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Join the conversation
Tax - hot topics for corporations

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Agenda

Tax – hot topics for corporations
– Intercompany transactions – Canadian tax perspective
– 2016 Federal Budget update
– Recent US developments
– Tax potpourri
– Questions and wrap-up
Intercompany transactions – Canadian tax perspective
Cash management - a tax perspective

Key provisions

- Shareholder Loan Rules - 15(2), 15(2.6), 214(3)
- Deemed Interest Rules - 17(1), 17(2)
- Pertinent Loan or Indebtedness (PLOI) – 15(2.11), 17.1
- Thin Capitalization Rules – 18(4), 18(6), 18(6.1)
- Interest Deductibility – 20(1)(c)
- Deemed Interest Paid as Dividend – 80.4
- Part XIII Tax – 212
- Upstream Loan Rules – 90(6)
- FA Dumping Rules – 212.3
- Transfer Pricing Rules – 247
15(2.11) - Pertinent loan or indebtedness elections

Election avoids the application of ss. 15(2) and 17(1) on loans to non-residents
- Deemed interest income to Canco
- Election due with the tax return for the year the loan is made

Repayment within 2 years
- PLOI is not applicable
- Protective PLOI election is possible
- If repayment occurs, amend tax returns and request a refund

Late filing
- Late filed election is possible within 3 years of filing due date
- Penalty is minimal ($100 / month)
- Late file election if there’s a chance of repayment?
Upstream loans

Certain loans to “specified debtors” from foreign affiliates included in income
- Included in income of the taxpayer, not the creditor
- Timing of inclusion = taxation year that includes the loan

Surplus
- Deduction for surplus available at the time of the loan
- 90 day rule?
- No pre-acquisition surplus for some loans
- Surplus deduction is included in income next year, fresh surplus deduction taken

Repayment
- Deduction in year of repayment
- Ensure actual repayment occurs
Unpaid amounts

78(1)

- Applies to unpaid amounts owing to non-arm’s length persons for more than 2 taxation years
- If applicable, unpaid amount is included in the taxpayer’s income in year 3
- Very common scenario of application is in respect of interest
- Administrative policy on 78(1) if debtor and creditor use accrual method
- Consider using strategy in Hill
  - Exchange cheques capable of being honored
  - Daylight loan
- Turn interest in to principal amount owing
- Good opportunity to review debt
  - Interest rate still reasonable
  - Satisfies “realness” of loan
- Election possible
Federal Budget update
2016 Federal Budget proposals - BEPS

Broad statements regarding
– Treaty abuse → Canada actively participating in development of multilateral instrument
– Exchange of tax rulings → CRA to commence spontaneous exchange in 2016

Not included
– BEPS-related changes other than country-by-country reporting (CbyCR) proposals
– No announcements regarding other OECD Action Plans → hybrid arrangements, interest deductibility
2016 Federal Budget proposals - CbyCR

- Draft legislation to implement requirement to submit CbyC Report to be released “in coming months”
- Applicable for taxation years beginning after 2015
- Applicable to groups with consolidated annual revenue of > €750M
  - Look to top entity in chain required to consolidate controlled subsidiaries
2016 Federal Budget proposals - debt parking

Inherent f/x gain at time of loan repayment
- At time loan made $100 USD = $100 CAD
- At time of repayment $100 USD = $90 CAD

Rather than repayment, loan acquired by CanSub
- No change in debtor → no settlement of debt, no f/x realization event

Proposed Legislative change
- At time loan acquired by non-arm’s length person it becomes a “parked obligation”
- Debtor deemed to realize f/x gain as if loan repaid at that time
- Applies to foreign currency debt that meets conditions on or after March 22/2016
2016 Federal Budget proposals – back-to-back arrangements

Current withholdings tax (w/h) tax rules for back-to-back loan arrangements

– Canco has obligation to Intermediary (any non-resident or arm’s length Canadian) and pays interest thereon

Intermediary has an obligation (Intermediary Debt) to a Non-Resident

– Obligation is either limited recourse debt, or there is an interconnection between both obligations

W/T liability to Non-Resident would be greater than w/h tax liability to Intermediary

Result → interest deemed paid to Non-Resident and not to Intermediary
2016 Federal Budget proposals - back-to-back arrangements

- Budget proposes to extend rules to back-to-back royalty arrangements, and other arrangements that are economically similar to interest/royalties
- Will apply to arrangements that are “sufficiently connected” to each other
- Applies to royalty payments after 2016
Recent US developments
Background & takeaways

April 4, 2016 – Treasury Department issues proposed rules addressing intergroup (internal) financing

New Regulatory burden
– Unless changed, will disrupt offshore cash management and reduce after-tax return on US investments
– Significant new compliance burden

Timing
– Government targeting implementation later this year
– New systems controls and treasury functions must be in place 30 days after finalization

Not likely to hurt the effective tax rate immediately
– Financing for new acquisitions likely affected
– Long-term pressure on maintaining current benefit for existing intercompany debt
What do the new rules do?

