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TaxNewsFlash Canada

U.S. Shareholders —Take Action by December 31

December 20, 2017
No. 2017-66

Certain U.S. individual shareholders residing in Canada may be affected in 2017 by the new proposed U.S. mandatory repatriation rules. As a result of a new transitional rule that will deem certain corporate foreign earnings as repatriated for U.S. income tax purposes, affected shareholders may want to have their Canadian company pay them dividends by December 31, 2017 to help mitigate the resulting unexpected increase in U.S. income tax. Doing so may ensure the shareholder's Canadian tax treatment better matches their U.S. tax treatment.

This edition of *TaxNewsFlash-Canada* is based on the U.S. tax bill passed by the U.S. House and Senate.

Background
The current U.S. tax bill, which is expected to be presented to President Trump to sign into law by the end of 2017, makes substantial changes throughout the entire U.S. Internal Revenue Code, including significant corporate and personal tax changes. The bill bridges some of the differences in the distinct House and Senate bills that were approved earlier this year (see *TaxNewsFlash-Canada* 2017-51, "U.S. Releases Proposed Tax Reform Changes" and *TaxNewsFlash-Canada* 2017-61, "U.S. Readying Final Tax Bill").

Among other changes, the new U.S. tax proposals expected to take effect by the end of 2017 will change the taxation of a U.S. corporation's foreign earnings from a "worldwide" system to a hybrid "territorial" system. Although intended to target multinational corporations, these rules may also have unexpected consequences for certain U.S.

individual shareholders of Canadian or other non-U.S. corporations with accumulated unrepatriated earnings.

Many measures in the U.S. tax bill will affect U.S. persons resident in Canada. For details of these changes, see *TaxNewsFlash-Canada* 2017-63, "Highlights of New U.S. Personal Tax Changes". For details of the corporate measures in the U.S. tax bill, see *TaxNewsFlash-Canada* 2017-65, "Canadian Multinationals — Prepare for U.S. Tax Changes".

Who will be impacted by the transitional rules?

U.S. individual shareholders holding a 10% voting interest in a specified foreign corporation (e.g., a Canadian corporation) that is a controlled foreign corporation (i.e., controlled by U.S. persons with each U.S. person in the controlling group owning at least 10% of the corporation's voting stock), may be caught by the new rules. Where the corporation is not controlled by U.S. shareholders, the deemed repatriation will still apply if at least one of the U.S. shareholders is a U.S. domestic corporation.

Mandatory repatriation

Under the proposed U.S. tax rules, U.S. individual shareholders must include in their income, for U.S. tax purposes, for the controlled foreign corporation's last tax year beginning before 2018, the shareholder's *pro-rata* share of the controlled foreign corporation's accumulated post-1986 historical Earnings & Profits (E&P). This income must be included to the extent that the E&P have not been previously subject to U.S. tax, determined as of the E&P on November 2, 2017, or December 31, 2017 (whichever is higher). The portion of E&P attributable to cash, or cash equivalents, would be taxed at a 15.5% rate, while the remainder would be taxed at an 8% rate (i.e., E&P that were reinvested in the foreign subsidiary's business, such as property, plant, fixtures and equipment). This lower tax rate is intended to recognize that these assets are in productive use and/or essentially illiquid.

The repatriation taxes will apply even though a Canadian corporation paid corporate tax in Canada on its "deferred income" (i.e., income not yet repatriated to the U.S. individual shareholder). Although the income inclusion for U.S. tax purposes is for 2017, U.S. shareholders can elect to pay the resultant tax liability over eight years in annual pre-set installments.

There is also a special rule for S corporations. Shareholders of S corporations who have an interest in a specified foreign corporation may elect to maintain deferral on such foreign income until the S corporation has a triggering event. A triggering event includes a change in entity status, a sale of substantially all of its assets, ceasing to conduct business, or the sale of the S corporation stock by the electing shareholder.

KPMG observations — Planning for mandatory repatriation
From a cross-border perspective, it may make sense for a Canadian corporation to pay out a dividend to its U.S. individual shareholder in 2017 to prevent a double tax situation. Matching the timing of the U.S. individual shareholder's income inclusion for U.S. and Canadian tax purposes could give the U.S. individual shareholder foreign tax credit relief that would not otherwise be available if a dividend were not paid.

Because the foreign tax credit rules are complex, you should speak with your KPMG tax adviser before paying a dividend from your Canadian company, to ensure that you have taken all the relevant considerations into account.

We can help

Your KPMG adviser can help you assess the effect of the U.S. tax legislation on your business and personal tax situations. For more details on U.S. tax reforms and their possible impact, contact your KPMG adviser.

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