

Cross-Border Financings—Will They Now Be On The Increase?

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Canadian corporations frequently find themselves involved as borrowers, co-borrowers or guarantors in financings with cross-border elements.

One example typically involves a Canadian subsidiary of a foreign corporation providing security as part of the overall security being provided by the parent corporation in support of its foreign sourced credit facility. Another common example involves a foreign corporation pledging the shares of its Canadian subsidiary as security for its indebtedness abroad.

Cross-border financings of the above nature involve not only the complexities inherent in the domestic financings, but also a unique set of issues specific to the international context, including conflict of laws considerations and the applicability of withholding tax on the amount of interest to be paid in connection with the financing, which may have in the past limited the number of such financings or the involvement of the Canadian subsidiaries.

However, recent legislative initiatives in Canada at both the federal and provincial level should address such issues and thereby facilitate cross-border transactions and help to reduce overall transaction costs for both lenders and borrowers.

The Securities Transfer Act, 2006 (Ontario)

The Ontario *Securities Transfer Act, 2006* ("STA") came into force on January 1, 2007. The enactment of the STA modernizes the law governing the pledging and transfer of securities in Ontario and addresses numerous conflict of law issues which arose under the previous regime. The STA will have a significant impact on cross-border financing transactions where uncertificated shares of a Canadian subsidiary are pledged as security to a foreign lender.¹

The STA, and the related amendments to the Ontario *Personal Property Security Act* ("PPSA"), are attempts to align Ontario law governing the transfer and pledging of securities with Revised Article 8 and 9 of the U.S. Uniform Commercial Code. Similar legislation has been enacted in Alberta and has been proposed in numerous other Canadian provinces.

The similarity between Revised Article 8 of the U.S. Uniform Commercial Code and the STA should create a more consistent cross-border legal framework and provide greater legal certainty for both lenders and borrowers in cross-border transactions involving uncertificated shares of Canadian corporations. The effect of the above should encourage the further use of uncertificated securities as collateral and lower overall transaction costs for both lenders and borrowers.

2007 Federal Budget Announcement Re: Elimination of Withholding Tax on Interest Payments

Under the current *Income Tax Act* (Canada) ("ITA") the payment of interest by a Canadian company to a foreign lender is generally subject to a withholding tax of 25%. For U.S.-based lenders, the withholding tax is reduced to 10% pursuant to the Canadian-U.S. Tax Treaty.

As a result of the withholding tax, foreign lenders commonly require Canadian borrowers to "gross up" interest payments to account for the additional cost. As a result, foreign lenders are often unable to compete with the rates provided by domestic lenders. Alternatively, the parties may choose to structure the loan in such a way so as to avoid the remittance of withholding tax. These alternate structures may not provide the flexibility needed by the parties and may have the effect of reducing the amount of credit made available to the borrower. There can also be significant costs in restructuring the loan to enable it to fall within an exception.

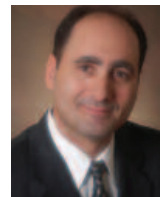
These issues were addressed in the federal budget tabled by Canada's Minister of Finance on March 19, 2007 (the "2007 Budget"). Included in the 2007 Budget was the announcement of the proposed elimination of withholding tax on interest payments made by Canadian taxpayers to arm's length non-resident U.S. lenders. This is also planned to be extended to lenders in other countries, in due course.

It is unclear at this time as to when the exemptions will come into effect; however, assuming the exemption is implemented as expected, the elimination of the withholding tax is expected to create more opportunities for foreign lenders, provide Canadian business better access to U.S. and foreign capital, and lower borrowing costs for Canadians.

Conclusion

The changes effected by the STA and the proposed 2007 Budget are likely to have a positive effect on the availability of cross-border financing and the costs associates with such transactions. The enactment of the STA facilitates cross-border financing transactions by aligning the law governing the pledging and transfer of securities in Ontario with U.S. legislation. Similarly, the 2007 Budget, if implemented, will allow cross-border financings to be effected without the withholding tax issues that have until now posed hurdles in certain.

While parties to cross-border transactions will need to continue to be wary of issues relating to licensing and reporting requirements, foreign margin regulations and lender liability, we expect the result of the enactment of the STA and the proposed 2007 Budget will, once such changes are implemented, lead to an increase in the amount of capital available at a lower cost to both the borrower and the lender, and more "direct" involvement by Canadian subsidiaries in the financing arrangements of their parent corporations.



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¹ Uncertificated securities differ from certificated securities in that the issue and transfer of the security is not evidenced by a physical document but rather simply registered and recorded in records maintained for that purpose by or on behalf of the issuer or securities intermediary.