UHY VICTOR

2019

CANADA / U.S. TAX SURVIVAL GUIDE

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Many tax changes were implemented in 2018 in the Canada-US cross-border tax world, mainly due to the 2017 passage of the US Tax Cuts and Jobs Act. Many of these changes are 'game changers', with numerous implications for cross-border tax planning. We have been proactive this past year with our clients in responding to these challenges, and continue to seek out and implement tax effective solutions for our Cross Border clients.

The UHY Victor Canada-US Tax Team ("CUTT") is pleased to present this guide, which covers recent developments affecting businesses active in both the US and Canada, as well as individuals with cross-border tax issues. The information presented in this guide is accurate to January 1, 2019.

The UHY Victor CUTT is a group of 11 experienced tax and accounting professionals, who have hands-on expertise assisting clients identify and implement practical solutions to their cross-border tax and business issues.

We thank the members of CUTT for their contributions and assistance in preparing this guide.

Do not hesitate to contact us if we can assist with your US-Canada cross-border issues.

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US TAX DEVELOPMENTS

TAX CUTS AND JOBS ACT

There have been many significant changes to both corporate and personal income taxation in the US. Some key changes are as follows:

Personal

- The exemption for estate taxes has doubled to $11.4 million.
- The standard deduction has increased for single filers and married couples filing jointly to $12,000 and $24,000 respectively.
- There are still seven tax brackets, but the ranges have been adjusted.
- The alternative minimum tax exemptions have been increased.

Corporate

- There is now a single corporate tax rate of 21% (previously, the highest corporate rate was 35%.)
- The corporate alternative minimum tax has been eliminated.
- Short-lived capital investments can be fully expensed for five years.
- Section 179 expensing limit has been doubled to $1 million.

International

- There is a deemed repatriation tax of accumulated profits of controlled foreign corporations (“CFC’s”) at a rate of between 8% and 15.5%.
- Introduction of a territorial tax system will allow for US Corporations to receive dividends tax-free from controlled foreign corporations.
- New GILTI and BEAT tax are introduced to avoid off-shore tax-reduction plans.

US TAX DEVELOPMENTS (CONTINUED)

REPATRIATION TAX

Newly enacted Section 965 (the "Repatriation Tax") is intended to tax the retained earnings of certain corporations outside of the United States. This new tax was aimed at large multinational corporations who never repatriated offshore profits due to high US tax rates.

However the effects of this Repatriation Tax are felt by many American shareholders of Canadian corporations.

This one time tax ranges from 8% to 15.5% and is payable over eight years.

Planning is available to mitigate some of the negative impact of this tax.

GILTI

Following the one-time Repatriation Tax, the Global Intangible Low-Taxed Income ("GILTI") taxes undistributed annual profits of a corporation controlled by an American. This has the effect of significantly reducing the Canadian tax deferral benefits of leavings undistributed profits in a foreign corporation.

Do not be fooled by the inclusion of the word Intangible. This tax is applicable to almost all active income that isn't otherwise taxed under Subpart F.

A Section 962 election may be available to provide some relief from the application of GILTI.

BASE EROSION AND PROFIT-SHARING (BEPS)

BEPS

The CUTT closely monitors developments pertaining to the Base Erosion and Profit-Sharing ("BEPS") initiative. BEPS is an Organization for Economic Cooperation and Development ("OECD") project aimed at setting new international standards for many issues including:

- Realigning tax laws to avoid international income shifting, double taxation, and tax evasion
- International corporate taxation
- Transfer pricing
- Bilateral tax treaties and policy shopping
- Preferential regimes and transparency

The BEPS final report was published on October 5, 2015 and includes agreed upon minimum standards to be adapted internationally. In 2016, negotiations were concluded for a multilateral convention ("MLI"). The MLI outlines steps for signatories to implement the BEPS proposals, including updates to international tax rules and recommendations for tax treaties and policy so they are uniformly implemented.

Legislation to implement the MLI was introduced in the Canadian Parliament in May 2018 but has not yet been enacted into law. It is expected that Canada will complete ratification at some point in 2019. The MLI will only apply to tax treaties between two countries if the MLI has been ratified and is in force in both tax jurisdictions.

BEPS

Country-by-Country Reporting

Companies with annual revenues in excess of USD $850 million are required to report on a country-by-country basis information on their profit, loss, and accumulated income.

OECD Common Reporting Standard & Financial Information Exchange

The automatic exchange of information is a new international standard of tax cooperation as set out in the OECD/G20 Common Reporting Standard ("CRS"). More than 100 jurisdictions, including Canada, are committed to implement the CRS.

Under the CRS, financial institutions must take steps to identify certain accounts held by, or for the benefit of, non-residents or dual residents and to report such accounts to the Canada Revenue Agency (CRA). The information would then be available for sharing with the jurisdiction in which the account holder resides for tax purposes under the provisions and safeguards of the Multilateral Convention on Mutual Administrative Assistance in Tax Matters or the relevant bilateral tax treaty.

On December 15, 2016, Part XIX was added to the Canadian Income Tax Act, implementing the CRS due diligence and reporting obligations in Canada. This legislation together with the administration by the CRA will allow the CRA to exchange financial account information with participating jurisdictions beginning in 2018.

Canada and the US signed an intergovernmental information exchange agreement in relation to FATCA in 2014, and financial information has been regularly exchanged between the two countries since 2016.

TRANSFER PRICING

In line with new developments in BEPS and the OECD regarding transfer pricing, both the IRS and CRA are increasing their scrutiny of cross-border transactions between related parties.

As a result, small and medium sized businesses are experiencing an increase in transfer-pricing audits.

Our methodology is to group transfer pricing transactions into the following general areas:

1. Intangible payments (such as royalty, licensing, or franchising fees);
2. Management and administration fees;
3. Intercompany loans; and
4. Sale of products

Our experience is that the IRS and CRA have focused primarily on the first three areas when performing transfer-pricing audits.

