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Punitive Repatriation Tax for US Expats

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The United States Internal Revenue Service ("IRS") and the Department of Treasury have recently issued proposed regulations implementing section 965 of the Internal Revenue Code ("IRC"). Section 965 was enacted on December 22, 2017 for the purpose of levying a one-time transition tax on post 1986 untaxed foreign earnings of specified foreign corporations ("SFC") (i.e. a controlled foreign corporation ("CFC") and any other foreign corporation that has a 10% US shareholder) owned by United States ("US") shareholders (includes individuals and corporations), deeming the untaxed earning to have been repatriated. This additional levy may be dubbed as "The Repatriation Tax".

It is imperative that Canadian professional accountants and tax practitioners be cognizant of these rules, notwithstanding that their professional practice may not involve US tax compliance, as it would be productive to identify their affected US citizen and US green card holder clients and advise them to comply with their US tax obligations. The new regulations affect U.S persons with direct and indirect interests in certain foreign corporations. Although the spirit of the legislation was drafted to target US based multi-national corporations sheltering funds abroad, the new rules are far-reaching. The repatriation tax does not simply affect US resident persons who are shareholders of a foreign corporation, but also affects US citizens and green card holders living outside the USA. Therefore Canadian residents owning a private Canadian corporation with little ties to the United States apart from retaining their US citizenship and/or green card, (hereinafter referred to as a US expat,) will experience an unexpected and unpleasant tax surprise in light of the new legislation. Adding insult to injury, the new proposed rules impose US tax without the benefits of foreign tax credits and no relief whatsoever is provided through the bilateral tax treaty between Canada and the US to alleviate potential double taxation.

Example of Punitive Repatriation Tax for US Expat

To best illustrate the effect, a simple example of how the new IRC 965 provisions would apply is provided. Say a US expat living in Canada owns a small business in Canada through a Canadian Controlled Private Corporation ("CCPC"). The CCPC has been successful and has retained earnings which have yet to be distributed. Under the old rules, the US expat reported its distributions from the CCPC on their US

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BC Speculation and Vacancy Tax

By Mark Servello, CPA, CGA
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As part of its 2018 Budget, on February 20, 2018, the BC government announced that it would be introducing legislation to impose an annual tax on residential properties, effective in 2018.

BC introduced proposed legislation for the Speculation and Vacancy Tax ("the SV tax") on October 16, 2018. BC has stated the SV tax is designed to discourage housing speculation and people from leaving homes vacant in BC's major urban centres.

The SV tax may apply to you if your residential property is located in one of these specified areas: municipalities within the Capital Regional District, municipalities within the Metro Vancouver Regional District (excluding Bowen Island, the Village of Lions Bay and Electoral Area A, but including UBC and the University Endowment Lands), the City of Abbotsford, the District of Mission, the City of Chilliwack, the City of Kelowna, the City of West Kelowna, the City of Nanaimo, and the District of Lantzville.

Reserve lands, treaty lands, and lands of self-governing Indigenous Nations are not included in the specified areas nor are islands that are accessible only by air or water.

Some residential properties are excluded from the SV tax even if they are located in a specified area. These include residential properties owned by Indigenous Nations, municipalities, regional districts, governments, and other public bodies, registered charities, housing co-ops, and qualifying not-for-profit organizations.

There are several exemptions from the SV tax. The two most commonly used exemptions will be the principal residence exemption and the rental exemption.

A principal residence is specifically defined for purposes of the SV tax. Principal residence means the place in which an individual resides for a longer period in a calendar year than any other place (there are separate rules relating to principal residence of spouses in situations where there is more than one principal residence).

Generally, in order to claim the principal residence exemption, the owner of the residence will have to be a resident of BC at the end of the calendar year. This will tie to the Federal Income Tax Act, which means in most cases if an owner is going to claim the principal residence exemption from the SV tax for a specific year, that owner will need to be a resident of BC for income tax purposes for that year as well.

In order to claim the rental exemption for 2019 and subsequent years, a home must be rented for at least 6 months per year (3 months for 2018). Short term rentals of less than one month do not count towards the 6-month total (3-month total for 2018).

The SV tax will be charged to owners who own the property on December 31 of each year and will be based on the assessed value of the property as determined by BC Assessment.

For a property which is owned on December 31, 2018, the SV tax will be 0.5% of the assessed value of the property on July 1, 2018.

For 2019 and subsequent years, the SV tax will be 2% for foreign owners and satellite families and 0.5% for BC residents and for other Canadian citizens or Canadian residents who are not members of a satellite family.

BC has stated a satellite family is an individual or a spousal unit where the majority of the total worldwide income for the year is not reported on a Canadian tax return.

All owners of residential property in specified areas of BC will have to complete an annual declaration for the SV tax. The annual deadline to complete the declaration is March 31. Any relevant exemptions will be claimed on this annual declaration. If there is SV tax owing for 2018, payment is due by July 2, 2019.

