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Fifth Protocol to Canada U.S. Treaty Impact on ULC's

September 18th, 2008

Association of Corporate Counsel
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FRASER MILNER CASGRAIN LLP
www.fmc-law.com

Panel

- Tom Bishop, Moderator Chair, ACC Energy Committee
- Anne Calverley, Q.C., Presenter Fraser Milner Casgrain LLP
- Don Sommerfeldt, Presenter Fraser Milner Casgrain LLP
- Christopher Steeves, Presenter Fraser Milner Casgrain LLP

INSERT POLLING QUESTION

- Please identify your level of expertise with Canada-U.S. cross-border tax-related matters.
- 1) Not familiar
- 2) Somewhat familiar
- 3) Very familiar

Hybrid Rules – Article IV(7)

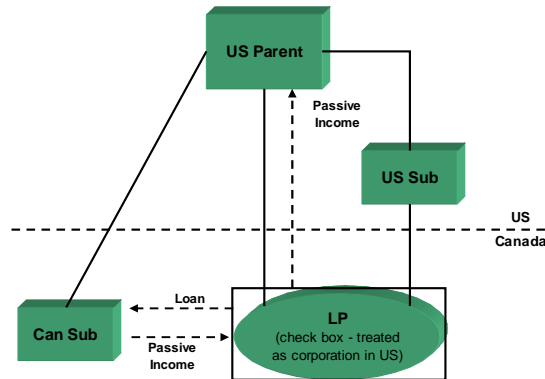
- New rules will deny certain treaty benefits*
- Generally affects “hybrids”
 - i.e. treated as “flow-through” entities in one country and corporations in the other country
- ULC’s are “hybrids”
 - *Canadian withholding tax of 25%, subject to treaty
 - *US withholding tax of 30%, subject to treaty

Hybrid Rules – Article IV(7)(a)

- Canada and the U.S. will deny treaty relief for interest/dividends/rent/royalties (“Passive Income”) received from an entity that is a flow-through entity in its home jurisdiction but not in the recipient’s jurisdiction (a “Hybrid” entity)
- Recipients of Passive Income from a Hybrid entity will not be considered to be a “resident” of its home jurisdiction for purposes of treaty relief from withholding tax rates.

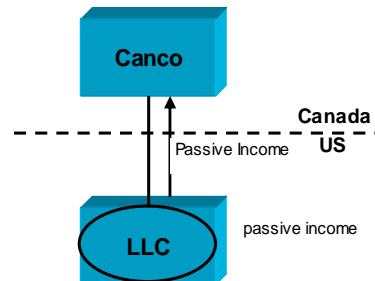
Example – First Rule Canada Will Deny Relief

- In this example, interest flows through hybrid LP for Canadian purposes
- LP has elected to be treated as a corporation for US purposes
- Passive Income in example is treated as dividend income to US parent will be subject to 25% rate of withholding tax



Example – First Rule US Will Deny Relief

- Passive Income will be subject to higher tax rate because US treats LLC as a flow-through entity while Canada treats LLC as a Corporation
- No U.S. income tax but 30% withholding tax on payment of Passive Income which is treated as a dividend



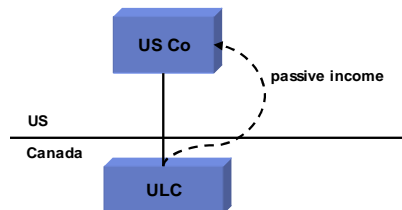
Hybrid Rules – Article IV 7 (b)

Second Rule

- Canada and the U.S. will deny treaty relief for passive income received from a Hybrid that is treated as a corporation in its home jurisdiction but not in the other jurisdiction

