



Cross-Border Financing Structures for Inbound Investment

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Cross-Border Financing Structures for Inbound Investment

- Hybrid Entities
- Hybrid Instruments
- Inbound Financing Issues
- Investment in Canadian Real Estate



Hybrid Entities

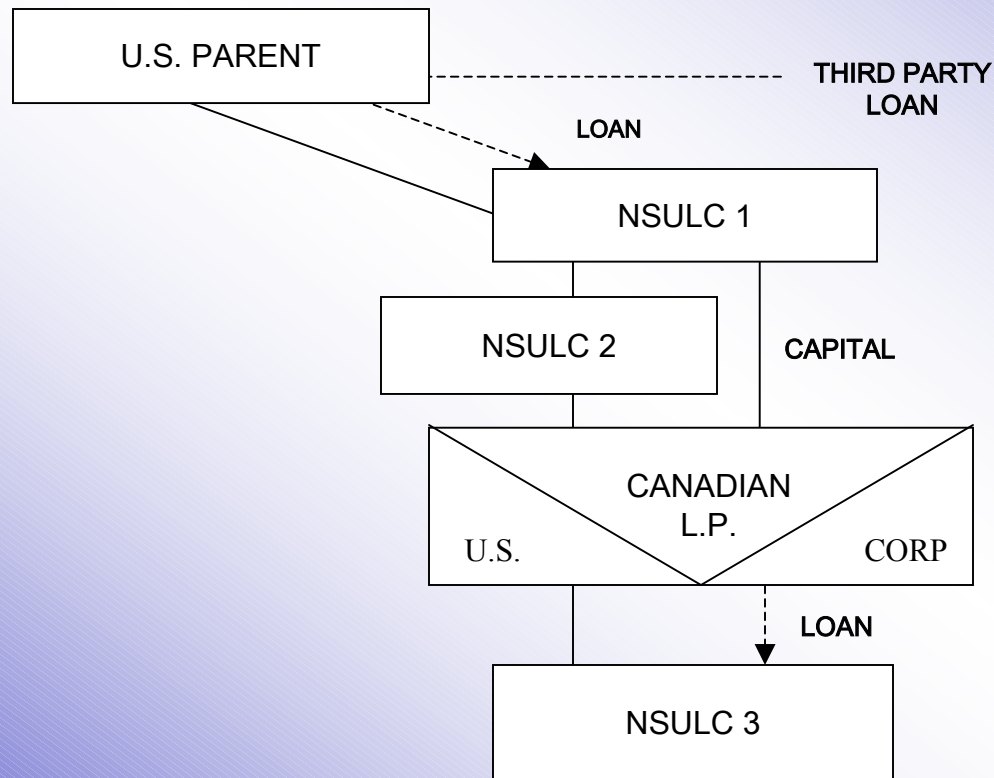
- Nova Scotia unlimited liability company (NSULC)
- Default classification of NSULC under U.S. check-the-box regulations is a partnership or disregarded entity



Hybrid Entities, cont'd

- Step-Up in U.S. Tax Basis
 - Section 338 election for corporate acquirors
 - Taxable liquidation for non-corporate acquirors
- Rollover reorganization for Canadian tax purposes

Dual Unlimited Liability Holding Company



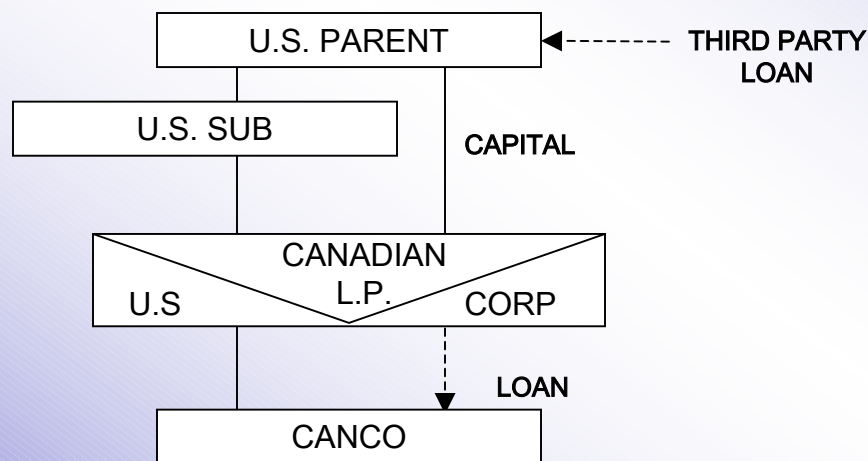


Dual Unlimited Liability Holding Company, cont'd

- Intended Results
 - U.S. Parent deducts interest on third party loan
 - No income inclusion re interest receivable by U.S. Parent from NSULC 1 or by U.S. Hybrid Entity from NSULC 3
 - NSULC 3 deducts interest for Canadian purposes passed through Canadian L.P. and NSULC 1 to U.S. Parent subject to 10% Canadian withholding tax

