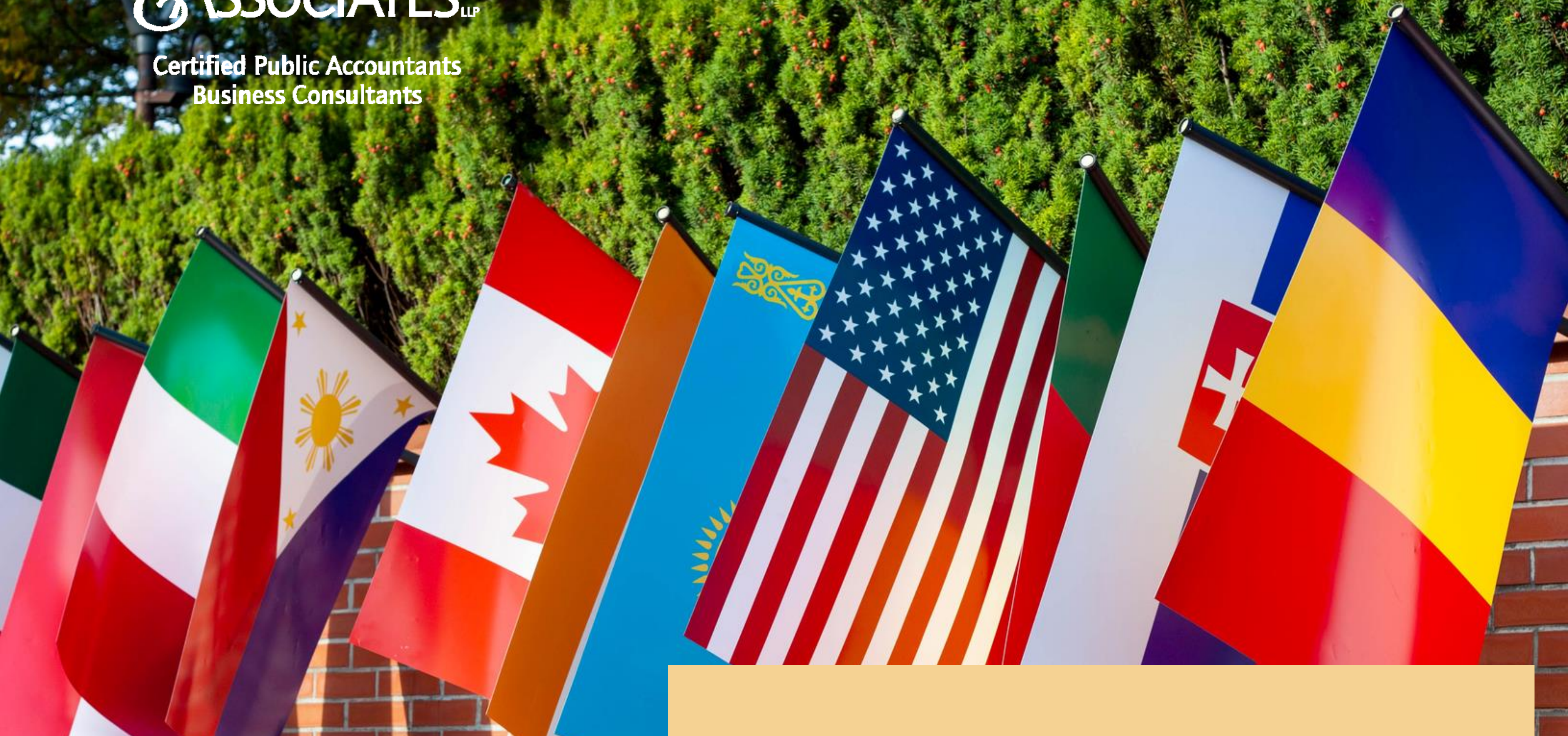


SOLUTIONS BEYOND THE OBVIOUS

Tax Considerations for Foreign Businesses Selling in the U.S.

