Business Expansion into the United States

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Roadmap of Session

- **Part 1: Corporate Law Considerations**
- **Part 2: Immigration Law Considerations**
- **Part 3: Canadian and U.S. Tax Considerations**

Part 1: Corporate Law Considerations

Part 1: Corporate Law Considerations

What is my current structure and what structure do I use to expand to the US?

- Corporation.
- Carrying on business through a branch.
- LLC.
- LP.

***** There are significant immigration, tax, and M&A/due diligence considerations when choosing an appropriate structure. Your structure will often be tax driven unless a corporation is required for specific business reasons.***

***** Carrying on through a branch will open the Canadian parent and all its assets to US exposure including litigation.***

Part 1: Corporate Law Considerations (Cont'd)

What US jurisdiction makes the most sense for me – tax and corporate considerations?

How do I contribute/move assets or capital?

- If a Canadian entity contributing cash or other assets to a US subsidiary or related entities, it is important to discuss and coordinate this with your US and Canadian tax advisors.
- Often a Canadian parent will contribute assets or cash to a US subsidiary in order to receive non-taxable repayment of the debt back rather than taxable. There are once again tax considerations involved with the contribution of assets from Canada to the US.
- You can use debtor equity.

Part 1: Corporate Law Considerations (Cont'd)

What are the laws of the local jurisdiction (municipal, county, state and federal) do I need to be aware of and comply with? How do I contribute/move assets or capital?

- It is important to ensure you are aware of all laws that will apply to your business.
- You must ensure you have all required licences to carry on business and to ensure you operate correctly.
- The new business may be required to collect and remit local taxes for example.

Part 1: Corporate Law Considerations (Cont'd)

What are my banking arrangements and what will they be going forward?

- Does your entity have an existing credit facility?
- If so, you should have discussions with your lender regarding your plans.
- If you are creating a new operation, you may need lender consent if you are moving secured assets to another jurisdiction so that the secured party can make the necessary registrations to ensure they have priority in the proper foreign jurisdictions.
- If there are foreign assets to be secured, the process is different than it is in Canada.
- Any new purchased US assets will very likely require new insurance policies as well.
- Creating new banking arrangements is difficult and time consuming. Lenders will want to secure against the Canadian parent assets or lend to the Canadian parent. This is a difficult process.

Part 1: Corporate Law Considerations (Cont'd)

Do I need to get employees into the US? Are they full-time or part-time?

- In addition to immigration considerations, you will need to be aware of any applicable employment codes or legislation and at what point they apply.
- You don't want to inadvertently become subject to employment laws of a foreign jurisdiction based on the amount of time a Canadian employee has spent in that jurisdiction.

Part 1: Corporate Law Considerations (Cont'd)

Do I need lender approval to move assets?

- When the new entity enters into commercial agreements, considerations should be given to the choice of law and attornment provisions as well.
- It is more important in US contracts than it is in Canada when the common law and statutory regimes are very similar throughout all the provinces (other than Quebec).

Part 1: Corporate Law Considerations (Cont’d)

Do I need to take step with respect to providing security over assets when they are in the US?

- It is important to work closely with your accounting, tax and legal advisors to ensure that the corporate structure, either in a new operation or an acquisition, are structured properly for tax compliance and optimization in the jurisdictions and to ensure that liability concerns have been addressed at the Corporate level.

Am I going to raise capitol in the US?

- Raising capital in the US is very similar to Canada, however you must ensure that any capital raised, especially from US residents is in compliance with US securities laws.

Part 2: Immigration Law Considerations

Part 2: Immigration Law Considerations

B-1 Business Visitor

- Generally Permissible Activities – meetings, conferences, trade shows, contract negotiations.
- Exceptions – Expanded Permissible Activities:
  - Investigating Investment Opportunities (Utilized for start-up activities prior to E-2 or L-1).
  - After Sales Service (NAFTA).
  - B-1 in lieu of H-1B.
  - Training Programs.
  - Professional Athletes.

