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US Tax Reform: Implications for US Citizens in Canada

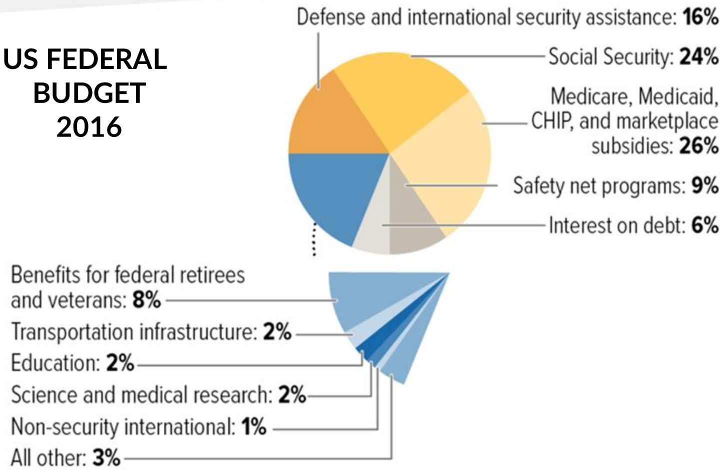
Agenda

- Background of US Tax Reform
- What is H.R.1? What is it made up of?
- Individual Highlights
- Corporate Highlights
- International Highlights
- Estate/Gift Tax Highlights
- Questions

General Comments

- Extensive reform, (biggest since 1986) but not simplification!
  - Impacts virtually every individual and business
  - Lower taxes (but not for those in Canada)
  - Complexity remains:
    - Did not abolish AMT
    - Did not abolish Estate and Gift tax
- Massive increase in National Debt
  - With current budget, could hit 30 trillion by 2025!
- See forbes.com 'Your Pension is a Lie"

US FEDERAL BUDGET 2016



Individual Highlights

1. **What did not change (good):**
   - Foreign earned income exclusion
   - Foreign tax credit regime
   - Benefits protected by the treaty
   - Preferential treatment for Canadian donations
   - American Opportunity Credit for Education
   - Tax rates on qualified dividends and capital gains
2. **What did not change (bad):**
   - Citizenship based taxation
   - No relief from onerous taxation/regulations on foreign investments
   - Net investment income tax on high income individuals

Individual Highlights

1. **What did change (good):**
   - Increased Child Tax Credit - was $1,000 per child now $2,000 ($1,400 refundable; much higher phase out
   - Increase standard deduction - was $6,300, now $12,000 (double, if filing joint)
   - AMT threshold increased from $54,300 to $70,300 (single) $84,500 to 109,400 (married filing joint)
2. **What did change (bad):**
   - Eliminate personal exemptions
   - Reduced itemized deductions for interest,
   - Deduction for property taxes not allowed on non-US properties
   - Eliminates miscellaneous deductions (e.g. accounting and investment fees, employment expenses, union dues)
3. **What did change (neutral):**
   - Lower tax rates: all except lowest bracket.

US Tax Rates

Income Tax Rate		Income Levels for Those Filing As:	
2017	2018-2025	Single	Married-Joint
10%	10%	$0 - $9,525	$ 0 - 19,050
15%	12%	$9,525 - $38,700	$19,050 - $77,400
25%	22%	$38,700 - $82,500	$77,400 - $165,000
28%	24%	$82,500 - $157,500	$165,000 - $315,000
33%	32%	$157,500 - $200,000	$315,000 - $400,000
33%-35%	35%	$200,000 - $500,000	$400,000 - $600,000
39.6%	37%	$500,000+	$600,000+

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Impact of Lower Tax Rates

- Net result: Lower US taxes, higher Canadian taxes
- Mr. X:
  - US Citizen
  - lives in Canada
  - US$40k in US pension from working in US; US$60k of Canadian source income

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Tax Rate Example

Mr. X US inc. $40k+ CDN inc. $60k	Old US Rules		New Rules	
	CDN	US	CDN	US
Total Income	$100k (C$125k)	$100k	$100k (C$125k)	$100k
Pers. Exemption		4k		0k
Std. Deduction		6k		12k
Taxable Income		90k		88k
Total Tax before foreign tax credit	$29k (C$36k)	17.8k	$29k (C$36k)	14.5k
Foreign Tax Credit	7.1k (C$8.9k)	10.7k	5.8k (C$7.3k)	8.7k
Net Tax	21.9k (C$27.1k)	7.1k	23.2k (C$28.7k)	5.8k
Total Tax	**US $29k**		**US $29k**	

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Child Tax Credit Example

Mr. and Mrs. Y CDN inc. $200k 3 children <18	Old US Rules		New Rules
	CDN	US	US
Total Income	$200k (C$250k)	$200k	$200k
Pers. Exemption		21k	0k
Std. Deduction		12k	24k
Taxable Income		167k	176k
Total Tax before foreign tax credit	$75(C$97k)	34k	30.6k
Foreign Tax Credit	0k (C$0k)	34k	30.6k
Net Tax	75k (C$97k)	0k	0k
Child Tax Credit	**US $0k**		**US $4,200**

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Corporate Highlights

- Lower Rates
- More Complexity
- Permanent Changes

Corporate Highlights

- Corporate tax rate to be reduced to 21%
- AMT fully eliminated
- Pass-Throughs taxed at a flat 20%
  - With income effectively connected with the US
  - Various income thresholds and tests
- Certain deductions for businesses have been modified, and some credits have been repealed or altered.