Synthetic NROs

- Illustrative Structure





Synthetic NROs, cont'd

- **Intended Results**
 - U.S. Parent deducts interest on third party loan
 - Canadian withholding tax on interest paid by Canco to Canadian L.P. (not a Canadian partnership)
 - Canco deducts interest
 - No subpart F income



Treaty Rates and Reverse Hybrids

- CRA 2004 Pronouncement:
 - OECD Commentary – Treaty rate should be denied to partners where entity taxed as a corporation under foreign law
 - CRA review
 - No change in CRA practice until review completed



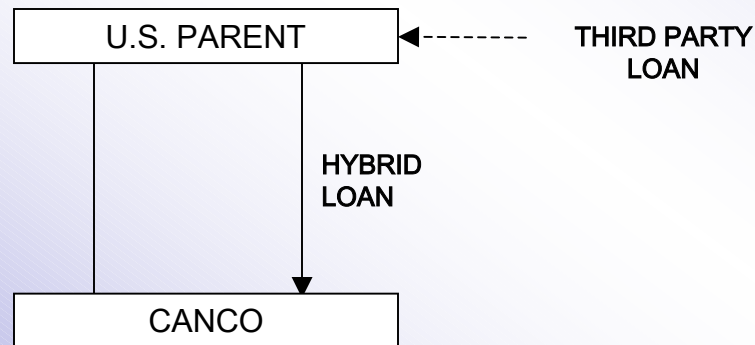
Hybrid Instruments

- Instrument classified as debt for Canadian purposes based on “legal substance”
- Instrument classified as equity for U.S. purposes based on e.g. subordination, long-dated maturity, interest roll-up



Hybrid Instruments, cont'd

- Cross-Border Tax Arbitrage – Illustrative Structure





Hybrid Instruments, cont'd

- Intended Results
 - Interest expense deductible for Canadian purposes
 - Dividend for U.S. purposes only to extent out of “e&p”; otherwise, basis reduction
 - U.S. parent deducts interest on third-party loan
 - U.S. foreign tax credits for Canadian corporate and withholding tax



Inbound Financing Issues

- Thin Capitalization Rules
 - 2:1 maximum debt equity ratio
 - Specified non-resident shareholders
 - Canadian corporation
 - Monthly calculations



Inbound Financing Issues, cont'd

- Thin Capitalization Rules – Back-to-Back Loans
 - Shareholder loan within limits to Canco on-lent to Subco
 - Could subsection 18(6) apply?
 - CRA – no, if two loans are in same amount; positive spread in Canco; legal control by shareholder over both Canco and Subco



Foreign Investment in Canadian Real Estate

- Current Investment Context
 - Foreign private investors
 - U.S. REITs
 - U.S. real estate funds (L.P.s)
 - German open-ended real estate funds
 - Israeli public companies



Foreign Investment in Canadian Real Estate, cont'd

- Basic Issues for Rental Income
 - Business or property income
 - Section 216 election
 - Loss carryovers
 - Withholding tax on internal leverage (s.212(13)(f) or s. 212(13.2))
 - Capital taxes

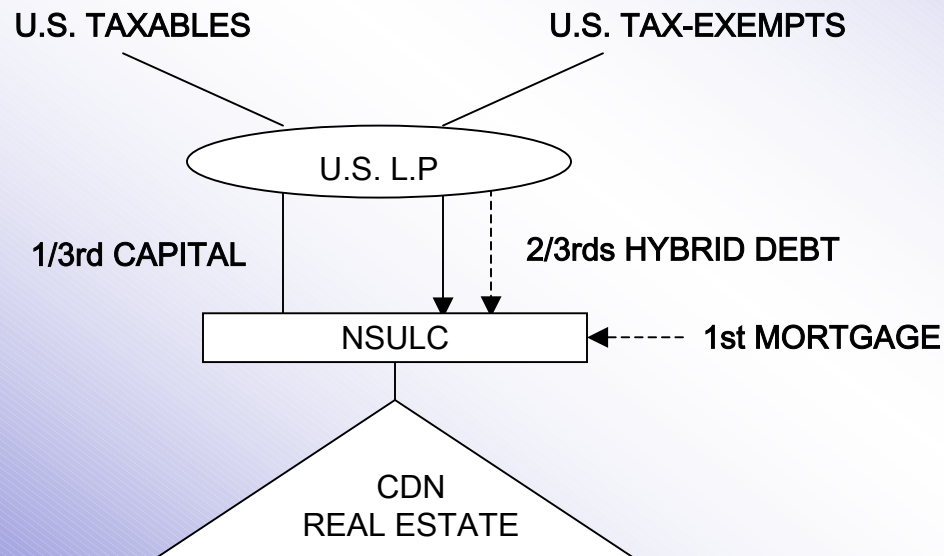


Foreign Investment in Canadian Real Estate, cont'd

- Comparative Structures
 - Canadian subsidiary
 - Non-Canadian subsidiary
 - Canadian trust
 - Non-resident trust