Part 2: Immigration Law Considerations (Cont'd)

TN USMCA/NAFTA Professional

- Nonimmigrant visa category permitting citizens of Canada and Mexico to work in the United States in prearranged business activities for US for foreign employers.
- 60+ NAFTA Professional Categories, including:
  - Accountant, Architect, **Computer Systems Analyst**, Disaster Relief Insurance Claims Adjuster, Economist, Engineer, Forester, Graphic Designer, Hotel Manager, Industrial Designer, Interior Designer, Land Surveyor, Landscape Architect, Lawyer, Librarian, **Management Consultant**, Mathematician, Range Manager, Range Conservationist, Research Assistant, **Scientific Technician/Technologist**, Social Worker, Silviculturist, Technical Publications Writer, Urban Planner, Vocation Counselor, Dietitian, Dentist, Medical Laboratory Technologist, Nutritionist, Occupational Therapist, Pharmacist, Physician, Physical Therapist, Psychologist, Recreational Therapist, Registered Nurse, Veterinarian, Agriculturist, Animal Breeder, Animal Scientist, Apiculturist, Astronomer, Biochemist, Biologist, Chemist, Dairy Scientist, Entomologist, Epidemiologist, Geneticist, Geochemist, Geologist, Geophysicist, Horticulturist, Meteorologist, Pharmacologist, Physicist, Plant Breeder, Poultry Scientist, Soil Scientist, Zoologist, Teacher.

Part 2: Immigration Law Considerations (Cont'd)

L-1A/L-1B Intracompany Transfers

- Nonimmigrant visa category created to facilitate the movement (***either via full-time secondment or intermittent entry***) of **executives**, **managers**, and **specialized knowledge personnel** employed by global business organizations.
- Beneficiary must have been employed in an executive, managerial, or specialized knowledge capacity for a minimum of one year in three years prior to the petition by a parent, subsidiary, branch, or affiliated company of the US petitioning employer.
- Can be utilized for US 50/50 joint ventures and branch offices.
- **"*New Office*" L-1 Petitions** - While the general rule for US employers seeking work-authorized visas for personnel is that the petitioning organization must have been active for at least one year, a specific exception called the "new office" L-1 permits US start-ups to utilize the L-1 program with an expanded set of qualifying criteria and revised processing procedures.
- Significant change in adjudication procedures – CBP only handling initial L-1 petitions for Canadians **unless intermittent or commuter L-1 petitions**.

Part 2: Immigration Law Considerations (Cont'd)

E-1 Treaty Trader and E-2 Treaty Investor Programs.

- E-2 and E-1 Treaty Countries (Treaties of Trade and Commerce).
  - https://travel.state.gov/content/travel/en/us-visas/visa-information-resources/fees/treaty.html.
- Determining Citizenship.
  - Individual's citizenship determined by passport or certificate of citizenship.
  - Company's citizenship determined by corporate documentation, passports (or certificates of citizenship) for majority of owners of investing company.

Part 2: Immigration Law Considerations (Cont'd)

E-1 Treaty Trader Program.

- Overview of E-1 Treaty Trader Program:
  - NIV category allowing citizens of treaty countries (individuals or companies).
  - Who engage in substantial cross-border trade that is primarily between US and treaty country.
  - To employ the Primary Trader (when investor is individual) or executive, managerial, or essential skills personnel in E-1 nonimmigrant status (personnel must have same citizenship as trader).
- Substantial trade (including trade in services and technology).
  - Continuous flow with numerous transactions over time.
  - 50% of total volume of international trade must be between US and trader's treaty country of nationality.

Part 2: Immigration Law Considerations (Cont’d)

E-2 Treaty Investor Program.

