Thin-capitalization rules

Things to know

- Thin-capitalization rules restrict the ability of Canadian corporations and trusts to deduct interest expense on debt owing to certain related non-residents. The thin-capitalization rules also apply to Canadian branches of foreign corporations.
- Generally, thin-capitalization restrictions apply if the non-resident owns 25% or more of the shares of the debtor corporation (by vote or value) or 25% or more of the interests in the debtor trust (by value).
- Interest deduction will be limited proportionally if a debtor's outstanding debts to related non-residents exceed 1.5 times the debtor's equity.
- Any non-deductible "excess" interest is treated as a dividend for withholding tax purposes, and would trigger withholding tax at a rate of 25% subject to reductions under an applicable tax treaty.
- Specific rules exist to address, among other things, back-to-back loan arrangements and borrowings by partnerships.

Things to do

- Keep the thin-capitalization rules in mind when planning how to finance your Canadian subsidiary and determining how much equity and how much debt to contribute.
- The intra-group debt-to-equity ratio of Canadian members of a corporate group should be monitored periodically to ensure compliance with the thin-capitalization rules.

USEFUL RESOURCES

Government of Canada

- IT-59R3: Interest on debts owing to specified non-residents (thin-capitalization) (Archived)

RELATED TOPICS

- Initial structuring and income tax considerations
- Forming a Canadian subsidiary
- Branch profits tax
- Branch of a foreign corporation vs. Canadian subsidiary

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