAL ESTATE



US REAL ESTATE CONSIDERATIONS

Offer / Contract

- ▶ “As Is” vs. With Legal Warranty
- ▶ Properly Identifying the Parties
- ▶ Inclusions/Exclusions
- ▶ Closing Date & Inspection Clause
- ▶ Closing/Settlement Costs
- ▶ Exit Clause & Additional Terms

Adjustments and Land Transfer Tax

- ▶ **Fundamental:** *how to take title*

CANADIANS OWNING US REAL ESTATE



US & CANADIAN
TAX COMPLIANCE

Non-resident selling US real estate

- ▶ **Must** file a US tax return in the year of sale
- ▶ Requires an Individual Tax Identification Number (ITIN)

US capital gains tax

- ▶ Rate depends whether seller is an individual, corporation, or pass-through entity

Canadians:

- ▶ **Must** report US sale on Canadian tax returns & pay tax on capital gains
- ▶ Possible claim for tax credit paid in the US, unless **mismatch**
- ▶ Tax on currency gains

CANADIANS OWNING US REAL ESTATE



Foreign Investment in Real Property Tax Act (FIRPTA)

If exception does not apply:

- ▶ Application for a FIRPTA withholding certificate
- ▶ Possibility to reduce the withholding to 10%

Exception to withholding

- ▶ Property is sold for \$300,000 USD or less;
and
- ▶ The buyer signs an affidavit

Non-resident selling US property: mandatory 15% withholding on **gross sale proceeds** & remitted to IRS within 20 days of closing

- ▶ **Buyer** is responsible for the withholding

OUR PROCESS



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