- Overview of E-2 Treaty Investor Program:
  - NIV category allowing citizens of treaty countries (individuals or companies).
  - Who have made substantial investment in a new or existing US enterprise.
  - To employ the Primary Investor (when investor is individual) or executive, managerial, or essential skills personnel in E-2 nonimmigrant status (personnel must have same citizenship as investor).
- Investor (individual or company) must have control of the US entity, including the ability to direct and develop the US enterprise (50% or higher).

Part 2: Immigration Law Considerations (Cont’d)

E-2 Treaty Investor Program (Cont’d)

- New v. Existing Enterprise
  - New – US subsidiary, branch office, or joint venture that is newly established by the E-2 investor.
  - Existing – Acquisition of all assets/liabilities of a company previously established by someone other than the E-2 investor.
- Whether a new or existing, enterprise must be active and operating at the time of the E-2 visa application.
- “Substantial Investment.”
  - Sufficient to ensure the successful operation of the US enterprise as measured by a proportionality test.
  - Proportionality test compares the amount or value of the funds or other qualifying investment instruments with the cost of establishing a viable enterprise of the nature contemplated.

Part 3: Canadian and U.S. Tax Considerations

Part 3: Canadian Tax Considerations
Creating Taxable Presence in the US – Treaty Implications

- A Canadian company should only be subject to US federal corporate income tax on income from:
  - US sources from certain non-business income, and
  - From income that is effectively connected with the conduct of a trade or business in the US under domestic US law.
  - Income from the installation of equipment, employees making sales calls, and the performance of services in the US will be sufficient to meet this threshold but Art. VII(1) of the Treaty generally limits US tax on the business profits of a Canadian company to business profits related to a permanent establishment ("PE").
- PE in the US can be created by having an employee who has, and habitually exercises authority to conclude contracts in the US
  - Senior employees who will be working partially in the US create risk
  - Risk of a Services PE – more later on this.
- Specific activity exemptions to the PE definition in the Treaty, include:
  - a fixed place of business used solely for, or a person acting in the US on behalf of a one or more of the following activities:
  - the use of facilities for the purpose of storage, display or delivery of goods or merchandise belonging to the resident;
  - the maintenance of a stock of goods or merchandise belonging to the resident for the purpose of storage, display or delivery;
  - the maintenance of a stock of goods or merchandise belonging to the resident for the purpose of processing by another person;
  - the purchase of goods or merchandise, or the collection of information, for the resident; and
  - advertising, the supply of information, scientific research or similar activities which have a preparatory or auxiliary character, for the resident.

Part 3: Canadian Tax Considerations
Creating Taxable Presence in the US – Treaty Implications

- Also, an exemption for the use of a broker or independent agent in the US, and as well as a management exemption
- Just because a Canco controls entities which carry on business in the US does not create a US permanent establishment for the Canco.

Suggested Action:

Enforce and monitor policy specifying US entity contracts are to be signed in the US, preferably by US resident persons in appropriate roles, and Canadian entity contracts to be signed in Canada by Canadian resident persons.

Part 3: Canadian Tax Considerations
Key Person PE

- PE can also be created through the provision of services in the US:
  - "Key Person PE" may be created where services are performed in the US by an individual who is present in the US for 183 days or more in any twelve month period, and during that period, more than 50 percent of the gross active business revenues of the enterprise consist of income derived from the services performed in the US by that individual.
  - This test considers service revenue from US subsidiaries or US customers relative to all active gross revenue.
  - If none of the Canadian employees stay in the US for 183 days or more for any 12 month period, the risk for creation of a Key Person PE is likely moderate particularly if active business.

Action: Estimate ratio of expected revenue from services performed in the US relative to expected total active gross income.

Action: Maintain and monitor day counts for Canadian employees' days in the US (not work days).

