TAXTALK

THE BIDEN TAX PROPOSALS AND THEIR IMPACT ON CANADIAN RESIDENTS WITH OPERATIONS AND FILINGS IN THE U.S.

The U.S. federal elections are finally over and Joe Biden has been inaugurated as President. Democrats also kept the majority in Congress, won the state of Georgia and picked up two Senate seats. This Senate win shifts the balance of power in the Senate from one of Republican control to one where neither party has a majority. However, if all Senators vote along party lines (including independent senators who typically vote with Democrats), any deadlock on legislation will be broken by Vice President Harris casting the deciding vote. This tiebreaking potential will give Democrats control of the Senate and Biden tax policy changes are now more likely to pass.

Highlighted below are some of the Biden campaign platform tax proposals that may impact Canadian companies and residents with U.S. operations.

Anticipated Tax Changes

The Biden campaign proposed numerous tax changes, most notably:

- Increase the top personal tax rate from the current 37% to 39.6% for taxpayers with income above $400,000
- Increase the top long-term capital gains and qualified dividend rate from the current 20% to 39.6% for taxpayers with income of over U.S. $1 million
- Reduce the estate tax exemption from the current $11.8 million to $3.5 million and increase the top estate tax rate from the current 40% to 45%
- Increase the corporate income tax rate from the current 21% to 28%
- Double the tax rate on Global Intangible Low Tax Income (GILTI) from 10.5% to 21%
- Impose a new alternative minimum tax of 15%
- Impose a 10% Offshoring Tax Penalty and Made in America Tax Credit

Impact on Canadian Residents

Individuals

Increased Individual Tax Rate

As indicated above, Biden would increase the top marginal income tax rate for individuals with income above $400,000 from 37% to 39.6% (the top marginal income tax rate in effect prior to the enactment of Donald Trump's Tax Cut and Job's Act (TCJA)).

Also the Net Investment Income Tax (NIIT) of 3.8% (which has been in place since 2013 and not part of Biden's Tax Proposals) will apply to increase the above marginal tax rate for individuals, estates and trusts that have income above the statutory threshold. The threshold amount is based on the filing status of the taxpayer. For instance, for "married filing jointly" the amount is $250,000. Individual taxpayers are liable for the tax on the lesser of their net investment income or the amount by which their modified adjusted gross income exceeds the statutory threshold. If applicable, the 3.8% NIIT will be added to the proposed top marginal rate of 39.6% for federal income tax rate of 43.4%.

These are the federal tax rates but when state tax is added, the combined federal and state tax will be relatively high as compared to the tax rate in Canada. For example, California has the highest individual income tax rate in the country. Their top marginal income tax rate is 13.3% and when added to the federal rate above, results in a combined federal and state income tax rate of 52.9% (56.7% if the 3.8% net investment income tax applies).

Increased Capital Gains Tax Rate

Biden would increase the long-term capital gains and qualified dividend rate for individuals with income in excess of $1 million from 20% to the proposed ordinary income tax rate of 39.6%. It is unclear whether the 39.6% rate would include the additional 3.8% tax on net investment income; if it did, the marginal rate for capital gains could be as high as 43.4%.

Estate and Gift Tax

Under current law, the estate and gift tax exemption is $11.8 million per person and $23.16 million per married couple on the gross estate at fair market value.

Biden would reduce the estate and gift tax exemption from the $11.8 million to $3.5 million per person (from $23.16 million to $7 million per married couple) and increase the estate tax rate from the current 40% to 45%. It is anticipated that this proposed change if passed in 2021 will apply retroactive to January 1, 2021.

Canadians with U.S. situs assets and whose net worth exceeds the anticipated estate tax exemption of $3.5 million, will be subject to U.S. estate tax on those assets on death. Note that U.S. assets, include not only U.S. real estate, but also shares in U.S. equities including those held in RRSPs, RRIFs or TSFAs, as well as U.S. retirement plans such as 401(k) plans and Individual Retirement Accounts (IRAs).

Businesses

Increased Corporate Tax Rate

Biden would increase the federal corporate income tax rate from 21% to 28% flat rate. Note that U.S. state income tax would be in addition to the federal rate. The average state income tax rate for a U.S. company operating in multiple states is about 6%. Therefore, the combined federal and state income tax rate would be 34% in the U.S. as compared to about 12.2% for small Canadian companies and about 26.5% for other Canadian companies operating in Ontario.

Canadian companies with U.S. subsidiaries or branches may want to examine their business structures and tax consequences of the proposed increase in tax rates.

Corporate Minimum Tax (AMT)

Biden is proposing a new 15% minimum tax on book income of companies that report net income of more than $100 million. Corporations would pay the higher of the regular corporate income tax or the 15% minimum tax. The AMT tax regime was in place in the U.S. prior to the Trump Tax Reform but was revoked with the TCJA for tax years ending after January 1, 2018. Biden's proposal restores the AMT but it will apply to larger corporations. This is to ensure that large companies pay some income tax even if they are in a loss position for tax purposes.

Changes to GILTI

Biden has proposed to double the current effective tax rate on GILTI from 10.5% to 21% (and from 13.125% to 26.50% starting in 2026).

The GILTI provisions are meant to discourage U.S. citizens from operating a foreign business through a foreign corporation, while trying to achieve tax deferral in the U.S. (i.e. a U.S. citizen operating a Canadian business through a Canadian corporation). Whether or not distributions are made to U.S. citizen shareholders from their foreign corporation, they are required to include the corporate income on their personal tax returns annually.

Offshoring Tax Penalty and Made in America Tax Credit

President Biden enacted (by Executive Order on January 25, 2021) a new Buy American regime to ensure U.S. companies and workers recap the benefits of government spending. The plan promises to increase the amount of U.S. content a project would require to qualify as being "Made in America". Also, a new "Buy America" office will be attached to the White House to oversee this program.

The plan would establish a 10% penalty surtax on U.S. companies that offshore manufacturing and service jobs to foreign countries to sell goods or provide services back to the U.S. market. Companies would also be denied deductions for expenses related to moving jobs and production overseas if these could be performed in the United States. Biden would also offer a "Made in America" tax credit, which would be a 10% advanceable tax credit for companies making investments that create jobs for U.S. workers and accelerate economic recovery by revitalizing existing closed or closing facilities, retooling or expanding facilities to advance manufacturing employment, or expand manufacturing payroll.

Canadian companies could be negatively impacted by Biden's "Buy America" plan. For example, Canadian companies that bid on American government contracts could be cut out of the procurement process if this plan goes through. Also the "Made in America" plan could disrupt the Canada - U.S. supply chain and lead to significant trade tensions.

The Takeaway

The above tax changes highlight the main proposals likely to impact Canadian residents with U.S. assets or U.S. operations.

These taxpayers should take active steps now to evaluate the impact of these proposed tax changes and plan for the possibility that they may get enacted. This may result in significant tax savings down the road.

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

Offices:	First Canadian Place 100 King Street West, Suite 5700 Toronto, Ontario M5X 1C7 Phone: 416-362-0515	1900 Minnesota Court, Suite 116 Mississauga, Ontario L5N 3C9 Phone: 905-451-4788 Fax: 905-451-3299

TaxTalk is prepared by our Tax Group (taxtalk@mgca.com). Please visit our web site at www.mgca.com.

McCarney Group LLP is an independent member of Morison KSi