US CITIZENS AND CANADIAN CORPORATIONS

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DISCLAIMER

The information presented in this presentation is not intended to be legal advice can cannot be relied upon. The issues are presented in a summary fashion. Many of the conclusions presented are the opinions of the presenter based on individual research and analysis and may differ from the opinions of other tax professionals. Webinar participants should seek tax advice specific to their own situations as the law discussed here is quite complicated and the penalties involved can be quite steep.

ABOUT MAX REED

Max can be reached at:

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Max solves US tax problems for Canadians including:

- Adding corporations on the UX tax implications of cross-border transactions and initial public offerings;
- Helping citizens in Canada deal with US tax issues including renouncing their US citizenship; and
- Advising Canadian investment funds on investments into the United States and receiving investments from US taxpayers.

Max is the co-author (with Dick Pound of Stikeman Elliot) of A Tax Guide for American Citizens in Canada, as well as over 20 technical and plain language articles on a wide range of cross-border tax topics. Recognized for his expertise, Max is often invited to speak at conferences and seminars for tax professionals and the general public. He was invited to testify before the Canadian House of Commons Finance Committee on the impact of US tax law on Canadians.

Prior to joining SKL, Max worked at White & Case LLP, an international law firm in new York City where he provided US tax advice to individuals, corporations, and foreign states.

He holds a BA and two law degrees from McGill University, where he won several academic and leadership awards and is admitted to the bars of BC and New York.

WHO WE ARE

- Our new firm name!
- Canada/US cross-border tax law firm
- Lawyers in Toronto and Vancouver
- We do:
  - Cross-Border Estate Planning/Inheritance
  - Cross-Border Corporate Tax planning
  - Tax and immigration services related to renunciation
  - Help with your client's tough issues
  - Disputes with IRS (including penalty resolution and voluntary disclosures)
- We don't do: compliance work

TODAY'S AGENDA

1. An overview of common issues – breadth not depth
2. LOTS of changes in last few years
3. Part 1 – Benefits of using a corporation
4. Part 2 – US tax rules
5. Part 3 – Mandatory repatriation tax
6. Part 4 – Accounting issues
7. Part 5 – Corporate Investments
8. Part 6- Other Issues

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PART ONE

BENEFITS OF USING A CORPORATION

Benefits of Incorporation

- Canadian personal tax rates are high (top marginal rate of close to 50%)
- Using a corporation to do business or provide services offers an opportunity to defer personal tax
- Offers liability protection
- No more easy income splitting
- May offer some tax reduction possibilities

Example

- Dr. Jones lives in Ontario
- She earns $300,000 a year
- If she doesn't incorporate she will pay $127,074 to Canada on that income (zero in US)
- If incorporated, her tax owing would be $37,500
- Rest of tax is deferred until she takes money out of the corporation
- Reason is that small business tax rates are low
- Extreme example, but illustrates benefits nicely in Canada only

PART TWO

BASICS OF US TAX REGIMES

US Tax Regimes

- US citizenship makes using a corporation more complicated
- The US has complex laws that apply to US taxpayers who own foreign corporations
- These are the same tax regimes that apply to Apple and Walmart
- Two important tax regimes: CFC and PFIC
- CFC = controlled foreign corporation
- PFIC = passive foreign investment company
- Both very complicated

CFC Regime

- CFC = controlled foreign corporation
- A foreign corporation is a CFC if:
- US taxpayers, who own at least 10% of the shares, own in aggregate more than 50% of the total combined voting power or total value of the stock
- Complicated rules that attribute ownership through family members
- Once classified as CFC, there are certain consequences that flow from this
- If a corporation classified as a CFC – likely not a PFIC

CFC Regime (2)

- Consequences of CFC status
- “Subpart F income” – tainted income that is taxed personally even if not distributed
- Menu of tainted income:
    - Interest
    - Dividends
    - Capital gains from sale of passive assets
    - Certain types of royalty/rental income
- New in 2018 – GILTI!
- Strategies to mitigate

SUBPART F INCOME

- Joe is US citizen
- Lives in Canada and is sole owner of Canadian corporation
- Corporation is CFC because Americans, who own at least 10%, own more than 50% of shares
- Corporation owns 10 shares of Apple Inc.
- Apple pays a dividend of $1 – total $10 of dividends
- Taxable at corporate level in Canada
- Subpart F in US – taxable personally unless Canadian corporate tax > 18.9%

GILTI

- GILTI ⟶ Global Low Taxed Intangible Income
- GILTI is found in new section 951A
- Drafted to apply to all US taxpayers who own CFCs including individuals
- GILTI makes active business income earned by a CFC taxable to shareholder even if undistributed
- With a 962 election, most US citizens in Canada will not owe GILTI income