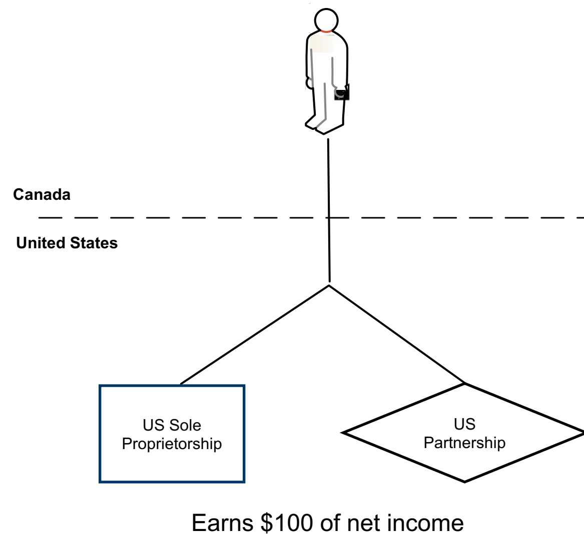
Part 3: Canadian Tax Considerations
Project PE

- A "Long Term Project PE" may be created where services are provided in the US for 183 days or more in any 12 month period with respect to the same or connected project for customers who are either residents of the US, or who maintain a PE in the US, and the services are provided in respect of that PE.
  - This test includes multiple employees working on the same project, but allows for segregation of projects geographically and commercially. For example you could have multiple different projects for the same customer.
- Evaluation of connected projects would be considered from the perspective of the Canco, not US subs.
- Indicators of projects that are commercially coherent includes:
  - projects concluded pursuant to a single contract,
  - if the nature of the work involved under different projects is the same, and;
  - whether the same individuals are providing the services under the different projects.
- Additionally, to be considered connected projects they must also constitute a geographic whole.
  - Technical notes to the Treaty suggests that a project providing services to multiple branches in different cities would not be considered connected projects.
- For both the Key Person PE and a Long Term Project PE, where Canco sends multiple employees to the US to provide services at the same time, the numbers are not additive.
  - For example if you send 9 employees all for the same 10 days, this would not be counted as 90 days - their collective presence is not additive. Canco still only considered present in the US for 10 days.
  - However if you sent 9 employees for 10 days but the employees are all in the US at different times, then this would be counted as 90 days.

Part 3: Canadian Tax Considerations
Services PE

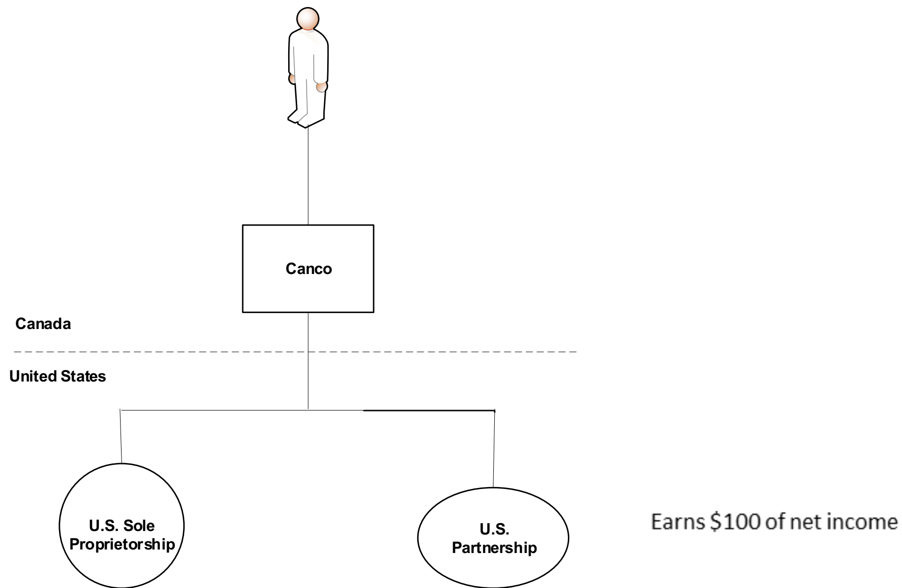
- If Canco deemed to be providing services through a Services PE then Article VII of the Treaty (Business Profits) would apply making the net profits attributable to the relevant services taxable in the US;
  - An exception exists in Article VII:4 such that business profits attributable to the mere provision of executive, managerial or administrative facilities or services should not become taxable in the US
  - Services not provided in the US should not become taxable in the US
  - Even if Canco creates a PE in the US, often the taxable income attributable to the PE is minimal.
  - If PE is not taxable in the US as a result of the application of Article VII:4, then as confirmed in the OECD commentary with respect to Article XV:2, no amounts would be deducted in respect of compensation for employees as a result of the PE being exempt from tax, then in effect no amount would be “borne by a permanent establishment” in the US, and therefore the treatment of the employees remuneration should be as if there was no PE.
- Action: Maintain work day counts in respect of defined projects.
- Action: Consider how cross border projects are defined, and how much of the work can potentially be done in Canada so as to minimize the potential creation of a Long Term Project PE, and the potential revenue attributable to it.
- Action: In as much as it is possible, ensure any services which are provided by Canco in the US can be characterized as executive, managerial or administrative in nature.
- Action: Secondment agreements are a common way to avoid this.

