Stop Sending Your Dollars to Donald

Recover investment income your community is needlessly paying to the US

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This article addresses the U.S. tax exposure of many Indigenous communities in Canada (including those who manage their investments through a trust) and the strategies that can eliminate this exposure. The strategies include the elimination, and refund, of claims for the U.S. withholding tax. This allows Indigenous communities to gain greater financial benefits from their U.S. investments. We have written about U.S. withholding tax recovery in an earlier issue of JAM. [Editor's note: see JAM 21, October 2017.] Since then, we have had considerable success in recovering money for Indigenous communities. The purpose of this article is to share some of those successes and to provide an update. First, we review background information.

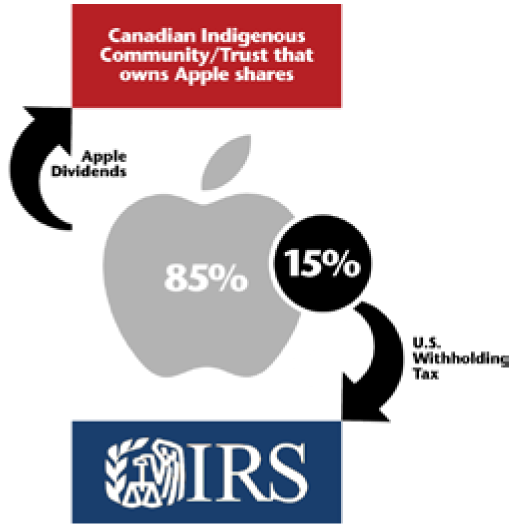
Understanding the Impact of U.S. Withholding Tax on Indigenous Communities

Many Indigenous communities are needlessly paying thousands of dollars in U.S. taxes on their investment income. The technical term for that tax is a "withholding tax," since the payment of the tax is withheld from U.S. investment income at source before it is distributed to the foreign investor (e.g. Indigenous communities). Generally, it is a 15% tax. Almost all Indigenous communities currently pay this 15% tax on U.S. dividends prior to receiving the balance. However, Indigenous communities may apply to be exempt from this tax based on their tax-exempt status in Canada. This would ensure that Indigenous communities receive the maximum benefit from their U.S. investments. For large investment portfolios, the 15% withholding tax adds up to thousands of dollars a year that does not need to be paid to the U.S. Internal Revenue Services (IRS).

To understand the impact of the 15% withholding tax, consider the following example. An Indigenous community buys a share of Apple. Apple then pays a dividend to the community of $10 on that share. The IRS withholds 15% of that amount ($1.50). Therefore, the community only receives $8.50. Below is a diagram that illustrates this example.

U.S. Taxes Can Be Eliminated

The U.S. withholding tax imposed by the IRS on Indigenous communities can be eliminated, and refunds can be claimed for prior taxes paid. Under U.S. law, Section 892 of the U.S. Internal Revenue Code (the "Code") exempts foreign governments from U.S. taxes. This exemption also applies to a political subdivision of a foreign country. Because they exercise governance powers, Indigenous communities may qualify for the Section 892 U.S. tax exemption. The exemption is significant for Indigenous communities. The U.S. withholding tax amounts to thousands of dollars a year paid to the U.S. Government. Instead, these funds should be paid to Indigenous communities.



The U.S. withholding tax exemption under Section 892 remains applicable for Indigenous communities that make their investments through a trust. Under Canadian tax law, the income earned through a trust owned by an Indigenous community is generally either paid out or attributed to the Indigenous community directly. Since the Indigenous community is tax

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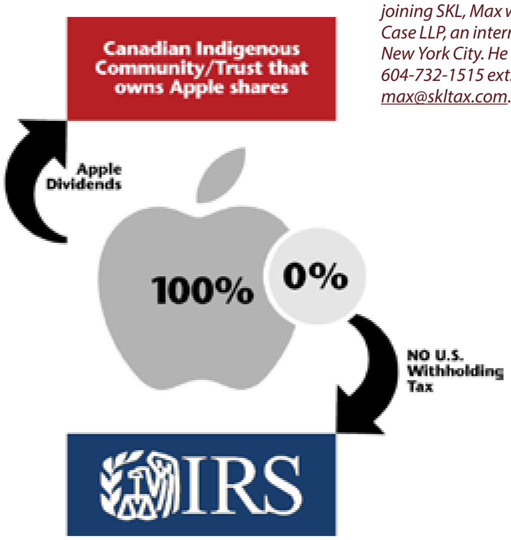
exempt and is paid the investment income, that investment income is tax free in Canada. Generally, the same is true under U.S. tax law. Since the Indigenous community should qualify for a tax exemption under Section 892, the trust income would be tax free in the U.S. This is because the Indigenous community is tax exempt in Canada and is paid investment income that is tax-free.

