2017 U.S. TAX CUTS AND JOBS ACT & CANADIANS … PLUSES AND MINUSES

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On December 22, 2017 what is known as The Tax Cuts and Jobs Act (the “Act”) was signed into law by the President. The Act is the most fundamental and sweeping tax legislation in more than thirty years; the last major U.S. tax legislation being the Tax Reform Act of 1986, as amended (the Code).

Most of the changes in the Act affect U.S. citizens or U.S. permanent residents. There are, however, significant changes to the U.S. Estate Tax, which as a result of the Canada-U.S. Income Tax Treaty (the “Treaty”), will have an effect on Canadians who own what is called “U.S. source assets”.

The most common type of “U.S. source assets” are vacation homes owned by Canadians in the United States, typically in Florida, California or Arizona. “U.S. source assets” also include ownership of common stock issued by companies located in the United States.

As a result of the Act, the Federal Estate Tax exemption increases from the 2011 level of $5,000,000 to $10,000,000 subject to annual adjustment but only until **December 31, 2025**. Effective January 1, 2018 that exemption becomes approximately $11,200,000. Unlike the changes to the U.S. corporate income taxes, which are permanent, this change to the Federal Estate Tax exemption is temporary. In addition, the amount of the Federal exemption will adjust on an annual basis based on notices published by the Internal Revenue Service.

Canadians, as a result of the Treaty, qualify for a portion of the Federal Estate Tax exemption based upon the Treaty’s formula calculation. This calculation takes into consideration a Canadian decedent’s worldwide assets in relation to their “U.S. source assets” (see the Spring 2014 edition of our Cross Border Bulletin. This calculation produces what is called the Enhanced Uniform Credit (EUC) which is substantially greater than the existing estate tax credit afforded to non-resident aliens under the Code of $13,000 which translates into a value of $60,000 of “U.S. source assets”. In addition to the EUC, the Treaty in a marital couple situation, also allows for an additional estate tax credit, called the Marital Credit, in an amount equal to the EUC for property passing to a surviving spouse.

The good news is that the Federal Estate Tax exemption now has increased substantially but the bad news is this change sunsets after December 31, 2025. So beginning January 1, 2026 the Federal Estate Tax Exemption reverts to the 2012 number, as adjusted, unless Congress and the President adopt new tax legislation making this change made by the Act to the Estate Tax exemption permanent.

Similar short-term changes to the Federal Estate Tax exemption occurred as a result of the 2001 Tax Reform Act that expired in 2012 but which were subsequently made permanent by the 2012 American Taxpayer’s Relief Act. Only time will tell if this change to the Federal Estate Tax exemption will be made permanent….stay tuned!

Other changes brought about by the Act that effect: (a) Canadians who own businesses in the United States or (b) Americans living in Canada that own Canadian businesses include the following, effective January 1, 2018:

(a) Corporate Income Tax Rate: The U.S. corporate income tax rate is reduced to **21%** from 35%.

(b) Business Interest: For every business located in the U.S. whose average annual gross receipts exceed $25 million, the deduction for business interest is limited to 30% of adjusted taxable income; this change can affect how the prospective purchase of a U.S. business is financed.

(c) Net Operating Losses: Existing U.S. businesses with net operating losses can now only carry those losses forward; the two-year carryback was repealed.

(d) Controlled Foreign (for U.S. Purposes) Corporations (CFC): A Canadian business that is owned more than 50% by U.S. shareholder(s) (a CFC) can now be subject to: (i) special repatriation transition tax based on retained earnings and (ii) a Global intangible low-taxed income assessment if the Canadian small business income tax rate is below 90% of the U.S. corporate tax rate of 21%; namely, if that rate is less than 18%; in that situation the U.S. shareholder(s) has to include as its income a portion of the CFC's net income.

For further information on this topic, please contact David Alexander, Esq. at Gross Shuman P.C. David can be reached at (716) 854-4300 x216 or DAlexander@gross-shuman.com

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