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SPECIAL EDITION: POSSIBLE TAX CONSEQUENCES AND FINANCIAL CONCIDERATIONS RESULTING FROM THE US ELECTION

PRESIDENT TRUMP: HIS LEGAL LEGACY, THE TURMOIL AND THE FUTURE

By David Chodikoff, Editor-in-Chief of Taxes & Wealth Management, Partner and Tax Litigation Leader, Miller Thomson LLP

I don't know about you but the American political scene has kept my attention pretty much up until now. The world has never seen a US President like Donald J. Trump. Whether you are pro or anti Trump, there is no question that this US President has dramatically and, in some ways, fundamentally changed both the internal dynamics of US democracy and America's role and place in the international community of nation-states.

One of his chief accomplishments has been the reshaping of the federal judiciary. It definitely will be his most lasting impact. So far, Trump has been responsible for the installation of two Supreme Court Justices with a third likely to be confirmed within a couple of weeks. He has also appointed over 205 judges to the Federal Court. By the way, these are all lifetime appointments. Trump's judicial appointments make up roughly 25% of all US circuit court judges. The President has appointed 53 judges on the 13 US circuit courts. All of this is significant because the Courts have the last word in US politics and set precedents that can shape the United States for years to come. It is fair to say that these judges have a conservative outlook. If you want to appreciate the importance of this last observation look no further than the most recent decision of the US Supreme Court and the positions taken by Justices Thomas and Alito in *Obergefell v. Hodges*.

Another major impact that President Trump has had is tax reform. The Tax Cuts and Jobs Act was a Republican tax bill that implemented major changes to the US tax code. The law saw the corporate tax rate reduced from 35% to 21% and provided temporary benefits for individuals and their families. The law was supposed to encourage businesses to invest in their operations

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resulting in improved productivity and higher wages for workers. It was also believed that the law would cause a boost of the country's gross domestic product to 3%, or even more according to the President, and would thus pay for itself and increase prosperity across the country. The reality, however, is different as these lofty goals have not been achieved.

Another significant Trump accomplishment was the December 2018 signing of the First Step Act. This was the first major legislative action in years that sought to reform the criminal justice system. The legislation, which received bi-partisan support, was a major step towards ending mass incarceration. The law reduced mandatory minimum sentences for drug felonies and expanded the early-release programs. The bill offered more rehabilitation and job training opportunities and creating more ways to treat prisoners humanely. It also made retroactive a 2010 federal sentencing law reducing the sentencing differences between crack and powder cocaine offences.

In contrast to these accomplishments, there is a dark side of this US presidency. Most often, it does commence with the question: "What will President Trump say or do next?" and that question is then followed by: "How bad can it get?" Some readers may ask: "What do I mean when I write: 'How bad can it get?'"

Simply, at least since the 1960's the racial divide in the United States has never been greater. President Trump has repeatedly failed to plainly and meaningfully denounced white supremacists. Do you remember his comments in the aftermath of the neo-nazi rally in Charlottesville, Virginia? "There are very fine people on both sides", his words. And this is just one example of the social rift that has been inflamed by this President.

From our Canadian perch, we can see, and almost feel, that racial strife. I can hardly imagine what the tension must be like for so many in various communities south of the border. Watching from afar, protests and gatherings of one political stripe or another is one thing, but actually living through such events is something else.

The responsibility for this racial tension in American society, in large measure, lies squarely at the feet of the American President. The President has a duty to unite his people not divide them. The President is supposed to represent all states and not just those that are "red" (Republican) states. By any measure, the current US President's behaviour is extraordinary and not in a good way. Put it like this: would you want your son or daughter to grow up and behave like this President? I doubt it.

In the last several months, we have seen a number of books published that provide insight into the Trump presidency and its shortcomings. One of the latest works is by noted reporter, Bob Woodward. Mr. Woodward has a reputation as an extremely accomplished and respected investigative journalist. Both Mr. Woodward and Carl Bernstein did much of the reporting on the Watergate scandal. As many will recall, these scandals led to a number of congressional investigations and the ultimate resignation of President Richard M. Nixon.

This is Mr. Woodward's second book on President Trump. His first book was titled: *Fear: Trump in the White House*, published in 2018. And now, his second book about this President entitled *Rage* was published in September 2020. What is remarkable about *Rage* is that at the end of this book Mr. Woodward reaches the conclusion that President Trump is unfit for office. Given Mr. Woodward's long and distinguished journalistic history, it is remarkable that he makes this point; even more so as he has covered and written about US Presidents since the days of Nixon and never before has he taken such a public position.

