

# When Will a Canadian Corporation be Treated as a Passive Foreign Investment Company?

*February 24, 2017 – Cross-Border Counselor*

by John D. Hollinrake, Jr.

A Canadian corporation will generally be a passive foreign investment company or “PFIC” if, for a tax year, (a) 75% or more of its gross income is passive income (the “PFIC income test”) or (b) 50% or more of the value of its assets either produce passive income or are held for the production of passive income, based on the quarterly average of the fair market value of such assets (the “PFIC asset test”). Gross income generally includes all sales revenues less the cost of goods sold, plus income from investments and from incidental or outside operations or sources, and passive income generally includes, for example, dividends, interest, certain rents and royalties, certain gains from the sale of stock and securities, and certain gains from commodities transactions. Cash and cash equivalents are generally treated as assets held for the production of passive income.

For purposes of the PFIC income test and PFIC asset test described above, if the Canadian corporation owns, directly or indirectly, 25% or more of the total value of the outstanding shares of another corporation, such Canadian corporation will be treated as if it (a) held a proportionate share of the assets of such other corporation and (b) received directly a proportionate share of the income of such other corporation. In addition, for purposes of the PFIC income test and PFIC asset test described above, and assuming certain other requirements are met, passive income does not include certain interest, dividends, rents, or royalties that are received or accrued from certain related persons (as defined in Internal Revenue Code Section 954(d)(3)), to the extent such items are properly allocable to the income of such related person that is not passive income.

Canadian corporations that are in the development or exploration stage commonly constitute PFICs under the PFIC income test because their only source of gross income is interest income and other investment income earned on their cash balances.

The same rules apply for other non-U.S. corporations.

## Related Capabilities

- [Canada Cross-Border Transactions](#)