Kotler van den Brink & Company
U.S. & Cross Border Tax Consultants

*Wes van den Brink, CPA, CGA, MS(TAX), EA**
*Trevor Bennington, CPA, CA, CPA(Montana)**
Marc W. Kotler, CPA, CA, CPA(Retired)
**practicing as a professional corporation*

The U.S. TAX FACTS

***Kotler van den Brink & Company** has been providing US and cross-border (Canada-US) tax consulting and compliance services to accounting and legal professionals since 1988.*

U.S. TAX CUTS AND JOBS ACT

We have been inundated the last few weeks with questions from clients and their Canadian advisors relating to the tax legislation that was signed into law by President Trump just before Christmas. The questions usually relate to the "Toll Charge" and "GILTI" provisions and whether these rules will negatively affect their U.S. citizen clients living in Canada who own interests in Canadian private corporations. Unfortunately the answer to this question is usually… YES!!

THE TOLL CHARGE RULES

The Tax Cuts and Jobs Act introduces new legislation that will tax U.S. citizen and resident shareholders on their share of the tax retained earnings of Canadian corporations which are controlled by U.S. persons ("CFC") as of 11/2/2017 or 12/31/2017, whichever is greater. Books have been written on the defined terms in the previous sentence, but suffice it to say that if you have a U.S. citizen who controls by vote or value a Canadian private corporation, that U.S. citizen will likely be subject to the new rules. The tax retained earnings, otherwise known in the U.S. tax world as accumulated earnings and profits ("E&P"), is essentially the accumulated income in the company that has not been paid out as dividends over the years.

The rate at which the U.S. will tax these retained earnings will depend on whether the CFC's assets are cash or cash equivalents, such as readily marketable stocks and accounts receivable. If the company has mostly cash or cash equivalents on the financials, the maximum tax rate will be in the 17% range. If the retained earnings exceed the cash investments, the rate will be less than 17%. The final rate of U.S. tax payable on the toll charge inclusion will ultimately depend on the taxpayer's marginal tax rate.

When assessing a shareholder's exposure to this tax, one must first consider whether they have foreign tax credit carryovers from prior years that they can be used to offset the tax generated by the inclusion. If there are insufficient credits, the next step will be to pay a dividend from the corporation to generate sufficient Canadian taxes to offset the tax created by the toll charge inclusion. **Calculating the correct dividend to pay on the Canadian side will be the key to minimizing the tax pain caused by the new toll charge rules and to prevent double taxation of income.**

Another issue to consider is the actual tax year of inclusion for the toll charge. In many cases, there is a requirement that a CFC use the same tax year as the controlling shareholder. For individuals, this would be December 31st, in which case the inclusion year will be 2017. In some cases the IRS

#208 - 15272 Croydon Drive
Surrey, BC V3Z 0Z5 Canada

Tel: (604) 531-6207
Fax: (604) 538-9713
Web: www.kvdb.com

accepts a non-December 31st year end, in which case the inclusion year will be 2018. It will very important to consider whether a CFC with a non-calendar year end will be required to switch to a December year end for 2017.

GLOBAL INTANGIBLE LOW TAXED INCOME (GILTI)

If the toll charge rules were not already bad enough, new legislation was introduced that may have put the proverbial fork into the deferral of tax which was previously available to U.S. citizens earning active business income in a Canadian private corporation. The GILTI rules will apply to all CFCs, even if the company's income is 100% active and it pays a high tax rate in its country of residence. It should also be kept in mind that, despite its name, these new rules have nothing to do with intangibles or low taxed income.

For the majority of U.S. citizen's, the GILTI provisions will become effective in 2018. In essence, these rules allow a 10% return on net depreciable business assets, with any corporate net active business income in excess of that 10% return flowing through to the U.S. citizen's personal tax return, even if not distributed. To mitigate GILTI's impact and to avoid double taxation of income, companies will be forced to carefully evaluate their dividend/salary mix each year.

A FEW TAKEAWAYS

What should you, as a non U.S. tax practitioner, take away from the above discussion when it comes to providing advice to your beleaguered and confused U.S. citizen clients who have spent many years accumulating assets in their CCPC's for retirement?

- First and foremost, the U.S. citizen client's exposure to the toll charge and GILTI rules needs to be considered as soon as possible and definitely before the 2017 U.S. return is prepared. In many cases there are planning opportunities available to mitigate the tax exposure (e.g. gifting to non U.S. citizen spouses may be beneficial). It will also be very important to determine whether a dividend is necessary in Canada to avoid double taxation of earnings. KVDB has made a point of touching base in January with every client - and their Canadian accountants - that we feel has an exposure to these rules.

- In order to assess the toll charge exposure, it will be necessary to prepare 11/2/17 and 12/31/17 financial information. This is the case even if the CFC has a non-calendar year end. Time will be of the essence, as a dividend may be necessary for Canadian tax purposes.

- For those CFCs who have a non-calendar year end, there will likely be a requirement to change the year end to December 31st in 2018 for U.S. tax purposes. It generally makes sense to change the year end for Canadian tax and accounting purposes as well, so elections may need to be filed with CRA to make this happen.

- It is important to remember that as of 2018, GILTI applies to active business income earned by CFCs. There may be an election available to a U.S. citizen shareholder that allows them to factor in the Canadian taxes paid by the Canadian corporation with a possible result being no GILTI inclusion if the Canadian taxes paid exceed approximately 13%. There may even be situations where it pays to elect out of CCPC status in Canada to increase the Canadian tax rate to a number exceeding 13%.