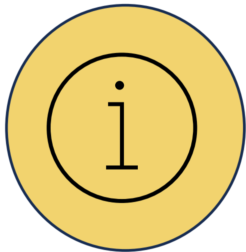
February 11, 2025

Tronconi Segarra & Associates LLP

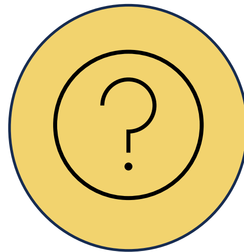
Certified Public Accountants
Business Consultants

TRONCONI SEGARRA & ASSOCIATES LLP
Certified Public Accountants
Business Consultants

Housekeeping



Tool Bar Handouts



Submit your questions anytime

Please complete the exit survey

We will send you a link to the recording

TRONCONI SEGARRA & ASSOCIATES LLP
Certified Public Accountants
Business Consultants

Today's Presenters

David Lever, CPA, Partner
Tronconi Segarra & Associates
dlever@tsacpa.com

Tom Mazurek, CPA, Partner
Tronconi Segarra & Associates
tmazurek@tsacpa.com

TRONCONI SEGARRA & ASSOCIATES LLP
Certified Public Accountants
Business Consultants

Expanding Internationally – U.S.

- "Testing the Waters" – operating as a U.S. branch
- Creating a U.S. based subsidiary entity
- Acquire an existing U.S. based business

Webinar: Expanding Through Acquisition #2 | Tronconi Segarra & Associates

- Develop business/export plan
- Get local professional advice

Tronconi Segarra & Associates LLP
Certified Public Accountants
Business Consultants

Federal Tax

- Foreign persons doing business in the U.S. are subject to federal tax on income that is effectively connected with the conduct of a trade or business within the U.S.
- However, the U.S. - Canada Tax Treaty provides that a Canadian company's business profits only are subject to U.S. federal income tax if it creates a Permanent Establishment (PE) in the United States

TRONCONI SEGARRA & ASSOCIATES LLP
Certified Public Accountants
Business Consultants

Permanent Establishment (PE)

- A PE, as defined under most tax treaties, includes:
  - A fixed place of business (i.e., branch, office, factory, workshop, place of management, a building site or construction or installation project if it lasts more than 12 months
  - A dependent agent in the U.S. with the authority to sign contracts on behalf of the business
  - Providing services to U.S. customers for 183 days or more in a 12-month period by an individual who was physically present in the U.S. and during that period, more than 50% of business revenues were derived from services performed in U.S.

Tronconi Segarra & Associates LLP
Certified Public Accountants
Business Consultants

Permanent Establishment (PE) (cont'd)

- A PE does not include a fixed place of business used solely for one or more of the following activities:
  - The use of facilities for the purpose of storage, display or delivery of goods or merchandise
  - The maintenance of a stock of goods or merchandise for the purpose of storage, display or delivery
  - The maintenance of a stock of goods or merchandise for the purpose of processing by another person
  - The purchase of goods or merchandise, or the collection of information
  - Advertising, the supply of information, scientific research or similar activities that have a preparatory or auxiliary character

Tronconi Segarra & Associates LLP
Certified Public Accountants
Business Consultants

Treaty-Based Returns

- A Canadian company conducting business in the U.S. that does not create a PE will not owe Federal income tax
  - File treaty-based Form 1120-F, *U.S. Income Tax Return of a Foreign Corporation* (only the information section); and
  - Form 8833, *Treaty-Based Return Position Disclosure* to report the treaty position that is being relied upon
    - Generally, file Form 1120-F - 5 ½ months after the end of its fiscal tax year (June 15)
    - Requires a U.S. tax identification number (EIN)
    - Statute of limitations clock starts ticking
    - Avoid future penalties and interest on non-filed returns

Treaty-Based Returns (cont'd)

- When a Canadian company has a PE, it should file Form 1120-F, *U.S. Income Tax Return of a Foreign Corporation,* complete all sections of the form and pay the amount of income tax due
  - A Canadian company with a place of business in the U.S. must generally file Form 1120-F - 3 ½ months after the end of its fiscal tax year (April 15)

Other Federal Issues

- Other questions may arise as a business expands into the U.S.:
  - Should the company create a U.S. business entity for its U.S. sales and activities?
  - How should U.S.-based business subsidiaries be structured and how will profits be repatriated to Canada?
  - Will Canadian employees be subject to U.S. federal income tax?

Should You Form an Entity?

- Why might you form an entity?
  - Marketing
  - Liability
  - Financing
  - Tax planning (i.e., managing US tax base)

Should You Form an Entity?