A tax credit may be available to reduce SV tax paid. An owner who is a resident of BC is eligible for a tax credit of up to $2,000 on a secondary property. An owner who is not a BC resident, but is a Canadian citizen or Canadian resident, will be eligible for a tax credit based on income earned in BC. Foreign owners and satellite families may be eligible to claim a tax credit up to 20% of their income earned in BC. The form to be used for a tax credit application has not yet been released.

Note: the SV tax is different from the City of Vancouver's Empty Homes Tax. If you own residential property in Vancouver, you may have to pay both taxes.

2019 Changes to Refundable Dividend Tax on Hand

By Jeff Saunders, CPA, CA
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In 2018, the Federal Government introduced several tax changes affecting small businesses and small business owners. One of these changes that did not get as much coverage in the press was a change to the system for Refundable Dividend Tax on Hand ("RDTOH"), for years commencing after 2018.

For corporations with a calendar year end, this change comes into effect on January 1, 2019. RDTOH is a calculation done within the Corporate Tax Return to facilitate integration and to ensure that tax payable on investment income is the same regardless of whether that investment income is earned inside a corporation or is earned personally.

The basic concepts of RDTOH are that a corporation pays a high tax rate when it earns investment income with a portion of this high tax rate being refundable to the corporation when it pays out a dividend to shareholders. In New Brunswick, the corporate tax rate on investment income is 52.7%. Of this 52.7% tax rate, 30.7% is refundable back to the corporation as a dividend refund when it pays out a dividend. The net overall tax rate to the corporation on the investment income is therefore 22.0% (52.7% - 30.7%).

When a corporation pays out dividends to shareholders there are two types – eligible dividends and non-eligible dividends. Eligible dividends are derived from corporate income that has been taxed at the higher general active business rate (29.0% in NB). This income is tracked in the company's General Rate Income Pool ("GRIP") and only dividends out of GRIP are considered eligible dividends. Non-eligible dividends are derived from corporate income that has been taxed at the lower small business rate (12.5% in NB). Prior to the changes coming into effect on January 1, 2019, the dividend refund received by a corporation on paying out dividends to shareholders did not consider whether eligible or non-eligible dividends were being paid.

Effective January 1, 2019, new eligible and non-eligible RDTOH pools will be created. The opening balance in the eligible RDTOH pool will be the lesser of:

a) The existing RDTOH balance, and
b) 38.33% of GRIP

Any RDTOH not included in the eligible RDTOH pool will be added to the non-eligible RDTOH pool.

When a company pays an eligible dividend, it can only get a refund out of its eligible pool. When a company pays a non-eligible dividend, it can get a refund from its non-eligible pool first, and from it eligible pool after its non-eligible pool is depleted.

As a result of these upcoming changes, small business owners should consult their local DFK office to determine whether planning is necessary to optimize their eligible RDTOH and GRIP prior to January 1.

For example, it can be extremely beneficial to move GRIP from an operating company that does not have RDTOH to a holding company which does have RDTOH.

Aligning GRIP and RDTOH in the same company will allow for payment of eligible dividends and dividend refunds from eligible RDTOH going forward. In NB the difference in personal income tax rates on eligible dividends and non-eligible dividends is 13.4% based on the top marginal tax bracket. The difference can be as high as 18.5% in lower marginal tax brackets. Therefore optimizing the GRIP and RDTOH can save shareholders between 13.4% and 18.5% on dividends they receive after December 31, 2018.

For an example of this, consider a holding company that owns 100% of the shares of an operating company. The holding company has a large RDTOH balance generated in prior years from portfolio investments but no GRIP balance. The operating company has a large GRIP balance generated in prior years from having income in excess of the small business deduction limit but no RDTOH. The operating company can pay an eligible dividend up to the holding company prior to January 1 in order to move the GRIP balance up to the holding company and aligning the GRIP and RDTOH in the same company. Without this alignment a future dividend of, for example, $100,000 would cost the shareholder at least an extra $13,400 of personal tax.

Where this is a one-time planning opportunity and the time to act is running out, we strongly recommend that you contact your local DFK office to determine if such planning will help you and your business.

Punitive Repatriation Tax for US Expats

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annual tax return and were able to use the Canadian taxes paid on such distributions as a foreign tax credit against any applicable US tax imposed on such distributions. This worked well to avoid paying any double tax as the distributions are taxed in Canada first, and then the Canadian taxes are used as a foreign tax credit against US tax.

Now under the new IRC 965 rules, the higher of the accumulated undistributed profit of the CCPC on November 2, 2017 and December 31, 2017 must be reported by the expat.

A deduction is permitted equal to 55.17% of the aggregate cash balance and 77.142% for the remainder. The net difference (between the income inclusion and the permitted deduction) must be reported on the taxpayer's 2017 tax return.

A reduction of taxes payable on this income may be afforded by using foreign tax credits carrying over from prior years plus any unused 2017 foreign tax credits.

The IRS has provided some relief to reflect the upfront tax burden by allowing taxpayers to elect to pay the transition tax in installments over an eight-year period.