The CRA is applying the OECD guidance and requires companies to establish transfer pricing agreements that conform to OECD transfer pricing guidelines. These agreements must provide economic support of arm's length terms, as well as complete and accurate descriptions of the transactions. The CRA however, has not adjusted their requirements to include OECD transfer pricing guidance to include the treatment of "cash boxes" affecting outbound financing of foreign subsidiaries of Canadian multinationals and BEPS' proposed simplified approach to low value-adding services.

OECD Action 13 has been implemented and requires corporate groups with annual consolidated revenues exceeding €750 million to maintain:

- **Country by Country reporting**
  Key information on all group members of the multinational
- **Master File**
  Key information about the Multinationals Group's Global Operations
- **Local File**
  Information and support on the local countries intercompany transactions

US reporting requirements are set forth in the Treasury Regulations, and are also similar to the OECD transfer pricing guidelines.

FOREIGN ASSET REPORTING

REPORT OF FOREIGN BANK AND FINANCIAL ACCOUNTS (FBAR)

US persons meeting the criteria listed below must file an FBAR annually with the US Department of Treasury using FinCen Report 114. The FBAR has the same filing deadline as individual income tax returns (although they are not filed together). Accordingly the FBAR filing deadline for an individual for it's 2019 taxation year is April 15, 2020 with an automatic six-month extension to October 15, 2020.

US persons are required to file an FBAR if:

1. The US person had either a financial interest in, or signature authority over at least one financial account located outside of the US; and
2. The aggregate value of all foreign financial accounts exceeded $10,000 USD at any time during the calendar year to be reported.

The following are considered US persons:

- US citizens
- US residents
- Green card holders
- Individuals electing non-resident status under a tax treaty
- Entities, which include: Corporations, Partnerships, Limited Liability Corporations, Trusts or Estates formed under the laws of the US

The FBAR must be filed electronically. Failure to properly file the form may be subject to penalties. The penalty is inflation adjusted. For penalties assessed after January 15, 2017, non-willful violations may result in a civil monetary penalty of $12,921.

Willful failure to file may be subject to a penalty equal to the greater of either $129,210 or 50% of the balance in the account at the time of the violation, for each violation.

FOREIGN ASSET REPORTING (CONTINUED)

FORM 8938

In addition to filing the FBAR to the Department of Treasury, Form 8938 must also be included in US personal tax return submitted to the IRS if financial account thresholds, higher than the FBAR, are met.

An individual who holds any interest in a specified foreign financial asset (SFFA) during the taxable year is required to file Form 8938. A specified foreign financial asset includes:

- A financial account maintained by a foreign financial institution
- Any stock or security issued by a foreign person
- A financial instrument or contract that has a foreign issuer or counterpart
- An interest in any foreign entity where such instrument is held for investment

Gold held in a safety deposit box, artwork, interests in a social security account, social insurance or other similar program, and personally owned real estate do not constitute specified foreign financial assets.

However, gold held by a custodian, interests in foreign trusts, foreign estates, foreign pension plans, and foreign deferred compensation plans do constitute a specified foreign financial asset.

Real estate held in a trust or other entity is not reportable by the individual. However, an interest in a foreign trust or foreign entity is reportable on separate tax returns which are then identified as filed on the FATCA form. Additional stock issued by a foreign corporation is a specified foreign financial asset.

The filing thresholds for Form 8938 in 2018 are:

	VALUE OF FOREIGN FINANCIAL ASSETS AT THE END OF THE YEAR	VALUE OF FOREIGN FINANCIAL ASSETS ANY TIME IN THE YEAR
WHILE LIVING IN THE US:		
Unmarried	$ 50,000	$ 75,000
Married and filing jointly	$100,000	$150,000
Married filing separately	$ 50,000	$ 75,000
WHILE LIVING ABROAD:		
Unmarried	$200,000	$300,000
Married and filing jointly	$400,000	$600,000
Married filing separately	$200,000	$300,000

FOREIGN ASSET REPORTING (CONTINUED)

FATCA INTERGOVERNMENTAL AGREEMENT (IGA)

Starting in 2015, Canada and the US started to share financial and tax information with one another.

The agreement requires Canadian financial institutions to report financial information on accounts held by US residents and US citizens (including US citizens who are residents or citizens of Canada) to the CRA, who then transfer this information with the IRS.

In addition, the IRS provides the CRA with increased information on certain accounts of Canadian residents held at US financial institutions.

Several exemptions are listed in the agreement. For example, the following are exempt from FATCA and will not be reportable:

- Registered Retirement Savings Plans (RRSP)
- Registered Retirement Income Funds (RRIF)
- Registered Disability Savings Plans (RDSP)
- Registered Education Savings Plans (RESP)
- Tax-Free Savings Accounts (TFSA)

Smaller deposit-taking institutions, such as credit unions with assets of less than $175 million will be exempt from this obligation.

The 30% FATCA withholding tax will not apply to clients of Canadian financial institutions. It will only apply to a Canadian financial institution if the financial institution is not compliant with its obligations as set out by the agreement.

Americans who are Canadian residents and non-compliant with their US tax filing requirements should be aware that Canadian financial institutions report information regarding their investments to the IRS. The same applies for Canadians with US tax filing requirements.

It was reported that in 2018 information on 1.6 million CDN bank accounts were reported to the IRS by the Canadian government.

FOREIGN ASSET REPORTING (CONTINUED)

T1135

Taxpayers who own specified foreign property with a cost of more than $100,000 CAD at any point during the year must file form T1135.

The CRA has simplified procedures for taxpayers who hold specified foreign property with a total cost base of more than $100,000 and less than $250,000 at any time in the tax year.

Taxpayers who hold more than $250,000 of specified foreign property must continue using the current detailed reporting method.

Specified foreign Property includes funds (such as cash) held in a financial account outside Canada, shares of non-resident corporations (including those held in Canadian brokerage accounts), debts owed by non-residents (such as bonds issued by non-resident corporations and governments), interests in non-resident trusts, real property outside of Canada, and other property outside Canada.

Form T1135 is due by the filing deadline for the taxpayer's income tax return for the year. The basic penalty for a missing or incomplete form is $25 per day or $100, whichever is greater, up to a maximum of $2,500. There are harsher penalties for taxpayers who knowingly fail to file the T1135 or make false statements.