While Canadians can watch with interest, or in amusement or in horror at the current US political scene, the likely outcome of this US Presidential race remains unknown. Polls point to a Biden win. But, the polls have been wrong before and as I write this column we are still weeks away from the actual vote.

Imagine if you will, a Trump re-election. How could his administration's policies impact Canada? What if the Democratic candidate for the US Presidency, Joe Biden wins? What could this mean for Canadians? A number of articles in this edition explore the tax policy implications for Canada, the future prospects for gold and investments, in general. In the final analysis, it is impossible to predict with absolute accuracy the future. However, our government should prepare itself for either outcome. Brace yourselves, the fallout from the American election is bound to effect all of us living on this tiny planet.

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A TALE OF TWO TAX PLANS: WHAT DOES THE US ELECTION MEAN FOR CANADA?

By Arthur Cockfield, Professor and Associate Dean (Academic Policy), Queen's University Faculty of Law

With the US federal election looming, President Donald Trump and Democratic presidential nominee Joe Biden have released dueling tax plans. Perhaps unsurprisingly, the Donald is promising more and bigger tax cuts while Biden has proposed hiking select taxes. What does all this mean for Canada? The main implication is that under a second-term Trump presidency, Canada would likely become even less competitive from a corporate income tax perspective compared to the United States. Under a Biden presidency, the reverse would occur and Canada would be better enabled to 'compete' with its current tax system.

The following sets out some general observations concerning the plight of Canada if Trump or Biden is elected.

In 2017, the United States engaged in significant corporate tax reform, with Trump's support, through the Tax Cuts and Job Act (TCJA). First, federal corporate tax rates were reduced from 35% to 21%. Second, the US international income tax system was switched from a residence-based system that seeks to tax all foreign active business income to a territorial system that exempts this income from taxation. Third, the TCJA created minimum taxes for both outbound direct investment (the Global Income Tax on Intangibles or GILTI) as well as inbound direct investment (the Base Erosion and Anti-Abuse Tax or BEAT). Fourth, the top individual tax rate was reduced from 39.6% to 37%, the individual income tax base was broadened, and a number of itemized deductions were eliminated or limited. It is noteworthy that Canada moved in the opposite direction by recently hiking the highest federal individual income tax rate to 33% for income over $200,000 (indexed for inflation) and creating a complex new Tax on Split Income (TOSI) system to combat dividend sprinkling to adult children by high income earners.

The corporate cuts in the United States are permanent while the individual tax reforms are set to expire at the end of 2025. If Trump is re-elected, it seems likely he will urge Congress and the Senate to make the individual tax changes permanent as well.

The US reforms steps make the US corporate tax system relatively more attractive than the Canadian system. In fact, the reforms wiped out Canada's 'tax advantage' that has been touted by Canadian governments since the Chretien administration. At least in theory, lower Canadian corporate income taxes compared to US taxes served to attract foreign direct investment to Canada. Canada now has a general corporate income tax rate of 38% (or 28% after the federal tax abatement). What really matters is the marginal effective tax rates (METRs) faced by firms on both sides of the border. While the calculation of these rates is complex and involves accounting for dividend imputation systems, it now appears that general METRs are lower in the United States compared to Canada.

The US has also adopted a territorial system akin to the one Canada has deployed for many decades. Under the Canadian approach, foreign active business income is effectively exempt from Canadian tax if it is earned within a related corporation based in a tax treaty partner (or Tax Information Exchange Agreement partner since 2007). It is interesting to note that the Canadian approach was once decried in a Harvard Law study as lousy tax policy that improperly encourages the use of tax havens.[1] Over time, however, most countries adopted the Canadian way and, in fact, the United States was the last major economy to hold out. US firms hence now get the same favorable tax treatment as Canadian ones: most foreign profits can now be booked offshore; with tax planning, these profits are often shifted to tax havens where they attract low or nil income taxation. This is another Canadian tax advantage that was eroded by the TCJA.

The imposition of new US minimum taxes, however, may cut the other way by increasing the global tax liabilities of US multinational firms. It is too early to tell whether the BEAT and the GILTI have bite or whether they can be planned around (as some practitioners and academics assert). If the taxes do give rise to greater tax liabilities, then Canadian resident firms will appear to be comparatively better off. While cloudy the future is (thanks Yoda), I predict these minimum taxes will be copied by Canada and other countries as a way to tamp down on aggressive international tax planning that is increasingly seen as a political liability around the world.

