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MEMORANDUM

From: VSH International Team

Date: January 28, 2019

Subject: 2018 U.S. Tax Updates

With 2018 now closed, we want to ensure that you are aware of your U.S. tax responsibilities and required filings. Outlined below are some issues especially relevant to U.S. persons living abroad followed by some useful tax planning ideas. We've included the top five new impacts immediately below. For further information on year end considerations, please read the tax updates and required filings.

GLOBAL INTANTIBLE LOW-TAXED INCOME (GILTI): GILTI is a new U.S. tax provision that will impact certain U.S. taxpayers that own non-U.S. corporations. Beginning in 2018, GILTI requires U.S. persons with investments in certain non-U.S. corporations to pay tax on their deemed return on investment every year, regardless of whether dividends are paid. The deemed return is generally a U.S. shareholder's aggregate net income from certain non-U.S. corporations, minus a 10 percent deemed return on tangible property. For companies with little or no basis in tangible assets, essentially the entire net income could be subject to U.S. tax each year. Proactive planning will be especially important for individual shareholders, as they will be the most significantly impacted.

EXPANSION OF PERSONAL HOLDING COMPANY INCOME: Recent legislation increased the amount of income currently taxable to controlling U.S. shareholders of non-U.S. corporations with passive income. Legislation also expanded the definition of a U.S. shareholder by incorporating a 10 percent value test in determining who is a U.S. shareholder, thus making it more likely for a person to be a U.S. shareholder and a non-U.S. corporation to be a controlled foreign corporation.

DISPOSITIONS OF PARTNERSHIP INTERESTS BY FOREIGN PARTNERS: This provision affects non-U.S. partners of partnerships engaged in a U.S. trade or business. The provision created a 10 percent withholding tax on the amount realized when a non-U.S. person sells, exchanges or otherwise disposes of a U.S. partnership interest. A U.S. purchaser of a partnership interest sold by a non-U.S. person must deduct and withhold a 10 percent tax on the amount realized on the sale or exchange, unless seller certifies that it is a U.S. person. The withholding requirement is applicable for sales and exchanges made after December 31, 2017.

ORGANIZE AS A CORPORATION OR OWN AS A SOLE PROPRIETOR: We advise that clients on both sides of the border organize as a C-corporation or sole proprietor when establishing a new company or presence abroad. The U.S. and Canada treat LLC's, LLP's and LLLP's differently for tax purposes. We want to ensure that your structure will be the most beneficial to you on both sides of the border.

IT'S A DYNAMIC TIME: As you may be aware, the U.S. government passed legislation which made significant changes to U.S. tax law. Formal guidance has been issued for many of these changes, however the specifics of some changes are still uncertain. We continue to closely watch for updates to the tax reform and will notify you of changes that may affect you.

If you have any questions or would like assistance determining whether any of the items in this letter apply to you, please don't hesitate to contact Kari Doss or Stephanie Hermanutz at (360) 734-8715. You can also email them at doss@vshcpa.com or hermanutz@vshcpa.com.

TAX OVERVIEW AND REQUIRED FILINGS:

Foreign Bank and Financial Account Reporting (FBAR):

Form 114 is required by U.S. persons to report non-U.S. financial accounts exceeding an aggregate of $10,000 USD at any time during the calendar year. The form is due April 15, with a 6-month extension available.

- *What is a financial account*? Bank, security, security derivatives and other financial instrument accounts. Generally, accounts in which assets are held in a commingled fund and the account owner holds an equity interest – such as a mutual fund – are financial accounts. In addition, commodity futures, options, and insurance or annuity policies with a cash surrender value are financial accounts.
- *What is not a financial account*? Individual bonds, notes, or stock certificates held by the filer as well as unsecured loans to a foreign trade or business that is not a financial institution.

Passive Foreign Investment Companies (including mutual funds held outside RRSPs):

Form 8621 discloses ownership in Passive Foreign Investment Companies (PFICs). Common PFICs include non-U.S. mutual funds or exchange traded funds (ETFs), non-U.S. corporations owning real estate and non-U.S. holding companies. PFIC status applies to non-U.S. companies with at least 75% of income from passive sources or at least 50% of assets that produce passive income. The PFIC rules, which are complex and often result in additional tax and interest, apply to U.S. persons who directly or indirectly own shares of a PFIC. If the required form is not filed, the tax return is considered incomplete and the statute of limitations will not begin. Form 8621 is not required if there is no excess distribution or gain during the year and the value of the PFIC is less than $25,000 USD (filing single).

Tax-Free Savings Accounts (TFSAs) and Registered Education Savings Plans (RESPs):

While these plans offer a great savings opportunity for Canadian taxes, the income earned in TFSAs and RESPs are not tax-free in the U.S. and often trigger additional U.S. disclosures. Individual circumstances vary as to whether there is an overall tax benefit to one of these accounts or the U.S. tax consequences and additional administrative burden outweigh the Canadian tax savings. TFSAs and RESPs may be considered foreign grantor trusts for U.S. tax purposes which would require Forms 3520 and 3520-A to be filed to report these accounts each year. Penalties for late filing or not filing are equal to the greater of $10,000 per form or 5% of the trust's assets.

