2009 International Taxation Conference

INVESTING DIRECTLY AND INDIRECTLY IN CANADA

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OVERVIEW

- Introduction
- Canadian Tax Environment
- Canada – India Tax Agreement
- Investing Directly in Canadian Businesses
- Investing in Canadian Corporations with Significant Foreign Assets
- Investing in Canadian Income or Royalty Funds
- Investing in Foreign MNEs with Canadian Business Operations

INTRODUCTION

- "India offers spectacular growth rates, an increasingly liberal investment regime and impressive capabilities in the area of science and technology. Canada is the best positioned economy in the G8, has falling tax rates, one of the most welcoming environments for investment in the world and has the resources necessary to meet India's growing energy and infrastructure needs."
- "Between us, our combined GDP is well on its way to four trillion dollars. Yet, at the moment, we are only doing five billion dollars worth of business per year."
- "[I]t is my sincere hope that our two governments will complete our bilateral nuclear cooperation agreement soon."
- "Canada is also keen to see completion of the Foreign Investment Protection and Promotion Agreement. Conclusion of this agreement would signal to investors of both countries that direct investment can be made in a predictable and secure business environment."
  - ***Remarks of Prime Minister Stephen Harper, Tuesday, 17 November, 2009 Mumbai, India***

INTRODUCTION

- Key Canada – India Developments
  - since 2006, 11 ministerial level visits between Canada and India
  - in 2009, opening of new Canadian trade offices in Hyderabad, Kolkata and Ahmedabad and expanded presence in New Delhi and Mumbai (India is now Canada's largest trade network outside of the United States)
  - signing of bilateral Science and Technology Agreement
  - among Canadian banks, Scotia has the largest presence in India, BMO and RBC have opened representative offices; TD has recently hired its first man on the ground to launch its representative office
  - SunLife and Aditya Birla group are cooperating to provide financial services (insurance, asset management, etc.)
  - Bombardier Transportation recently received a EUR 530 million order to supply 424 coaches to Delhi Metro Rail Corp. by December 2010

INTRODUCTION

- Indian foreign direct investment in Canada in 2008 totalled $1.02 billion, an increase of 150 percent from 2007
- Cross border acquisitions by Indian investors into Canada
  - Essar Global Limited acquisition of Algoma Steel Inc. by plan of arrangement for $1.850 billion (2007)
  - TransWorks Information Services Ltd. (Aditya Birla group) acquisition of Minacs Worldwide Inc. (business process outsourcing) by takeover bid and compulsory acquisition for $250 million (2006)
  - Hindalco Industries Ltd. acquisition of Novelis Inc. (aluminum rolled products) for $6 billion (2007)
  - Aditya Birla group acquisition of additional interests in AV Nackawic Inc. and AV Cell Inc. (the joint venture company established by Aditya Birla group and Tembec Inc. in 1997 to acquire Alcell Forest Products Inc. (pulp and paper) from Repap Enterprises Inc. for $9 million); the transaction brings Aditya Birla group's ownership in both joint ventures to 95% (2008)

INTRODUCTION

- **Jubliant Organosys Ltd. acquisition of DRAXIS Health Inc. (biotech/pharmaceutical) for $255 million (2008)**
- **GMR Infrastructure Ltd. investment in shares of Homeland Energy Group Ltd. (consumable fuels/equipment) for $28 million (2009)**
- **Kavveri Telecom Products acquisition of 67% of Montreal-based Trackcom Systems International (technology/R&D) from Trackcom Systems; remaining 33% to be acquired over 4-5 years (2009)**
- **in addition, India's investors have made investments in several major U.S. and U.K. multinationals with business operations in Canada**
- **Canadian companies have also sold interests in foreign ventures to Indian acquirors (e.g sale of EnCana Brasil Petroleo Limitada by Encana Corporation to Bharat Petroleum Corporation Ltd for $165 million (2007); sale of their Mongolian joint venture (uranium) by Uranerz Energy Corporation/Bluerock Resources Ltd. to Jindal Steel & Power Ltd. for $2.6 million (2008))**

INTRODUCTION

- Key sectors of interest
  - oil and gas – large cap companies are expected to spin off assets (PetroCanada/Suncor merger)
  - oil sands – (recent Petro China $1.9 billion investment in Athabaska oil sands projects)
  - mining (base and precious metals) – Ontario is shutting down its coal-fired power plants in the next few years
  - pulp and paper/forestry
  - renewable/clean energy
  - telecommunications
  - manufacturing

INTRODUCTION

- **Opportunities in Canadian capital markets and the Canadian market generally**
  - **more than 55% of the world’s mining companies and more than 40% of the world’s oil and gas companies are listed on the Toronto Stock Exchange**
  - **more than 65 listings of Chinese issuers on the Toronto Stock Exchange**
  - **costs of going public in Canada are much lower than in the U.S. or the U.K.**
  - **regulatory and liability considerations are more manageable than in the U.S.**
  - **large pools of capital are managed by Canadian pension funds that have an interest in investment in India**
  - **Canada’s banks are well capitalised, stable and secure (Canada’s share of the international financial services sector is growing)**

CANADIAN TAX ENVIRONMENT

- **Canada ranked only twenty-fifth of ninety-eight countries with respect to openness to world markets (based on cross border investment flows as a percentage of GDP) for the period 2001-2007, a seven place drop from Canada's ranking during the period 1994-2000 (C.D. Howe Institute Report, 2008)**
- **Canada has actively taken steps to address this situation**
  - **rate reductions to achieve a 25% all-in corporate tax rate by 2012**
  - **elimination of non-resident withholding tax on most arm's length interest payments**
  - **appointment of the Advisory Panel on Canada's System of International Taxation in 2007 and its report issued on December 10, 2008 recommending among other items the further reduction of withholding taxes on dividend, interest and royalty payments under Canada's future tax treaties and protocols**

CANADIAN TAX ENVIRONMENT

- Canada taxes non-residents on
  - gains on the disposition of taxable Canadian property (e.g. non-listed shares of Canadian corporations), significant shareholdings (at least 25%) of listed shares of Canadian public corporations, real property situated in Canada, branch assets used in carrying on a business in Canada, interests in other entities where value is primarily derived from Canadian real property, resource property or timber resource property
  - taxable income earned in Canada from a business carried on in Canada
    - additional branch tax – domestic rate of 25%
- Federal Corporate rate of tax 2010 – 18%
- Provincial rates of tax range from 10% - 16%, depending in certain provinces on type of income earned in that province
- Capital gains are taxed as to one-half at applicable corporate rates
- Canadian non-resident withholding tax is levied where applicable at a domestic rate of 25%