- Why might you form an entity?
  - Marketing
  - Liability
  - Financing
  - Tax planning (i.e., managing US tax base)

Choice of Entity: LLCs

- LLCs (limited liability companies)
  - Excellent choice for US owners, but not for Canadian owners
  - While flow through or disregarded under US tax law, treated as corporations under Canadian law
    - Potential treaty benefit denial

Choice of Entity: Limited Partnerships

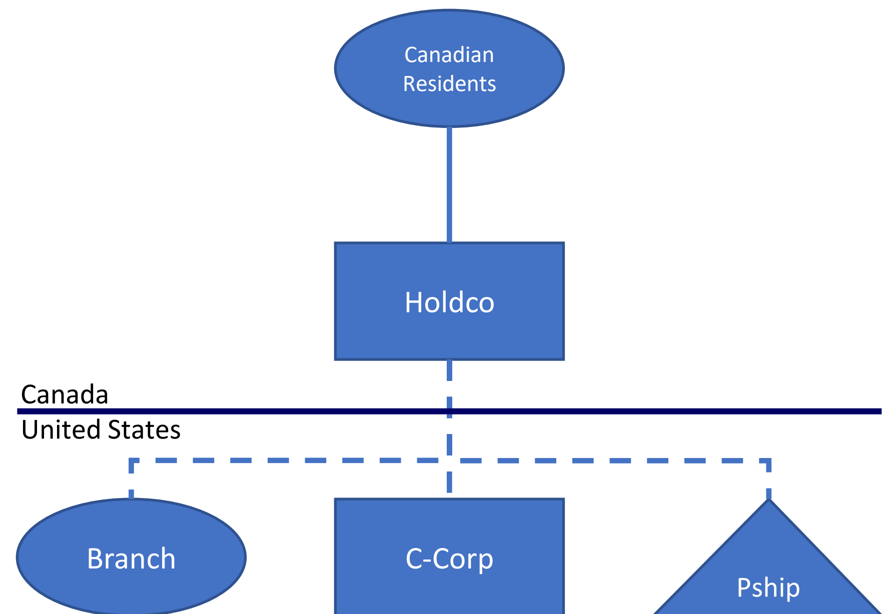
- Less common (except for real estate investments)
  - More flexibility in operations and management (determined by contract under partnership agreement, not bylaws)
  - Need general partner, likely US entity
- Tax implications
  - Branch profits tax applies
  - Tax filings for nonresident owner
  - Less repatriation strategies available
  - Treatment of partnership interest disposition

Choice of Entity: Corporation

- Most common approach
  - Well established law and practice in the United States
  - Favored by outside investors
  - Straightforward structuring of employee incentives
- Tax implications
  - No branch profits tax
  - No tax filings for nonresident owner
  - More repatriation strategies available
    - Intercompany debt

How Should a US Entity Be Held?

- Canadian corporation?
  - Generally, 5 percent withholding tax on dividends
- Canadian individual(s)?
  - US estate tax issue
  - 15 percent withholding tax on dividends



Repatriation of Profits/Transfer Pricing

- Management fee
- Intercompany Debt
- Royalty
- Dividends
- Sale of product

Other Business Considerations

- Payroll compliance
- Human resources / benefits
- Workers’ compensation
- Unemployment insurance

TRONCONI SEGARRA & ASSOCIATES LLP
Certified Public Accountants
Business Consultants

State and Local Tax

- Inbound businesses are often advised they have "treaty protection" for their business activities in the U.S.
  - Treaty applies to U.S. Federal income taxes only
  - The 50 states are not bound by U.S. tax treaties or permanent establishment rules and may tax foreign companies doing business within their borders
  - A foreign company may have state and/or local gross receipts, income, sales & use, property and payroll tax filing obligations depending on their business activities

Tronconi Segarra & Associates LLP
Certified Public Accountants
Business Consultants

