TD Wealth

Standing in a Bucket

Monthly Perspectives
June 2025

15 minutes

Standing in a Bucket: Section 899

As Winston Churchill famously said, “For a nation to try to tax itself into prosperity is like a man standing in a bucket and trying to lift himself up by the handle.”

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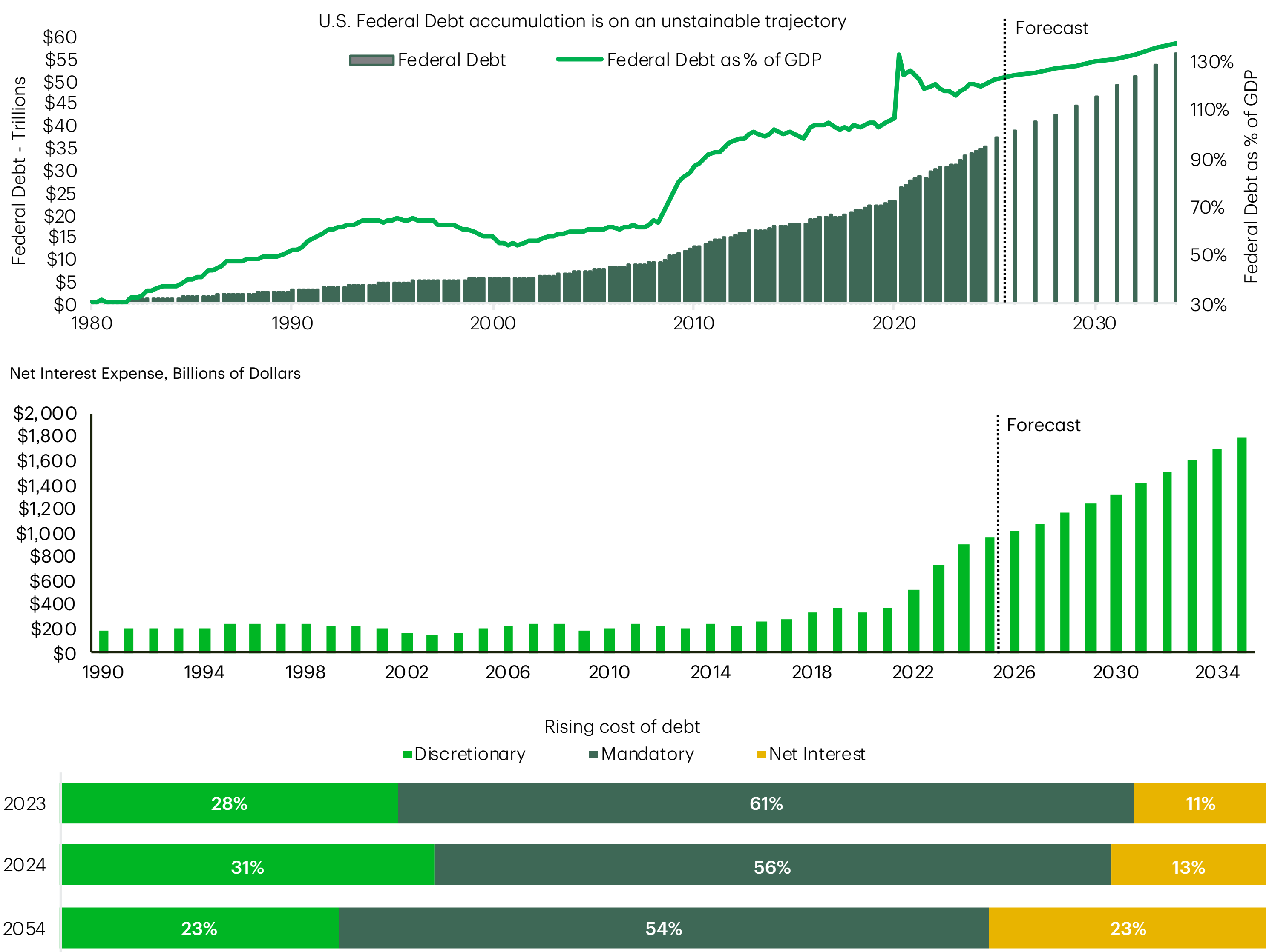
The United States has long been a beacon for investment capital. Trust in its institutions — its divisions of power, its rule of law, its central-bank independence and its benevolent use of soft power — has made it the world’s pre-eminent economic force. Its bond market has been a safe haven for which foreign investors expect little risk premium. Its equity markets have been the envy of the world, with U.S. companies now comprising nearly 70% of the global market. U.S. equity valuations are on average 20% to 30% higher than European and Japanese stocks, despite the fact that, for some sectors, international stocks have similar return on capital. The U.S. also accounts for an estimated 60% of global private-equity AUM and dominates in venture and growth equity.