IRS STREAMLINED FILING PROCEDURES

PURPOSE

The IRS introduced the Streamlined Filing Compliance Procedures in 2012 to provide US taxpayers (individual taxpayers and estates of individual taxpayers) who had failed to report and pay taxes on foreign financial assets with:

1. A streamlined procedure for filing amended or delinquent returns.
2. Terms for resolving their tax and penalty obligations.

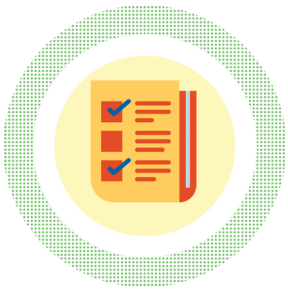
The failure to report and pay taxes must not have resulted from willful conduct on their part. Non-willful conduct is conduct that is due to negligence, inadvertence, mistake, or conduct that is the result of a good faith misunderstanding of the requirements of the law.

Returns submitted under these procedures may be selected for audit under existing audit selection processes applicable to any US tax return. They may also be subject to verification procedures. This means that the accuracy and completeness of submissions may be checked against information received from banks, financial advisors, and other sources.

If a taxpayer is concerned that their conduct was willful, they should consider participating in the Offshore Voluntary Disclosure Program.

After a taxpayer has completed the streamlined filing compliance procedures, they will be expected to comply with US law for all future years and file returns according to regular filing procedures.

ELIGIBILITY



In order to be eligible for the program:

- The taxpayer must certify that previous compliance failures was due to non-willful conduct.
- If the IRS has initiated a civil examination of a taxpayer's return for any taxable year, regardless of whether the examination relates to undisclosed foreign assets, the taxpayer will not be eligible to use the streamlined procedures.
- Taxpayers who want to participate in the program need to have a valid Taxpayer Identification Number (TIN) or Social Security Number.
- Taxpayers eligible to use streamlined procedures who have previously filed delinquent or amended returns must pay previous penalty assessments.

IRS STREAMLINED FILING PROCEDURES (CONTINUED)

STREAMLINED FOREIGN OFFSHORE PROCEDURES (NOT RESIDING IN US)

In order to be eligible for Streamlined Foreign Offshore Procedures, US taxpayers (individuals or estates of individuals) must:

- Meet the Streamlined non-residency requirement.
- If joint filing, both spouses must meet the non-residency requirement.

The procedures for eligible US taxpayers are to:

1. File amended tax returns and all required information returns for each of the most recent 3 years for which the US tax return due date has passed.
2. File any delinquent FBARs for each of the most recent 6 years for which the FBAR due dates has passed.

The full amount of the tax and interest due in connection with these filings must be remitted with the tax returns.

STREAMLINED DOMESTIC OFFSHORE PROCEDURES (RESIDING IN US)

The procedures for eligible US taxpayers who do not meet the non-residency criteria (individuals or estates of individuals) are to:

1. File amended tax returns and all required information returns for each of the most recent 3 years for which the US tax return due date has passed.
2. File any delinquent FBARs for each of the most recent 6 years for which the FBAR due dates has passed.
3. Pay a 'Title 26 miscellaneous offshore penalty', which is equal to 5% of the highest aggregate balance/value of the taxpayer's foreign financial assets that are subject to the penalty during the years in the covered tax return period and the covered FBAR period.

The full amount of the tax, interest, and miscellaneous offshore penalty due in connection with these filings must be remitted with the amended tax returns.

CROSS BORDER STRUCTURES

HYBRID ENTITIES

Hybrid entities refer to investment vehicles that are taxed differently in a non-Canadian jurisdiction than they are in Canada.

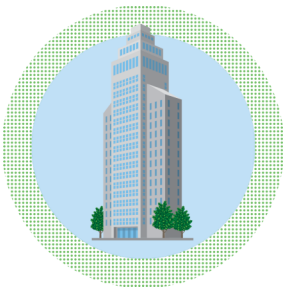
Canadian hybrid entities are not entitled to treaty benefits and are subject to a 25% withholding tax on cross-border payments. Canadian hybrid entities include Canadian Unlimited Liability Companies ("ULC"). Currently, ULCs may only be incorporated in the provinces of British Columbia, Nova Scotia, and Alberta. Note that there are techniques that may be available to avoid the denial of US Treaty benefits for certain situations.

US hybrid entities, such a Limited Liability Corporations ("LLCs") have access to protection under the Canada-US Tax Treaty when used to invest in Canada, and are entitled to treaty rates as follows:

- Branch tax (5% rather than 25%)
- Interest (0% rather than 25%)
- Dividends (5% or 15% rather than 25%)
- Royalty payments (nil or 10% rather than 25%)
- Capital gains (possibly no withholdings required, depending on the circumstances)

As a result of differing tax treatments between the United States and Canada, Canadians considering investing in US LLCs should be wary. In many situations this structure has negative tax implications for Canadian investors. Access to important tax treaty benefits are often not available for Canadians invested through LLCs, which often results in double taxation.

TOWER STRUCTURES



Tower structures are corporate configurations located in both the US and Canada that utilize hybrid entities to structure their financing. By doing so, an interest expense may be deducted in both the US and Canadian entities. Many observers refer to these structures as a "double dip" as they take advantage of the different tax treatments which the American and Canadian governments will apply to the same transaction.

A number of developments since 2013 have resulted in various countries attacking these tower structure arrangements. As a result, any corporation still utilizing a tower structure should review their structure and plan accordingly.

CROSS BORDER STRUCTURES (CONTINUED)

CANADIAN FOREIGN AFFILIATE DUMPING RULES

Foreign affiliate dumping ("FAD") refers to a situation in which a foreign parent company has a Canadian subsidiary (referred to as a Corporate Resident in Canada, or "CRIC") that in turn uses debt to invest in shares of other foreign affiliates of the parent company which would result in the CRIC benefiting from a large loan interest deduction while also allowing the CRIC to receive intercorporate dividends from the foreign affiliate tax free. To combat this abuse, the Canadian FAD rules would deem a dividend to be paid by the CRIC equal to the value of the CRIC's investment in its foreign affiliate (thereby resulting in withholding tax). Additionally, the paid-up capital ("PUC") of the CRIC's shares in the foreign affiliate would be ground down.

