

NEW PROPOSED REGS CLARIFY US REPATRIATION TAX ELECTIONS

Canadian Tax Highlights
September 27, 2018

Practices & Industries

International Tax

*Originally published in Canadian Tax Highlights, Volume 26, Number 9, August 2018.
Reprinted with permission.*

On August 1, 2018, the US Treasury released new proposed regulations to implement a key feature of the Tax Cuts and Jobs Act: the one-time repatriation tax under Code section 965. Proposed regulation section 1.965-7 provides new details regarding the nature, availability, and timing of taxpayer elections under sections 965(h), 965(i), and 965(m). Below is a brief overview of some key provisions that may be relevant to a US person (an individual or a corporation) with a certain ownership interest in a Canadian corporation.

Section 965(h) election. A US shareholder of a deferred foreign income corporation (dfic) may elect to pay its net repatriation tax in eight instalments over eight years: 8 percent in years 1-5, 15 percent in year 6, 20 percent in year 7, and 25 percent in year 8. An election is revoked only by paying the full amount of the unpaid section 965(h) net tax liability. An instalment is otherwise due on the tax return due date for its taxable year without regard to extensions.

The unpaid section 965(h) net tax liability is due immediately if the taxpayer (1) fails to timely pay an instalment; (2) liquidates or sells substantially all of its assets; (3) for nonindividuals, ceases its business activity; (4) is no longer a US person; (5) was not a member of a consolidated group and then becomes a member (unless the buyer enters into an agreement with the US treasury secretary that it assumes liability for the remaining instalments); or (6) in the case of a consolidated group, the group ceases to exist (unless the buyer agrees that it assumes liability for the remaining instalments). If a taxpayer does not pay the correct amount for the first instalment, the remaining instalments are not accelerated if the deficiency or additional liability is not due to negligence, intentional disregard, or fraud; the taxpayer's section 965(h) election is not affected, and the deficiency is prorated between the remaining instalments.

A section 965(h) election is made by attaching a statement, signed under penalty of perjury, to the taxpayer's return for the relevant taxable year. The statement includes the taxpayer's name, taxpayer identification number (TIN), total net tax liability under section 965, section 965(h) net tax liability, section 965(i) net tax liability with respect to which a section 965(i) election is effective (explained below), and

NEW PROPOSED REGS CLARIFY US REPATRIATION TAX ELECTIONS

the amount of each anticipated instalment.

Section 965(i) election. An S corporation (S corp) shareholder that is a US shareholder of a DFIC may elect under section 965(i) to defer its net repatriation tax liability with respect to the s corp until a taxable year that includes a triggering event. A triggering event is the first of three events: (1) the corporation ceases to be an S corp (the first day of the first taxable year that the corporation is not an s corp); (2) substantially all of the S corp's assets are liquidated or sold (including in a title 11 or similar case), the S corp ceases its business, the S corp ceases to exist, or any similar circumstance; and (3) the taxpayer transfers any share of S corp stock (including at death), unless the transferee enters into an agreement with the US treasury secretary that it is liable for the same net tax liability as the taxpayer.

If a taxpayer transfers less than all of its S corp shares, the transfer is a triggering event only for that portion of the section 965 liability allocated to the transferred stock. If a triggering event occurs, a taxpayer still may elect under section 965(h), but an election may be made only with the consent of the treasury secretary if the triggering event occurs due to a liquidation or sale of substantially all of the S corp assets. If an S corp shareholder makes a section 965(i) election, the S corp is jointly and severally liable for the deferred payment and also for any attributable penalties or additions to tax. A taxpayer that makes a section 965(i) election must continue to report its deferred net tax liabilities on its tax return for each year thereafter until the amount has been fully assessed.

A section 965(i) election must be made no later than the due date, taking into account any extensions, of the S corp shareholder's return for the taxable year that includes the last day of the taxable year of the S corp. The election is made by attaching a statement, signed under penalty of perjury, to the S corp's return for that year. The statement must generally include the shareholder's name, TIN, the name and TIN of the S corp, the shareholder's net income tax for the taxable year that includes section 965 inclusion amounts, the shareholder's net income tax for the taxable year determined without regard to section 965, and the S corp's net section 965(i) tax liability.

Section 965(m) election. A real estate investment trust (REIT) that is a us shareholder of a DFIC may also defer its net section 965 liabilities over eight years under section 965(m). A REIT may not make a section 965(h) election for any instalment year. If there is a liquidation or sale of substantially all of the assets of the REIT, a cessation of business by the trust, or any similar circumstance, then any section 965 amount not yet included in gross income is included in gross income the day before the date of the event, and the unpaid portion of any tax liability with respect to the section 965 inclusion is due on the date of the event.

The proposed regulations clarify some unresolved issues with respect to the repatriation tax, but questions still remain. US persons and Canadian advisers should be aware of this tax because it applies to a broad group of US taxpayers.