International Highlights

- Move to a territorial tax system
- Deemed Repatriation

Transition Tax (Section 965)
Who does this effect?

- One Time Tax for all:
  - Deferred Foreign Income Corporations (DFII)

What is a DFII?

- Deferred Foreign Income Corporations
  - CFC
  - With US Shareholder who owns at least 10% in VOTES
  - Positive Retained Earnings
  - NOT Passive Foreign Investment Company

What is a CFC?

- Controlled Foreign Corporation
- Defined a CFC when US Shareholders have more than 50% by votes **or** value

What is a DFII?

- Deferred Foreign Income Corporations
  - CFC
  - With US Shareholder who owns at least 10% in VOTES
  - Positive Retained Earnings
  - NOT Passive Foreign Investment Company

What is a US Shareholder?

- Previously, it was defined as a US citizen who owns at least 10% of votes
- Under the new law, beginning in 2018 a US shareholder is defined as a US citizen who owns at least 10% of votes **OR value**
- No holding requirement
  - Previously 30 day holding requirement

What is a DFII?

- Deferred Foreign Income Corporations
  - CFC
  - With US Shareholder who owns at least 10% in **VOTES**
  - Positive Retained Earnings
  - NOT Passive Foreign Investment Company

Transition Tax (Section 965)

- Deemed Subpart F Inclusion is calculated “Accumulated post-1986 deferred foreign income”
  - Earnings and Profits/Retained Earnings
  - Calculation is done on the GREATER of retained earnings on November 2nd or December 31, 2017

Transition Tax (Section 965)

- EXCLUDE:
  - Any income that was previously taxed by the US
    - US Income
    - Subpart F Income – passive/investment income included as income on the Form 5471
    - Deficit

Transition Tax (Section 965)

- Rates:
  - 15.5% on cash and cash equivalents
    - Currency, investments, accounts receivable etc.
  - 8% on the remainder

Example

- US citizen owns 100% of a Canadian corporation
- Retained earnings (E&P) as of December 31, 2017 is $1,000,000
- All assets cash

• E&P Inclusion	$1,000,000
• Deduction for cash	(557,000)
• Subpart F Inclusion	$443,000

Transition Tax (Section 965)

- Inclusion amount is reported on Form 5471
- Brought into income on 2017 Form 1040 of US shareholder
- Taxed as ordinary income at individual graduated rates

Example

- US citizen owns 100% of a Canadian corporation
- Retained earnings (E&P) as of December 31, 2017 is $1,000,000
- All assets cash

E&P Inclusion	$1,000,000
Deduction for cash	(557,000)
Subpart F Inclusion	$443,000
Taxed @39.6%	$175,428

Transition Tax (Section 965)

- Due on 2017 return
- Option to pay over 8 years
  - 8% in each of the first five years
  - 15% for year 6
  - 20% for year 7
  - 25% for year 8

Transition Tax (Section 965)

- What should we do?
  - Foreign Tax Credit carryovers available

Example

- US individual owns 100% of a Canadian corporation
- Retained earnings (E&P) as of December 31, 2017 is $1,000,000
- All assets cash
  - E&P Inclusion $1,000,000
  - Deduction for cash (557,000)
  - Subpart F Inclusion $443,000
  - Taxed @39.6% $175,428
  - General Foreign Tax Credit Carryover (100,000)
  - Reduce to $75,428

Transition Tax (Section 965)

- What should we do?
  - Declare dividends in 2017 to utilize the foreign tax credit

What does this mean for next year?

- Going forward you will receive 100% deduction for dividends received from foreign corporations that are NOT Passive Foreign Investment Corporations (PFICs)

Example

- Canadian corporation ABC Inc. is owned 100% by a US shareholder.
- In 2018 they issue a dividend to US shareholder of $100,000 CAD.
- This is a taxable dividend in Canada but in the US you receive a 100% deduction.
- Therefore none of this would be picked up by the US shareholder on their 2018 US Form 1040
- No foreign tax credit available for Canadian tax paid on dividend

International Highlights

- Additional Income Inclusion to eliminate the deferral of tax
  - Global Intangible Low Taxable Income (GILTI)

- New Excise tax for large multinationals
  - Base Erosion Anti Abuse Tax (BEAT) – Minimum tax for corporations with over $500 million in gross receipts

GILTI – Global Intangible Low Taxed Income

- Separate income inclusion not relating to Subpart F on Form 5471
- Potential Double Taxation
- Excess of “Tested Income”/ “Deemed Tangible Income Return”
  - Tested Income – Income Less various deductions
  - Deemed Tangible Income Return – 10% of shareholders basis in tangible property used to produce income
- Included and taxed as ordinary income

GILTI – What does this mean for Canadian CFCs?

- Pay out income as wages
- Pay out dividends to ensure sufficient Canadian tax
- High tax exception
  - If the local foreign effective corporate rate is at least 90% of the US tax then the income is not subject to these rules.

New Estate and Gift Tax Limits

- Increased Lifetime Exemption for US citizens and residents
  - $11.2 million (indexed for inflation)
- Applicable for both US estate and gift tax
- Applicable beginning January 1, 2018-2025
- In 2026 reverts back to $5.49 million exemption
- No changes to annual gift exclusion of $14,000 a year
- Gifting to Non-resident spouse remains at $149,000 for 2017 (indexed for inflation)

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