Rain or shine, through good times and bad, the United States more often than not has acted as the stabilizer in financial markets; this time, though, the reverse is true. There are many reasons for this, but for the sake of brevity, let’s just state one of the biggest: they have a *huge* debt problem, and it’s headed in the wrong direction, accumulating rapidly. The fixes are difficult and complex, as the difference between expected and realized DOGE savings has made clear. Despite the recent push to cut “waste, fraud and abuse,” debt-servicing costs are projected to double in approximately 10 years, and eventually reach nearly a quarter of total expenditures (Figure 1).

Figure 1: Debt is growing rapidly and getting expensive



Source: Congressional Budget Office, TD Economics.

To solve this problem, the current administration has a plan to right the ship by: *increasing tariff revenue* (a form of taxation); while simultaneously spurring growth by *reducing income tax revenue*, by making tax cuts that were set to expire at the end of 2025 permanent. A strategy based on reducing one's goodwill — in this case, a nation's intangible assets — to drive growth seems at odds with business experience. Historically, this leads to increased financial costs, market-capitalization losses, reputational damage and the loss of strategic optionality. That seems like poor policy.

Even worse has been the implementation. Recall the havoc in financial markets following "Liberation Day." It seems like, at any given moment, something extraordinary can happen. As recently as last week, for instance, the U.S. Court of International Trade surprised markets with a ruling that invalidated the foundation of President Trump's tariff policy, finding no constitutional or statutory basis for the use of the International Emergency Economic Powers Act (IEEPA) to install tariffs — only to have the U.S. Court of Appeals for the Federal Circuit issue an emergency pause on the ruling, granting a temporary stay until "further notice." Whatever the outcome, our base case (as laid out in our most recent edition of *Portfolio Strategy Quarterly*) is for U.S. tariffs to land somewhere between 10% to 25% (Figure 2). This is consistent with the broader consensus of 12% to 14% across the board (inclusive of China).

One Big Beautiful Bill Act - Section 899

To be clear, U.S. politicians don't hold a monopoly on counterproductive tax policy. In recent years, Canadians have had an education (at times unwelcome) on the efficacy of proposed tax legislation. There were proposals to increase the inclusion rate for capital gains, changes to the filing requirements for bare trusts (including joint accounts and real property held in joint names), among other proposals, and taxpayers were made to grapple with the uncertainty around what was law and what was merely indicative of the government's future intentions.

This uncertainty stems from a surprising quirk of Canadian tax law. In this country, changes to taxation are generally effective the moment a notice of ways and means motion is tabled. That means that the federal government can change the administration of tax law by giving formal notice that it intends to make a change to the law. So, while the implementing legislation may only pass through the legislative process at some point in the future, taxes may be collected from the date of the notice. The challenges of this long-standing policy were on full display in recent months as some measures were abandoned (capital-gains inclusion increase) while others died as a result of prorogation (amendments to the bare trust rules).

