

Foreign corporations owned by U.S. citizens

As a general rule, if you are a U.S. citizen or greencard holder and you live outside the United States for more than 330 days during the year or become a tax resident of another country during the year, the U.S. Internal Revenue Service (IRS) will view you as a U.S. person living abroad and you will be eligible for the Foreign Earned Income Exclusion on your U.S. federal income tax return.

Individuals who qualify for the exclusion in 2018 can deduct up to US\$104,100 of ordinary income on their U.S. tax return. In other words, an individual can earn up to US\$104,100 in wages, business income and/or capital gains without being taxed on it by the United States.

Until very recently, individuals who operated businesses through foreign corporations could leave any earnings exceeding US\$104,100 inside their corporations, deferring taxation on this income until it is paid out as dividends.

However, the Trump administration's tax reform has changed this tax planning strategy and creates new obligations for U.S. persons who have ownership in a foreign corporation, including corporations in Canada:

1. Earnings retained in foreign corporations now have to be repatriated to the U.S. and will be taxed at a rate of 15.5%. Tax payments can be spread over 8 years.
2. The option of retaining earnings inside foreign corporations is no longer possible; all income generated through a foreign corporation will now be taxed by the United States in the year it was earned. However, the exclusion for individuals for the first US\$104,100 earned still applies.

The majority of foreign corporations will now have to pay taxes to the United States on earned income, regardless of their tax home.

If you are in this situation, there may be solutions for avoiding the application of these new rules. Please contact one of our tax specialists for advice on this matter.

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