

U.S Tax Changes, Implications for U.S. Structures

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U.S. Tax Reform – CDN Perspective

U.S. “Tax Cuts and Jobs Act” enacted December 22, 2017

- Changes to U.S. corporate tax rates
- Taxation of gains arising from sale of U.S. partnership and LLC interests by non-residents
- §199A Deduction for pass-through income (“Qualified Business Income”)
- Global Intangible Low-tax Income (“GILTI”)
- Code §962 Election
- Increase to U.S. estate tax exemption
- U.S Tax Changes, Implications for U.S. Structures



Changes to U.S. Corporate Tax Rates

- Starting January 1, 2018, the US federal corporate tax rate changed from graduated rates up to 35% to a flat rate of 21%
 - Federal corporate alternative minimum tax also eliminated
 - Bonus depreciation for assets purchased after September 27, 2017
- Move to a territorial tax system for foreign earnings
 - Repatriation tax – foreign entity retained earnings
 - GILTI – current taxation on foreign business income



Taxation of Gains Arising from Sale of U.S. Partnership and LLC Interests by Non-Residents

- *Grecian Magnesite v. Commissioner*
- The Act added two new sections to the Internal Revenue Code (“IRC”):
 - IRC section 864(c)(8) treats a gain or loss on the sale of a private partnership interest by a foreign (non-US) taxpayer as effectively connected income (ECI) if the sale of all partnership assets at FMV would be deemed effectively connected income (ECI)
 - IRC section 1446(f) provides coordinating withholding requirements on the sale or disposition of private partnership interests by non-U.S. taxpayers if any portion of the gain is deemed to be ECI under section 864(c)(8) at a rate of 10% for disposition beginning January 1, 2018



§199A Deduction for pass-through income (“Qualified Business Income”)

- Income from non-corporate pass-through businesses (i.e. sole proprietorships, partnerships, s-corporations, and some trusts and estates)
- Two components:
 - 20% of Qualified Business Income (QBI); plus
 - 20% of qualified real estate investment trust (REIT) dividends and qualified publicly traded partnership (PTP) income
- Result: reduction to max marginal personal income tax on QBI from 37% to 29.6%



§199A Deduction for pass-through income (“Qualified Business Income”)

- **20% of Qualified Business Income (QBI) component**—depending on the taxpayer’s income, subject to several limitations:
 - Type of trade business
 - Amount of W-2 wages paid by the qualified trade or business
 - Unadjusted basis immediately after acquisition (UBIA) of qualified property held by the trade or business



§199A Deduction for pass-through income (“Qualified Business Income”)

- “Qualified Trade or Business” – any §162 trade or business **except**:
 - A trade or business performed by a C corporation
 - For taxpayers with taxable income that exceeds the threshold amount, specified service trades or businesses (SSTBs)
 - Involving the performance of services in the fields of health, law, accounting, actuarial science, performing arts, consulting, athletics, financial services, investing and investment management, trading, dealing in certain assets or any trade or business where the principal asset is the reputation or skill of one or more of its employees or owners
 - The trade or business of performing services as an employee



§199A Deduction for pass-through income ("Qualified Business Income")

- **Ineligible** business income
 - Capital gains and losses (even if earned from a pass-through business entity), dividends, and interest income that is not "properly allocable to a trade or business"
 - W-2 income
 - Reasonable compensation paid by S-corporations to owners
 - Guaranteed payments from partnerships to their partners
 - Payments received by a partner for services under section 707(a)



§199A Deduction for pass-through income (“Qualified Business Income”)

- QBI Deduction = Lesser of:
 - QBI component plus the REIT/PTP component
 - 20% of the taxpayer's taxable income minus the net capital gain

Subject to specified service trade or business (SSTB), W-2 wages, and UBIA limitations if income is above certain thresholds:

For 2018 - limitations phased in for joint filers with taxable income above \$315,000 but below \$415,000, and all other taxpayers with taxable income above \$157,500 but below \$207,500



Global Intangible Low-tax Income (“GILTI”)

- Pre-TCJA, a foreign corporation’s earnings were generally deferred from U.S. taxation until they were repatriated (by dividend) or unless a Subpart F income inclusion event occurred
- Targeted at multinational entities (MNEs) – to impose a minimum tax on foreign earnings generated from offshore assets held in low-tax jurisdictions
- The result: an annual income inclusion for all United States shareholders, of CFCs, regardless of whether the income was actually distributed (including shareholders of CFCs). Treated as a new form of subpart F income.