UPSTREAM LOANS

When a foreign subsidiary loans money either to its Canadian parent company or a person who does not deal at arm's length to the Canadian parent (other than a controlled foreign affiliate), there may be a potential income inclusion to the Canadian entity if such loan remains outstanding for more than two years. Depending on the circumstances, an offsetting deduction may be available.

THIN CAPITALIZATION RULES

Canadian and US tax laws each limit the amount of interest that a company may deduct when the foreign parent capitalizes the domestic company with an excessive debt load relative to it's equity investment. Canadian thin-capitalization rules now limit deductible interest on loans from certain non-residents at a ratio of 1.5:1 debt to equity ratio.

INTERCOMPANY LOANS

When arranging a cross-border intercompany loan, the purpose, nature, and terms of the loans should be considered. In some circumstances there could be deemed interest, income inclusions, or withholding tax implications.

WITHHOLDING TAXES

CANADIAN WITHHOLDINGS REGULATION 102

Many US corporations providing services in Canada continue to struggle to comply with Regulations 102 and 105.

When a US employee performs temporary employment duties in Canada, that employee is required to file a Canadian income tax return. If that employee earns under $10,000 based on a proration of their annual salary over their stay in Canada, the Canada-US Tax Treaty may exempt the US employee from tax in Canada (conditions apply).

However, notwithstanding the ultimate Canadian tax liability of the US employee, Regulation 102 requires US employers to register for Canadian payroll accounts, withhold, and remit Canadian income taxes to the Canadian government.

WITHHOLDING TAXES (CONTINUED)

REGULATION 102

Canada provides two options to avoid the withholding and remittance of Canadian income taxes from US employees who render employment services in Canada:

i) Non-Resident Employer Certification

Employer Obligations

- Must be resident in a country that maintains a tax treaty with Canada (such as the Canada-US Tax Treaty);
- Must have applied for and received certification from the Canada Revenue Agency under this program;
- Required to file a treaty-based tax return in Canada (no income tax obligation

Employee Obligations

- Must be resident in a country that maintains a tax treaty with Canada (such as the Canada-US Tax Treaty);
- Must not be liable for income tax in Canada as a result of a tax treaty (ie. they earn less than $10,000 of income attributable to Canada);
- They work less than 45 days in Canada within a calendar year or less than 90 days over the previous 12 months
- Not required to file a Canadian tax return

ii) Regulation 102 Waiver

- Applicable when a US employee is exempt from Canadian income tax under the Canada-US Tax Treaty (ie. less than $10,000 of income)
- Must apply for this waiver from the Canadian government (and Quebec if applicable) at least 30 days prior to commencement of employment services
- Employee is still required to file a Canadian tax return in order to apply for a treaty exemption from Canadian taxes

WITHHOLDING TAXES (CONTINUED)

CANADIAN WITHHOLDINGS REGULATION 105

Regulation 105 imposes a 15% withholding tax on fees, commissions, or other amounts earned by US individuals and corporations from services rendered in Canada. If these services are rendered in the province of Quebec, they will be subject to an additional Quebec withholding tax of 9%.

Often these withholding taxes can be recouped. The US entity must file a Canadian (and Quebec) tax return at the end of the entity's fiscal year and claim a refund to the extent that they qualify for refunds according to the Canada-US tax treaty.

But to avoid the initial withholding and tax refund process, US service providers can request a reduction or waiver of their Canadian withholding requirement either 30 days before the services are to commence in Canada, or 30 days before the first payment is due for these services. This waiver is only available when there will not be an ultimate tax liability under the Canada-US Tax Treaty. A treaty-based Canadian tax return must still be filed in order to receive the exemption under the treaty.

WITHHOLDING TAXES (CONTINUED)

The IRS continues to hire new agents to audit withholdings on payments to non-residents.

US WITHHOLDING REQUIREMENTS

WITHHOLDING AGENTS

Entities making payments to non-residents are required to appoint a withholding agent. This withholding agent is required to withhold, remit, and report these payments to the IRS.

Generally, withholding taxes are reported on Forms 1042 and 1042-S, and are filed with the IRS either on or before March 15th. The withholding agent is required to deposit the amounts withheld in a US bank.

REDUCTIONS AND EXEMPTIONS

The Canada-US Tax Treaty reduces most withholding rates. An application for reduction or exemption from US withholding under a treaty is generally made to the withholding agent.[1]

File Form W-8BEN with the US financial institution or withholding agent to claim treaty exemption or reduced rate of withholding.

US taxable income by a partnership and LLCs with effectively connected income requires withholdings. Forms 8805 and 8813 are used to report the withholding tax.

Interest income may be exempt from withholding tax.

[1.] By completing Form 8233 and then having the withholding agent forward the form to the IRS within five days.

REAL ESTATE

AMERICANS WITH RENTAL PROPERTY IN CANADA

Americans who own Canadian real estate must:

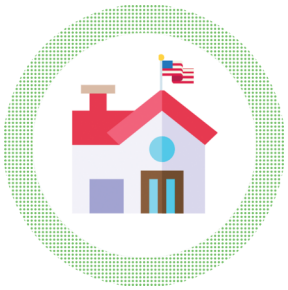
- File annual Canadian income tax returns (and Quebec, where applicable).
- Remit withholdings to the CRA on a monthly basis
- Withhold at least 25% of the gross rental income. This can be reduced to 25% of the projected net income if an NR6 application is filed to the CRA in advance of the first rent payment of the year.

Americans selling Canadian real estate must:

- File annual Canadian income tax returns (and Quebec, where applicable).
- Remit withholdings of 25% (plus 12.875% in Quebec) on the gross sale proceeds within 10 days of the sale. These withholdings can be reduced if a clearance certificate is obtained in advance of the transaction closing.