Figure 2: Scenario Breakdown for Tariffs

Scenario	Description
Bull Case (40% probability): Less than 10% in U.S. tariffs imposed on average	This was our original base case: on average a 10% across-the-board U.S. tariff rate, with some variation across countries and likely higher tariffs on Chinese goods. It would represent a significant climbdown from the tariffs announced so far, which is possible if efforts at diplomacy and negotiation lead to reduced "reciprocal tariffs" and exemptions for goods categorized as critical for the U.S. economy.
Base Case (45% probability): 10% to 25% in U.S. tariffs imposed on average	This scenario would still mark a significant increase in the average U.S. tariff rate, from around 3% previously. Chinese goods imports would see a much larger tariff rate than the rest of the world given the strategic competition between the U.S. and China, and efforts by the U.S. administration to decouple the world's largest and second-largest economies. So far, exemptions for China have been narrower in scope and negotiations have yielded limited results in lowering the tariff rate.
Bear Case (15% probability): Greater than 25% in U.S. tariffs imposed on average	President Trump's administration maintains its announced tariffs rate for all countries following the 90-day pause of reciprocal tariffs, with limited exemptions. Negotiations break down as many countries refuse to yield to U.S. demands and the trade war escalates.

This matters. People need to understand their options so they can make informed decisions about their assets, income and financial arrangements. But it's not just Canadian tax law that impacts Canadian residents — other countries' laws (and the means by which changes become law) affect us as well. The U.S. bill referred to as the *One Big Beautiful Bill Act* (OBBBA), which was recently passed by the House of Representatives, highlights this perfectly.

What is OBBBA?

As the name suggests, OBBBA is a big piece of legislation (more than 1,000 pages), and it includes many proposed tax measures in the U.S. that impact even non-citizens and non-residents. These include a new Section 899, which increases federal income tax and withholding tax rates on certain types of U.S.-sourced income earned by Canadian corporations, partnerships, individuals, trusts and private foundations. The new section would impose higher withholding rates on U.S.-sourced dividends, interest, royalties, rents and pension income earned by non-resident taxpayers from "discriminatory foreign countries." The U.S. maintains that Canada is imposing unfair foreign taxes (such as the digital services tax).

How are U.S. investments currently taxed in Canada?

As it stands, the rules around U.S. investment taxation are complicated and highly dependent on the type of investment. For the sake of simplicity, here's a line-item breakdown:

Exempt from U.S. withholding tax:

- U.S. securities and U.S.-listed ETFs held in certain registered retirement accounts, such as an RRSP, RRIF or LIRA
- Qualified interest income from a U.S. bond, whether held directly or through a Canadian or U.S. ETF

Subject to U.S. withholding tax:

- U.S. securities and U.S.-listed ETFs held in TFSAs, RESPs, FHSAs and non-registered accounts
- Canadian mutual funds or ETFs that hold U.S. stocks, or those that wrap a Canadian ETF that holds U.S. stocks, or wrap a U.S. ETF that holds U.S. stocks
- Canadian mutual funds or ETFs that wrap a U.S. ETF that holds international stocks (potential for double withholding tax by U.S. and third-party country)

This tax treatment may come as a surprise to some investors because they may not have clear line of sight on the withholding process. As an individual investing in ETFs that hold U.S. stocks, for example, you may not see the impact of the current withholding tax because it's withheld before income is distributed to the investor — that's all happening in the background. Generally, the withholding tax rate on individual investors is 30% reduced to 15% by treaty. When paid directly by the taxpayer in a non-registered account, a foreign tax credit is generally available.

What would change if S. 899 were to become law?

Under the proposed S. 899, the increase in the withholding tax rate begins at five percentage points and phases in over four years to a maximum of 20 percentage points. It's not yet clear from the draft legislation whether this additional tax would be on top of the non-treaty rate of 30% or the treaty rate of 15% (or the 0% rate for RRSPs and RRIFs), but in any event, it's generally accepted the rate would increase on U.S. source dividends, interest, royalties, rents and pension income in some if not all account types. Capital gains are not expected to be impacted; however, dispositions of U.S. real property would likely be caught under the Foreign Investment Real Properties Tax Act (FIRPTA).

If a Canadian were to dispose of U.S. real property that is subject to U.S. tax, under FIRPTA there would be a 15% withholding tax applied on the gross sale price and remitted by the purchaser. The proposed withholding tax increase under S. 899 is expected to be applied on top of the FIRPTA withholding tax. That means this Canadian taxpayer could ultimately be subject to a 35% tax withholding (15% under FIRPTA plus 20% under S. 899).