If Trump is elected, he has promised to promote even greater tax cuts for corporations and individuals. Somewhat surprisingly, Trump is not promising radical tax reform such as switching to a consumption-based tax system or a flat tax; the sorts of reforms that Republicans began promoting in the late 1990s (think of Steve Forbe's Flat Tax proposal). These more radical forms gave Canadian policy-makers nightmares because it seemed likely Canada would have to overhaul its tax system to account for the change — that never took place.[2]

In terms of the individual tax reforms, workers are generally much less mobile compared to capital. Nevertheless, there is always a 'brain drain' concern if levels of taxation get too far out of whack on both sides of the border.[3] There is some empirical evidence that suggests Canadian technology workers and others were motivated in part by tax reasons in the 1990s to take up work within the United States.[4] Still, so many other factors come into play — politics, weather, school districts, job opportunities and so on — that tax likely does not play a significant factor at motivating cross-border moves.

Canada's prospects seem sunnier under a Biden presidency. Biden has promised to increase the US federal corporate income tax rate to 28% and reinstate the corporate alternative minimum tax that was repealed by the TCJA. Biden intends to restore the 39.6% individual income tax rate for individuals with taxable income above USD$400,000. Biden also hopes to reduce the favorable tax

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1 See William J. Gibbons, *Tax Factors in Basing International Business Abroad* (Cambridge: Harvard Law School, International Program in Taxation, 1957), as cited by J. Harvey Perry, *A Fiscal History of Canada—The Postwar Years* (Toronto: CTF Canadian Tax Paper no. 85, 1989) at 1033.

2 Arthur Cockfield, *The Impact of U.S. Consumption Tax Reform on Canada*, 4 Law & Bus. Rev. Am. 74 (1998).

3 For discussion, see Arthur Cockfield, *NAFTA Tax Law and Policy* (Toronto: University of Toronto Press), at 22-45.

4 Analysis of income tax data on taxpayers who left Canada for foreign countries during the 1990s shows that individuals who earned more than$150,000 a year were seven times as likely to leave than the average taxpayer. Statistics Canada, *Brain Drain and Brain Gain: The Migration of Knowledge Workers Into and Out of Canada* (Ottawa: Statistics Canada, 2000).

treatment for long-term capital gains and qualified dividends above USD$1 million.

Assuming Biden is elected and follows through on his tax promises, Canada's corporate income tax system will be more in line with the US system and this could help to restore Canada's tax competitiveness vis-à-vis the United States. The proposed US individual income tax reforms would also bring the United States closer to the system within Canada.

Readers of this newsletter may also be interested in US reforms directed at estates and gifts. Canada abolished its estate and gift taxes in the early 1970s when a capital gains tax was introduced: the main way that estates in Canada are taxed is via the deemed sale of all assets at death under the *Income Tax Act*, which triggers a capital gain. In contrast, the United States imposes a separate federal tax at a rate of 40% on very large estates and gifts. Under the TCJA, the USD$5 million estate tax exemption was doubled to USD$10 million (as this amount is indexed for inflation, the 2020 exemption covers estates and gifts equal or less to USD$11.58 million).

Biden has promised to restore the old USD$5 million threshold and, much more importantly, eliminate what is called the 'step-up basis' in inherited assets. Under the current US approach, the value of most assets is increased (or 'stepped-up') from its cost to its fair market value at death, eliminating any capital gains tax. While lacking details at this stage, the Biden plan could hence tax estates in a similar manner to the Canadian way: estates have to pay capital gains tax on the difference between the fair market value at death and the adjusted cost base of the asset due to the deemed disposition at death. (Notably, Canadian deemed capital gains taxes at death can sometimes be planned around through, for instance, estate freezes or sales of shares of a small business eligible for capital gains exemptions.)

A trickier issue surrounds the sunset provision in the TCJA whereby the estate tax reforms and the higher exemptions are set to expire in 2025. Trump has promised to make the tax changes permanent, but it seems likely that Biden would push Congress to maintain the expiry date.