Global Intangible Low-tax Income (“GILTI”)

GILTI = “Net-Tested Income” – “Net-Deemed Tangible Income Return”

- **Net tested income** – generally means CFC’s gross income (other than ECI subject to US tax, Subpart F income, dividends received from related persons, and certain foreign oil and gas extraction income) less allocable deductions
- **Net deemed tangible income return** – generally equal to:
 - (i) 10% of the aggregate of the United States shareholder’s pro rata share of a CFC’s qualified business asset investment; over
 - (ii) the amount of interest expense taken into account to determine such U.S. shareholder’s net CFC tested income.



Global Intangible Low-tax Income (“GILTI”)

- Some relief for U.S. domestic corporate shareholders
 - New Code §250 deduction for 37.5% of foreign-derived intangible income (“FDII”) resulting in an effective rate of U.S. tax of 13.125% for tax years during 2017-2025
 - Beginning in 2026, the FDII deduction drops to 21.875%, resulting in an effective rate of U.S. tax of 16.406%
 - 50% deduction for GILTI for tax years during 2018-2025, which equates to an effective rate of U.S. tax of 10.5%
 - Beginning in 2026, GILTI deduction drops to 37.5% equating to an effective rate of U.S. tax of 13.125%
 - Foreign tax credits of up to 80%



CODE §962 ELECTION

Code §962 Election

- Code §962 election allows individuals to treat C.F.C. inclusion amounts as if received by a domestic corporation
- Election available only to individual U.S. Shareholder (owning 10% or more, including constructive ownership)
- Code §962 election results in
 - Electing shareholder is taxed on income inclusion from a C.F.C. at the highest corporate rate in effect for the taxable year
 - Electing shareholder is entitled to a deemed paid credit for foreign income taxes paid by the C.F.C. under Code §960
 - The amount of the income inclusion is increased to include the amount of the creditable foreign corporate income tax under Code §78

Code §962 Election

- If the election is applicable to G.I.L.T.I. inclusion:
 - Deduction under Code §250 is available under final regulations – currently G.I.L.T.I. deduction is 50%
 - F.T.C. is limited to 80%
- F.T.C. limitations under Code §904 continue to apply
- If foreign tax rate is 13.125% or higher, in principle no additional U.S. tax will be due for electing shareholders
- Election is annual

Actual Distribution

- Actual distribution of E&P previously taxed under Subpart F and G.I.L.T.I. are taxed again as a distribution from a foreign corporation
 - P.T.I. rules are limited to the net U.S. tax that was paid on the income inclusion
 - If qualified, dividend subject to U.S. income tax at 20% (otherwise 37%)
 - Direct F.T.C. is allowed for dividend withholding tax

Illustration: Facts

Facts

- Foreign gross income – \$100
- Foreign tested income – \$100
- No Q.B.A.I.
- Inclusion percentage for Individual U.S. Shareholder – 100%
- Foreign Corporate tax rate – 13.125%
- No Withholding tax on dividend distribution



Illustration: Analysis

Income Inclusion without Code §962 Election

- Foreign corporate income tax paid = \$13.125
- G.I.L.T.I. inclusion = \$86.875 [$100\% \times (100 - 13.125)$]
- **G.I.L.T.I. tax due = \$32.143** [$37\% \times 86.875$]

Income Inclusion with Code §962 Election

- Foreign corporate income tax paid = \$13.125
- G.I.L.T.I. inclusion = \$86.875 [$100\% \times (100 - 13.125)$]
- Section 78 gross up $100\% \times \$13.125 = \13.125
- Total gross income = \$100 [$86.875 + 13.125$]
- §250 deduction = 50% → taxable income - \$50
- Tentative U.S. tax (21%) = \$10.5
- 80% F.T.C. available = \$10.5 [$80\% \times 13.125$]
- **G.I.L.T.I. tax due \$0** [$10.5 - 10.5$]

Illustration: Distribution

At Distribution

- Distribution amount – \$86.875
- All is P.T.I.
- No additional U.S. tax is due

At Distribution

- Distribution amount – \$86.875
- P.T.I. limited to U.S. tax paid
- Taxable dividend – \$86.875
[86.875 - 0]
- Assuming dividend is not qualified (37%) – \$32.143 additional U.S. tax
- Assuming dividend is qualified (20%) – \$17.375 additional tax

Code §962 Election – Worth It?

- Mitigates U.S. tax on individual when
 - A C.F.C. generates G.I.L.T.I. tested income
 - Pays foreign tax
 - But does not pay dividend
 - Eligible for qualified dividend treatment
- If dividend does not qualify for preferential long-term capital gains rate, Code §962 election would result in greater total tax liability
 - But the election allows deferral at a relatively low cost, specifically for G.I.L.T.I. income

ESTATE TAX

Use It or Loose It (Maybe)

Estate and Gift Tax in the U.S.