We would also reinforce that equities are less affected by Section 899 because it appears to target income and not capital gains. U.S. equities are considered "growth" and have traditionally seen earnings rise faster than Canada. For example, the current P/E ratio is 21.4x the forward 12-month consensus earnings estimate with a dividend yield of 1.3%. Canadian equities are considered "value." They are trading at a lower P/E of 15.7x, with a lower projected growth rate of 8% and a higher dividend yield of 3.1%.

If it were passed as is, when would S. 899 come into effect?

If enacted, generally S. 899 would take effect on the first day of the calendar year following the *latest* of the following events: (1) 90 days after the enactment of OBBBA; (2) 180 days after the enactment of the "unfair foreign tax" by the relevant non-U.S. jurisdiction; or (3) the initial effective date of the "unfair foreign tax."

This means that, at the earliest, the rules would change on January 1, 2026. Canadians will therefore have some time after the final legislation is approved and passed into law to make decisions about their U.S. investments and the impact of any changes to the current laws. The Canadian federal government may also be proactive and bring some tax-relief provisions to counter the impact of Section 899.

Is it law now?

No, it's not law. And, unlike the Canadian system, the U.S. tax system has no mechanism allowing for the collection of taxes in advance of the bill's enactment. The passing of the Act by the U.S. House is procedural and not sufficient authority in itself for the IRS to start collecting taxes based on the proposed measures.

It's expected that the current version of the OBBBA will be considered by the Senate Finance Committee, where provisions of the House measure could be changed, before being presented to the full Senate. The version of the legislation passed by the Senate may be completely different than the current version. That second draft will then need to go back to the House and through the Senate again and only once an agreed upon final version is approved by the House and the Senate would it be signed into law.

What other tax measures in the OBBBA could impact Canadians?

The estate of a Canadian owning U.S. "situs assets" (i.e., assets that have a U.S. location or connection, such as U.S. real estate and U.S. stocks) with an aggregate value of US$60,000 is generally required to file an estate tax return with the U.S. government. If their worldwide estate exceeds this exemption amount, estate tax is payable at graduated rates starting at 18% and can reach up to 40%. In 2025, the estate and gift tax exemption is US$13,990,000. It is set to expire after December 31, 2025, and be reduced by one-half. The OBBBA proposes permanently extending the estate and lifetime gift tax exemption, and to increase the exemption amount to US$15 million for a single taxpayer (US$30 million for a married couple filing jointly). The exemption will be indexed for inflation going forward. For U.S. persons (including citizens and green card holders) additional provisions may be relevant.

What do I need to do now?