CANADIAN TAX ENVIRONMENT

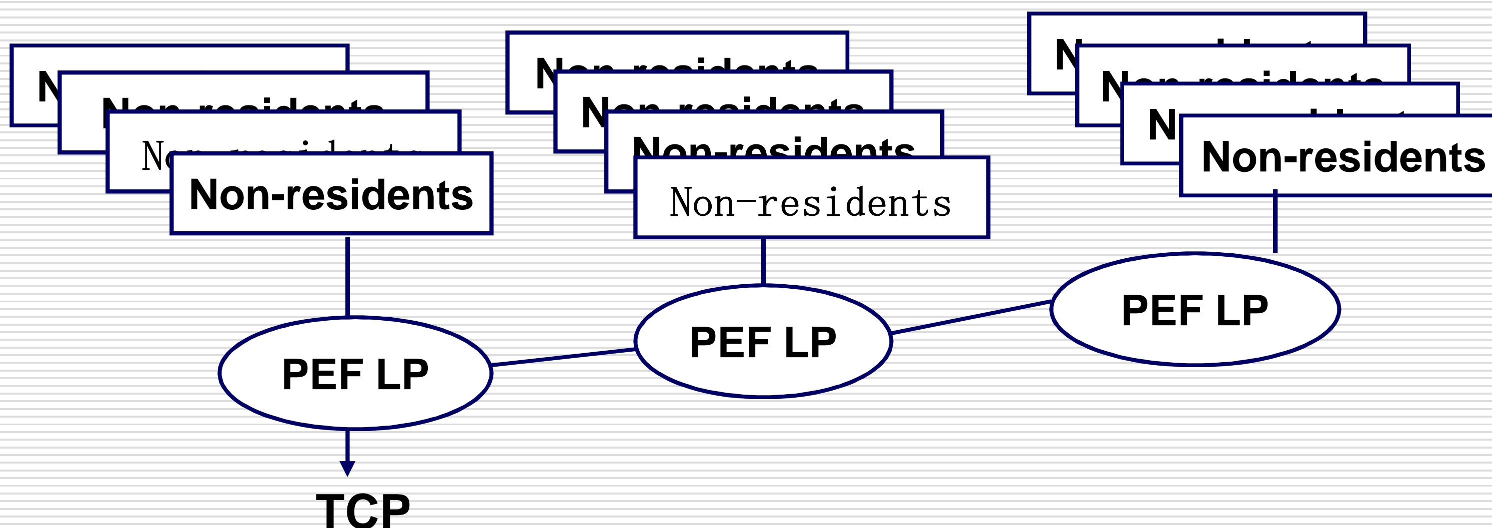
- **Canada enforces its entitlement to tax dispositions by non-residents of taxable Canadian property through a cumbersome filing and reporting regime**
- **Onus is on the purchaser to make reasonable inquiry as to the status of the vendor; if the vendor is a non-resident of Canada**
  - **the vendor must notify the Canadian government of and apply for a certificate in respect of its disposition**
  - **the purchaser, unless the certificate is received, is personally liable and must withhold as much as 25% or 50% of the sale proceeds and remit the amounts withheld on a timely basis**
  - **the purchaser is given the statutory right to withhold these amounts from the sale proceeds**
- **These rules do not apply to excluded property (listed shares, debt, mutual fund trust units); 2008 amendments may reduce compliance burdens for treaty-exempt property**
- **A non-resident vendor who disposes of excluded property (except treaty-exempt property) may still be required to file a Canadian tax return and pay Canadian tax**

CANADIAN TAX ENVIRONMENT

- **Cash Flow Burden**
  - **a purchaser will withhold unless a section 116 certificate with an adequate certificate limit is delivered on closing**
  - **a purchaser will remit the withheld amount to the CRA by the end of the next month absent either an adequate section 116 certificate or a CRA "deferral letter"**
  - **withheld amounts typically are placed in low-yield escrow arrangements**
  - **remitted amounts often exceed the non-resident's actual Canadian tax liability and can only be recovered by filing, after year-end, a Canadian tax return**

CANADIAN TAX ENVIRONMENT

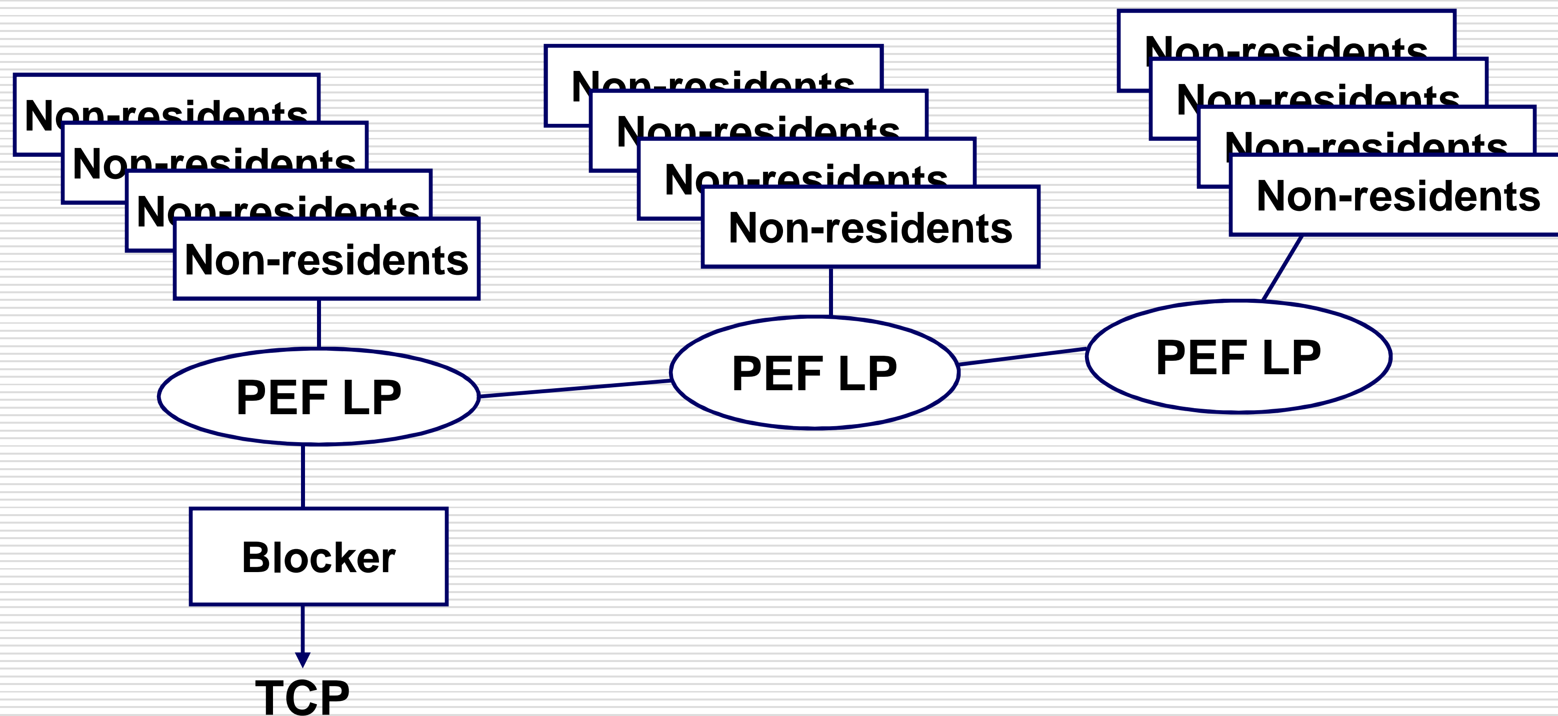
- A private equity fund may have too many investors to assemble the information needed for a section 116 application