Statement of Specified Foreign Financial Assets (Form 8938):

Form 8938 is required to be filed by U.S. individuals, businesses owned by U.S. individuals, and trusts with U.S. owners and/or beneficiaries if they own non-U.S. assets valued at more than $50,000 USD (depending on circumstances, the threshold may be higher). Assets considered for this test include (1) depository or custodial accounts with non-U.S. financial institutions; (2) stocks or securities issued by foreign entities; (3) any other financial instrument or contract issued by a non-U.S. person; and (4) any interest in a non-U.S. entity. If this form is not filed, your return is considered incomplete.

Net Investment Income Tax (NIIT):

The NIIT applies at a rate of 3.8% to certain investment income when modified adjusted gross income is over $125,000 USD (depending on filing status, the threshold may be higher). This tax is not a creditable tax, meaning that tax paid in Canada cannot be used to reduce the NIIT through foreign tax credits. The tax is applied in addition to ordinary tax rates on investment income including but not limited to: interest, dividends, capital gains, rental and royalties, businesses involved in trading of financial instruments or commodities, and businesses that are passive activities to the taxpayer.

Renouncing U.S. Citizenship:

An increasing number of dual citizens are choosing to renounce their U.S. citizenship to eliminate required annual U.S. tax filings. Disclosures on Form 8854 must be filed for the year of expatriation, in addition to a final U.S. tax return. You must be current on all your required U.S. tax filings for the 5 years preceding expatriation. Taxpayers

with a net worth greater than $2 million USD are subject to an expatriation tax. The expatriation tax is calculated as if all assets were disposed of at fair value.

Registered Retirement Savings Plans (RRSP):
The U.S. does not provide the same tax treatment for RRSPs as Canada. Contributions to a RRSP are not tax deductible in the U.S. Although contributions to a RRSP may reduce Canadian tax, because the deduction is not available in the U.S., it is possible for U.S. tax to result. RRSP accounts must be disclosed on Form 8938 (Statement of Specified Foreign Financial Assets) if a taxpayer meets the filing threshold.

OWNERSHIP OF NON-U.S. CORPORATIONS:

Foreign Personal Holding Company Income:
Even when dividends have not been distributed, controlling U.S. shareholders of a non-U.S. corporation with passive income may be subject to U.S. tax. Income such as dividends, capital gains, interest and rents are subject to tax in the year they are reported and are taxed at ordinary tax rates. The passive income inclusion is limited to net income in the corporation during the year. The occurrence of passive income in your non-U.S. corporation requires complex calculations to ensure accurate reporting and to apply any available exclusions to minimize U.S. tax. Non-U.S. corporations are required to use a calendar year for U.S. tax reporting purposes.

Shareholder Loans from Non-U.S. Corporations:
Loans from non-U.S. corporations to their U.S. owners may be reclassified as income to the owners for U.S. tax purposes. Non-U.S. corporate earnings that are invested in U.S. property are subject to U.S. tax even if they have not yet been distributed to the owner as a dividend. For this purpose, investment in U.S. property includes loans to U.S. persons. Effectively, one cannot avoid U.S. tax by paying out loans rather than dividends. It may be possible, however, to have short-term shareholder loans without resulting in deemed income so long as the loans are properly structured.

PLANNING TIPS:

- Consult your investment advisor if you have non-U.S. mutual funds or exchange traded funds and inform them of your status as a U.S. person. Determine if restructuring your investments is necessary to reduce tax compliance burdens.
- When setting up a new non-U.S. corporation, consider adopting a year end of December 31 to streamline the preparation of annual disclosures.
- Avoid loans from non-U.S. corporations to U.S. owners, as they may be considered income to the owner for tax purposes and subject to U.S. tax.
- Depending on filing status and income amounts, it may be advantageous for U.S. tax purposes to pay wages instead of dividends from a controlled foreign corporation. Additional analysis would be needed.
- If you are considering making a large contribution to your RRSP consider how this will affect your U.S. tax liability before the Canadian tax return is filed. Contributions to RRSPs are not deductible in the U.S.
- Consider U.S. estate and gift planning and ways to maximize transfer benefits. The estate tax exemption for U.S. citizens and a U.S. domiciliary is $11.18 million for 2018 ($11.4 million for 2019). The annual gift tax exclusion is $15,000 for 2018.
- If you have any involvement with a trust outside the U.S., you may have a reporting requirement. A U.S. person who makes a transfer to or receives a distribution from a foreign trust, who is considered the owner of foreign trust assets, or who receives a gift from a foreign person during the year must file an annual foreign trust return. Penalties for not filing a trust return when required start at $10,000. Bring this to our attention as soon as possible; filing or a request for extension may be required as early as March.

If you have any questions or would like assistance determining whether any of the items in this letter apply to you, please don't hesitate to contact Kari Doss or Stephanie Hermanutz at (360) 734-8715. You can also email them at doss@vshcpa.com or hermanutz@vshcpa.com.

These suggestions are only an overview and would need further examination for your unique scenario before implementation. Please also note these suggestions are for U.S. tax planning purposes only and should be reviewed with your Canadian accountant to determine the effect in Canada.

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