REAL ESTATE (CONTINUED)

CANADIANS WITH RENTAL PROPERTY IN THE US



Real estate holders should be aware of the tax implications of the following activities:

- Disposition of US real property investment
- US withholding on dispositions
- Application of the Foreign Investment in Real Property Tax Act ("FIRPTA")
- How to structure ownership of US vacation properties. Often the use of trusts and partnerships can achieve significant tax savings.
- Exposure to US Estate Tax

Canadian real estate investors must:

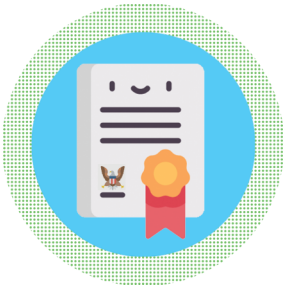
- File annual US tax returns. (This applies to individuals, corporations, partnerships, LLCs, trusts, and estates.)
- Apply a withholding tax on amounts realized on disposition or sale (FIRPTA):
    a. If the buyer acquires the US real property for use as a residence and the sale price does not exceed $300,000, there is an exemption from the withholding tax.
    b. If the amount realized exceeds $300,000 but does not exceed $1,000,000 **and** the property will be used by the transferee as a residence, then the withholding rate is10% on the full amount realized.
    c. If the amount realized exceeds $1,000,000, then the withholding rate is 15% on the entire amount, regardless of the use by the transferee.

The 15% withholding is applicable to the ownership of US real property held directly by individuals, indirectly through partnerships, and the ownership of stock in a US real property holding corporation.

The PATH Act of December 2015 introduced changes regarding foreign investment in US real estate. The main change is an exemption for qualified pension funds from FIRPTA. The PATH Act has also made changes to regulations on foreign investment in US REITs.

ESTATES AND TRUSTS

US ESTATE, GIFT, AND GENERATION SKIPPING TAXES



A broad range of individuals must consider the impacts of the US Estate Tax. Subject to the various exemptions, this tax may apply to:

- All US citizens (residing in the US or abroad)
- Canadians who reside in the US (either via a green card or with established permanent residence.)
- Canadians who own US real estate or tangible personal property located in the US, and
- Canadian shareholders of US companies (ie. stock market investments).

The December 2017 Tax Cuts and Jobs Act has increased the exemptions from the US Estate Tax that are relied upon by many clients.

The following are the 2019 exemptions, which are subject to annual adjustment for inflation:

Federal Unified Estate & Gift Tax life time exemption	$11,400,000
Federal Generation Skipping Transfer Tax exemption	$11,400,000
Annual Gift Tax exemption per donee	$15,000
Annual gift to non-resident alien spouse	$155,000

ESTATES AND TRUSTS (CONTINUED)

US ESTATE, GIFT, AND GENERATION SKIPPING TAXES

The Federal Estate and Gift Tax rate (not subject to inflation adjustment) is 40%.

An individual can transfer up to $11,400,000 during their life and at death. A married couple can transfer double that amount – up to $22,800,000. Transfers between spouses are generally exempt from taxation. A deceased spouse's unused exemption can be transferred to the surviving spouse and added to their exemption.

The tax cost basis of assets held by a decedent at death is generally adjusted to the values at the date of death.

It is very important to note that while exemptions exist from the US Estate and Gift Tax, similar exemptions do not apply to most states. Therefore, a person may not have a federal Estate Tax liability, but may be subject to estate, inheritance, or gift taxes in the state of jurisdiction.

US residents who maintain trusts under Canadian jurisdiction, such as Canadian estates, may be required to file special information returns regarding the assets held in the trusts. These trusts may be subject to income taxation. Not filing required information returns can subject the trust to substantial penalties (See "Other US reporting issues").

CANADIAN TRUSTS

Deemed Canadian Resident Trusts

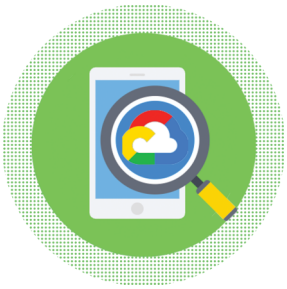
A trust created outside Canada may be deemed to be a Canadian resident trust where:

- A Canadian resident makes a contribution to a foreign trust; or
- A Canadian resident is a beneficiary of a foreign trust and a "connected contributor" contributes assets to that trust.

E-COMMERCE

E-Commerce transactions can raise many questions concerning sourcing the sale of goods and services, and the buyers location. A further complication to consider is the possibility of unintentionally creating a Permanent Establishment (PE) in a foreign country by maintaining a computer server in that foreign jurisdiction. This may require the allocation of revenue to the PE based on the activities conducted by or for the PE.

SOURCING



- Sales of inventory purchased are generally sourced where title transfers.
- Sales of intangibles are generally sourced to the seller's country of residence,

However the CRA will also consider the jurisdiction of primary use.

- Income from the licensing of intangibles is ordinarily sourced based on use.
- Income from services is generally sourced where the services are performed, which generally means where personnel are employed and capital is expended.

ONLINE SERVICES

NEW for 2019: ***An e-commerce business that provides services or goods to Quebec residents may be required to collect and remit Quebec Sales Tax***

- Generally, advertising services are sourced where the income-producing activities are performed.
- When income producing activities take place partly within and outside the US, it requires an allocation of revenue. The allocation must be based on the facts and circumstances.
- Internet Service Providers (ISP) involve the use of labor and equipment which requires an allocation based on the place of performance rule, i.e. location of server, routers, or other equipment.
- When sourcing an Application Service Providers' (ASP) Software as a Service (SaaS), you determine where the activities giving rise to income occur based on the facts and circumstances.
- Sale of digital products such as software, e-books, music, and videos present different sourcing issues. Location of purchaser may be unknown in which case sourcing may necessitate the use of the buyers domain.

E-COMMERCE (CONTINUED)

PERMANENT ESTABLISHMENT

Tax treaty concept which requires a physical location. This is either where business operations are regularly conducted by employees or agents, or the location of a server.