Part 3: Canadian Tax Considerations
Personal Investment in US Pass-Through (Branch)



Prior Law		
U.S. personal tax (39%+State)		$45
Canadian personal tax:		
Basic tax owing	$48	
Less foreign tax credit	($45)	
Tax payable		$ 3
Global tax payable		**$48**
New Law		
U.S. personal tax (37%+State)		$43
Canadian personal tax:		
Basic tax owing	$48	
Less foreign tax credit	($43)	
Tax payable		$ 5
Global tax payable		**$48**
No difference to status quo.		

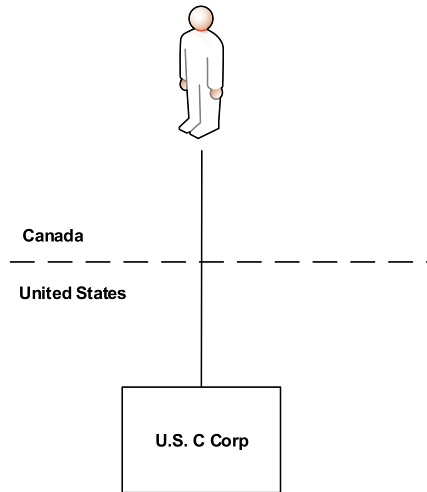
Part 3: Canadian Tax Considerations
Corporate Investment in US Pass-Through (Branch)



Earns $100 of net income

Prior Law		
U.S. corporate tax (35%+State)		$40
U.S. branch tax ($60 @ 5%)		$3
Canco's Canadian tax implications as follows:		
Basic tax owing	$27	
Foreign tax credit	($27)	
Canadian corporate tax payable	$0	
Distributable cash to Canadian individual	$57	
Personal tax on eligible dividend @ 32%		$18
Global tax payable		**$61**
New Law		
U.S. corporate tax (21%+State)		$26
U.S. branch tax ($74 @ 5%)		$ 4
Canco's Canadian tax implications as follows:		
Basic tax owing	$27	
Foreign tax credit	($27)	
Canadian corporate tax payable	$0	
Distributable cash to Canadian individual	$70	
Personal tax on eligible dividend @ 32%		$22
Global tax payable		**$52**

