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US STRUCTURING IN THE TRUMP ERA

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Attorneys

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Many proposals, rumors, and news reports ("fake" and other-
wise) in the last few months have highlighted potentially significant changes to the us tax
system—the lowering of the us corporate tax rate, for example, or the introduction of a
border-adjustment regime. Regardless of the uncertainty about these changes, Canadian businesses
need guidance on how to enter or expand into the us marketplace. With cross-border businesses, in
particular, it is important to carefully consider the owner's short- and long-term plans for
establishing or expanding the us business. It is also important to be as flexible as possible to
anticipate inevitable changes in the tax rules.

The Canadian business's objectives in the us marketplace are critical when it comes to determining
the business's structure. If a growth mode is projected for the new us business, with many years
of losses or nominal profits, or if a plan exists to reinvest profits in the us business rather
than repatriate them, the best approach may be a plain vanilla structure, with a Canadian holdco
that owns a usco. Currently, the us corporate tax rate is high—a 34 percent federal tax rate
applies at us$75,000 of taxable income—but this may have little practical effect if the business
has losses or minimal profits for several years. In addition, us corporate tax rates will likely
decrease in the future. Moreover, a corporation with us manufacturing operations may have little
us tax on those operations if a border-adjustment tax is enacted: this new type of us tax proposes

to reward a corporation that exports products from the United States that are manufactured there.

However, the currently high us corporate tax rate is not the only disadvantage to operating in corporate form. For example, the US corporate tax system double-taxes the ultimate distribution of profits to owners, and a corporation does not have a preferential capital gains rate: that rate applies only to a business owned by an individual or to a trust that is operating in a flowthrough structure such as a partnership. However, these downsides to the corporate structure could be mitigated if (1) transfer pricing is used to reduce elements of double taxation, (2) profits are reinvested in the us business rather than repatriated, or (3) the us corporate tax rate is reduced.

On the other hand, if the objective is to return profits to Canada as quickly as possible, one should consider using a limited partnership structure in the United States. A Canadian individual who owns a limited partner interest in a US limited partnership either directly or through a trust (for estate- planning reasons) is currently taxed in both the United States and Canada as profits are earned, with (generally) offsetting credits. No second level of taxation is imposed when the profits are paid out to the Canadian investor, although this also means that the high Canadian tax rates on individuals are not deferred. In addition, the preferential US capital gains rate of 20 percent is available in this structure, a rate that is particularly advantageous when a business is sold. These advantages are not available for a corporate partner, and a limited partnership vehicle is not practical for a public company or a company with many owners.

A partnership structure's disadvantages include the need for the individual partners to file US tax returns: multiple tax returns may need to be filed because there are many US taxing jurisdictions. Another disadvantage is the administrative burden of quarterly federal withholding tax obligations (and possibly state withholding) that are imposed on each partner's allocable share of the partnership income. Moreover, an individual who owns a limited partnership interest may face us estate tax. For these reasons, a trust and not an individual is often the investor.

Another structuring alternative exists: it provides for effectively one level of taxation, but it obviates the need for an individual or trust investor to file US federal and state tax returns. A Canadian holdco partnership may be interposed to own the limited partner interest in the US limited partnership; that Canadian partnership checks the box to be taxed as a corporation for US tax purposes. This structure entails corporate- level taxation of the US partnership profits and a branch- profits tax on repatriating profits to Canada; however, for Canadian tax purposes, the US partnership income flows through and is taxed currently to the Canadian partners with, generally, a credit for the US taxes paid by the Canadian partnership. But, as discussed above, a Canadian corporate owner of a US business cannot access the preferential US tax rate on capital gains that applies to individuals and trusts; this disadvantage may be less problematic

if the US corporate rate decreases. However, this structure does avoid the double tax inherent in a purely corporate structure.

Another structuring consideration is that Canadians often partner with US persons to operate a US business. The US investors typically prefer a flowthrough tax structure, such as a limited liability company (LLC) or a limited partnership, and these structures can work for Canadian investors, too, if the factors noted above are taken into account. For example, if US investors want to use an LLC and the Canadian business will leave profits in the United States, the Canadian business may form a US corporation to own its LLC interest. Using a limited partnership achieves any flowthrough taxation that the Canadians desire, and gives the US investors the same tax advantages as an LLC, with little added complexity.

If the US tax landscape changes drastically, it may become necessary to unwind the structure by a transfer or sale of the US business into a structure more favorable for the Canadian owners. It may be possible to make this change without paying current US tax. For example, a Canadian individual with a US limited partnership interest may decide that paying current tax at high Canadian rates is not the best approach: the US business may be transferred into a corporate structure without current US taxation. Although it is generally harder to avoid triggering tax when shifting from a corporate to a flowthrough structure, there are methods to mitigate current US tax. Of course, Canadian tax rules need to be considered in a restructuring, too.

Moreover, US state-tax law should also be considered. Federal tax rates may decrease, but it seems unlikely that many—if any—states will reduce their tax rates, particularly because many states are struggling fiscally. For this reason among others, transfer-pricing techniques and intercompany agreements must always be considered regardless of changes in tax rates or the imposition of new types of US taxes. Significant changes to US tax law may occur in, for example, the recently finalized US debt-equity regulations, which are apparently pending review by the Trump administration. Canadians who want to do business in the united states must closely watch the rapidly evolving US tax law.