This last bit makes high net worth individuals nervous (including those Canucks who cannot plan around US estates and gifts tax imposed on their US-based assets). To take advantage of the current expanded gifts and estate tax exemption threshold, some wealthier taxpayers are transferring assets into trusts with family members as designated beneficiaries — in the event Biden is elected and decides to reduce the threshold. If Trump remains President or Congress/Senate refuses to enact Biden's proposal, then the trust can be undone.

In summary, US tax reforms via the TCJA in 2017 made Canada look comparatively less attractive from a corporate income tax perspective. If Trump is elected, we will likely see more of the same and the Canadian tax system may appear comparatively burdensome. Biden, on the other hand, promises moderate tax increases on individuals and corporations that would restore the United States to a tax position that is more aligned with the current Canadian approach.

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THE US PRESIDENTIAL ELECTION, THE ECONOMY, AND GOLD: HOW TO PREPARE FOR THE COMING MARKET CRASH

By Nick Barisheff, Founder, President and CEO of BMG Group Inc.

Global stock markets suffered the worst first quarter in their history in 2020, as the COVID-19 pandemic rattled markets. After slowing 5% in the first three months of 2020, the US economy shrank by a whopping 33% in the second quarter. If you think these numbers are bad, it is only going to get worse. The second wave of the pandemic is forcing governments around the world to renew lockdown measures that will push the US economy, and most western economies, to the brink.

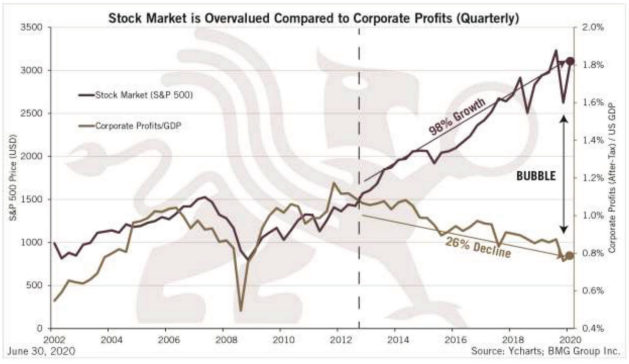
CHAOTIC ELECTIONS, A BATTERED ECONOMY

This is all happening at a time when the US is about to face the most chaotic presidential election in its history in November. Rioting and civil insurrection are occurring in US cities, and crime is accelerating. Lawsuits over mail-in ballots have already started across the country. What's more, the nomination of Amy Coney Barrett as successor to Ruth Bader Ginsburg promises to be hotly contested, as the choice of nominee will have huge implications following the election. If the election result is disputed, the US Supreme Court may end up deciding whether Trump or Biden will be president for the next four years.

If the global pandemic, civil unrest in many US cities, and war looming in Armenia, thus pulling Russia, NATO and the European Union into a conflict were not enough, the US economy, as well as most western economies — including Canada's — are going to get a whole lot worse.

OVERVALUED MARKETS, DECLINING CORPORATE PROFITS

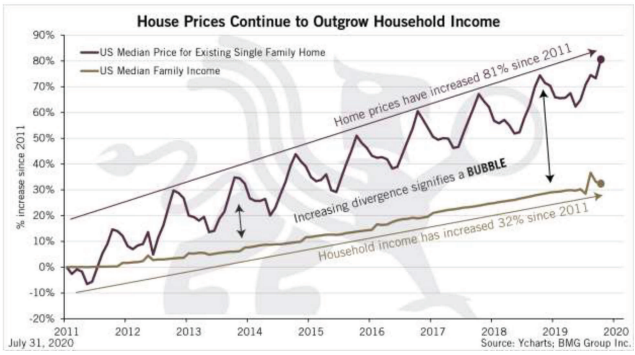
US equity markets and corporate profits were already on a divergent path well before COVID-19 hit, and this trend will only continue — especially if the second wave forces more closures and lockdowns in the fall and winter. Restaurants, hotels, travel and tourism, airlines, and small businesses across the country are barely hanging on. Bankruptcies are set to skyrocket.