- Imposed on global assets for:
 - U.S. citizens
 - Non-citizens having a U.S. domicile
- For others, imposed on U.S. situs assets only
- Domicile - assessing subjective intention of an individual
 - Green Card and temporary visas as a factor; Not a conclusive fact

Domicile

≠

U.S. tax resident for income tax

Estate and Gift Tax

- 40% at Federal level
 - The first \$1,000,000 of taxable value taxed at graduated rates totaling in \$345,800.
- Imposed on the fair market value of a taxable transfer by gift during life or bequest at death
- Note: Gift of tangible or intangible asset is not treated as a deemed taxable sale followed by a taxable gift of cash
 - Recipient of gift takes a carryover basis, preserving income tax event for future sale

Generation-Skipping Tax in the U.S.

- The Generation-Skipping Tax (“**GST**”) applies on transfers that skip a generation
 - Example: Grandparents leave assets to grandchildren
 - Applies to direct transfers and transfers to trust to children, grandchildren, and possibly other descendants
- Applies in addition to estate tax / gift tax

Estate and Gift Tax – Unified Credit

- U.S. citizens and domiciled individuals are eligible for a lifetime credit that currently excludes \$11.58 million dollars of assets
 - Set to revert to \$5.0 million (plus an inflation adjustment) in 2026
 - May disappear earlier. Next elections in 2021...
 - May be used for gifts during life or bequests at death
 - Recent regulations confirm no clawback

Property Given Away During Life

- Property given away during life, may be included in a taxable estate at death, principally in the following circumstances
 - **§2035**: The property is given away “with strings attached” and the “string” is given away within 3 years of death; FMV at death is included in estate and a credit is given for any gift tax paid;
 - **§2036**: The property is given away during life, but donor continues to have a right to the income from the property or retains the right to designate the persons who can possess or enjoy the property or its income
 - **§2037**: The property is given away during life, but the recipient must survive the death of donor in order to enjoy possession of property
 - **§2038**: The property is transferred during life, but donor retains power to alter, amend, revoke, or terminate the transfer, thereby affecting the continued enjoyment of the property
 - **§2041**: Property over which the decedent has at the time of his death a general power of appointment

ABI Earned in the U.S. Paid as Dividend

Combined Corporate and Personal	Personal/Partnership U.S. Business	Canco U.S. Branch	U.S. Corporation	Canco owning U.S. Corporation	U.S. LLC	Canco owning U.S. LLC 30% branch tax*	Canco owning U.S. LLC 5% branch tax
After US tax reform	53.53%	54.47%	63.29%	54.47%	60.31%	66.46%	54.47%
Prior to US tax reform	53.53%	62.54%	69.79%	62.54%	64.96%	72.40%	62.54%
Change (+ Increase / - Decrease)	0.00%	-8.07%	-6.51%	-8.07%	-4.65%	-5.94%	-8.10%
Personal tax deferral							
Deferral - After US tax reform	n/a	29.52%	42.29%	33.47%	30.71%	21.76%	29.52%
Deferral - Prior to US tax reform	n/a	24.29%	34.79%	27.54%	25.36%	17.90%	24.29%
Deferral - Increase (Decrease)	n/a	5.23%	7.49%	5.93%	5.35%	3.86%	5.20%

* No treaty relief - Article IV Par. 7(a)



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ABI Earned in the U.S. Paid via Redemption

Combined Corporate and Personal	Personal/Partnership U.S. Business	Canco U.S. Branch	U.S. Corporation	Canco owning U.S. Corporation	U.S. LLC	Canco owning U.S. LLC	Canco owning U.S. LLC
						30% branch tax*	5% branch tax
After US tax reform	53.53%	54.47%	42.14%	45.41%	29.60%	47.21%	36.82%
Prior to US tax reform	53.53%	62.54%	52.40%	55.09%	39.60%	54.50%	43.82%
Change (+ Increase / - Decrease)	0.00%	-8.07%	-10.25%	-9.68%	-10.00%	-7.29%	-7.00%
Personal tax deferral							
Deferral - After US tax reform	n/a	29.52%	21.14%	22.60%	0.00%	2.51%	11.87%
Deferral - Prior to US tax reform	n/a	24.29%	17.40%	18.58%	0.00%	0.00%	5.57%
Deferral - Increase (Decrease)	n/a	5.23%	3.75%	4.01%	0.00%	2.51%	6.30%

