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2025 U.S. tax reform – possible impacts for Canadians

Proposed tax legislation impacting U.S.
withholding tax rates

Many Canadians invest in the U.S. stock market to diversify their portfolios. As a result, it's important to stay up to date on tax issues that may impact such investments and whether it may affect your overall return on publicly traded U.S. securities. This article discusses the potential U.S. tax implications for Canadian resident individuals who are not U.S. persons (i.e. not U.S. citizens, U.S. green-card holders or U.S. residents) and Canadian corporations that are not U.S.-owned foreign corporations if recently proposed U.S. legislation is enacted.

Specifically, on May 22, 2025, the U.S. House of Representatives passed H.R. 1, *One Big Beautiful Bill Act* (the Bill), which moves the Bill to the Senate for consideration. The Bill will go through a similar process of research, discussion and possible changes before voting by the Senate. The Republicans currently hold a majority of the seats in the Senate.

It's important to note that the legislative process in the U.S. differs from that of Canada and this proposed legislation may be subject to further changes in the Senate.

This article is current based on proposed legislation as of May 26, 2025, and does not consider any potential changes put forward in the Senate process. This article does not address how these proposed changes in the U.S. may impact your Canadian taxes and the foreign tax credit relief that may be available under the Canadian tax rules. It's important to seek advice from your qualified tax advisor to determine the potential tax implications based on the most up-to-date information in this developing situation.

U.S. government's policy intent of the proposed legislation

While the Bill aims primarily to extend previously enacted tax cuts and expand on election promises made by President Donald Trump, the Bill includes proposed legislation for new Internal Revenue Code Section 899, "Enforcement of Remedies Against Unfair Foreign Taxes." The legislation is intended to implement a tool for the U.S. government to retaliate against "discriminatory foreign countries" that have implemented, in their view, an "unfair foreign tax."

"Unfair foreign taxes" are defined in the proposed legislation to include the undertaxed profits rule, digital services taxes, diverted profits taxes, and potentially any unfair foreign taxes provided by the U.S. Treasury Secretary.

Canada's digital services tax (DST)

Canada enacted the DST in 2024, which imposes a 3% tax on revenue earned from certain digital services that rely on engagement, data and content contribution from Canadian users and certain sales or licensing of Canadian user data.

If Canada is considered a "discriminatory foreign country" under the Bill, this may change how the U.S. taxes Canadian resident individuals who are not U.S. persons and Canadian corporations that are not U.S.-owned foreign corporations.

Implications for U.S. tax under the proposed legislation

Under the Canada-U.S. tax treaty, U.S. tax rates on U.S. source income are generally reduced from U.S. statutory rates when payments are made to a resident of Canada. However, proposed Section 899 may increase the rate of U.S. tax on U.S. source income paid to Canadian residents to beyond the treaty rates and U.S. statutory rates.

Under the proposed Bill, there would be an increase to the "specified rate of tax" at a rate of 5% in the first year and subsequent annual increases of 5% for residents of a "discriminatory foreign country," where that foreign country continues to impose, in the U.S. government's view, an "unfair foreign tax." For most portfolio income, the rate increases will start from the treaty reduced rate and, with the annual rate increases, will be capped at 50%, which is the U.S. domestic statutory rate of 30% plus an additional 20%. Different capped rates may apply to income that is effectively connected with a U.S. trade or business.

For any foreign countries that currently have "unfair foreign taxes," which may include Canada, the rate increases would begin after the year of enactment. If the

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Bill is enacted in 2025, the rate increases would begin in calendar year 2026.

If proposed Section 899 is enacted as written, there would be implications for Canadian residents who receive U.S. source income that's subject to U.S. taxes, such as:

- For U.S. source dividends that are currently subject to 15% U.S. withholding tax under the treaty, this may increase the U.S. withholding tax by 5% each year, up to a top rate of 50%.
- For Canadian corporations that have U.S. subsidiaries that are subject to a 5% withholding tax on dividends under the treaty (i.e. the Canadian corporation holds at least 10% of the voting stock of the U.S. corporation), this may increase the U.S. withholding tax by 5% each year, up to a top rate of 50%.
- For income that is effectively connected with a U.S. trade or business (e.g. distributions from certain Publicly Traded Partnership (PTP)) that's generally subject to graduated U.S. tax rates, this may increase the U.S. tax rate to 41% for corporations and 57% for individuals.
- For U.S. withholding tax on the disposition of U.S. real property interest (e.g. a U.S. vacation property), which is generally subject to U.S. withholding tax at the rate of 15% on gross sale proceeds, this may increase by 5% each year.

In addition, under U.S. domestic tax rules certain portfolio interest¹ may be exempt from U.S. withholding tax. Where income is excluded from the application of a specified rate of tax under the U.S. domestic tax rules, it may continue to be exempt based on commentary indicating Congressional intent.

Under the treaty, U.S. source dividends and interest are currently exempt from U.S. withholding tax when paid to Canadian pension, retirement and employee benefit plans, including, but not limited to, registered retirement savings plans (RRSPs) and registered retirement income

¹ Generally, interest from U.S. federal and corporate debt obligations (e.g. U.S. government and corporate bonds) issued after July 18, 1984, and U.S. state and municipal bonds may qualify for this exemption. Interest on bank or savings institution deposits in the U.S. and interest on amounts held by an insurance company may also be exempt from U.S. withholding tax.

funds (RRIFs). It's uncertain how the proposed rules would apply where income is generally exempt from U.S. withholding tax under the treaty provisions. However, to the extent that Section 899 would impose a U.S. withholding tax at source, there is concern for double taxation since, generally, foreign taxes paid on income earned in an RRSP/a RRIF are not recoverable as a foreign tax credit under Canadian tax rules.

In general, capital gains and losses realized on the sale of U.S. portfolio investments by Canadian residents, such as the sale of shares of a U.S. corporation, are not subject to U.S. taxation. However, this rule does not apply to the sale or transfer of investments that are considered effectively connected with a U.S. trade or business. In these cases, special U.S. tax rules apply and the proposed legislation may increase the applicable U.S. tax rate.

If your investment portfolio includes U.S. real estate investment trusts (REITs), U.S. ETFs or PTPs, ask your RBC advisor for a separate article that discusses the current U.S. tax implications of holding U.S. securities.

Conclusion

When determining the merits of investing in the U.S., there are many factors to consider in addition to the investment itself, such as the overall after-tax return of the investment. The proposed changes could lead to tax inefficiencies for Canadian residents who have largely relied on the treaty to reduce or eliminate double taxation. As the Bill continues to work through the legislative process, it's difficult to assess whether it will pass in its existing form.

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You should speak with your RBC advisor and your qualified tax advisor for assistance in evaluating your investment exposure in the U.S. and the implications under this proposed legislation.

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