Example – Second Rule Canada Will Deny Relief

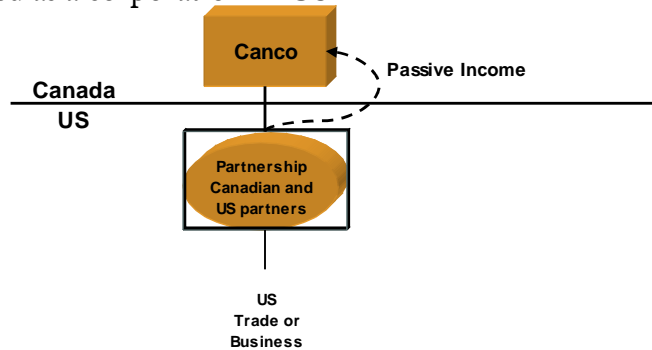
- ULC is fiscally transparent in US but not in Canada



- Passive Income will be subject to 25% withholding tax

Example – Second Rule US Will Deny Relief

- Partnership is fiscally transparent in Canada but elects to be treated as a corporation in US



- Passive income will be subject to 30% withholding tax rate

Tax Benefits of ULC's

U.S. Perspective on ULC's

- Tax treatment similar to having a branch operation in Canada
 - Canadian source losses and tax deductions of ULC can be deducted by U.S. corporate shareholder
 - U.S. shareholders may claim foreign tax credit for Canadian taxes paid by ULC
 - May enable purchase of shares of a ULC to be treated as if an asset purchase for US tax purposes

Tax Benefits of ULC's

Canadian Perspective on ULC's

- ULC treated as a corporation in Canada
 - ULC files tax returns in Canada (not its shareholders)
 - Subsequent sale of ULC may be exempt under the Treaty

Resulting Canadian Withholding Tax

Payment by ULC to US resident	Current	Future
Dividends to 10% + corporate shareholder	5%	25%
All other dividends	15%	25%
Interest to related party (subject to treaty phase out)	10%	25%
Royalties	10%	25%

Tax Planning for Treaty Changes

- There are a variety of alternatives to avoid the increased withholding tax but no “cookie cutter” solutions – choice of restructuring dependent on a variety of factors

Tax Planning for Treaty Changes

Alternatives

- ULC could pay dividends, royalties, interest prior to effective date of proposals
- Consider “unchecking” the box for ULC’s
 - Lower Canadian tax rates may make Canadian subsidiary that is not a flow-through ULC or a branch operation attractive to US investors
 - Need to consider U.S. tax consequences

Tax Planning for Treaty Changes

Alternatives

- Consider restructuring non-arm's length payments from ULC of interest and royalties to a country with a favorable tax treaty*
- GAAR should not apply to restructuring if foreign country treats the ULC as a corporation

* Such as Netherlands, Ireland or Switzerland - generally 10% rate of withholding

Tax Planning for Treaty Changes

Alternatives

- Shares of ULC could be transferred by U.S. shareholders to a hybrid entity in a treaty country that is eligible to "check the box" for U.S. tax purposes*
 - May be subject to Canadian tax on gains if the value of the shares is derived from real property (including rights to explore or exploit mineral deposits, sources or other natural resources)
 - Consider possible application of Canada's general anti-avoidance rule (GAAR)

• MIL (Investments) S.A. case

Tax Planning for Treaty Changes

Alternatives

- Consider winding-up ULC and carrying on business in Canada as a branch
 - Canadian tax on gains arising from disposition of assets by ULC
 - May give rise to Canadian withholding tax on distribution to U.S. shareholders
 - Going forward as a branch
 - Canadian tax return
 - Canadian branch taxes on money repatriated to US parent (5%)
 - Not subject to Canadian transfer pricing rules (contemporaneous documentation and penalties)

Timing Considerations

- Protocol has been ratified by Canadian Parliament
 - Bill S-2 – became law on December 14th, 2007
- Protocol requires U.S. Senate approval
 - Has not yet been added to the calendar
- Expectation is that it will enter into force in 2008 or 2009