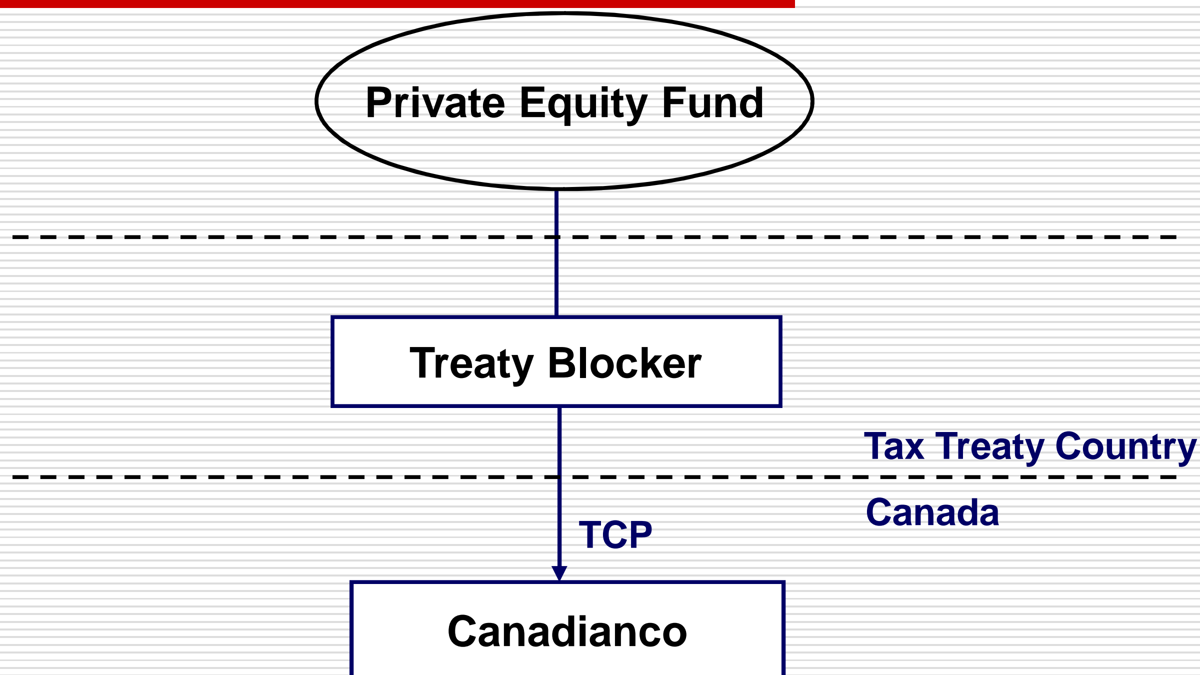
- To complete a s. 116 notification, the lower tier PEF needs to determine, in respect of each ultimate investor, its name, entitlement to treaty benefits, and share of the TCP income or gain
- Each ultimate investor may also be required to file a Canadian tax return

CANADIAN TAX ENVIRONMENT

- Owning the TCP through a "blocker" creates a single vendor to avoid information gathering and tax return filings in respect of multiple non-residents



CANADIAN TAX ENVIRONMENT



- **Structuring Considerations**
  - **favourable tax treaty and domestic regime**
  - **residency**
  - **beneficial ownership**
  - **tax avoidance attacks**

CANADIAN TAX ENVIRONMENT

- The Advisory Panel's December 10, 2008 report recommends:
  - elimination of section 116 withholdings where the non-resident certifies that a TCP gain is treaty-exempt
  - definition of "excluded property" be expanded to include all publicly-traded Canadian securities
- Canada's venture capital industry recommends:
  - that the definition of "taxable Canadian property" be narrowed
  - that investments in corporations, partnerships and trusts be TCP only where the entity derives more than 50% of its value from Canadian real property

CANADA – INDIA TAX AGREEMENT

- **Canada has tax treaties in force with 87 countries**
  - **articles 6 and 13 of Canada's tax treaties address the taxation of gains arising on disposition of taxable Canadian property and in some cases mitigate the application the Canadian domestic rules**
  - **Canada-India Tax Agreement is among a small number of tax treaties which preserves Canada's right to tax income and gains on all taxable Canadian property (except ships and aircraft operated in international traffic)**
  - **Income Tax Conventions Act (Canada) ensures in such cases that Canada retains its right to tax by sourcing the gain to Canada, even if factually the transaction occurs entirely outside of Canada (section 6.3)**
  - **Canada-India Tax Agreement has no carve-outs found in many of Canada's treaties for**
    - **shares in a foreign corporation that are listed or quoted on an approved stock exchange**
    - **shares in a foreign corporation deriving their value from immoveable properties in which a business is carried on**
    - **shares other than a substantial interest (10% or less)**

CANADA – INDIA TAX AGREEMENT

- Articles 10, 11, 12 of Canada's treaties generally mitigate Canada's domestic withholding tax rate
- Canada-India Tax Agreement, Article 10 provides for a rate of
  - 15% of the gross amount of dividends if the beneficial owner is a company which controls directly or indirectly at least 10% of the voting power in the company paying the dividends
  - 25% of the gross amount of dividends otherwise
- Canada-India Tax Agreement, Article 11 provides for a rate of
  - 15% of the gross amount of interest (subject to exemptions for interest on government debt and interest on debt guaranteed by export entities of each country
- Canada-India Tax Agreement, Article 12 provides for a rate of
  - 15% of the gross amount of royalties for the use of paragraph (a) properties and included services (e.g. patents, trademarks)
  - 10% of the gross amount of royalties for the use of paragraph (b) properties and included services (e.g. industrial, commercial, scientific equipment)

CANADA – INDIA TAX AGREEMENT

- **Determination of whether the Indian investor will make the investment directly into Canada or indirectly through a holding vehicle in a more attractive intermediary jurisdiction will involve weighing**
  - **the absence of a foreign tax credit pick-up in India for Canadian tax payable at the intermediary holding company level**
  - **lower withholding tax rates payable on distributions to the intermediary**
  - **exemption from Canadian capital gains tax available to the intermediary on a disposition of the Canadian investment**
  - **exemption from mainstream corporate and withholding tax in the intermediary jurisdiction**
  - **possibility to finance the acquisition or otherwise redeploy earnings and proceeds of disposition outside India to the advantage of the Indian investor without repatriation**
- **Possible intermediary jurisdictions for Canadian investment include The Netherlands, Luxembourg, Cyprus**