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Sale of US Business Entity – Not Assets

	Personal/Partnership Sale of U.S. business	Canco Sale of U.S. business	Sale of U.S. C Corp shares	Canco sale of U.S. C Corp shares	Sale of U.S. LLC interest	Canco Sale of U.S. LLC interest 30% <i>branch tax</i>	Canco Sale of U.S. LLC interest 5% <i>branch tax</i>
Combined Corporate and Personal							
After US tax reform	26.77%	54.47%	26.77%	28.83%	26.77%	47.21%	36.89%
Prior to US tax reform	26.77%	62.54%	26.77%	28.83%	26.77%	28.83%	28.83%
Change (+ Increase / - Decrease)	0.00%	-8.07%	0.00%	0.00%	0.00%	18.38%	-8.10%
Personal tax deferral							
Deferral - After US tax reform	n/a	29.52%	0.00%	19.08%	0.00%	2.51%	11.81%
Deferral - Prior to US tax reform	n/a	24.29%	0.00%	19.08%	0.00%	3.74%	3.74%
Deferral - Increase (Decrease)	n/a	5.23%	0.00%	0.00%	0.00%	-1.23%	5.20%

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Sale of US Business Assets – No Redemption

	Personal/Partnership U.S. Business	Canco U.S. Branch	U.S. Corporation	Canco owning U.S. Corporation	U.S. LLC	Canco owning U.S. LLC 30% branch tax*	Canco owning U.S. LLC 5% branch tax
Combined Corporate and Personal							
After US tax reform	26.77%	54.47%	63.29%	54.47%	55.85%	66.46%	54.47%
Prior to US tax reform	26.77%	62.54%	69.79%	62.54%	55.85%	72.40%	62.54%
Change (+ Increase / - Decrease)	0.00%	-8.07%	-6.51%	-8.07%	0.00%	-5.94%	-8.10%
Personal tax deferral							
Deferral - After US tax reform	n/a	29.52%	42.29%	33.47%	35.85%	21.76%	29.52%
Deferral - Prior to US tax reform	n/a	24.29%	34.79%	27.54%	35.85%	17.90%	24.29%
Deferral - Increase (Decrease)	n/a	5.23%	7.49%	5.93%	0.00%	3.86%	5.20%

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Sale of US Business Assets – Redemption

						Canco owning U.S. LLC	Canco owning U.S. LLC
Combined Corporate and Personal	Personal/Partnership U.S. Business	Canco U.S. Branch	U.S. Corporation	Canco owning U.S. Corporation	U.S. LLC	30% branch tax*	5% branch tax
After US tax reform	26.77%	54.47%	42.14%	45.41%	26.77%	47.21%	36.82%
Prior to US tax reform	26.77%	62.54%	52.40%	55.09%	26.77%	54.50%	43.82%
Change (+ Increase / - Decrease)	0.00%	-8.07%	-10.25%	-9.68%	0.00%	-7.29%	-7.00%
Personal tax deferral							
Deferral - After US tax reform	n/a	29.52%	21.14%	22.60%	0.00%	2.51%	11.87%
Deferral - Prior to US tax reform	n/a	24.29%	17.40%	18.58%	0.00%	0.00%	5.57%
Deferral - Increase (Decrease)	n/a	5.23%	3.75%	4.01%	0.00%	2.51%	6.30%

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U.S. Real Estate Rental

Combined Corporate and Personal	Personal/Partnership U.S. Business	Canco U.S. Branch	U.S. Corporation	Canco owning U.S. Corporation	U.S. LLC	Canco owning U.S. LLC
						No branch tax
After US tax reform	53.53%	66.43%	63.29%	60.52%	60.31%	66.43%
Prior to US tax reform	53.53%	72.26%	69.79%	67.52%	64.96%	72.26%
Change (+ Increase / - Decrease)	0.00%	-5.84%	-6.51%	-7.00%	-4.65%	-5.84%



Sale of U.S. Real Estate

Combined Corporate and Personal	Personal/Partnership U.S. Business	Canco U.S. Branch	U.S. Corporation	Canco owning U.S. Corporation	U.S. LLC	Canco owning U.S. LLC
						No branch tax
After US tax reform	26.77%	60.59%	63.29%	60.52%	55.85%	66.43%
Prior to US tax reform	26.77%	65.81%	69.79%	67.52%	55.85%	72.26%
Change (+ Increase / - Decrease)	0.00%	-5.22%	-6.51%	-7.00%	0.00%	-5.84%