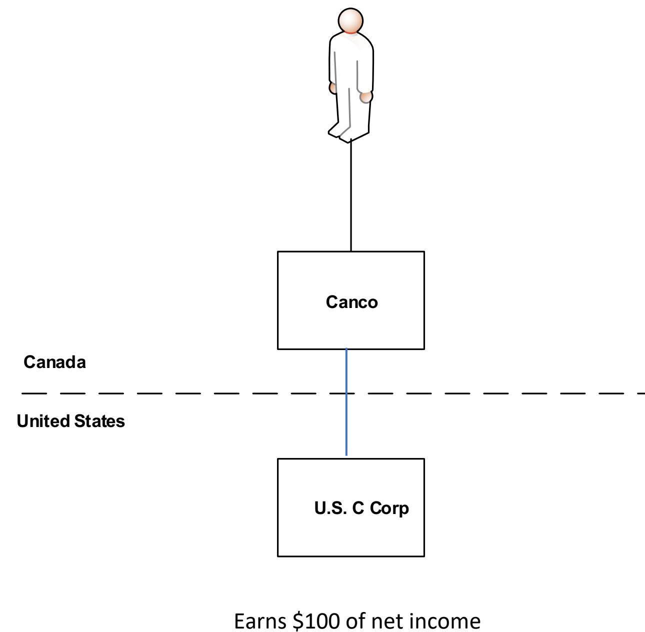
Part 3: Canadian Tax Considerations
Personal Investment in US Corporation



Earns $100 of net income

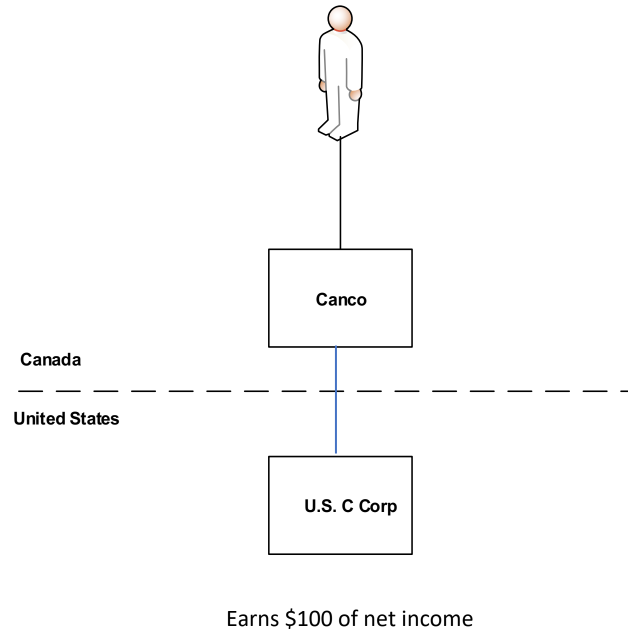
Prior Law	
U.S. corporate tax (35%+State)	$40
U.S. withholding tax of 15% on $60 dividend	($9)
Canadian personal tax on $60 dividend @48%	$29
Foreign tax credit on U.S. withholding tax	$ 9
Global tax payable:	**$69**
New Law	
U.S. corporate tax (21%+State)	$26
U.S. withholding tax of 15% on $74 dividend	($11)
Canadian personal tax on $74 dividend @ 48%	$35
Foreign tax credit on U.S. withholding tax	$11
Global tax payable:	**$61**

Part 3: Canadian Tax Considerations
Corporate Investment in US Corporation



Prior Law	
U.S. subsidiary corporate tax	$40
Distributable cash to Canco of $60	
Less U.S. withholding tax @ 5%	$3
Canco – no corporate income tax due to surplus regime; no FTC for U.S. withholding tax.	
Distributable cash to Canadian individual $57	
Personal tax on eligible dividend @ 32%	$18
Global tax payable	**$61**
New Law	
U.S. Subsidiary corporate tax (21%+State)	$26
Distributable cash to Canco of $74	
Less U.S. withholding tax @ 5%	$4
Canco – no corporate income tax due to exempt surplus regime; no FTC for U.S. withholding tax.	
Distributable cash to Canadian individual of $70	
Personal tax on eligible dividend @ 32%	$22
Global tax payable:	**$52**

Part 3: Canadian Tax Considerations
What About Using Debt To Strip Out Profits?



