

2023 Tax Filing Season Newsletter



Many happily welcomed 2023 as they considered 2022 was the hardest year on record. On one hand, we welcome the return to more normal every-day life, such as a return to travel, gathering for festivities, sporting events, and so much more. On the other hand, our economic landscape and geopolitical environment kept us on our toes all year around. The way it stands today, those historical events such as the Russian-Ukraine war, China zero-Covid policy, the highest inflation rate in decades, steep interest rate hikes, continuing supply chain issues will likely continue shaping the current year.

It seems the CRA and IRS have continued to struggle with staffing issues and administering COVID-19 benefits as processing tax returns continue to lag behind documented service standards.

The CRA's website states that personal tax returns which are filed electronically should be assessed within two-weeks of filing. We have seen processing times up to 6 months for electronically filed personal tax returns. A target processing time of 8-weeks for paper filed returns is the standard posted by the CRA, however we have experienced several months before paper filed returns are processed.

In this issue of our annual cross-border tax newsletter, we provide highlights of changes that took place in 2022 or are set to take place in 2023 involving both the Canadian and U.S. taxation landscape as well as trending topics and facts to keep you in-the-know as we move into the tax season to come.

2022 Fall Economic Statement

Real Estate Transactions

There have been increased concerns regarding the potential abuses of the principal residence exemption (PRE) due to flipping properties. Beginning on January 1, 2023, a property which is owned for less than 365 consecutive days by the seller will be deemed to be a "flipped property" and therefore taxed as business income. The deeming of the profit to be business income instead of a capital gain means that the full profit is taxable unlike capital gains, which are only 50% taxable. It also means that the property cannot be designated as a principal residence and therefore all the profit is exempt from Canadian tax. There is also a loss limitation, meaning that although the flipped property is deemed to be business income, a net loss cannot be used to offset other income and gains.

This strict policy contains several exceptions to the holding period. They include the death of the property's owner, a marital breakdown, or the owner has an eligible relocation, etc.

Personal Services Business (PSB)

We are frequently asked should I, a US citizen in Canada, incorporate my business? When we explain the complexities and associated cost that come on the US side with operating through a corporation, clients are surprised. Another reason to consider incorporation carefully is the personal service business or PSB treatment on the Canadian side. The CRA announced in February 2022 that it intends to look closer at incorporated business services, specifically IT consulting, accounting, trucking, construction, and catering.

As active business income up to \$500,000 CAD is eligible for the small business deduction if earned through a corporation. The income is taxed personally at much higher rates when it is paid out as employment income or a dividend.

A corporation which is deemed to be a PSB is not eligible for the small business deduction, and the income is subject to an additional 5% tax. PSBs are also restricted with respect to permitted deductions.

If you offer consulting services through a corporation, your corporation may be deemed to be a PSB which is very costly. If you have received a letter from the CRA asking about your business services, please contact us to determine whether the PSB rules apply to you.

Share Buyback Tax

Taking a cue from our US neighbours, the Canadian Federal government announced that beginning on January 1, 2024, Canadian corporations with buyback public company shares will be subject to a 2% excise tax on the net value of the buyback. Details on this new tax are expected in 2023.

Clean Energy Credits and Incentives

Canada has announced new investment tax credits for corporations investing in clean technology. The investment credit is equal to 30% of the capital cost of eligible equipment such as that which generates solar, wind or water energy. The credit will apply to equipment placed in service on or after the day of the 2023 federal budget release with a gradual phase out beginning in 2032 and a complete phase out after 2034.

To encourage corporations to support clean hydrogen production, the Canadian Federal government proposed a tax credit as high as 40% for eligible investments made as of the 2023 federal budget date and phased out after 2030.

Interestingly, no individual clean energy incentives have been announced.

More information to follow in the 2023 federal budget so stay tuned!

First-time Homebuyers

Over the past decade, Canadian housing costs have been going up which meant that many taxpayers are not able to enter the Canadian housing market. The federal government announced in 2022, the Tax-Free First Home Savings Account (**FHSA**), which will be effective beginning on April 1, 2023. The FHSA is like the tax-free savings account (**TFSA**) which was introduced in 2009. There are several differences to note such as:

1. There is a 15-year time-limit for participation, beginning on the day on which the account is created or by the end of the year in which you turn 71
2. The contribution limit per taxpayer is \$8,000 CAD per calendar year and \$40,000 CAD during your lifetime and unused contribution room of up to \$8,000 may be carried over to subsequent tax years, once the FHSA has been opened
3. First time home buyer is defined as an individual who is at least 18 years of age, resident in Canada, purchasing a qualified home and has not live in a qualifying home as a principal residence, which is owned by the individual in the current year or in any of the previous four years. NOTE, the ownership requirement is not limited to qualified CANADIAN properties
4. The contribution to the FHSA is tax deductible, unlike TFSA contributions
5. Non-qualifying withdrawals are taxable
6. Unused balances may be rolled over to a RRSP or RRIF without affecting your contribution room
7. RRSP funds may be transferred to the FHSA – resulting in a tax-free withdrawal
8. You cannot open a FHSA if you owned a qualifying home in the current or any of the four immediately preceding years

For those with FHSAs who emigrate from Canada, they will be allowed to continue contributing to the account but will not be permitted to make a qualified withdrawal unless they become Canadian tax residents.