CANADA – INDIA TAX AGREEMENT

- **Canada-Netherlands Income Tax Convention (enacted 1986; amended 1994)**
  - **flexibility in determining corporate residence**
  - **5 per cent withholding rate for dividends requires either ownership of 25 per cent of capital or control directly or indirectly of at least 10 per cent of the vote; no holding period**
  - **10 per cent withholding rate on interest**
  - **capital gains are exempt from tax in source state unless**
    - **immovable property**
    - **shares (non-listed) forming substantial interest (10 per cent or more) where value is derived principally from immovable property BUT carve out "in which" the business is carried on**
    - **tax free corporate reorganization carve out**
- **Use of Netherlands B.V. or Cooperative structures to eliminate intermediary jurisdiction corporate mainstream or withholding tax**

CANADA – INDIA TAX AGREEMENT

- Canada – Luxembourg Tax Convention (enacted 2000)
  - flexibility in determining corporate residence
  - 5 per cent withholding rate requires control directly or indirectly of at least 10 per cent of the voting power; no holding period
  - 10 per cent withholding rate for interest
  - Capital gains exemption from tax by source state unless
    - immovable property
    - shares (non-listed) forming substantial interest (10 per cent or more) where value is derived principally from immovable property BUT carve out "in which" the business is carried on
    - tax free corporate reorganization carve out
- Luxembourg tax advantages
  - participation exemption
  - no withholding tax on corporate distributions to treaty partner (2009)
  - no capital tax

CANADA – INDIA TAX AGREEMENT

- **Canada – Cyprus Tax Convention (enacted 1985)**
  - **tax residence of corporation based on nationality**
  - **dividend withholding rate is 15 per cent**
  - **interest withholding rate is 15 per cent**
  - **capital gains are exempt from tax in source state unless**
    - **immovable property**
    - **shares where value derived principally from immovable property**
- **Use of Cyprus company to eliminate intermediary jurisdiction corporate mainstream and withholding tax**

INVESTING DIRECTLY IN CANADIAN BUSINESSES

- **Use of a Canadian acquisition company**
  - **taxable Canadian corporation**
  - **protection of and flexibility to withdraw invested capital**
- **Funding the acquisition – intercompany vs. arm's length indebtedness into the Canadian acquisition company**
  - **attractive interest deduction to Canadian borrower**
  - **thin capitalisation rule restricts debt to equity on a 2:1 ratio (returns of capital will affect ratio) from specified non-resident shareholders**
  - **domestic rules exempt interest on most arm's length debt from non-resident withholding tax; interest on non-arm's length debt is generally not exempt in Canada's treaties (except the Canada-U.S. Income Tax Convention) treaty rate is generally 10 – 15%**
  - **Canada has indicated that the exemption in the Canada – U.S. Income Tax Convention should not be construed as indicating a change in Canada's international treaty policy**
  - **Canada does not have consolidation or group relief; where the acquisition company acquires the target and subsidiaries it will be important to do post-acquisition planning to match the acquisition debt against operating profits using debt-push down techniques**

INVESTING DIRECTLY IN CANADIAN BUSINESSES

- **Acquisition of assets vs. shares**
  - purchaser will generally prefer to acquire assets; vendors generally prefer to sell shares
- **An asset sale will generally result in**
  - increased tax cost to the vendor (but consider accrued losses in vendor; sale of significant intangibles)
  - increased tax basis in the assets to the purchaser
  - increased complexity in regard to transfer of assets
  - exposure to indirect taxes
  - goodwill is amortizable as to 75% of cost on a declining balance basis
- **A share sale will generally result in**
  - the purchaser acquiring the historic tax position of the target company
  - the vendor realising a capital gain on disposition
  - no allocation by the purchaser of a portion of the purchase price to goodwill
  - no step up in inside tax basis of assets
  - on an acquisition of control, tax attributes of the target company will be restricted or eliminated

INVESTING DIRECTLY IN CANADIAN BUSINESSES - CORPORATIONS

- **Meaning of acquisition of control**
  - **“control of a corporation has been acquired by a person or group of persons”**
  - ***de jure* test (Buckerfields, Duha)**
  - **“group” – degree of connection required (public shareholders generally not a group)**
  - **deeming rules (e.g. reverse takeovers)**
- **Avoiding acquisition of control**
  - **public not a “group of persons”**
  - **non-voting shares**
  - **no steps triggering deemed acquisition of control**
- **Implications of an acquisition of control include**
  - **a deemed year-end**
  - **losses and other deductions eliminated or restricted**
  - **acceleration of aging periods for other tax attributes**

- **An acquisition of control of a corporation can lead to reduction or elimination of losses**
  - **capital losses (only offset capital gains) will expire and no carryovers to years after acquisition of control**
- **Non-capital losses**
  - **from a non-business source (i.e. property and ABIL losses) are treated as capital losses (expire and no carry backs)**
  - **business losses can be carried forward 20 years and back 3 years and used in accordance with "streaming rules" which restrict losses to situations in which the loss business is carried on with a**
    - **reasonable expectation of profit**
    - **or a "similar business" generates income**

INVESTING DIRECTLY IN CANADIAN BUSINESSES - CORPORATIONS

- **A "similar" business is one that is "of the same general nature or character"**
  - **Corporation B manufactures electrical appliances and has accumulated non-capital losses; Corporation A acquires control of Corporation B**
    - **Situation 1**

      Corporation A is a profitable manufacturer of electrical appliances; Corporation A causes Corporation B to continue to manufacture electrical appliances and Corporation B becomes profitable; no part of Corporation B's business is discontinued
    - **Situation 2**

      Corporation A is a profitable manufacturer of electrical appliances and causes Corporation B to start to manufacturer and sell Corporation A's profitable line of appliances in addition to its own line
    - **Situation 3**

      Corporation A is a manufacturer of wheeled goods (bicycles, carriages, etc.) Corporation A causes Corporation B to discontinue the manufacturer of electrical appliances and start to make baby carriages at a profit

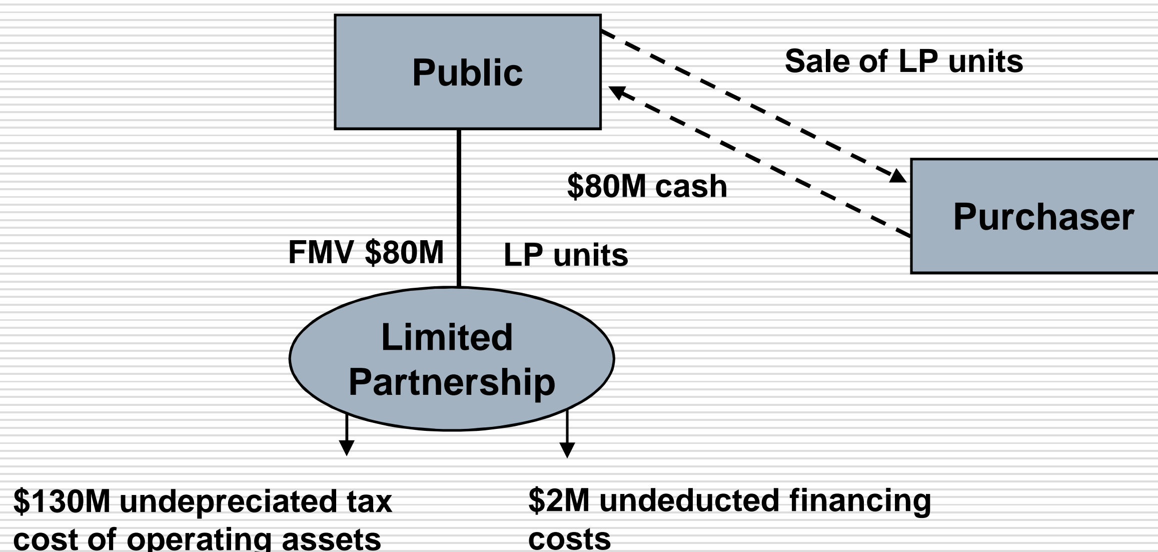
    In Situations 1 and 2, Corporation B's non-capital business losses may be deducted from the post-acquisition of control gains, in Situation 3, Corporation B's non-capital losses cannot be used