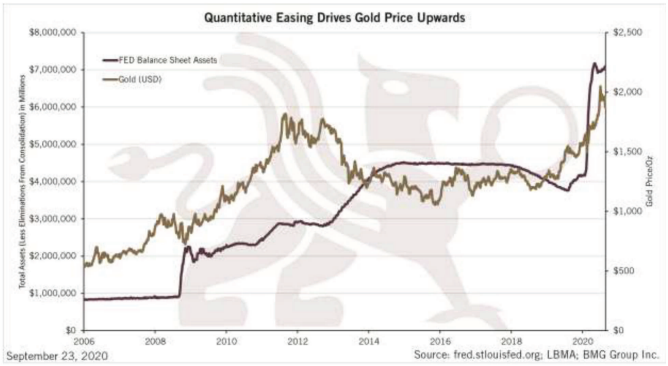
COMING DEFAULTS IN THE REAL ESTATE SECTOR

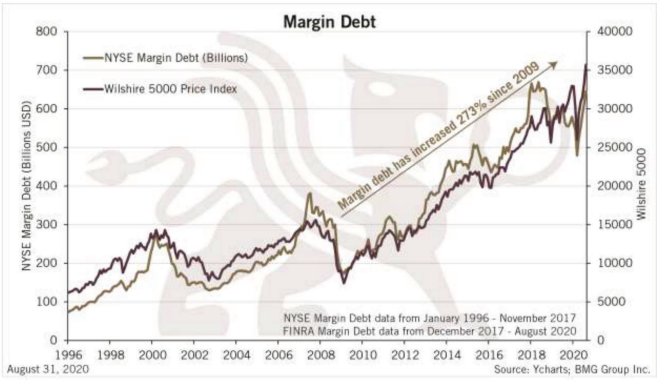
One of the biggest economic issues — one that hasn't received a lot of attention — is the wave of defaults that will hit all areas of the real estate sector. Financial districts of major cities are ghost towns. It's just a matter of time before large tenants terminate or default on their leases. Developers are stuck in a rut, as demand has collapsed.

Mortgage defaults and collapsing real estate markets will in turn lead to problems in the banking sector. In fact, mortgage delinquency rates in the US climbed to 8.2% at the end of June — the highest level since 2011. More than 8% of all US mortgages were past due or in foreclosure.



To keep the economy from collapsing, the U.S. Federal Reserve and other western central banks will have to print even more money, which will only exacerbate the bubbles in the financial markets and margin debt levels. What's most worrisome is that all these factors — declining markets, a shrinking economy, and the second wave of the pandemic — are morphing together just as the US is about to face one of the most chaotic presidential elections in history.



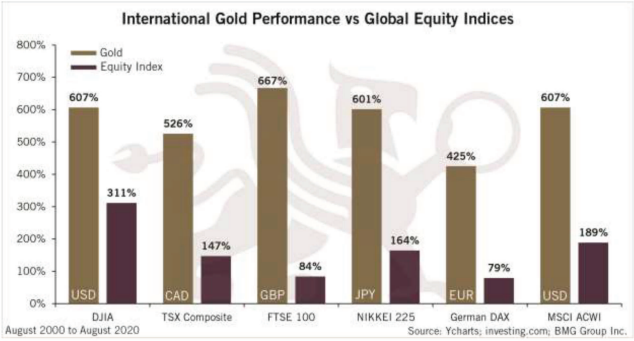


HOW SHOULD INVESTORS PROCEED?

What are investors to do? If you listen to the media or those in the industry, the mantra is to stay invested for the long term. That strategy works well during long bull markets. However, this strategy doesn't make sense when you're standing on the edge of a precipice — which we are today.

The market is poised to fall much further, so it does not make sense to stay invested in financial assets and suffer additional losses. In fact, if a portfolio declines by 50%, it would have to increase by 100% just to break even. Market history is full of examples of this.

For self-directed investors using discount brokerage accounts, a better strategy would be switching to Class D units of BMG Mutual Funds. The best place to be invested while awaiting the market crash is gold bullion, because gold has a low correlation to other asset classes and has historically appreciated during broad market corrections. In fact, gold has risen dramatically this year, and will continue to do so while other asset classes continue to decline.



AN INVESTMENT STRATEGY FOR TODAY'S MARKETS

For accredited investors and institutions, an even better strategy would be switching to gold, experiencing significant gains, and then redeploying those gains to a diversified portfolio of stocks, bonds, REITs, gold and silver when the market has finished correcting. This is exactly what the BMG Diversified Hedge Fund is designed to do.

A properly structured and timed transition into the best-performing funds across four asset classes — equities, fixed income, real estate, and gold and silver bullion — will significantly improve yields and capital appreciation while maintaining low levels of volatility, when there is a broad and sustained market recovery.

At BMG, we back-tested this strategy with our BMG Diversified Hedge Fund and found that implementing it during the 2008 financial crisis would have resulted in annual gains of 22% for 12 years afterwards. Plus, investors would have received over $45,000 in dividends over this period on an initial $25,000 investment.