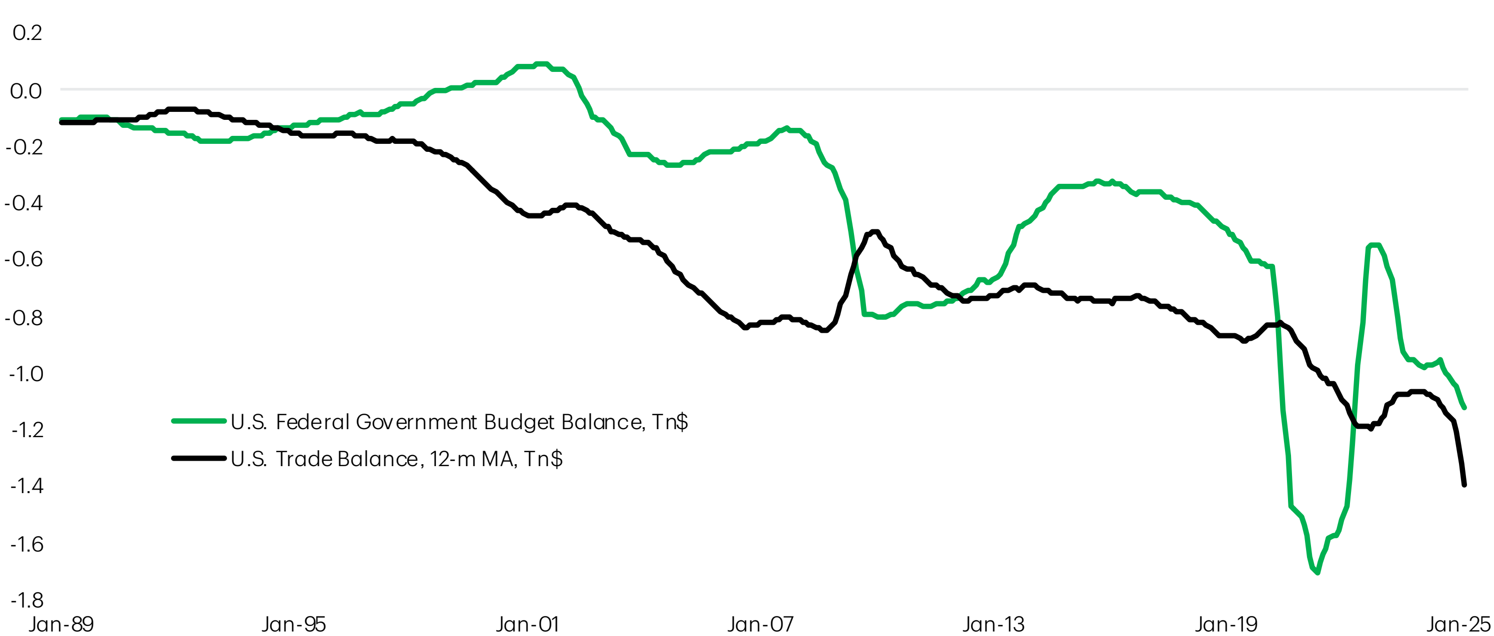
Of course, all of this is supposed to be about solving U.S. trade imbalances. But the question that begs asking is this: if tariffs are so effective at narrowing trade deficits, how come the ones during President Trump's first term didn't do that? In fact, the reverse happened. The U.S. trade deficit widened from around $45 billion in 2018 to $140 billion today (Figure 3).

This can be explained in part by the trend in U.S. private savings, which have fallen behind investment; hence the need for foreigners to "subsidize" U.S. consumption. The more effective way to reduce the trade deficit would actually be to cut the government's deficit, given that the latter contributed to the strong domestic demand post-pandemic. But as recent activities south of the border have laid plain, U.S. politicians have no appetite to tighten their belts. In fact, they've shown the opposite inclination — in the form of deficit spending and taxation on foreign investors who subsidize their consumption.

The proposed S. 899 also has the feel of a negotiating tactic designed to force the EU, Canada and UK to rethink their digital services taxes, which are deeply unpopular in the U.S. If we've learned anything, it's that a lot can change between now and when the OBBBA is enacted.

With that in mind, let's expect the best but plan for the worst. Tax policy on the other side of the border is relevant to the decisions and plans we make for our wealth and our assets. Taking the time now to familiarize yourself with your asset holdings, account types and currently applicable Canadian and foreign tax treatment will serve as a strong foundation when new information becomes available. Working with an advisor who has an extended team of professionals with expertise in cross-border issues helps ensure you have the information you need when you need it. At the end of the day the best way to manage risk is to ensure you have the right plan in place and to stay diversified.