This means that a non-resident who makes a withdrawal from the FHSA will be taxed at a 25% flat tax rate.

US persons are cautioned that the FHSA is viewed to be like a TFSA and therefore income generated in the account will be subject to US taxation as it is earned.

The government has also increased the first-time homeowners tax credit from \$5,000 to \$10,000 starting in 2022.

Reporting Rules for Canadian Taxpayers with Trusts – Delayed...again

Way back in 2018, the Government announced that there would be more detailed reporting for trusts beginning with year-ends on or after December 31, 2021 and later deferred to December 31, 2022 year ends. In November 2022 it was announced that the effective date of the new reporting regime would be deferred a second time for years ending after December 30, 2023.

The new reporting rules pertain to trusts resident in Canada and non-resident trusts that must currently file a T3 return, including trusts that are inactive or dormant. **(Hence, if you have any inactive / dormant trusts, consider wrapping those up ASAP.)**

At a high level, the proposed changes are as follows:

- Certain trusts that don't currently file a T3 "Trust Income Tax and Information Return" will now have the filing obligation.
- Trusts must report the identity of all trustees, beneficiaries and settlors, including the identity of individuals who have control over the administration of the trust (e.g., a protector).
- The reporting rules now apply to a "bare trust" arrangement (i.e., a trust that is reasonably considered to act as an agent for beneficiaries in all dealings of the trust's property).

- Trusts with all units listed on a designated stock exchange are exempt from these additional reporting rules.
- Disclosure of information subject to solicitor-client privilege is also exempt.

Exemptions remain in place for certain specialized trusts or trusts holding assets worth \$50,000 or less.

TFSA

The CRA has announced that the 2023 TFSA contribution limit has been increased to \$6,500 CAD due to the inflation adjustment. This is a reminder that individuals who have not been a Canadian tax resident in any year since the introduction of the TFSA in 2009, will not receive contribution room for years where they were not residents of Canada for **the full calendar year**. We have seen increased CRA activity around ineligible TFSA contributions. Specifically, the CRA is issuing notices of assessment for the 1% per month penalty on ineligible contributions. The penalty will continue to accrue until the ineligible contributions are removed or the taxpayer receives additional room. If you think you have made an ineligible TFSA contribution, please reach out to us so we can help.

CRA Authorizations – Business Accounts

The CRA has once again updated its process for authorizing representatives such as HCBT, specifically when it comes to business accounts. Effective October of 2022, clients must now approve HCBT as a representative of the business by using "[My Business Account](#)". It is no longer sufficient for us to simply electronically file the authorization form signed by our clients with the CRA. In addition to providing the signed authorization form, clients must now log onto "My Business Account" and authorize HCBT as its representative within **10 business days**. If this is not done, HCBT will not be on record with the CRA as an authorized representative of your business.

Build Back Better Act – Reminder of 2022 Changes

Net Investment Income Tax (NIIT)

Under the Build Back Better Act which was recently signed into law by President Biden with an effective date of January 1, 2022, the NIIT has been expanded to self-employment and business taxpayers with more than \$400,000 (\$500,000 for joint filers) of taxable income.

In summary, the NIIT now applies to:

- Income of an S corporation shareholder (if the shareholder materially participates in the S corporation business)
- Gains from the sale of S corporation stock or interest in a partnership or LLC (if the selling owner materially participates in the business being sold)
- Gains from the sale of assets of a partnership, LLC or S corporation (if such gain is allocated to an owner who materially participates in the business being sold).

In other words, the expanded NIIT applies to all income earned by an individual, unless such income is either taxable wages or subject to the self-employment tax. For US citizens who are residents of Canada who derive their active income from self-proprietorships or partnerships and thus subject to CPP contribution, NIIT should not apply.

U.S. Surcharge on Ultra High Net Worth Taxpayers

Individual taxpayers will see a surcharge equal to the sum of 5% of their Adjusted Gross Income (AGI) that exceeds \$10 million. The threshold for married taxpayers filing separately is \$5 million and for estates and trusts the threshold is \$200,000. This is in addition to 3% of the amount of the taxpayer's AGI that exceeds \$25 million (\$12.5 million for married taxpayers filing separately; \$500,000 for an estate or trust).

