TAXTALK

2019 YEAR END TAX PLANNING FOR CANADIAN BUSINESSES DOING BUSINESS IN THE U.S.

This summary addresses common year-end 2019 federal tax issues for Canadian businesses with U.S. operations.

The first tax-filing season under U.S. Tax Reform brought many challenges for businesses to analyze the tax implications of the new rules to their bottom lines. With the end of the 2019-year fast approaching, you can incorporate the lessons learned from 2018 into your year-end tax planning. Highlighted below are tax planning strategies you can use to minimize your tax burden for 2019.

General Tax Planning Strategies

General tax planning strategies for businesses include postponing income and accelerating deductions, and careful consideration of timing-related planning strategies with regard to purchase of new equipment, tax credits and choice of entity.

Deferring Income/Accelerating Expenses

This technique has long been employed by businesses that do not expect to be in a higher tax bracket in the following year. For example, if you use cash-basis accounting, you might defer income into 2020 by sending your December 2019 invoices toward the end of the month (Note that U.S. Tax Reform allows businesses with three-year average annual gross receipts of $25 million or less to use cash-basis accounting). Businesses using the accrual method can defer income by postponing delivery of goods or services until January 2020.

Likewise, businesses can accelerate deductible expenses into 2019 by putting them on a credit card in late December and paying it off in 2020.

Capital Asset Purchases and Tax Depreciation

Purchasing equipment and other qualified assets has been a valuable tool for reducing taxable income for businesses for years, but U.S. tax reform further enhanced these opportunities by expanding bonus depreciation and expensing of qualified capital assets (Section 179 expensing where you can deduct the entire cost of the asset in the current year subject to certain limits below).

Section 179 Expensing

Businesses should take advantage of Section 179 expensing for a couple of reasons. First, is that in 2019 businesses can elect to expense (deduct immediately) the entire cost of new equipment up to a maximum of U.S. $1.02 million for the first $2.55 million of property placed in service by December 31, 2019. Note that the Section 179 deduction cannot exceed net taxable business income and create a tax loss. The deduction is phased out dollar for dollar on amounts exceeding the $2.55 million threshold and eliminated above amounts exceeding $3.57 million.

Second, U.S. tax reform legislation also expanded the definition of Section 179 property to allow businesses to elect to include certain improvements made to nonresidential real property after the date when the property was first placed in service (see below).

These changes apply to property placed in service in taxable years beginning after December 31, 2017.

1. Qualified improvement property, which means any improvement to a building interior. However, improvements do not qualify if they are attributable to:

* the enlargement of the building,

* any elevator or escalator, or

* the internal structural framework of the building.

2. Roofs, HVAC, fire protection systems, alarm systems, and security systems.

Bonus Depreciation

Under bonus depreciation, businesses are allowed to immediately deduct 100% of the cost of eligible property placed in service after September 27, 2017, and before January 1, 2023, after which it will be phased downward over a four-year period: 80% in 2023, 60% in 2024, 40% in 2025, and 20% in 2026.

The immediate expensing and bonus depreciation provisions are intended to increase business expansion in the U.S. These changes will also provide an incentive to Canadian businesses that want to expand their activities in the U.S. via a U.S. structure, or enter the U.S. market for the first time.

Qualified Property

Qualified property for Section 179 and bonus tax depreciation is defined as property that you placed in service during the tax year and used predominantly (more than 50 percent) in your U.S. trade or business. Property that is defined as property that you placed in service during the tax year and then disposed in the same year does not qualify, nor does property converted to personal use in the same tax year it is acquired.

Qualified property includes computer systems, computer software, vehicles, machinery, equipment, and office furniture.

Note that the above U.S. tax depreciation rules are applicable to both U.S. domestic and foreign-owned entities.

Tax Credits

Some of the most popular tax credits for businesses survived tax reform include Small Business Health Care tax credit and research and development ("R & D") credits.

Small Business Health Care Tax Credit

Small business employers with 25 or fewer full-time-equivalent employees with average annual wages of $50,000 indexed for inflation (e.g. about $54,200 in 2019) may qualify for a credit to help pay for employees' health insurance. The credit is 50 percent (35 percent for non-profits) of employer-paid health care premium in 2019.

Research and Development ("R & D") Credits

Prior to U.S. tax reform, corporations with R & D expenditures could have chosen to deduct these costs immediately in their current tax return, or amortize them over a period of at least 60 months. In this case, amortization would begin in the month the business first receives economic benefit from the R & D.

After tax reform, immediate expensing benefits begin to sunset and beginning with the 2021 tax year, businesses will no longer have the option to immediately expense R & D expenditures. The new rules also offer preferential treatment for expenses incurred in the U.S. Starting in 2021, U.S. based R & D will be eligible for amortization over a five–year period, whereas foreign R & D must be amortized over 15 years. This treatment is intended to encourage R & D activities in the U.S. as opposed to in a foreign country.

Entity Choice: C Corporation or Pass-Through

U.S tax reform provided for a tax deduction of up to 20% of an individual's "qualified business income" ("QBI"). This deduction coupled with the reduction of the corporate tax rate to a flat 21% from a top rate of 35%, make it worthwhile for businesses to re-evaluate whether their current entity type is the most tax efficient.

The QBI deduction effectively reduces the top income tax rate applicable to ordinary business income from 37 percent to 29.6 percent. This deduction applies to pass-through entities such as, sole proprietorships, partnerships and S corporations. Note that the QBI deduction is slated to end after 2025. At the end of the day, your business's individual circumstances will determine the optimal structure.

Summary

Year-end tax planning could make a big difference to your tax bill.

If you need more information, please Contact Basil Punit, Partner, U.S. Taxation for more information.

A memorandum of this nature cannot be all-encompassing and is not intended to replace professional advice. Its purpose is to highlight tax planning possibilities and identify areas of possible concern. Anyone wishing to discuss the contents or to make any comments or suggestions about this TaxTalk is invited to contact one of our offices.

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