

Highlights of American Tax Reform for Canadians

Presented by: Lorne Saltman
February 7, 2018



Topics to Discuss

1. Introduction: Tax Reform in U.S.A. and Internationally
2. Corporate tax rates
3. Individual tax rates
4. Estate tax
5. Limits on interest deductibility
6. Territorial system of international taxation
7. Capital gains on sales of U.S. partnership interests

Corporate Tax Rates

- Top federal rate of 35% reduced to 21%
- In states with high state taxes, such as New York and California, the combined federal and state tax rate is in the range of 25%-27%, comparable to Canada's combined federal and provincial rates
- Accordingly, the previous cross-border tax rate arbitrage in favour of Canada is gone

Individual Tax Rates

- Top federal rate lowered from 39.6% to 37% but “sunset” in 2025
- In states (and even in some cities, such as New York) with local income taxes, the combined top rate is in the range of 42% to 44%
- Long-term capital gains and qualified dividends still taxed at 20%
- Net investment income tax unchanged at 3.8%

Individual tax rates on pass-through income

- U.S. individuals have used pass-through entities to earn business income and obtain limited liability protection where possible, e.g. partnership, “S” corporation, limited liability company
- Individuals can now deduct up to 20% of their domestic “qualified business income”, and 20% of their aggregate “qualified REIT dividends”
- As a result, the effective top individual tax rate on this pass-through income is 29.6% (using 37% as the top rate)
- 20% deduction expires in 8 years



Estate/Gift/Generation Skipping Taxes

- The exemption for estates of decedents dying, generation-skipping transfers, and gifts made after December 31, 2017 and before January 1, 2026 is doubled
- For 2018, the exemption is approximately USD\$11.2 million (approximately USD\$22.4 million for a married couple) and is indexed for inflation each year

Domestic And International Tax Reform

- Limit on Interest Deductibility
 - Every business (excluding business with gross receipts of USD\$25 million or less and certain real property trades or businesses that elect out) can only deduct business interest equal to sum of business interest income plus 30% of adjusted taxable income (generally taxable income before (a) any of income or expense not properly allocable to trade or business, (b) business interest expense or business interest income, (c) NOL deduction, (d) 20% deduction for certain pass-through income, and (e) for years beginning before January 1, 2022, any deduction for depreciation, amortization or depletion, (i.e, before 2022 calculation is EBITDA, after 2021 it is EBIT).



Domestic and International Tax Reform...cont'd

- **Limit on Interest Deductibility**
 - Follows BEPS initiative of OECD on the assumption that companies borrow excessively to reduce taxes
 - Implication may be negative for Canada, as U.S. companies shift their borrowings to subsidiaries, such as in Canada where there is no 30% limitation, thus eroding the Canadian tax base

International Tax Reform

- Transition tax
 - Every U.S. shareholder of a “specified foreign corporation” is subject to deemed subpart F inclusion of accumulated foreign income, provided that an individual is only subject to this tax if the SFC is a *controlled foreign corporation* or a foreign corporation with at least one corporate U.S. shareholder
 - Rate of 15.5% on cash and equivalents, and 8% on other foreign assets
 - Limited foreign tax credit availability for corporations but not available for individuals

International Tax Reform...cont'd

- Participation Exemption
 - 100% deduction for U.S. corporation (excluding “S” corporations) in respect of foreign-source dividends paid from 10% owned foreign corporation
 - Major change towards a territorial system
- Global Intangible Low-Taxed Income (“GILTI”)
 - Inclusion in income of U.S. shareholder (including U.S. citizen resident in Canada) equal to excess of net controlled foreign corporation’s “tested income” over deemed tangible income return
 - Excludes high-taxed income of CFC (e.g. Canadian subsidiary with tangible assets)
 - A U.S. corporate shareholder can deduct up to 50% of GILTI inclusion, resulting in an effective tax rate of 10.5%
 - Generally, the break even foreign tax to avoid GILTI is 13.125%