October 30th, 2007 Economic Statement

- Canadian federal corporate tax rate reduced to 15% by 2012 (plus applicable provincial tax)
- Proposed rate of tax is 12% less than US tax rates
- Lower rates may make Canadian subsidiary (that is not a ULC) attractive to U.S. investors

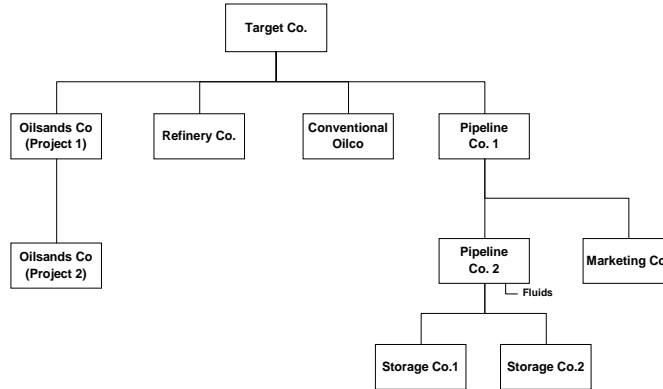
Declining Canadian Tax Rates

	2008	2009	2010	2011	2012
Federal	19.5%	19.0%	18.0%	16.5%	15%
Alberta*	10%	10%	10%	10%	10%
Total Corporate Tax Rate	29.5%	29.0%	28.0%	26.5%	25.0%

* This rate may be reduced to 8%

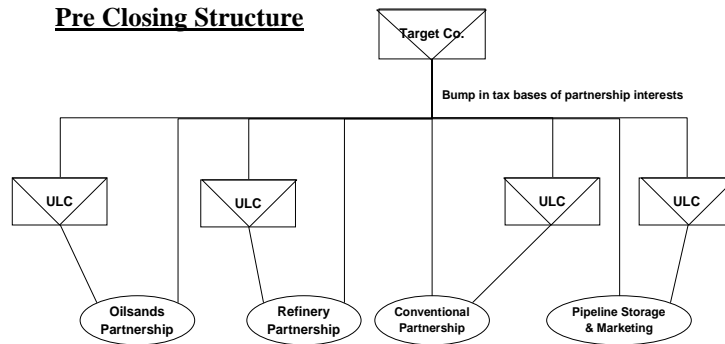
Future Tax Planning Involving Takeover of Targetco

Existing Targetco Structure

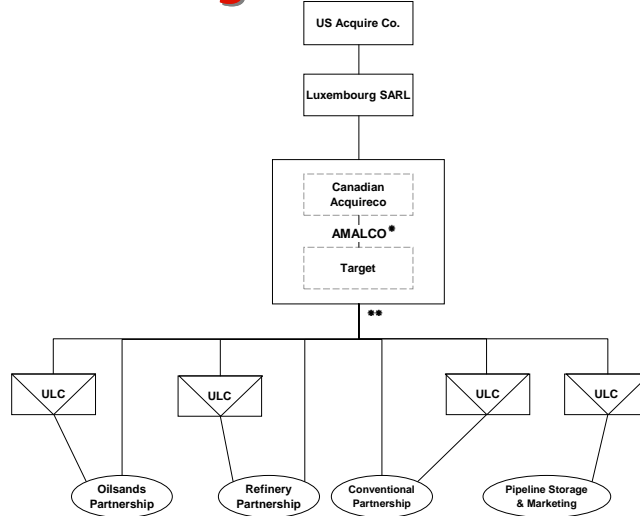


Future Tax Planning Involving Takeover of Target Co.

Pre Closing Structure



Post Closing Structure



Post Closing Structure

- * Canadian Acquireco acquires control of Targetco and is thereafter amalgamated so that interest expense in Canadian Acquireco may be deducted against income of Target.
- * After amalgamation the resulting basis in the partnership units held by Amalco is increased to their fair market value (i.e. up to Canadian Acquireco's cost to acquire shares of Target).

Question & Answer Session

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