TAXBULLETIN
WILKINSON TAX GROUP

US TAX REFORM
POTENTIAL FOR A HUGE US TAX BILL IN APRIL 2018!

It seems like everyone is against the Canadian business owner these days. First, the Canadian government imposes the new private company income splitting and passive income rules and then the US government imposes new taxes in that country on foreign corporations. As the US taxes its citizens and permanent residents on their worldwide income, Canadian resident US persons that own shares in Canadian corporations may be caught by these new US tax measures.

As part of its Tax Reform, the US government has imposed two new taxes, a “transition tax” and a tax on income earned in a foreign corporation with little tangible assets. The transition tax is the most pressing matter as it potentially imposes a large tax bill due in April 2018. The latter tax is called “GILTI” and we understand it is not effective until the 2018 taxation year.

While the provisions appear to be aimed at multinational corporations, they also affect non-resident US citizens and green card holders.

We are not US tax experts and this Bulletin is only intended to provide awareness of these issues and highlight the possible implications to our clients. It is not intended to be a detailed examination of these provisions nor should it be considered professional advice. We strongly recommend that you discuss these changes with a cross-border expert. We have relationships with cross-border specialists that we will work with to guide you through these new provisions.

Transitional Tax

Simplified, this tax is being imposed because the US is changing how it taxes foreign entities. Previously, US taxpayers paid tax when dividends were received from foreign corporations and under the new “territorial” system certain taxpayers will receive dividends from foreign companies tax free. In order to catch all of the income that would have been taxed under the old system had dividends been paid, a one time transitional tax will apply to deem a repatriation of foreign earnings that have not been taxed in the US.

The transitional income will be included in 2017 income such any taxes will be due by April 15, 2018. However, as discussed hereinafter, the payment of the taxes may be deferred for up to 8 years.

The first step is to determine whether the Canadian company is a Controlled Foreign Corporation (CFC) for U.S. purposes. This is a three step process:

1) Is a shareholder a United States person (includes a U.S. citizen, green card holder, U.S. resident, U.S. corporation, U.S. estate or U.S. trust)?
2) Does that U.S. person own 10% or more (directly, indirectly or constructively) of the voting stock of the foreign corporation?
3) Do United States shareholders, either individually or in aggregate, own more than 50% of the votes **or** value of the foreign corporation?

If the Canadian company is a CFC then the transition tax may be applicable to any earnings and profits (E&P) that has been retained in the company since January 1, 1987. Simplified, it is the growth in the retained earnings since January 1, 1987 subject to adjustments required to comply with the tax provisions.

The tax will generally be equal to 15.5% of the cash and equivalents in the CFC and 8% on the balance of E&P. In some circumstances these rates could be slightly higher for an individual. A foreign tax credit may be claimed against this tax where Canadian tax is paid in 2017 or 2018 on dividends or possibly wages from the CFC. Consideration needs to be made in respect to the possibility of the 3.8% Net Investment Income Tax applying to the payment of a dividend.

If there are US taxes owing, the taxpayer can elect to make the payment over an 8 year period with the first payment, equal to 8% of the transitional tax, due this April 15th. If a 2018 dividend or wage will be used to generate a foreign tax credit to avoid double taxation then it is likely that the 8 year payment deferral period will not be available as a planning tool.

“GILTI”

The GILTI provisions require that an amount be included in a US taxpayer’s income where a CFC’s income is over 10% of the net cost of its depreciable tangible assets used in business. This provision will impact service based corporations especially hard as they will often have little tangible business assets.

Note that for the purposes of the GILTI test, the company will be a CFC of the U.S. person if they own shares representing 10% or more of the votes or value of the foreign corporation.

In the absence of any planning, US taxes and Canadian taxes on the same income may be due in different taxation years resulting in double tax as a foreign tax credit may not be available. US shareholders of affected CFCs may be required to receive additional income annually to avoid double taxation.

If you are a US taxpayer that owns shares in a Canadian corporation, please contact us immediately to determine how these measures affect you.