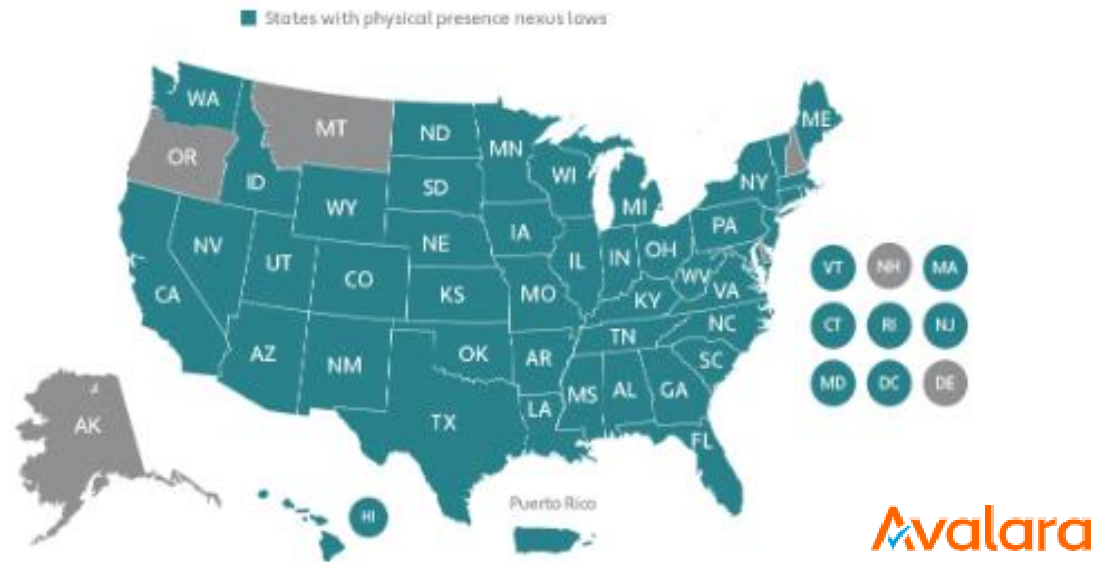
Nexus

- Nexus describes the amount and degree of a taxpayer's business activity that must be present in a state before the taxpayer becomes subject to the State's taxing jurisdiction or power
  - Some definite link, some minimum connection between a state and the person, property, or transaction it seeks to tax
  - States impose differing nexus standards:
    - Physical presence
    - Economic presence
    - Factor presence

Tronconi Segarra & Associates LLP
Certified Public Accountants
Business Consultants

Sales and Use Tax

- Prior to the U.S. Supreme Court's 2018 decision in *South Dakota v. Wayfair*, physical presence in a state was required to create nexus for sales and use tax.



TRONCONI SEGARRA & ASSOCIATES LLP
Certified Public Accountants
Business Consultants

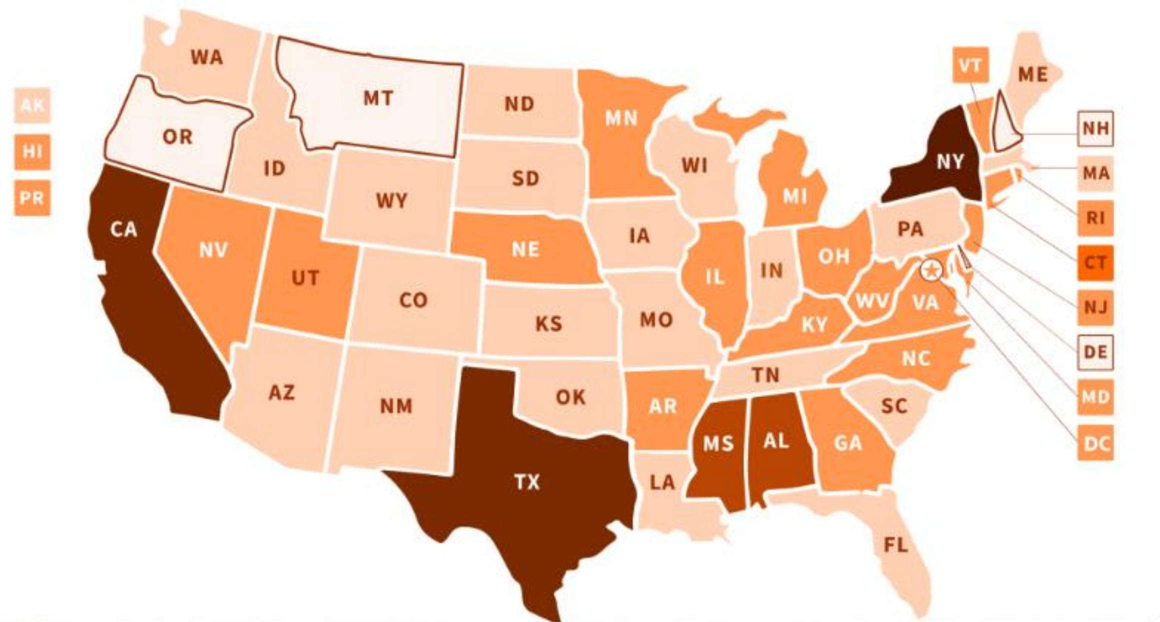
Sales and Use Tax

- The 2018 *Wayfair* decision overturned the long-standing physical presence standard for sales and use tax.
  - Established Economic Nexus for sales and use tax.
  - States can now require out-of-state sellers without physical presence in their state (i.e., remote sellers) to collect and remit sales or use tax when the seller's sales exceed the state's monetary or transactional threshold.