- ISPs will source revenue to a PE if there are equipment and personnel present.
- Allocation within and without is based on the locations where the income producing activities occur.
- Income for automated web-based services, ASP, and SaaS is sourced based on the primary and secondary income-producing activities.
- The location of a fully automated server creates a PE; however, profits may be allocated based on where substantial activities for the maintenance and operation of the Web site occurs.
- In 2018, the US Supreme Court rules in *South Dakota v Wayfair Inc.* which indicated that US states may require e-commerce businesses transacting with its residents to collect and remit state sales taxes.

U.S. EXPATRIATION

EXPATRIATES

Expatriates are US citizens who relinquish their US citizenship or long-term permanent residents who surrender their green cards.

An increasing number of Americans have been expatriating despite the complicated renunciation process. In 2017, a record number of Americans formally renounced their US citizenship or residency.

Taxpayers must file an Exit Return the year of their renunciation, which triggers a deemed sale of their assets the day before the expatriation date at fair market value. This sale has a capital gains tax with an annually adjusted for inflation exclusion of $711,000 in 2018.

The tax attributable to the deemed sale of property may be extended until the due date of the return for the taxable year in which such property is disposed of, provided that an election to defer the tax is made. An irrevocable election to defer the tax may be made, however adequate security must be provided. Generally, a bond or letter of credit are considered acceptable security interests. Interest will be charged on any deferral of tax.

Certain property deemed sold will not qualify for the election such as:

- Any deferred compensation payments
- Any specified tax deferred accounts
- Any interest in non-grantor trusts

Special rules apply to US withholding on deferred compensation payments.

COVERED EXPATRIATES

Only covered expatriates are subject to these deemed sale rules. A covered expatriate is a person whose:

- Average annual net income for the 5 tax years ending prior to the date of loss of US citizenship exceeds $165,000 (2018); or
- Has a net worth of $2 million of more at the time of expatriation.

Such a person must certify under the penalty of perjury that he or she has met the requirements for the 5 preceding taxable years. The $165,000 (2018) annual income is indexed for inflation ($139,000 in base year 2008).

U.S. EXPATRIATION (CONTINUED)

DATE OF EXPATRIATION

A citizen shall be treated as relinquishing his or her US citizenship on the earliest date where:

- A renunciation of US nationality occurs before a diplomatic or consular officer of the US pursuant to paragraph (5) of section 349(a) of the Immigration and Nationality Act;
- The US State Department furnishes a signed statement of voluntary relinquishment of US nationality;
- The US State Department issues a certificate of loss of nationality;
- A court of the US cancels a naturalized citizen's certificate of naturalization.

EXCEPTIONS

Two exceptions to the exit-tax regime are:

- Individuals who were born with dual citizenship in Canada and the US, continue to be a citizen and tax resident of Canada as of the date of expatriation, and they have not been a US resident for more than 10 taxable years during the 15-year period ending with the taxable year of expatriation;
- US citizens who renounce their US citizenship before reaching the age of 18 1/2, provided that they were not a US resident for more than 10 taxable years before the renunciation.

Individuals considering expatriation should be aware that Congress enacted immigration legislation (the Reed Amendment) in 1996. This amended the grounds of visa ineligibility and of inadmissibility to the US. Under the Reed Amendment, any former US citizen who officially renounced their US citizenship and who is determined by the Attorney General to have renounced it for the purpose of avoiding taxation by the US will be inadmissible to the United States and ineligible for a visa.

Long term residents of the US terminate their resident status by:

- Filing Form I-407 Abandonment of Lawful Permanent Resident Status with the US Citizenship and Immigration Services (USCIS) or a consular officer; or
- Beginning to be treated as a resident of a foreign country under the residence tie breaker rules in a treaty with the US, does not waive the benefits of the treaty, and notifies the secretary of such treatment on Form 8833 and Form 8854.

A long-term resident is defined as an individual who has held a green card for any portion of at least 8 of 15 years preceding expatriation. Even one day in a year is considered any portion of a year.

MISCELLANEOUS

PE FOR SERVICE PROVIDERS TO CANADA

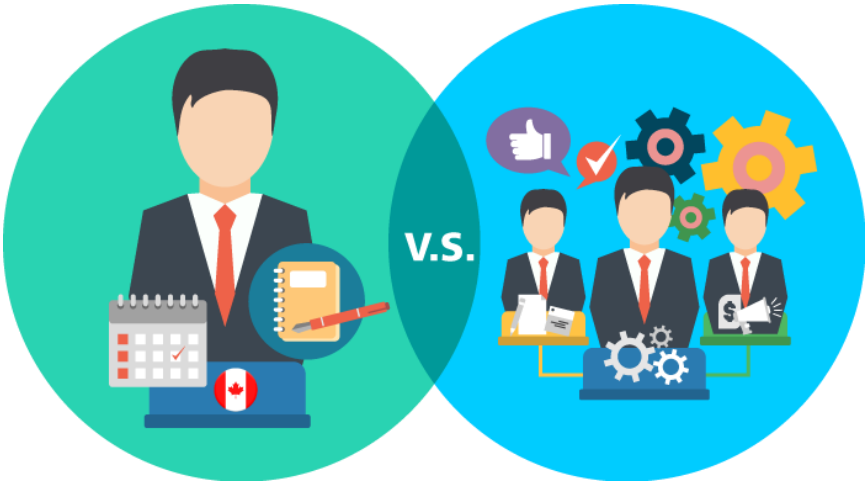
Effective January 1, 2010 the fifth protocol to the US Canada Tax Treaty introduced a new definition of Permanent Establishment (Article V). **Cross border contractors are now deemed to have a permanent establishment in the other country if they pass either:**

The Single Individual Test (for Individuals):

Services are performed by an individual who is present in the other Contracting State for more than 183 days in a 12-month period and during this period more than 50% of the gross active revenues of the enterprise are generated from these services; or

The Enterprise Test (for Corporations):

Services are provided in the other Contracting State for more than 183 days in a 12-month period with respect to the same or connected project. These services are provided for customers who are either residents of, or maintain a PE in the other State and the services are provided to the other PE.



