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TaxNewsFlash

Canada

U.S. Proposals May Trigger Tax Increases for Canadians

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Canadian companies and investors that hold U.S. investments could be affected by new U.S. tax changes that are currently making their way through the legislative process. The U.S. House of Representatives recently approved a new budget bill (the "One Big Beautiful Bill Act") that proposes, among other things, to effectively increase tax rates for Canadian individuals and entities that earn U.S. income. The budget bill, which includes modified tax measures previously proposed in 2025, are meant to address what the U.S. considers to be "unfair foreign taxes" applied by many countries, including Canada. Although these measures are still subject to amendments and must clear several legislative hurdles before they are enacted, affected Canadian companies and investors should continue to follow the developments of these proposals and consider planning opportunities.

Following approval from the U.S. House of Representatives, the bill that contains these measures will now be sent to the U.S. Senate, which is expected to make further changes, including possibly amending the tax provisions. Note that the final version of the bill must also receive U.S. Senate and presidential approval before it can become law.

Background

Earlier this year various members of the U.S. House of Representatives introduced legislative bills that proposed to impose additional tax on U.S. income of individuals and entities in certain foreign jurisdictions that impose certain "discriminatory or extraterritorial taxes". In particular, the bills proposed measures affecting countries that enacted or have an undertaxed payments rule (UTPR) or a digital services tax (DST), under the Organization for Economic Cooperation and Development's (OECD) two-pillar project to address the tax challenges arising from the digitalization of the economy. The earlier bills followed a U.S. executive order that informed the OECD that any commitments made by the previous administration to its two-pillar approach "have no force or effect" in the United States.

The OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting (BEPS) involves more than 140 countries. The OECD released model rules in 2021 for countries to implement a global minimum tax of 15% for MNEs with annual revenue of at least €750 million. The adoption of the new rules is based on a "common approach" which means that jurisdictions are not required to adopt the rules, but if they choose to do so, they must implement the rules consistently with the model. The rules include an income inclusion rule (IIR) and a UTPR, which is a backstop to the IIR. The UTPR may allow foreign jurisdictions to impose additional tax on multinationals with an effective rate below 15%. Canada enacted a DST in 2024, and released draft legislation that would apply a UTPR as of December 31, 2024.

It is not yet certain when, or even whether, the U.S. bill will be passed into law. In the U.S. legislature, passing new tax rules can take considerably longer than in Canada. Before it can be enacted, U.S. tax legislation must generally move through the House, the Senate, and Congress as a whole before it is presented to the President for signing. At many of these stages, the bill is subject to debate and further amendments. However, the U.S. President has indicated that he hopes to sign the bill by July 4, 2025.

For further details, see *TaxNewsFlash-Canada* 2025-03, "U.S. Bill Proposes Additional Tax on Foreign Jurisdictions". For more on Canada's commitment to the OECD's two-pillar solution, see *TaxNewsFlash-Canada* 2024-28, "Large Businesses — Digital Services Tax Now in Effect", *TaxNewsFlash-Canada* 2023-31, "Multinationals — Act Now to Meet Pillar Two Obligations" and *TaxNewsFlash-Canada* 2024-27, "Canada Enacts Bundle of Outstanding Tax Measures".

Canadian corporations

The One Big Beautiful Bill Act would increase the rates of tax imposed on Canadian individuals, corporations, governments, and private foundations on US source interest, royalties, effectively connected income, branch profits tax and Foreign Investment in Real Property Tax Act (FIRPTA) income. In addition, the U.S. bill greatly broadens the application of the BEAT (Base Erosion Anti-Abuse Tax) to Canadian controlled U.S. businesses. The BEAT functions as a type of alternative minimum tax that applies where payments that are deductible against US business income are made to foreign related parties. Although the BEAT exists under current law, the U.S. bill would make more Canadian controlled companies subject to the BEAT and would increase their rate of BEAT.

The rate increases could occur as early as 2026 but will depend on when the U.S. bill is signed into law.

Under the proposals included in the U.S. bill, Canadian corporations that receive income, such as dividends from U.S. subsidiaries, would be subject to an increased rate of tax on such dividends. The bill increases the rate of tax by 5% over the existing rate each year that “unfair foreign taxes” remain in effect, up to a maximum of 20% over the existing U.S. statutory rate. For dividends, the maximum U.S. tax rate could escalate to 50%.

Canadian investors

The proposals also subject Canadian individuals who own U.S. securities to the 5% additional tax increases each year until the U.S. tax rate reaches 50%.

KPMG observations
These changes could significantly increase tax rates for affected Canadian corporations and investors. In particular, over time, this change could increase the tax rate for Canadian corporations that receive dividends from U.S. subsidiaries to 50% (from the existing preferential 5% treaty rate), and to 50% (from the existing preferential 15% treaty rate) for Canadian individuals who own shares of U.S. corporations.

Although the United States has said that these measures will not apply to jurisdictions, including Canada, that do not apply “unfair foreign taxes” such as a UTPR or a DST, during the 2025 federal election, the Canadian government promised to maintain international tax rules proposed by the OECD.

Tax exemptions

The U.S. tax bill also proposes to remove tax exemptions for foreign governments and related entities on income received from investments in certain U.S. securities. Similarly, this additional tax will apply as long as certain “unfair foreign taxes” remain in effect.

KPMG observations
If this change is enacted, certain Canadian government pension plans and other controlled entities will no longer be considered tax exempt under U.S. tax law and could be required to pay U.S. tax.

For further details, see the following reports by KPMG’s member firm in the U.S.: “KPMG reports: Tax title for “One Big Beautiful” bill” and “Evaluating Possible U.S. Retaliatory Tax Measures”.

We can help

Your KPMG adviser can help you assess the effect of the proposed U.S. tax legislation on your business and personal tax situations. For more details on potential U.S. tax changes and their possible impact, contact your KPMG adviser.

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