TAX NEWSLETTER

Fall 2018

An Independent Member Firm of
DFK Canada Inc. and DFK International

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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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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 55.71% 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.