Earns $100 of net income

Prior Law	
U.S. C Corp corporate tax	$0
Interest paid to Canco of $100 (No U.S. withholding tax)	
Canco's corporate tax after RDTOH refund:	$20
Distributable cash to Canadian individual $80	
Personal tax on non-eligible dividend @ 42%	$34
Global tax payable	**$54**
New Law	
If U.S. C Corp annual gross receipts >$25 million, interest deduction limited to 30% of EBITDA.	
U.S. C Corp corporate tax on $70 @ 26% (21%+State)	$18
U.S. withholding tax of 5% on dividend portion ($70 less U.S. corporate tax of $18)	$ 3
Canco's corporate tax on $30 interest after RDTOH refund	$ 6
Distributable cash to Canadian individual of $72	
Personal tax on eligible dividend of $52 @ 32%	$16
Personal tax on non-eligible dividend of $20 @ 42%	$ 8
Global tax payable	**$51**

Part 3: Canadian Tax Considerations

CRA Entity Classification

CRA uses Two Step Approach

1. Identify characteristics of foreign business entity under relevant foreign law.
2. Compare to characteristics of domestically recognized entities.
   - Process is challenging for entities with “hybrid” features.
   - Statutory definition of “corporation” in Canadian Tax Act not helpful.
   - Based on prior court decisions, the defining attributes of corporations are legal personality, and existence separate and distinct from personality and existence of owners.

Part 3: Canadian Tax Considerations

CRA Entity Classification

- C corporations = foreign corporation for Canadian purposes.
- S corporation = foreign corporation for Canadian purposes.
- LLCs = foreign corporation for Canadian purposes.
- US LPs = partnership for Canadian purposes.
- US LLPs and LLLPs = foreign corporation for Canadian purposes.
- Accordingly, need to watch US tax issues and match them to the Canadian tax issues as best as possible to avoid potential double tax issues.
- Entity selection and careful monitoring critically important!

Part 3: Canadian Tax Considerations
Canadian Considerations for a US Subsidiary: Foreign Affiliate Regime

- The Canadian foreign affiliate system exempts certain foreign active business income from tax (exempt surplus) or defers tax until the income is repatriated to Canada (hybrid surplus and taxable surplus), and provides in the case of hybrid surplus and taxable surplus certain deductions in respect of foreign tax and foreign withholding tax.
- If the foreign income is passive (income from property) and earned by a controlled foreign affiliate, then the income is taxable on a current basis (no deferral) = Foreign Accrual Property Income
  - Anti-deferral regime that taxes attributed income rather than dividends from controlled foreign affiliates.
  - Requires Canadian recognition of passive income by Canadian shareholders in the year income is earned.

Part 3: Canadian Tax Considerations
Canadian Considerations for a US Subsidiary: FAPI

- Generally, the tax results where FAPI applies are similar to Canadian resident earning the income directly.
- Share of FAPI as determined by participating percentage defined in 95(1).
- Deduction in respect of foreign taxes paid applicable to the FAPI = FAT
  - Participating percentage is nil if FAPI is less than $5,000
  - Participating percentage determined at end of CFA year
  - See Reg 5904 where more than one class of shares – based on entitlement to dividends
  - FAT in subsection 91(4) similar to foreign tax credits

Part 3: Canadian Tax Considerations
Canadian Considerations for a US Subsidiary: FAPI – cont'd

- FAPI applies to controlled foreign affiliates ("**CFA**") earning passive income where no re-characterization applies
- What qualifies as a CFA is expansive
  - De jure control – effective control by virtue of rights to majority of the votes in election of board of directors
  - Includes a foreign affiliate that is controlled by the taxpayer or would be controlled if the taxpayer also owned all of the shares owned by:
    - Each person not dealing at arms length with taxpayer
    - Each of up to 4 Canadian residents, and
    - Each person that does not deal at arm's length with any of the four other Canadian residents
  - 95(2.01) extends definition where shares held by holdco, trust or partnerships
  - 95(2.02) prevents double counting.