Figure 3: Larger Fiscal Deficit = Wider Trade Deficit



Source: Macrobond, Wealth Investment Office as of May 29, 2025

Market Performance

Canadian Indices ($CA) Return	Index	(%) 1 Month	(%) 3 Months	(%) YTD	(%) 1 Year	(%) 3 Years	(%) 5 Years	(%) 10 Years	(%) 20 Years
S&P/TSX Composite (TR)	103,670	5.56	3.87	7.05	21.05	11.55	14.92	8.99	8.25
S&P/TSX Composite (PR)	24,842	5.37	3.08	5.85	17.54	8.09	11.49	5.72	5.14
S&P/TSX 60 (TR)	5,101	5.13	3.19	7.07	21.36	11.36	14.94	9.42	8.61
S&P/TSX SmallCap (TR)	1,491	7.20	7.94	6.17	13.69	6.55	14.94	6.16	4.57
S&P/TSX Preferred Share(TR)	2,095	5.05	1.65	4.40	13.99	5.88	10.86	4.10	3.17
U.S. Indices ($US) Return									
S&P 500 (TR)	12276	6.29	-0.37	1.06	13.52	14.41	15.94	12.86	10.47
S&P 500 (PR)	5569	6.15	-0.72	0.51	12.02	12.68	14.19	10.87	8.34
Dow Jones Industrial (PR)	40669	3.94	-3.58	-0.64	9.26	8.61	10.74	8.91	7.23
NASDAQ Composite (PR)	17446	9.56	1.41	-1.02	14.21	16.52	15.03	14.19	11.76
Russell 2000 (TR)	10665	5.34	-4.10	-6.85	1.19	5.03	9.64	6.64	7.68
U.S. Indices ($CA) Return									
S&P 500 (TR)	16954	5.89	-5.09	-3.38	14.47	17.71	15.86	13.98	10.98
S&P 500 (PR)	7691	5.74	-5.41	-3.91	12.95	15.93	14.11	11.97	8.85
Dow Jones Industrial (PR)	56164	3.54	-8.14	-5.01	10.18	11.74	10.66	9.99	7.73
NASDAQ Composite (PR)	24093	9.14	-3.38	-5.37	15.17	19.88	14.95	15.32	12.28
Russell 2000 (TR)	14728	4.94	-8.63	-10.95	2.03	8.05	9.56	7.69	8.19
MSCI Indices ($US) Total Return									
World	17219	5.99	2.28	5.18	14.21	13.72	14.72	10.50	8.89
EAFE (Europe, Australasia, Far East)	12499	4.72	9.31	17.31	13.92	12.03	11.98	6.49	6.27
EM (Emerging Markets)	2979	4.31	6.42	8.89	13.64	5.64	7.52	4.34	6.69
MSCI Indices ($CA) Total Return									
World	23780	5.58	-2.56	0.55	15.17	17.00	14.64	11.60	9.40
EAFE (Europe, Australasia, Far East)	17261	4.32	4.14	12.15	14.87	15.26	11.90	7.55	6.77
EM (Emerging Markets)	4113	3.91	1.38	4.10	14.59	8.68	7.44	5.37	7.19

Currency									
Canadian Dollar ($US/$CA)	1.38	-0.43	-4.99	-4.48	0.81	2.80	-0.06	0.99	0.45
Regional Indices (Native Currency, PR)									
London FTSE 100 (UK)	8495	3.27	-0.42	7.33	6.01	4.86	7.62	2.31	2.89
Hang Seng (Hong Kong)	22119	5.29	1.52	16.10	28.82	2.84	0.28	-1.62	2.63
Nikkei 225 (Japan)	36045	5.33	2.18	-4.84	-1.36	11.65	11.65	6.32	6.26

Benchmark Bond Yields	3 Months	5 Yrs	10 Yrs	30 Yrs
Government of Canada Yields	2.66	2.81	3.20	3.48
US Treasury Yields	4.35	3.96	4.41	4.93

Bond Indices ($CA Hedged) Total Return	Index	1 Mo (%)	3 Mo (%)	YTD (%)	1 Yr (%)	3 Yrs (%)	5 Yrs (%)	10 Yrs (%)
FTSE TMX Canada 91-day Treasury Bill Index	477	0.22	0.70	1.26	3.98	4.16	2.58	1.80
FTSE TMX Canada Universe Bond Index	1185	0.02	-0.91	1.38	7.26	3.53	-0.05	1.82
FTSE TMX Canada All Government Bond Index	1108	-0.16	-1.24	1.19	6.73	2.82	-0.82	1.42
FTSE TMX Canada All Corporate Bond Index	1460	0.58	0.11	1.98	8.87	5.62	2.15	2.96
U.S. Corporate High Yield Bond Index	304	1.52	0.21	2.03	7.90	5.71	5.06	4.25
Global Aggregate Bond Index	263	-0.49	-0.22	1.13	4.62	1.81	-0.40	1.61
JPM EMBI Global Core Bond Index	537	0.86	-0.27	2.37	6.37	4.12	0.92	2.16
S&P/TSX Preferred Total Return Index	2095	5.05	1.65	4.40	13.99	5.88	10.86	4.10

Source: TD Securities Inc., Morningstar®, TR: total return, PR: price return, as of May 31, 2025.

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