Changes to the FDII and GILTI

The Build Back Better Act contains several revisions to the Global Intangible Low-Taxed Income (GILTI) tax, one of the taxes that is imposed on U.S. citizens who own foreign corporations. It ranges from a 10.5% to 13.125% minimum tax on income from various property and other non-US assets. For 2022, the GILTI deduction decreases from 50% to 28.5% and a tax rate increases to 15%. In addition, GILTI provisions will be amended to apply on a country-by-country basis.

Similar changes apply to the foreign-derived intangible income (FDII)

On a brighter side, the Code increases the allowable deemed paid foreign tax credit for GILTI from 80% to 95% of properly allocated taxes.

Reporting e-Commerce Transactions – Delayed

The IRS has given taxpayers, who use online platforms to conduct business, a one-year reprieve with respect to the revised reporting requirements as announced in the American Rescue Act in 2021. The reporting threshold was reduced from \$20,000 to \$600, in aggregate, for transactions on various online platforms such as PayPal, Venmo, eBay, Etsy and others. This would have meant that an individual selling even one item for more than \$600 would be required to report the transaction on Form 1099-K. While the reduced filing threshold has been delayed for the 2022 tax year, it will be applicable for 2023 transactions unless further action is taken by Congress to increase the reporting threshold.

COVID-19 Related Distributions

A reminder that if you took a distribution from an IRA or other qualified plan during 2020, you have until December 31, 2022 to repay the amount in full without paying income tax on the distribution. While unrepaid distributions are subject to income tax, the early withdrawal penalty for those under 59 ½ will not be subject to the 10% early withdrawal penalty.

2022 Inflation Reduction Act

New Measures

As worldwide inflation spiked to the new highs during the Covid months and continued into 2022, the US Government enacted its new set of policies with a catchy name - the Inflation Reduction Act. One of the new provisions introduced by the Act is a new corporate minimum tax, of 15% that will apply to corporations reporting more than \$1 billion of income.

Another corporate tax measure includes the 1% tax on publicly traded domestic (i.e., US) company stock buybacks. The intent is that instead of buying back corporate stock, corporations will use excess funds to invest in employees, equipment, and paying dividends which are believed to have a wider economic impact. An important note here is that certain merger and acquisition transactions will be subject to the 1% tax

Tax Extenders

The Affordable Care Act (**ACA**) contained a premium tax premium to help low-income and middle-income Americans afford health insurance. The American Rescue Plan Act (**ARPA**) extended the premium tax credit through 2025 and reduced the premium for many taxpayers. Specifically, taxpayers whose household income is up to 150% of the federal poverty line will not be required to pay any premium when purchasing a health plan through the ACA marketplace. Premiums required at levels up to 400% of the federal poverty line were reduced by up to 2.5%.

Green Initiatives

The U.S. Federal Government introduced “green initiatives” to encourage taxpayers to invest in clean energy alternatives. The measures introduced include:

Solar Project Tax Credit: Aimed at individual taxpayers, this is a 10-year extension of solar credits for homeowners who are adopting solar energy alternatives such as rooftop solar panels, energy efficient water heaters, heat pumps and HVAC systems.

EV Tax Credit: Electric vehicles (**EVs**) placed into service after December 31, 2022, will be able to claim the EV Tax Credit of up to \$7,500. The credit is set to expire on December 31, 2032. For EVs which are previously owned for at least 2 years may be eligible for a separate EV Tax Credit equal to the lesser of \$4,000 or 30% of the vehicle’s price. These credits are subject to modified adjusted gross income limits (\$150,000 Single; \$300,000 Joint; \$225,000 Head of Household) as well as price limits for the EV. Generally, EVs with a manufacturer’s suggested retail price of more than \$80,000 will not qualify for these tax credits.

EV Charger Tax Credit: This tax credit was set to expire on December 31, 2021 however it has been extended through December 31, 2032. In addition, the credit limit was increased for installations completed after December 31, 2022, from \$30,000 to \$100,000 of installation costs. The credit rate of 30% still applies. The credit applies to businesses as well as individuals.

Since Canada has not adopted similar initiatives at the individual levels, it is unlikely that any of them would benefit US citizens with permanent homes in Canada.

The IRS Gets a Financial Boost

The Inflation Reduction Act allocated \$80 billion of additional funding to the IRS over the next 10 years. This funding is expected to help with the modernization of the IRS’ taxpayer services, technology (business systems modernization), operations support and enforcement. The December 2022 omnibus bill contained a 2% cut to the IRS© 2023 fiscal budget. We have our fingers crossed that the additional funds will help the IRS process its backlog of over 12.4 million paper.