Example

- Dr. Jones lives in Ontario
- She is a US citizen
- She owns 100% of corporation
- Corporation is CFC
- She earns $300,000 a year through a corporation
- Her corporate tax owing would be $37,500
- If she makes a 962 election, would owe only a small amount of US tax
- Most income can be deferred from personal tax

What is a PFIC

- Foreign corporation that earns passive income or holds passive assets
- Two tests: income test and asset test
- Income test – 75% of corporation’s income is “passive”
- Asset test – 50% of corporation’s assets produce passive income
- Once a PFIC always a PFIC until “purge”

PFIC PAIN

- Loss of non-recognition treatment in re-organizations
- Gain taxed at 37% plus retroactive interest charge dating back to purchase of investment
- No foreign tax credits on the gain
- Dividends denied preferential treatment
- Dividends also subject to punitive tax regime
- Complex compliance requirements with steep fines

Example

- Dr. Jones lives in Ontario with her husband John
- She is Canadian only; he is a US citizen
- She owns voting shares of corporation
- Corporation has $500,000 of investments
- He owns some non-voting shares
- Corporation is a PFIC and he has a tax problem
- Dividends will be very expensive in the US

Conclusions

- Better to have it classified as a CFC in the US
- Avoid PFIC at all cost
- Even with GILTI, possible to incorporate and achieve tax deferral with 962 election
- No US tax risk – but some complex accounting forms to do
- If leave enough money in the company (say - $100,000) tax deferral is worth the complexity

PART THREE

MANDATORY REPATRIATION TAX

MANDATORY REPATRIATION TAX

- Applies to individual US citizens (and US corporations) owning foreign corporations that are CFCs for US tax purposes
  - CFC defined in previous section
- ~17.5% tax on post-1986 retained earnings that are invested in cash or marketable securities
- Significant double tax exposure for individuals
- More info ⟶ http://www.skltax.com/code-section-965-individual-taxpayers-technical-explanation/
- This is a 2017 tax event

Example

- Dr. Jones born in the United States
- Owns a Canadian corporation (a CFC)
- Canadian corporation has CAD $1,000,000 in investments
- Dr. Jones will owe CAD $175,000 in US tax for tax year 2017
- Double tax risk since Canadian tax paid owed when distributed to her
- Solution –to generate tax in Canada in 2018 to carry back to offset US tax
- The tax credit generated can be used to offset 2017 US tax bill or get refund of repatriation tax installments paid
- Avoid double taxation!

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PART FOUR

ACCOUNTING ISSUES

FORM 5471

- Form 5471 is complicated disclosure form required of those who own foreign corporations
- Rules when it has to be filed are complicated
- Ownership imputed from spouse/relatives
- Take home – if you own shares in a corporation, check to see if you have to file this form
- Large penalties if form not filed (USD $10,000/year)
- Keeps audit year open

FORM 926

- Required when property transferred to foreign corporation of, among other things, cash > USD $100,000

FORM 8621

- Required annually to report an interest in a PFIC
- When required a bit complicated
- Must file if you get a distribution from the PFIC
- Attached to tax return
- Failure to file keeps audit period open indefinitely

FORM 8992

- Required to report GILTI income

FORM 8993

- Required to report 50% deduction against GILTI

PART FIVE

CORPORATE INVESTMENTS

Subpart F

- Common strategy is to leave money in company and invest it corporately to defer it from personal tax
- Investment income earned corporately may be taxable personally in US
- If Canadian tax rate > 18.9% - may offer some relief

PFIC

- Corporations that own investments -> very high risk of PFIC status
- Common scenario
- Spouse/kids are US citizens
- They own small percentage in corporation that has investments
- Can make it very expensive to take out investment income (see “PFIC Pain” slide earlier)

PART SIX

OTHER ISSUES

REORGANIZATIONS

- Canadian tax advisors often propose corporate re-organizations
- Very complicated for US citizen shareholders
- US tax rules will generally prevent tax free re-organization
- Always get US advice before completing re-organization

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SURPLUS STRIPPING

- Opportunity to take out money from corporation at capital gains rates rather than dividend rates
- Very complicated and modest risk
- Capital gains are in the 24-27% range
- Dividends are generally in the 40-44% range in Canada
- Real savings
- Can work for US citizens

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Example – Surplus Stripping

- Dr. Jones is a US citizen in Canada
- She has $1 million in investments in her corporation
- She wants to take out $500,000 to buy a house
- If as a dividend, tax would be $237,000 (47.4%)
- Using surplus stripping strategy tax would be $ 133,800 (26.67%)
- Savings is $103,200

RESOURCES

- Polaris Tax: www.polaristax.com
    - max@polaristax.com
    - 604-283-9301
- National Post Columns
- Our book
    - A Tax Guide for American Citizens in Canada

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QUESTIONS?

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THANK YOU!