INVESTING DIRECTLY IN CANADIAN BUSINESSES - CORPORATIONS

- **An acquisition of control will also result in:**
  - **the undepreciated capital cost of depreciable property is written down to FMV**
  - **similar rules apply to write down of cumulative eligible capital balances to FMV**
  - **limitations on use of other tax attributes**
    - **resource pools**
    - **investment tax credits**
    - **SR & ED pools**
    - **reserves**

INVESTING DIRECTLY IN CANADIAN BUSINESSES - PARTNERSHIPS

- Acquisition of partnership interests in a Canadian business may offer enhanced tax benefits



- Unlike corporations, partnerships are not subject to acquisition of control rules which require the tax basis of assets to be written down to FMV
- A purchaser who buys the LP units for $80M acquires $130M of tax depreciation, plus $2M of deductions for previously incurred financing costs (all of the LP's unamortized tax pools plus the undeducted balances of financing costs)
- "At risk" rules may restrict use of losses by limited partners
- Amending the LP agreement may also enhance tax attributes to the buyer

INVESTING IN CANADIAN CORPORATIONS WITH SIGNIFICANT FOREIGN ASSETS

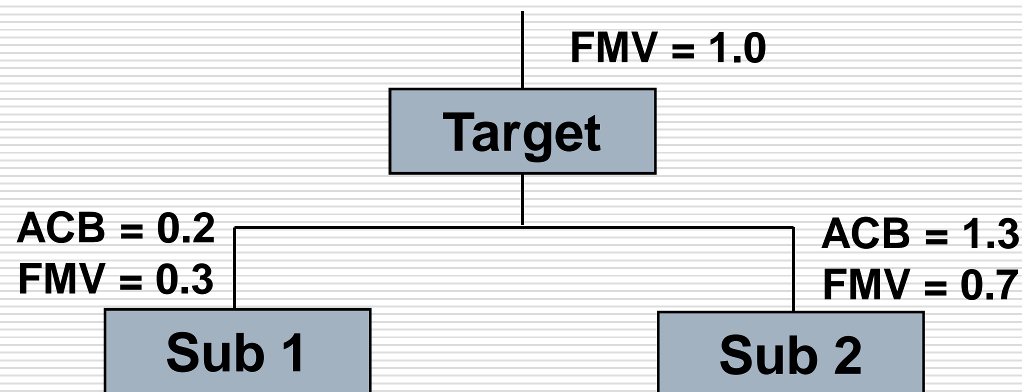
- **Two opportunities exist to step-up the inside tax basis of assets of a target corporation on an acquisition**
- **While these opportunities are not limited to foreign assets, they will generally be of considerable interest where a Canadian corporation has little or no Canadian assets and is sold by Canadian vendors to a foreign purchaser who wishes to extract the assets from the Canadian tax system and liquidate the Canadian corporation**
- **It will be important to ensure that the extraction planning will not trigger tax in the foreign jurisdiction where the assets are situated; otherwise Canadian tax savings may be irrelevant**

INVESTING IN CANADIAN CORPORATIONS WITH SIGNIFICANT FOREIGN ASSETS

- **Pre-acquisition planning for step-up in tax basis of target assets**
  - **where an acquisition is friendly and target's depreciable or non-depreciable capital properties have a FMV in access of tax basis, pre-acquisition, the target may step-up the tax basis of those properties, as designated, to an amount not exceeding the FMV of each property**
  - **amendments will extend this step-up to foreign currency gains embedded in debt denominated in a foreign currency**
  - **each designated capital property is deemed to have been disposed of and reacquired at the elected amount**
  - **the designation enables target to use net capital losses and non-capital losses (i.e. NOLs) that it would not otherwise have been able to use (or that would have been available on a restricted basis only) to eliminate tax otherwise payable on the step-up**
  - **not available for eligible capital property (e.g. goodwill and other intangibles)**

INVESTING IN CANADIAN CORPORATIONS WITH SIGNIFICANT FOREIGN ASSETS

- Pre-acquisition planning for step-up in tax basis of target assets

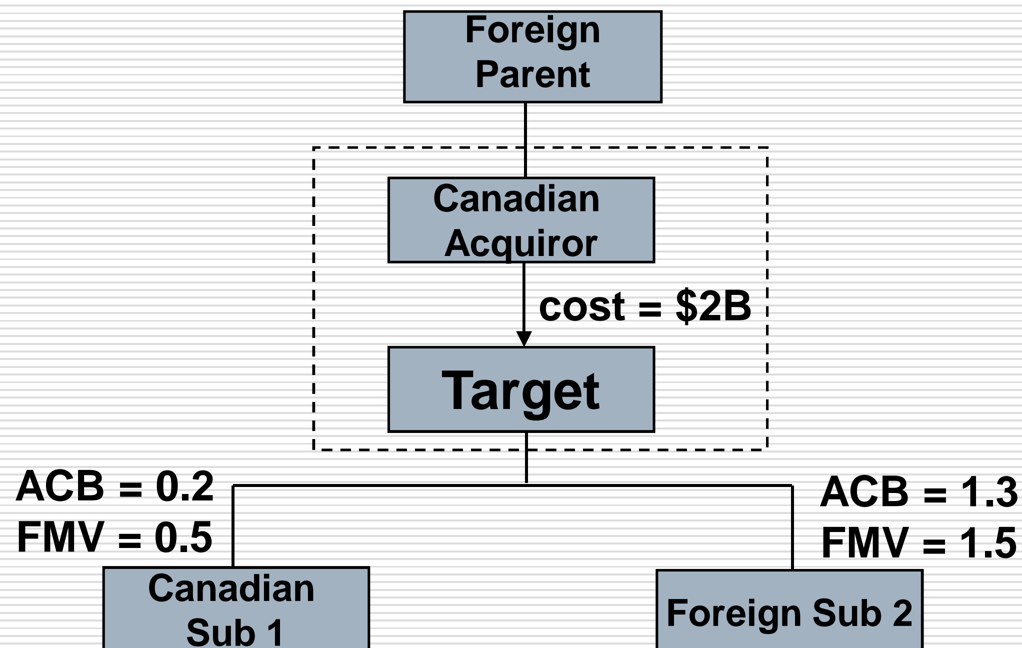


- Target must, on acquisition of control, write-down the shares of Sub 2 which will allow a write-up of the shares of Sub 1