U.S. Acquisition Structure I

- NSULC with Hybrid Debt



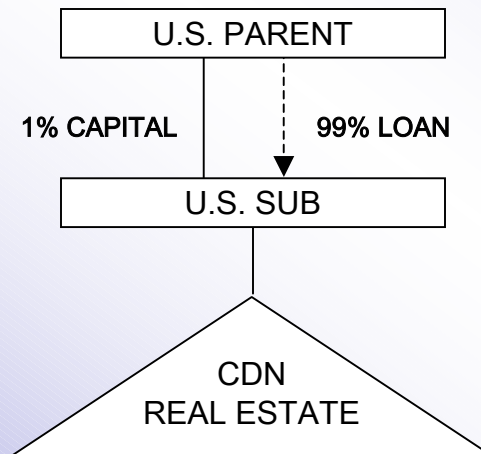


U.S. Acquisition Structure I, cont'd

- NSULC with Hybrid Debt – Intended Results
 - Canadian interest deductions
 - 10% / 0% Canadian withholding tax
 - U.S. foreign tax credits without deemed paid credit
 - No over-accrual of income for U.S. purposes

U.S. Acquisition Structure II

- Branch of a U.S. Corporation



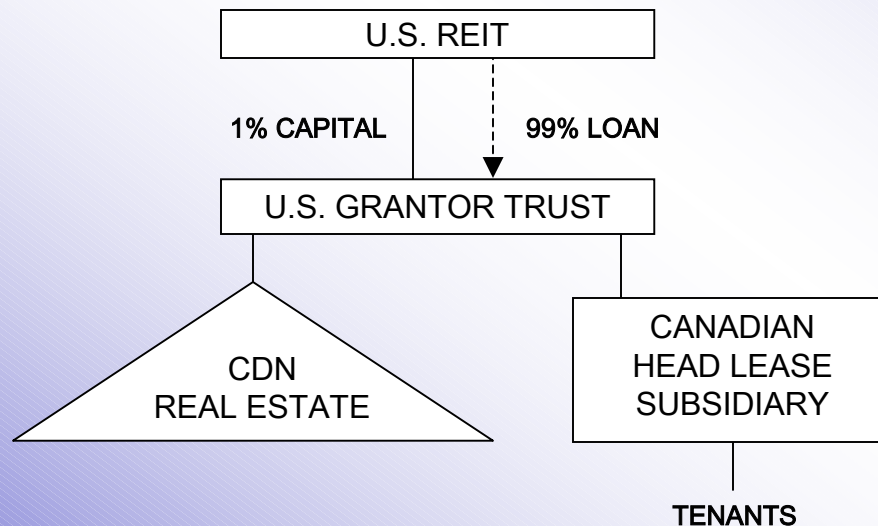


U.S. Acquisition Structure II, cont'd

- Branch of a U.S. Corporation – Intended Results
 - No thin capital limitation in Canada
 - Interest income eliminates on consolidation
 - 10% Canadian withholding tax under s. 212 (13.2)
 - Part XIV branch tax

U.S. Acquisition Structure III

- Non-resident trust with s. 216 election





U.S. Acquisition Structure III, cont'd

- Non-resident trust with s. 216 election –
Intended Results
 - No thin capital limitation in Canada
 - No Canadian withholding tax under s. 212 (13.2)
 - U.S. foreign tax credits
 - No over-accrual of income for U.S. purposes
 - No capital taxes



U.S. Acquisition Structure III, cont'd

- Non-resident trust with s. 216 election - Issues
 - Complexity of two tier structure
 - Source withholding and refund claims
 - No loss carryovers
 - Trust interest is taxable Canadian property



Foreign Investment in Canadian Real Estate

- Participating Debt
 - Treaty interpretation of “interest”
 - *Sherway Centre Ltd. v. The Queen*
 - CRA Position



Foreign Investment in Canadian Real Estate, cont'd

- Treaty - shopping
 - GAAR and Treaties
 - Amendment to *Income Tax Conventions Interpretation Act* under 2004 Budget