MISCELLANEOUS (CONTINUED)

SALES TAX IN CANADA

US entities are required to register for and charge Canadian sales taxes if they meet the definition of "carrying on business" in Canada.

2019 SALES TAX RATES

Province	GST	PST	HST
Alberta	5%	-	-
British Columbia	5%	7%	-
Manitoba	5%	8%	-
New Brunswick	-	-	15%
Newfoundland	-	-	15%
Nova Scotia	-	-	15%
North West Territories	5%	-	-
Nunavut	5%	-	-
Ontario	-	-	13%
Prince Edward Island	-	-	15%
Quebec	5%	9.975%	-
Saskatchewan	5%	6%	-
Yukon	5%	-	-

Further to the 2011 introduction of the Harmonized Sales Tax ("HST"), the CRA implemented a number of significant changes to the regulations on supplies of services performed in Canada.

The supply of services is generally based on the business address of the customer. There are exceptions for certain services, which include:

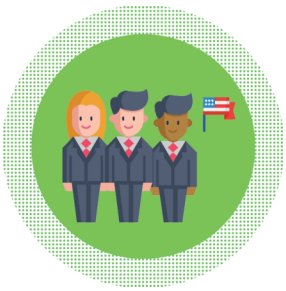
- Personal services
- Services in relation to real property, goods, or a location-specific event
- Services rendered in connection with litigation
- Customs brokerage services
- Computer-related services and internet access
- Repairs, maintenance, and photographic-related goods

There is no change to the place of supplies of real property and goods by way of sale.

A supply of real property is considered to be made in the province where the property is situated and therefore the sale is subject to the provincial GST/HST rate. A supply of goods by way of sale is deemed to be made in a province if the supplier delivers the goods or makes them available to the buyer in that province.

MISCELLANEOUS (CONTINUED)

US PASSIVE FOREIGN INVESTMENT CORPORATIONS ("PFIC") RULES



Increased PFIC information has to be reported by US shareholders annually on Form 8621.

A new de-minimis threshold amount was established relating to PFIC reporting. PFIC reporting is required if on the last day of the tax year either:

- The value of all PFIC stock owned directly or indirectly by the shareholder exceeds $25,000; or
- The shareholder only holds the PFIC stock indirectly and the value of the indirectly owned stock exceeds $5,000.

The IRS has provided regulations on determining indirect ownership and reporting requirements of PFICs. There are new anti-duplication rules so that stock is not counted twice when determining whether a person with an interest in a domestic corporation is an indirect owner of a PFIC that is held by that same domestic corporation.

There is also additional guidance on how PFIC shareholders should complete IRS Form 8621 and IRS Form 5471.

SECTION 385 US INTERCOMPANY DEBT-EQUITY RULES

In 2018, the IRS has issued final regulations on the recharacterization of certain intercompany debt instruments as equity for tax purposes in the US. These rules do not apply to the first $50 million of debt issued by a corporation (as short-term debt or funding new investments of a controlled subsidiary.)

Under Section 385, debt issued by a corporation to an affiliate is recharacterized as equity if it is issued:

1. In connection with a distribution to shareholders, or
2. An exchange for stock of an affiliate, or
3. Certain exchanges for property in an asset reorganization

MISCELLANEOUS (CONTINUED)

ANTI-INVERSION GUIDANCE

In 2016, the IRS issued tough new regulations affecting inversion transactions. The tax consequences of transferring a domestic entity to a foreign entity in an inversion transaction are based on the percentage of ownership of the foreign corporation by the owners of the domestic entity before the transaction.

If the percentage is at least 60% but less than 80%, special taxes are applied to the inverted entity. If the percentage of ownership is at least 80%, the foreign

LEVERAGED PARTNERSHIPS

The IRS has issued new regulations to limit the use of leveraged partnerships as a structure to take cash out of a business tax-free. Prior to these new regulations, partners could distribute cash tax-free if it was funded with partnership debt. Under these new regulations, the partnership's liabilities will be treated as non-recourse liabilities in certain situations.

OTHER US REPORTING ISSUES

FORM 5471 – Information Return of US Person with respect to certain foreign Corporations. Failure to file a complete and accurate Form is subject to a $10,000 civil penalty per filing.

FORM 5472 – Information of a 25% foreign-owned US Corporation or Foreign Corporation engaged in a US trade or business (such as US LLCs). Failure to file a complete and accurate Form is subject to a $10,000 civil penalty per filing.

FBAR – FinCen Report 114 (formerly TD F 90-22.1) – Information detailing foreign bank accounts and other foreign investments if the aggregate value of such accounts at any point in a calendar year exceeds $10,000. Failure to properly file the form may be subject to penalties, including a civil penalty of $10,000. Reasonable cause for failure to file may eliminate the penalty. **Willful failure to file may be subject to a civil monetary penalty equal to the greater of either $100,000 or 50% of the balance in the account.**

WITHHOLDING - 1042, 1042-S – Failure to file the Form is subject to a $100 penalty per filing. Failure to withhold will subject the withholding agent to personal liability for the tax and interest on the unpaid tax.

FORM 1120F – US Income Tax Return of a Foreign Corporation. Required of a foreign corporation that conducts business in the US, whether or not it is through a US office. Failure to file Form 1120F may result in the income of the foreign corporation to be taxed on a gross basis.

MISCELLANEOUS (CONTINUED)

OTHER CANADIAN REPORTING ISSUES

T1135 – Foreign Property Reporting: Canadian resident taxpayers that own foreign property with a total cost above $100,000 at any point during a year are required to file a T1135 information return with the CRA to report certain information regarding the foreign property and any income derived from it. This form should be filed by the filing deadline for the taxpayer's income tax return for the year. The maximum penalty for a missing or incomplete form is $25 per day or $100, whichever is greater, up to a maximum of $2,500. There are harsher penalties if the taxpayer knowingly fails to file the T1135 or makes false statements.