INVESTING IN CANADIAN CORPORATIONS WITH SIGNIFICANT FOREIGN ASSETS

- Post-acquisition planning for step-up in tax basis of target assets
  - "Bump" may be available, post-acquisition, on the liquidation of target into acquireco or on their amalgamation following a purchase of target shares in prescribed circumstances
  - applies only to the tax basis to acquireco of any non-depreciable capital property held by target (at the time that its control was last acquired by acquireco and without interruption until its winding up or amalgamation); basis can be increased (in the aggregate) to an amount equal to acquireco's investment in the target shares – which, in the following example, should equal the FMV of the shares
  - enables acquireco to subsequently dispose of the target assets after step-up without the imposition of Canadian tax in respect of any accrued gain

INVESTING IN CANADIAN CORPORATIONS WITH SIGNIFICANT FOREIGN ASSETS



- **Most transactions structured to obtain the bump are extremely complicated**
- **On merger of Canadian Acquiror and Target, Canadian Acquiror may step up the tax cost of Canadian Sub 1 shares to $0.5B and increase the tax basis on the Foreign Sub 2 shares up to $1.5B**

INVESTING IN INCOME OR ROYALTY TRUSTS

- Royalty trusts first launched in 1986
- High level of distribution to investors
- Elimination or deferral of corporate taxation and represented a significant advantage over corporations that were taxable 32-45% in Canada
- Cash distributions were in part income and in part a tax-free return of capital
- Income distributions received by tax-exempt plans such as retirement savings and pension plans were non-taxable
- Underlying income producing assets were revenue producing and generally mature, requiring low capital investment
- Traded at high multiples of cash flow
- Vendors of assets who sold to trust vehicle in search of mature revenue streams had highly favourable asset realizations

INVESTING IN CANADIAN INCOME OR ROYALTY TRUSTS

- "Tax fairness plan" announced October 31, 2006 designed to eliminate any tax advantage that income/royalty trusts had over corporations – enacted 2007
- Intended to bring Canadian taxation of trusts in-line with other jurisdictions
- End of tax-favoured status
  - impose an entity level tax of approximately 32% on all publically traded trusts or partnerships (SIFTs) when distributions of income are made to investors – existing trusts or partnerships are grandfathered to 2011, subject to certain conditions
  - investors are taxed as if they receive dividends from a Canadian corporation
- Economic and market pressures
  - significant declines in stakeholder values
  - growth by trusts limited to "normal growth guidelines" (100% over 4 years)
  - reduced ability for trusts to raise capital
  - loss of following and analysts coverage

INVESTING IN CANADIAN INCOME OR ROYALTY TRUSTS

- **Legislation to facilitate conversion to corporations initially released by Minister of Finance on July 14, 2008**
- **Amended rules released November 28, 2008**
- **Automatic tax deferral with no paper requirements for investors**
- **Create a mechanism that allows windup of commercial trusts on a tax deferred basis**
- **Two conversion methods:**
  - **unit exchange alternative**
  - **distribution alternative**
- **60 day time period; 2013 sunset provision**

INVESTING IN CANADIAN INCOME OR ROYALTY TRUSTS

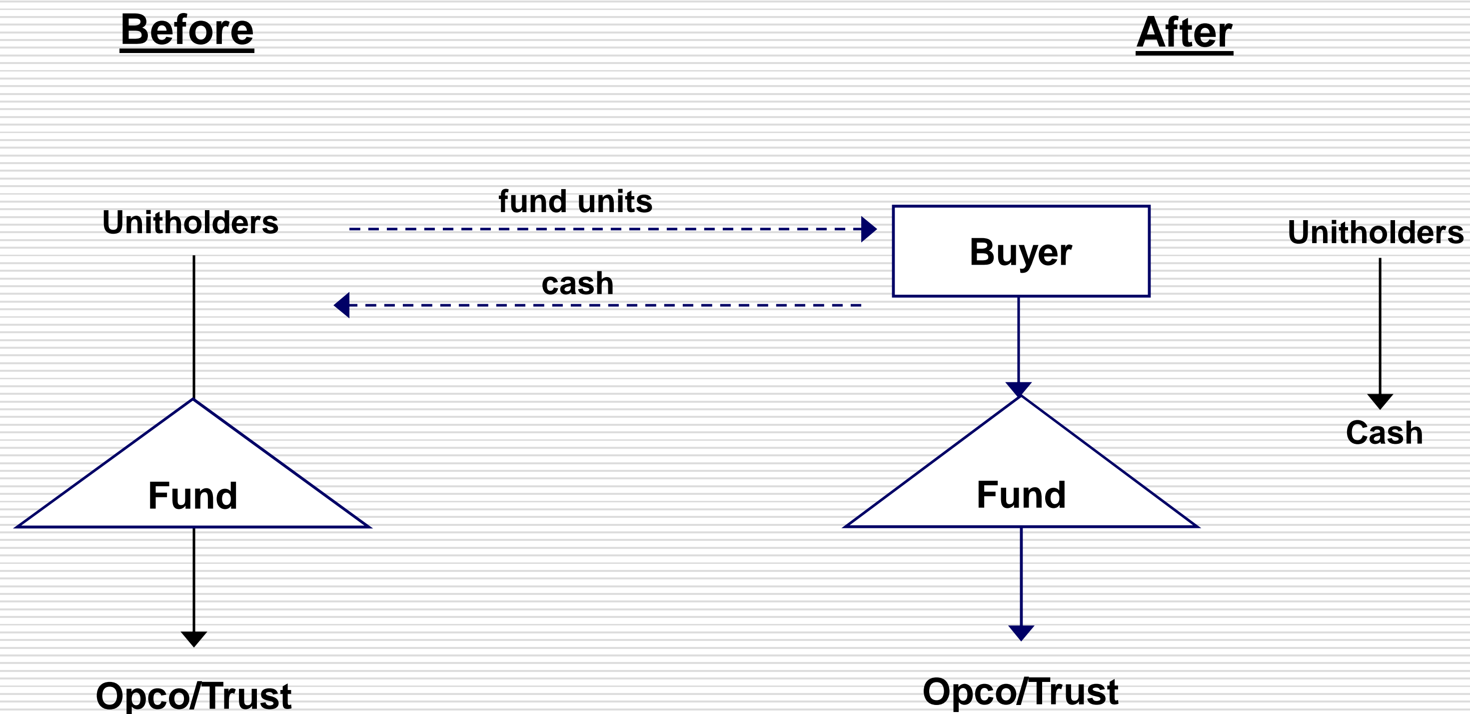
- In August 2009 there were 156 income trusts remaining of which 75 had a market capitalization of less than $150 million
- It is expected that most of the larger income trusts will convert to corporate form or be acquired prior to 2011; smaller entities may consider additional options such as converting to a mutual fund structure, recapitalizing with arm's length debt or rolling into an umbrella fund to provide better value to investors through some form of liquidity programme

