Tax Considerations of Entering the U.S. Market

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Canadian businesses have long been enticed by the attractive opportunities available to them in the U.S. market. The countless opportunities are enhanced by the many benefits that have been especially tailored by the U.S. government for Canadian businesses and individuals looking to expand. Some of these benefits include relaxed rules on visa requirements for border crossing and the tax benefits provided by the U.S.-Canada Tax Treaty. However, business savvy Canadians know that their entry into the U.S. market takes more than just crossing the bridge. Business planning that contemplates the intricate tax considerations of border crossing is a must for Canadian companies that wish to enter the U.S. and remain in good terms with the U.S. government, or as we like to call it, our beloved Uncle Sam.

The top three tax considerations for Canadian businesses contemplating entry into the U.S. market.

1) **To cross and how to cross**. In contemplating entry into the U.S. market, businesses should inquire into what is the best structure for cross-border operations. Is your company looking to establish a branch in the U.S.? Is a subsidiary a structure that should be considered? Will your company just be sending employees or other agents to conduct business activities across the border? Is your company planning to just ship goods into the U.S. with no other presence? These questions will obviously trigger business and financial considerations. However, the tax treatment of the structure with which you choose to conduct business in the U.S. can make a significant financial impact and should be considered from the start. For example, a Canadian business that simply sends an employee to conclude contracts in the U.S. may be prevented from claiming a number of tax benefits found under the U.S.-Canada Tax Treaty, whereas a Canadian business that creates a subsidiary can generally plan around the restrictions that would prevent its claim for the same tax benefits. Different structures and planning strategies will apply to different types of business ventures and the right fit can offer lower income tax rates and other benefits under the U.S. Tax Code and/or the U.S.-Canada Tax Treaty.

2) **Me, myself and I can do it**. Start-up businesses that wish to expand into the U.S. will generally have one or more aggressive entrepreneurs behind it who are willing to invest the time and research necessary to get their business going in the U.S. That type of attitude often leads individuals to personally cross the border to either obtain contacts or run other business-related activities on the American side. Surely, the activities undertaken by such individuals can be pre-planned to avoid negative tax consequences to the Canadian business. However, tax consequences must be considered for individuals themselves who are crossing the border. Unbeknownst to many Canadians (and Americans, for that matter), the United States

taxes U.S. residents on their world-wide income (i.e., income sourced from the United States and outside of the United States). Therefore, even if an individual is not a resident of the United States, but is entering the U.S. frequently enough to reach U.S. resident status, he or she may be taxed in the U.S. on his or her world-wide income. U.S. resident status is based on a formula that takes into account a number of years and includes those visits that are personal in nature as well.

3) **Location, Location, Location**. Depending upon the type of business and the business structure being used in the U.S., the jurisdiction in which your business will be established, or in which goods or services will be sold, can affect your bottom line. States, cities and other local governments can impose a number of state and local taxes, which will vary from government to government. Generally, the types of taxes being imposed by these jurisdictions will include franchise taxes, income taxes, property taxes and transfer taxes (including the sales tax). Individual owners may also have to personally consider the effect of state and local taxes on them if a "flow-through" business structure is used (i.e., a structure in which the owners of the business, instead of the business itself, will recognize the income, losses and other tax items of the business).

Of course, tax considerations are only one variable in the formula for successful operations in the U.S., but one that is crucial. Businesses that start selling goods or otherwise operating in the U.S. without first considering the U.S. tax consequences of their activities often find themselves caught in a position where they are out of compliance with U.S. tax laws and face potential remedial actions that can be much more costly than it would have been to simply do the initial homework. A well planned entry into the U.S. will allow a Canadian business to profit from the U.S. market while staying in the good graces of Uncle Sam.

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