**Require extensive documentation**
- Related party debt generally involving a foreign corporation

**Turns debt into equity**
- Fewer opportunities to use tax-advantaged debt classification and to “inject leverage” in M&A and internal restructuring transactions
- Complicates offshore and cross-border cash management
- Creates complicated U.S. tax consequences from routine cash management transactions (e.g., cash pooling)

**Scope**
- Pre-April 4 intercompany debt is exempt provided not modified or refinanced
- Rules phase in for debt issued from April 4 on
Internal controls: documentation and record keeping

Intercompany debt agreements need to look more like third-party loan agreements
– Must be memorialized within 30 days of issuance
– Must maintain more extensive proof of creditworthiness
– Applies to all types of intercompany credit (e.g., trade payables or A/R and A/P for “cross charges”), not limited to formal “loans”

Must document and retain records showing performance on the debt (evidence of payment made, enforcement action taken if payment not made)
– Must be memorialized within 120 days of relevant date (due date for payment)

Non-compliance for loans between parties with no U.S. tax nexus can have collateral effects on other transactions involving US affiliates
Impact

Internal controls: restrict intercompany borrowings by group members

- Treasury and tax departments must implement new protocols to limit risk of tax leakage

Restricted benefit for intercompany debt in M&A transactions, internal restructurings

- Significantly more difficult to “push debt down” in a tax-efficient manner
- Limits opportunity for tax synergies from US acquisitions and investments
- Re-evaluate projections for in-pipeline US M&A investments
- Going forward, increased time and complexity for due diligence of a target’s tax profile
Actions

1. Coordinate tax, treasury, M&A, and legal on new terms for intercompany debt, protocols for borrowings and restructuring transactions

2. Assessment and tracking
   - Identify grandfathered debt
   - Identify sources of intercompany debt in non-tax functions (e.g., treasury, operations)
   - Track intercompany distributions and loans involving or outside the US group
   - Implement controls to avoid unintended tax consequences

3. Tax attribute studies (earnings & profits, tax basis)—the opportunities that exist under the new rules will require high degree of certainty on these numbers
Tax potpourri
Proposed new rules

Apply to dividends received on or after April 21, 2015

Common scenarios now ‘potentially’ caught:

– Distribution of cash from operating company
– Asset protection
– Asset value extraction
– Purification for capital gains exemption
– Change of asset ownership
– In-house loss utilization
– Share ownership change

All types of dividends should be considered including cash dividends, stock dividends (including high-low stock dividends), dividends-in-kind, deemed dividends on stated capital increases, deemed dividends on share redemptions and deemed dividends on taxable wind-ups.
Uncertainties and next steps

How will CRA interpret purpose tests?
– Will take time for rulings, interpretations and assessment experience

Safe income exception new wording
– Safe income only available if safe income is contributing to a gain on a share

Safe-income determination time
– Safe income may not be available if there has been a “safe-income determination time”

Next steps for corporations
– Transactions/reorganizations involving inter-corporate dividends? Check with tax group and/or tax advisors
– Consider alternative transactions
– Keep safe-income calculations up to date
Regulation 105

Withholding on fees, commissions and other amounts paid by any person to a non-resident in respect of services rendered in Canada

Issues

– Wide application (applies between two non-residents)
– Seeing a lot of CRA activity in this area, and see significant non-compliance
– Penalty is 10% of tax that should have been withheld, failure to file on T4A-NR, plus failure to file for non-resident tax return, if applicable
– Treaty based returns for non-resident – justifying treaty position under audit may be difficult
– Permanent establishment returns for non-resident – transfer pricing
– Regulation 102 withholding and returns for employees performing the service

Solutions

– Lots of detail on invoices
– Structure services from related non-residents as a secondment?
– Waiver?
Regulation 102

Withholding on employment exercised in Canada

New treaty-based waivers

– 2015 draft legislation provides an exception from withholding tax requirements for qualified employers and qualified employees
– The employer must be certified - Form RC 473 Application for Non-Resident Employer Certification
– The employer must monitor and have documentation to ensure employees are qualified employees
  – Employee must work in Canada < 45 days in calendar year or must be present in Canada for < 90 days in any 12-month period that includes the time of payment
  – Employee musts be resident in a country with which Canada has a tax treaty
  – Apply 30 days before qualifying employee starts work in Canada

Form R102-R – Regulation 102 Waiver Application

– Project basis, application is limited
– Must be submitted 30 days before start of employment in Canada or the initial payment for employment
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