INVESTING IN CANADIAN INCOME OR ROYALTY TRUSTS

- Significant opportunities exist for foreign investors with cash reserves to make investments in this sector
- Principal tax considerations
  - tax-efficient return for unitholders
  - value to unitholders for existing tax attributes
  - possibility to add tax attributes to enhance business value going forward

INVESTING IN CANADIAN INCOME OR ROYALTY TRUSTS

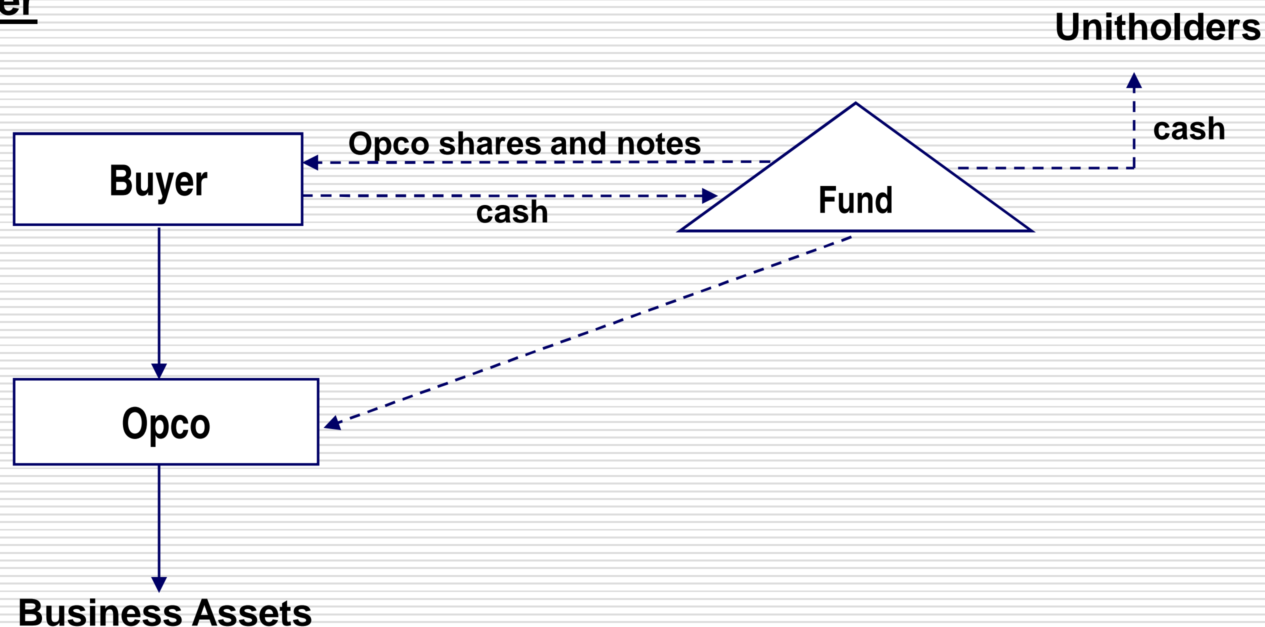
First generation structure acquisition of fund units



- **Buyer acquires fund units**
- **Buyer liquidates fund structure**

INVESTING IN CANADIAN INCOME OR ROYALTY TRUSTS

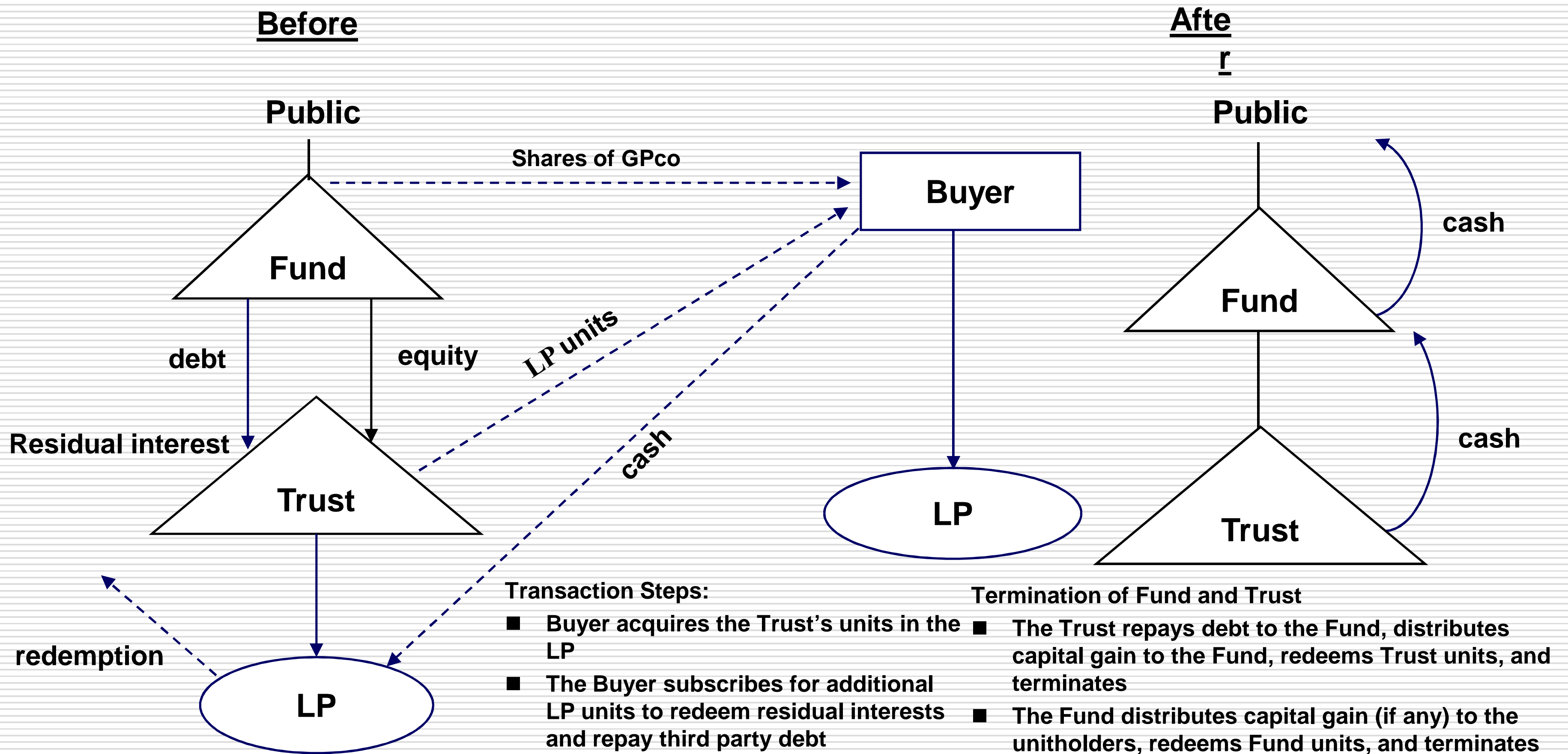
First generation structure acquisition of underlying business entity