T1134 – Foreign Affiliate Reporting: Taxpayers are required to file an annual T1134 information return to report information regarding their foreign affiliates and controlled foreign affiliates. In very general terms, a foreign affiliate is a non-resident corporation in which the taxpayer and persons related to the taxpayer own at least 10% ownership, with the taxpayer alone owning at least 1% of the non-resident corporation (ownership may be direct or indirect). These returns should be filed no later than 15 months following the taxpayer's taxation year end (due date to be reduced to 12 months in 2020 and 10 months after 2020). Assuming that the taxpayer is not required to file more than 50 T1134 returns, the maximum late-filing penalty with respect to T1134 returns is $2,500 per missing form.

T106 – Reporting Non-Arm's Length Transactions with Non-Residents: Taxpayers are required to report their transactions with non-arm's length non-residents for each taxation year by filing a T106 information return if the combined annual amount of these transactions exceeds $1,000,000. Common reportable transactions include sales, purchases, or the borrowing and repayments of loans and indebtedness. These forms should be filed by the filing deadline for the taxpayer's income tax return for the year. Assuming that the taxpayer is not required to file more than 50 T106 slips, the maximum late-filing penalty with respect to T106 forms is $2,500 per missing form.

T4A-NR – Payments to Non-Residents for Services Performed in Canada: Taxpayers that make payments during the calendar year to non-residents for services performed in Canada are required to file a T4A-NR information return with the CRA. A T4A-NR return reports both the gross payments made to non-residents and the withholding tax on these payments remitted to the CRA. The filing deadline for T4A-NR information returns is the last day of February of the following calendar year. The maximum penalty for late-filing a T4A-NR information return varies from $1,000 - $7,500, depending upon the number of T4A -NR slips required to be filed.

MISCELLANEOUS (CONTINUED)

OTHER CANADIAN REPORTING ISSUES (CONTINUED)

NR4 – Other Payments to Non-Residents: Canadian residents and non-residents that carry on business in Canada are required to file an annual NR4 information return to report payments made to non-residents during the year. Common payments which are required to be reported on a NR4 return include interest, dividends, rents, management fees, and royalty or licensing payments.

A NR4 return reports both the gross payments made to the non-resident and any withholding tax remitted to the CRA with respect to the payments. The filing deadline for NR4 returns is 90 days after the calendar year end. The maximum penalty for late-filing a NR4 return varies between $1,000 and $7,500 depending upon the number of NR4 slips required to be filed.

NR6 – Undertaking to Withhold on a Net Basis from Rental Income Paid to Non-Residents: The default Canadian income tax treatment for rents earned in Canada by non-residents is a 25% withholding tax on gross rents. Non-residents may elect to pay Canadian income tax on rental income on a net basis by filing an annual Section 216 election return with the CRA. In order to withhold on a net basis, non-residents (together with their Canadian resident agents) must annually file Form NR6 with the CRA. Form NR6 should be filed before the first rental payment of the year, and must be approved by the CRA prior to withholding on a net basis.

NR301 - Declaration for Benefits under a Tax Treaty for Individual, Corporation, or Trust: Must be completed by entities benefiting from treaty reduced withholding rates on dividends, interest, management fees, rents, and royalties paid to or for the benefit of non-residents.

NR302 - Declaration for Benefits under a Tax Treaty for a Partnership: Must be completed by entities benefiting from treaty reduced withholding rates on dividends, interest, management fees, rents, and royalties paid to or for the benefit of non-residents.

NR303 - Declaration for Benefits under a Tax Treaty for a Hybrid Entity: Must be completed by entities benefiting from treaty reduced withholding rates on dividends, interest, management fees, rents, and royalties paid to or for the benefit of non-residents.

MISCELLANEOUS (CONTINUED)

OTHER CANADIAN REPORTING ISSUES (CONTINUED)

T2 SCHEDULES 91 & 97 – Treaty-Exempt Income Tax Return for Non-Resident Corporations: Non-resident corporations that carry on business in Canada but do not have a permanent establishment in Canada under the applicable bilateral income tax treaty are required to file an annual corporate income tax return (T2) to report their claim for a treaty-based exemption from Canadian income tax. The filing deadline for filing a corporate income tax return is six months after the corporation's fiscal year end. The maximum penalty for late-filing a corporate income tax return is $2,500.

T5018 – Construction Industry Subcontractor Payment Reporting: Taxpayers that carry on business in the construction industry are required to annually report to the CRA payments made to subcontractors during the year by filing a T5018 information return. Taxpayers can choose to use either the calendar year or their fiscal year to report these payments. The maximum penalty for late-filing a T5018 return varies from $1,000 - $7,500 depending upon the number of T5018 slips required.

BACK-TO-BACK RULES

In 2014, Canada introduced regulations to prevent the use of intermediaries to reduce withholding taxes on interest payments to non-residents or in the avoidance of thin capitalization rules.

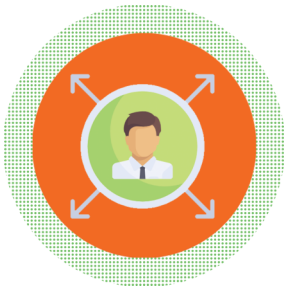
Canada has now expanded the **back-to-back rules**, preventing the use of intermediaries to reduce withholding taxes by:

1. Expanding the application to royalties, rents, and similar payments
2. Extending the application to structures with multiple
3. Intermediaries
4. Adding character substitution rules

Canada has also extended the rules to include outbound loans (in an attempt to avoid shareholder loan rules).

MISCELLANEOUS (CONTINUED)

EXPANSION OF SUBSECTION 55(2) ANTI-AVOIDANCE RULE



Dividends paid between Canadian corporations are generally paid tax-free. However, there is an anti-avoidance rule in **Subsection 55**(2) of the Income Tax Act which prevents tax-free dividends from being paid when the purpose is the reduction or avoidance of capital gains on the sale of shares of the corporation that paid the dividends.

Subsection 55(2) now applies to tax-free intercorporate dividends when they were issued:

1. To reduce or avoid capital gains on the disposition of shares
2. To reduce the fair market value of any share
3. To increase the cost of property of the dividend recipient

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