International Tax Reform...cont'd

- Foreign-Derived Intangible Income (“FDII”)
 - Favourable tax rate on income from exports related to U.S.-owned intangibles
 - A U.S. corporation can deduct 37% of FDII (and 21.875% after 2025)
 - FDII is income attributable to (a) sale of property to foreign persons for use outside the U.S.A., (b) provision of services to any person with respect to property located outside the U.S.A.
 - Effective tax rate on FDII is 13.125% (16.406% after 2025)
 - Likely to be challenged at WTO as export subsidy

Capital Gains On Sales Of U.S. Partnership Interests

- For Canadians investing through an LP or LLC in a non-real estate investment in the U.S., the rules have changed
- The disposing partner will be treated as if it sold the underlying business assets and, therefore, becomes subject to tax at ordinary rates (21% for corporations and up to at least 37% for individuals) rather than long-term capital gains rates for individuals (20%)
- Choose to have Canadian corporation invest in a U.S. corporation instead



Questions?



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Loosening the Strings: Internal Free Trade in Canada

The Comeau Case

Presented by: Ian A. Blue, Q.C.
February 7, 2018



R. v. Gérard Comeau

Background

In October, 2012 M. Comeau lived in Tracadie, New Brunswick.

He drove across the Restigouche River to Quebec

He stopped at Pointe-A-la-Croix and the Listiguj First Nation Indian Reserve.

All this took about fifteen minutes.

R. v. Gérard Comeau

Background

Once he arrived in Quebec, the RCMP observed him.

He purchased a quantity of beer, wine and liquor.

The RCMP followed him to the border and radioed ahead to Campbellton RCMP who stopped, searched and charged him Mr. Comeau.

R. v. Gérard Comeau

The Charge

- He was charged under s. 134(1)(b) of New Brunswick's Liquor Control Act:
 - *134(1)(b). Except as provided by this Act or the regulations, no person, within the Province, by himself, his clerk, employee, servant or agent shall(b) have or keep liquor not purchased from the Corporation.*

R. v. Gérard Comeau

M. Comeau's argument

- We defended M. Comeau
- We argued that s. 134(b) was unconstitutional because it violated s. 121 of the Constitution Act 1867:

All Articles of the Growth, Produce, or Manufacture of any one of the Provinces shall, from and after the Union, be admitted free into each of the other Provinces.

R. v. Gérard Comeau

- No one had ever successfully argued s. 121 before.
- Because 98 years ago, the SCC had said that the only things s. 121 specifically prohibited were custom duties at the provincial border and not any other types of interprovincial trade barriers

Gold Seal Limited v The Attorney General of the Province of Alberta (1921), 62 SCR 424 [Gold Seal Case].



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Comment on Subsequent Cases

- What has changed since 1920 when the Gold Seal case was decided?

R. v. Gérard Comeau

What Changed to cast doubt on Gold seal?

- The SCC 's new decisions on The Charter have provided new rules for interpreting our Constitution.
- In 2003 the Supreme Court said that our Constitution is a living tree and that this is “a fundamental tenet of constitutional interpretation.”
- [R v Blais, [2003] 2 SCR 236 at para 40].

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What Changed (Cont'd)

- The Court has also said that the Constitution must be interpreted “purposefully” and must consider:
 - the wording of the act,
 - the legislative history of the provision,
 - the scheme of the act, and
 - the legislative context of the provision.

[R v Kapp, 2008 SCC 41, [2008] 2 SCR 483 at para 82.]

R. v. Gérard Comeau

Wording

- S. 121 requires that goods “shall be admitted free”.
- We now know that this was a change from earlier rules that had said goods “shall be admitted free from duty”.
- This change had been made in the mid 19th century when the world was changing rapidly and countries started to use non-tariff trade barriers to protect their industries.

R. v. Gérard Comeau

Legislative History

- One of the main reasons people agreed to Confederation was the prospect of interprovincial free trade with no trade barriers of any kind.
- This would replace the end of the 1854-1864 period of reciprocity between BNA and the US.
- s. 121 was therefore an important provision of the BNA, 1867 and for the Confederation.