TRONCONI SEGARRA & ASSOCIATES LLP
Certified Public Accountants
Business Consultants

Sales and Use Tax

Economic nexus thresholds



TRONCONI SEGARRA & ASSOCIATES LLP
Certified Public Accountants
Business Consultants

Sales and Use Tax (cont'd)

- The states do not have uniform standards re: sales thresholds, effective dates, measurement periods, or types of transactions included in the sales/transaction threshold counts
- Each state imposes its own laws and regulations defining the taxability of goods and services
  - Over 13,000 sales tax jurisdictions in the U.S.
  - Some states allow localities to administer their own sales tax
  - Requires filing periodic (monthly, quarterly, annual) returns
  - Should be asking for resale and exemption certificates even if not registered to collect tax

TRONCONI SEGARRA & ASSOCIATES LLP
Certified Public Accountants
Business Consultants

Income Tax

- Physical Presence Nexus
  - Having a physical presence (i.e., property, payroll) in a state creates nexus
- Economic Nexus
  - Some state courts and taxing authorities have applied a test based on an economic connection to the state, while other states have expressly adopted by statute an economic presence standard for income tax purposes

TRONCONI SEGARRA & ASSOCIATES LLP
Certified Public Accountants
Business Consultants

Income Tax (cont'd)

- Factor Presence Nexus
  - Under this standard, a company will be considered to be doing business in a state if it had property, payroll or <u>sales</u> that exceeded certain thresholds during the tax period
  - These standards have been adopted by states like California, Michigan, New Jersey, New York, Ohio, Pennsylvania, Texas, and Washington among others.

TRONCONI SEGARRA & ASSOCIATES LLP
Certified Public Accountants
Business Consultants

Income Tax (cont'd)

- Federal Nexus Limitations
  - The Federal Interstate Income Tax Act of 1959 (P.L. 86-272) prohibits any state from imposing a "net income tax" on income derived within that state from interstate commerce if in-state activity is limited to:
    - "Mere solicitation" of orders for tangible personal property (does not include services or digital property);
    - Provided that the orders are sent outside the state for approval; and
    - Fulfilled by shipment or delivery from a point outside the state
    - Protection may not be afforded to foreign sellers

Tronconi Segarra & Associates LLP
Certified Public Accountants
Business Consultants

Income Tax (cont'd)

- P.L. 86-272 traps
  - Business can still be subject to minimum taxes or alternative base taxes
    - California $800 Fixed Minimum Tax
    - Ohio Commercial Activities Tax (CAT)
    - Texas Margin Tax
    - Washington Business & Occupations Tax (B&O)
  - Though these liabilities are minimal, they can add up over the years, especially after you add interest and penalties

Tronconi Segarra & Associates LLP
Certified Public Accountants
Business Consultants

Other SALT Issues

- Other issues may arise as a business expands into the U.S.:
  - Business registration (legal and tax) and license fees
  - Non-income-based taxes such as gross receipts tax
  - Payroll taxes including employee income tax withholding and unemployment taxes
  - Taxes on real and personal property
  - Taxes and fees imposed by local governments

Questions

This publication has been prepared for general guidance on matters of interest only; it does not constitute professional advice. You should not act upon the information contained in this publication without obtaining specific professional advice. No representation or warranty (express or implied) is given as to the accuracy of completeness of the information contained in this publication; and, to the extent permitted by law, Tronconi Segarra & Associates LLP, its members, employees and agents do not accept or assume any liability, responsibility or duty of care for any consequences of you or anyone else acting, or refraining to act, in reliance on the information contained in this website or for any decision based on it.

Copyright 2025 Tronconi Segarra & Associates. All rights reserved.

TRONCONI SEGARRA & ASSOCIATES LLP
Certified Public Accountants
Business Consultants

Contact Information

David Lever, CPA, Partner
Tronconi Segarra & Associates
dlever@tsacpa.com
716-633-1373

Tom Mazurek, CPA, Partner
Tronconi Segarra & Associates
tmazurek@tsacpa.com
716-633-1373