

TAX REFORM IN US SENATE

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Early on December 2, 2017, the US Senate passed its version of the Tax Cuts and Jobs Act, after the US House of Representatives passed its version of the tax reform legislation on November 16, 2017. On December 4, 2017, the House is expected to vote on whether it will go to conference with the Senate on the tax reform legislation. The House and Senate must then reconcile the two different bills and craft one piece of legislation; that single piece of legislation must be passed by both chambers before it can be signed into law by President Trump.

The Senate bill and the House bill have some similarities, but they also contain key differences. Some notable provisions in the Senate's bill include the following, generally effective for taxable years beginning on January 1, 2018.

International Tax

Shift from worldwide taxation to territorial taxation. Like the House bill, the Senate bill provides that a US corporate shareholder that owns at least 10 percent of the voting stock in a foreign corporation (Forco) is taxed on the Forco's US-source income only when a dividend is paid. The proposal thus provides that a US corporate shareholder is entitled to a 100 percent dividends-received deduction for the foreign-source portion of dividends paid by the foreign subsidiary.

Deemed repatriation of offshore earnings. Consistent with the House bill, the Senate bill provides that a US corporate shareholder that owns at least 10 percent of a Forco generally must include in income its pro rata share of the Forco's undistributed earnings and profits. Earnings held in cash and cash equivalents are taxed at a 14.5 percent rate (14 percent in the House bill); other earnings are taxed at a 7.5 percent rate (7 percent in the House bill). A US shareholder can elect to pay the tax liability over no more than eight years.

Taxation of certain partnership interest sales. Overturning a recent Tax Court case, the Senate bill generally provides that a non-US partner in a US partnership is taxed on the sale of a partnership interest in the same manner as if the partnership engaged in a sale of all its assets. This proposal is consistent with the IRS's longstanding position on this issue.

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Definition of "US shareholder" of a controlled foreign corporation (CFC). For the purposes of determining whether a Forco is a CFC, the Senate bill expands the definition of "US shareholder" to include any US person that owns at least 10 percent of the total value of shares of all classes in a Forco. (Current law limits the definition to those that own at least 10 percent by vote.)

Elimination of 30-day rule for a CFC. The Senate bill eliminates the requirement that a Forco be a CFC for 30 consecutive days before a US shareholder has subpart F inclusions with respect to the Forco.

Individual Tax

Individual income tax rates. The Senate bill retains the seven marginal tax rates for individuals, modifying them to 10, 12, 22.5, 25, 32.5, 35, and 38.5 percent. The top rate applies to income in excess of \$500,000 (for single filers) or \$1 million (for joint filers). The Senate bill does not change the current tax treatment of capital gains or dividends, and it does not repeal the 3.8 percent net investment income tax. Moreover, the Senate bill, like the House bill, does not change the current citizen-based taxation system. Thus, US citizens living in Canada would still be required to file and pay tax on their worldwide income.

Estate tax. Consistent with the House bill, the Senate bill doubles the amount of the estate and gift tax exemption for taxable years after 2017 (approximately \$11 million for individuals, \$22 million for couples). The Senate bill, however, does not repeal the estate tax.

Business Tax

Corporate tax rate. Consistent with the House bill, the Senate bill reduces the maximum corporate tax rate to 20 percent, but the reduction does not apply until 2019.

Deduction for passthrough "qualified business income." Unlike the House bill, the Senate bill does not provide a special tax rate for certain kinds of passthrough income, but it allows an individual owner to deduct 23 percent of the owner's share of the passthrough's domestic qualified business income. "Qualified business income" means US domestic business income other than investment income. The deduction generally cannot exceed 50 percent of the taxpayer's allocable or pro rata share of W-2 wages paid by the passthrough entity, except for taxpayers with taxable 5/9/2018 Tax Reform in US Senate http://www.ctf.ca/ctfweb/EN/Newsletters/Canadian_Tax_Highlights/2017/12/171201.aspx 2/2 Comment: Comments may not appear immediately. Comments Terms Of Use Submit income not exceeding \$250,000 (for single filers) or \$500,000 (for joint filers). The deduction generally does not apply to individual owners of certain service businesses (such as health, law, accounting, engineering, consulting, financial, and brokerage services), unless the individual's taxable income does not exceed \$250,000 (for single filers) or \$500,000 (for joint filers).

At the time of writing, Treasury Secretary Steven Mnuchin expects tax reform legislation to be passed and sent to President Trump by Christmas. Last-minute amendments to the Senate bill bridged some of its differences with the House bill, but there remain significant inconsistencies that the two chambers must work out. Nonetheless, it appears that comprehensive tax reform legislation will be enacted. If it is, there will be significant changes for Canadians with US connections. For instance, a Canadian business looking to expand into the United States could face lower corporate tax rates. In addition, a

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Canadian corporation may now fall into CFC status, given the broadening of the definition of "US shareholder."