- **Buyer acquires Opco from the Fund**
- **Fund pays the cash to its unitholders as a capital gains distribution and unit redemption and terminates**

INVESTING IN CANADIAN INCOME OR ROYALTY TRUSTS

Second generation structure acquisition of underlying business entity



INVESTING IN CANADIAN INCOME OR ROYALTY TRUSTS

- **Vendor tax considerations:**
  - **Canadian unitholders should realize the same capital gains (or capital losses) whether they sell Fund units or whether there is a lower tier sale of Opco shares and notes or LP units and a cash distribution from the Fund (trust deed amendments may be required)**
  - **non-resident unitholders**
    - **incur no Canadian tax on a sale of Fund units to the buyer, if own less than 25% of the units or are tax-treaty exempt**
    - **should not be Canadian withholding tax (25% rate, subject to tax treaty reduction) on a distribution by the Fund of lower tier sale proceeds**
  - **contractually allocate responsibility for**
    - **distribution of cash to unitholders**
    - **terminating the Fund and the trust**
    - **contingent tax and other liabilities in the Fund and the trust**
    - **final tax reporting**

INVESTING IN CANADIAN INCOME OR ROYALTY TRUSTS

- **Buyer tax considerations**
  - **pre-signing tax due diligence**
    - **ensure grandfathering from the SIFT rules**
    - **other past tax liabilities (e.g. payroll, GST/PST, foreign taxes)**
    - **existing tax attributes**
  - **generally, the Buyer can collapse the structure without tax cost (pre-closing amendments to the trust deeds may be required)**
  - **caveat re: "under water" debt**
    - **in the first generation structure, if Opco's debt to the Fund is "under water", the buyer will require a pre-closing reorganization to eliminate the debt (to avoid debt forgiveness tax rules)**
  - **preserving LP tax attributes for the Buyer**
    - **amending the LP agreement**
    - **"Bump" may be available, depending on structuring for non-depreciable capital property of the LP**

INVESTING IN CANADIAN INCOME OR ROYALTY TRUSTS

- **Buyer tax considerations**
  - **Buyer may prefer an "indirect" acquisition of LP units in which**
    - **Buyer forms Canadian acquisition company**
    - **Buyer subscribes for new LP units with cash used to redeem existing units**
    - **Buyer obtains a greater tax "at-risk" amount to access LP tax losses**

INVESTING IN FOREIGN MNEs WITH CANADIAN BUSINESS OPERATIONS

- Canada generally relies on abuse of law concepts to challenge what it considers to be abusive treaty shopping
- Exception is the new Limitation of Benefits (LOB) provision in the Canada – U.S. Income Tax Convention effective from February 1, 2009 in respect of withholding taxes and for taxable years that begin after 2008 in respect of other taxes
- Any restructuring of current investments or any structuring of planned investments in Canada held through the U.S. should include a review of how the LOB clause will affect both the U.S. entity and its foreign owner
- Any acquisition of a U.S. entity which receives Canadian-sourced payments should also as part of the due diligence include a review of the impact of the LOB clause on the U.S. entity once new ownership is in place

INVESTING IN FOREIGN MNEs WITH CANADIAN BUSINESS OPERATIONS

- **If a U.S. recipient of Canadian-sourced cash flows is not eligible for treaty benefits by reason of the LOB rules**
  - **dividends, interest and royalty payments may be subject to the Canadian domestic non-resident withholding tax rate of 25% instead of reduced or zero treaty rates**
  - **the permanent establishment threshold which protects a U.S. business with Canadian activities from Canadian tax on business profits may not apply**
  - **sales of certain taxable Canadian property may be subject to capital gains tax and reporting procedures**

INVESTING IN FOREIGN MNEs WITH CANADIAN BUSINESS OPERATIONS

- **Eligibility for treaty benefits under the LOB provisions**
  - **qualifying persons**
    - **U.S. resident corporations must be public companies whose principal class of shares are primarily and regularly traded on one or more recognized stock exchanges or subsidiaries of such companies**
    - **neither the Bombay Stock Exchange nor the National Stock Exchange are considered recognized stock exchanges for the purposes of this definition**
  - **U.S. resident corporations ultimately owned by an Indian investor will not be qualifying persons unless such investors hold their interest through a U.S. resident public company, the shares of which meet the listing and trading requirements**

INVESTING IN FOREIGN MNEs WITH CANADIAN BUSINESS OPERATIONS

- **Eligibility for treaty benefits under the LOB provisions**
  - **derivative benefit test**
  - **applies only to Canadian-sourced dividends, interest and royalty payments**
  - **requires that more than 90% of the aggregate votes and value of the U.S. resident corporation must be owned directly or indirectly by either qualifying persons or a person who**
    - **is a resident in a country with which Canada has a comprehensive treaty and is entitled to the full benefits of that treaty**
    - **would be qualifying person or would qualify under the active trade or business test if that person were a resident of, and carried on business in, the U.S., and**
    - **would be entitled to a rate of withholding tax on the relevant item of income under its treaty with Canada that is no greater than that available under the U.S. treaty**
  - **deductible expenses paid or payable to non-qualifying persons must be less than 50% of the U.S. resident company's gross income (for U.S. tax purposes) for its preceding fiscal year**
- **U.S. resident corporations controlled by an Indian investor will not meet the derivative benefits test, *inter alia*, as the Canada – U.S. treaty is more favourable than the Canada-India treaty in respect of most if not all items**

INVESTING IN FOREIGN MNEs WITH CANADIAN BUSINESS OPERATIONS

- **Eligibility for the treaty benefits under the LOB provisions**
  - **active trade or business test**
  - **applies generally to all Canadian-sourced cash flows including proceeds of disposition of shares in Canadian companies**
  - **U.S. resident corporation must be engaged in the active conduct of a trade or business in the U.S. which meets the substantiality test; treaty benefits are then available on those items of income derived from Canada *in connection with* or *incidental to* that U.S. trade or business, whether directly or indirectly through one or more persons resident in Canada**
  - **cash flows, including capital gains may need to be apportioned between amounts attributable to a connected U.S. business and those not so attributable**
  - **Canada has indicated an intention to apply this test flexibly where treaty shopping is not involved**

INVESTING IN FOREIGN MNEs WITH CANADIAN BUSINESS OPERATIONS

- **Where questions arise as to eligibility for treaty benefits under the LOB provisions, the U.S. resident may request a determination from the Canadian competent authority to resolve the uncertainty**
- **The Canadian competent authority must determine whether**
  - **the person's creation and existence had as a principal purpose the obtaining of benefits not otherwise available**
  - **it would be appropriate, having regard to the purpose of the LOB clause, to deny treaty benefits**
- **May 22, 2009 guidelines for taxpayers requesting treaty benefits**
- **June 2009 issue of draft forms for non-residents to establish treaty entitlement**

THANK YOU!