With the tax eliminated, the Indigenous community receives 100% of the Apple dividend rather than just 85%. The following diagram illustrates the scenario where the tax is no longer withheld.

How to Eliminate the U.S. Tax Going Forward



To eliminate the U.S. withholding tax, the Indigenous community's investment portfolio needs to be managed on a segregated basis. This means that the Indigenous community and/or their trusts needs to own the investments directly rather than through a pooled fund. A pooled fund is a collective fund that includes other investors who may not be exempt from U.S. tax. If the investments are managed in pooled funds, an Indigenous community may wish to assess, with their investment advisors, whether moving these investments to a segregated basis is beneficial. There may be extra fees associated with changing the structure of the investments. Currently, the U.S. withholding tax is paid directly to the IRS by the organization that holds the investments (the "custodian"). The custodian can be instructed to stop paying the withholding tax.

There are several steps that an Indigenous community may take to determine whether they are able to eliminate the U.S. tax on their investments. First, the Indigenous community should get an opinion to determine whether the community and/or their trust qualifies for the U.S. tax exemption under Section 892. Specifically, the opinion would determine the classification of the community and/or their trust under the U.S. Foreign Account Tax Compliance Act (FACTA). This determination is important because a failure to comply with FACTA can result in the imposition of a 30% penalty on payments from U.S. sources. Many communities and/or their trusts should qualify for the tax exemption under Section 892. However, getting an expert opinion is very important. This is because the legal requirements for the U.S. withholding tax exemption are complex and each community and or their trust is different. Second, the community may file forms with the custodian to stop the withholding tax. This step can be taken once the eligibility for the exemption has been determined. The forms that are submitted to the custodian are based on the content of the expert opinion. Third, after the forms are processed, the withholding tax will no longer be applied going forward. This process only needs to be done once.

Past Successes – Stopping the Tax Going Forward

We have stopped the U.S. tax exposure for about 25 Indigenous communities across Canada. This has saved each of these communities thousands of dollars a year. For example, one community had already invested $20 million on a segregated basis. Their three-year average of U.S. tax paid on their investment amounted to over $27,000. Therefore, the savings that they will incur over ten years is around $270,000. Below are some examples of savings based on actual results obtained.

Portfolio Size	Annual Savings	10 year savings
$80 million	$70,000	$700,000
$75 million	$95,000	$950,000
$60 million	$33,000	$330,000
$50 million	$32,000	$320,000
$40 million	$25,000	$250,000
$12 million	$9000	$90,000

Indigenous communities unnecessarily pay thousands of dollars to President Trump every year. That can be stopped, and refunds obtained, and the money used to fund important community projects.

Refund Claims

Indigenous communities may claim a refund of the tax that was paid for three prior years. This is in addition to stopping future payments of the 15% U.S. withholding tax. A refund is likely in cases where the investments were managed on a segregated basis.

It is still possible for Indigenous communities to get a refund if the investments are held in pooled funds. However, there is a lower chance of success. That means in cases where it is not possible for whatever reason for a community to manage their investments on a segregated basis, it may still be possible to recover some of the U.S. tax paid. For example, an Indigenous community was recently issued a refund by the IRS for taxes paid through money invested in pooled funds for the prior three years. This amounted to a refund of over $400,000. Across Canada, we have recovered about $2 million in past taxes paid for over a dozen communities.

Conclusion

This article demonstrates that there are opportunities for Indigenous communities, or their trusts, to stop their money from being sent to Donald Trump.

- The US tax can be stopped going forward using a one-time process, if the investments are held on a segregated basis.
- Three years of refunds are fairly straightforward to get, if the investments are held on a segregated basis.
- Three years of refunds are possible, but not guaranteed, if the investments are made through pooled funds.

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