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Scheme of the Act

- S. 121 was part of the financial deal underlying Confederation.
- It provided provinces with a new revenue source to replace their old tariffs.
- Revenue would come from the increased prosperity that interprovincial-trade profits would provide.

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- In 1920, s. 121 was misinterpreted by the SCC in *Gold Seal*.
- *Gold Seal* was about whether the CTAA had been properly proclaimed in Alberta.
- It was not really about s. 121.

R. v. Gérard Comeau

Gold Seal Concluded

- The Gold Seal interpretation of s. 121 was an expedient decision.
- We are hopeful that the Supreme Court will not follow it when it releases its Comeau decision.

R. v. Gérard Comeau

The Trial before Judge Ronald LeBlanc

- We argued that s. 134(b) of the LCA violated a purposive and progressive interpretation of s. 121
- We called one of Canada's foremost historians of the Constitutional era, Dr. Andrew Smith, as a witness.
- The Crown called a political scientist, Dr. Tom Bateman of St. Thomas University.



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What the Crown Did Not Argue

- The Crown did not suggest that the our interpretation of s. 121 was wrong or overlooked any point of law.
- They did not dispute our analysis of the Gold Seal Case.
- They not cite any contrary decision on point.
- Their arguments were political rather than legal.

R. v. Gérard Comeau

- On April 29, 2016 Judge LeBlanc dismissed the charge against Gerard Comeau.
- He held that s. 121 permits the free movement of goods among the provinces without barriers, tariff or non-tariff.
- His Judgment was an impressive piece of judicial scholarship of which any provincial court of appeal or the Supreme Court of Canada would be proud.



R. v. Gérard Comeau

Judge LeBlanc's Decision

- Judge LeBlanc held that the Gold Seal case was wrongly decided.
- He said that Interpreting s. 121 of the Constitution Act, 1867 as permitting the free movement of goods among the provinces without barriers, tariff or non-tariff will have a resounding impact.

R. v. Gérard Comeau

Judge LeBlanc's decision

- Interpreting s. 121 of the Constitution Act, 1867 as permitting the free movement of goods among the provinces without barriers, tariff or non-tariff will have a resounding impact.

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The SCC Case.

On January 16, 2017, the Crown sought leave to appeal from the SCC.

The Defence supported this request so that s. 121 could be clarified by the SCC.

On May 4, 2017 all nine judges of the SCC granted leave to the New Brunswick Crown to appeal directly from Judge Le Blanc's decision.

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SCC Case

- All governments except Yukon and Manitoba intervened to attempt to set aside Judge LeBlanc's Decision.
- Twelve non-government interveners also participated, to support the decision .
- The Court heard the case on December 6 and 7, 2017

R. v. Gérard Comeau

The SCC Case

- Trade barriers have resulted in Canadians paying higher prices for Canadian goods than would otherwise be required.
- One study estimates that inter-provincial trade barriers add between 8% and 14% to the cost of all goods and services in Canada.

R. v. Gérard Comeau

SCC Case

- Eliminating those costs would lead to a real GDP gain of between 3% to 7% or between \$50 and \$130 billion annually.
- Another study shows that Canadians pay an implied tariff equivalent of 6.9% on all goods sold in Canada due to provincial trade barriers.
- This contrasts with the United States where there are few comparable inter-jurisdictional trade barriers.

R. v. Gérard Comeau

SCC Case

- We are optimistic that the Court will hold that it is time to allow the Gold Seal Interpretation and all the internal trade barriers that depend on it to creep quietly into history.
- We hope that the Court will provide Canadians with a progressive and purposive interpretation of s. 121 so that it may fulfill its proper and intended constitutional role of benefitting all Canadians, not just special interest groups.



R. v. Gérard Comeau

The SCC Case

- This would release enormous economic potential that would benefit Canadians and Canada for generations to come.
- Stand by!
- Thank you for your attention.



Questions?



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