Part 3: Canadian Tax Considerations
Canadian considerations for a US Subsidiary: FAPI – cont'd

- Gotchas to watch for
  - Need to recalculate taxable income using Canadian tax rules in Canadian dollars
    - US tax depreciation often more aggressive than Canadian – may be substantively more taxable income under Canadian rules
    - Differential treatment of certain types of US entities by Canadian and US tax systems results in complications
      - LLC, LLP, LLLP may not get full credit for taxes paid in respect of the FAPI
  - Reporting is often an issue.
  - Re-characterization gets missed

Part 3: Canadian Tax Considerations
Buying or Selling a US Business

- Pre-planning may change how much tax you pay both while you hold the business and when you sell the business.
- Consider FAPI and surplus implications prior to sale
  - Plan not to be a controlled foreign affiliate
  - Plan to fall into re-characterization provisions or
  - Plan to ensure active business characterization
- Consider applicable withholding tax rates on any distributions and structure favorably
  - Restructure to eliminate hybrid entity or to use a blocker
- Avoid inadvertent inversions

Part 3: Canadian Tax Considerations
Canadian considerations: Foreign Affiliate Dumping

- Where there is foreign ownership above a corporation resident in Canada ("**CRIC**") consider the foreign affiliate dumping rules.
  - Intent was to shut down abusive planning, but the rules are broad and complex.
  - March 19, 2019 proposed legislation – extended application of FAD rules to non-resident individuals, trusts, or a group not at arm's length.
    - Individuals moving to the US
  - Results in deemed repatriation of funds resulting in Canadian withholding tax

Part 3: Canadian Tax Considerations
Transfer Pricing Considerations

- Cross border transactions between a parent company and its related parties are subject to transfer pricing rules.
- Arm’s length principle – terms and conditions should be identical whether you re dealing with parties at arm’s length or not.
- Required to make reasonable efforts to determine and use arm’s length transfer prices
  - Reporting obligation (T106) often missed
  - Must compile contemporaneous documentation by tax filing due date in order to meet this test
  - Must be able to provide to CRA within three months of written request
- Use transfer pricing principals where operating through a branch

Part 3: Canadian Tax Considerations
Application of the Canada – US Treaty?

- Very generally, it addresses issues of residency and of taxation of passive income with the goal of eliminating double taxation – not always successfully.
  - The states don't always follow the Treaty.
- Consider if you are actually covered by the Treaty – Crown Forest.
- The key sections will depend on the industry and the circumstances, but in particular, good to be aware of:
  - Article IV Residence
    - Especially Art 4:6 and 4:7 if using hybrid entities
  - Article V Permanent Establishment
  - Article X Dividends
  - Article XVIII Pensions and Annuities
  - Article XXIX-A Limitation on Benefits
  - Annex B
- Depending on industry and structure OECD BEPS/MLI may also be relevant
  - Digital tax – update

Part 3: Canadian Tax Considerations
GST when selling into the US

Part 3: Canadian Tax Considerations
GST Considerations for Exporting to the US

- Supplies of property (tangible and intangible) and services made outside Canada, in accordance with the "Place of Supply" rules, are not subject to GST.
- Goods and services are generally "zero-rated" when exported from Canada. Where supplies are made inside Canada, they may still be taxable at 0% ("zero-rated") where they are ultimately exported.
- Canadian companies do not have to charge GST for services performed entirely outside of Canada. Services performed inside Canada, where the recipient is a non-resident, are "zero-rated".
- Supplies of intangible personal property, such as a right or intellectual property that may not be used in Canada are considered to be made outside Canada and therefore, not subject to GST.
- If the supply is made by electronic means (such as software or web hosting), it may be GST exempt. Care must be taken in context of e-commerce to determine whether supply is being made of intangible personal property ("IPP"), or of a service, so that the appropriate place of supply rules can be applied and or zero-rating provision.
- Special rules apply if it is a drop shipment – i.e. a non-resident directs the Canadian company to deliver the goods to another person in Canada.

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