Now is not the time to stay invested. Many baby boomers will simply not live long enough to break even. Instead of moving to cash, consider that gold can provide your portfolio investment gains, true diversification away from stock and bond markets, and a hedge against the coming market crash. The chaos in the economy and the US presidential election means the price of gold will continue to increase dramatically in the foreseeable future.

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INVESTING THEMES IF BIDEN OR TRUMP WINS THE US ELECTION

By Cenk 'Jenk' Albayrak, CIM, Senior Investment Advisor & Portfolio Manager, National Bank Financial Ltd.

Investors should be reminded that there are more scenarios to consider than Biden versus Trump. It also depends on whether there is a sweep or a divided congress. The general consensus from strategists seems to be that what may be best for the market would be a Biden win as investors would benefit from a less volatile President but they would also want a divided Congress for protection from sweeping legislative changes.

A COUPLE OF GENERAL POINTS

Generally, the view is that Biden may benefit defensive and secular growth sectors and would not benefit cyclical and value-oriented sectors. Meanwhile, under Trump it is viewed that defensive sectors may lag and financials, oil and gas and industrials will benefit.

Biden is pro green energy, so this may benefit utilities, plays on electric vehicles (including Copper which is an essential component), solar and hydrogen. Meanwhile oil and gas companies may benefit from a Trump presidency. A split congress is less likely to pass stricter regulations, whether it be fracking, pipelines or pharma.

Trump is viewed as corporate friendly — pro lowering taxes and deregulation: So, positive for financials; Negative for multinationals that profit from China or offshoring.

Both are pro defense. Biden doesn't see making cuts to the defense budget and thinks that US presence should remain in the middle east. Trump has raised the defense budget every year.

There is also a push to Environmental, Social, and Corporate Governance (ESG) globally and companies that are working on transitioning will be beneficiaries. For example, we recently saw the news out of BP and their flip to renewables. That would get more attention with a Biden win.

RISK OF A CONTESTED ELECTION COULD RATTLE THE MARKETS

In a National Bank of Canada Geopolitical Briefing dated September 22, Angelo Katsoras outlines the potential implications of a contested election.

One scenario with the potential to rattle the markets is a close presidential election where one candidate openly questions the legitimacy of the results. This could involve mail-in votes still not fully counted days or weeks past election day. In 2016, 24 of ballots cast in the presidential election were mailed in. This percentage will no doubt be much higher this time around as more voters will shun polling stations to avoid the risk of infection.

Something similar to this scenario occurred in 2000 between George W. Bush and Al Gore. The election hung in the balance for five weeks amid a battle over vote counting in Florida. The winner was declared on December 13 only once Gore conceded defeat after the Supreme Court intervened to award Bush the state. During the five-week wait, the S&P fell 12%, although the dotcom collapse also played a role in the decline.[1]

An indication of the delays that could ensue this time around was provided by New York's Democratic Congressional primaries on June 23. The volume of mailed ballots was 10 times higher than usual and, in some congressional contests, the winners were not announced until well over a month later.[2]

Given the animosity between the two parties and their supporters, a replay of 2000 would likely be even tenser, with both parties por-

1 "If Joe Biden wins the U.S. presidential election, will the market collapse?" *The Globe and Mail*, July 31, 2020.

2 "Markets Aren't Great at Handling Contested Elections," *Bloomberg*, September 2, 2020.

traying the other side as a threat to the country's future. It is also important to note that the dispute in Florida took place during a much calmer period than today. It occurred before all of the following: 9/11, China's ascension as a world power, the rise of divisive social media, and Covid-19.

Not surprisingly, both campaigns have put together massive legal teams to prepare for the risk of a contested election.

Officially, states must certify their electors by December 8 and electors must then cast their ballots by December 14. Congress then meets to ratify the results on January 6, and the president is inaugurated on January 20. In the event that no president is chosen by the date of the inauguration, an acting president would have to be chosen to temporarily lead the country until the leadership dispute is resolved. Some constitutional experts say this person would be Speaker of the House Nancy Pelosi, although Republicans would no doubt vigorously oppose this choice.[3]

INVESTING REGARDLESS OF THE OUTCOME

There are secular themes that may benefit from either presidency such as the move to digital and themes like cybersecurity, cloud computing, 5G, data storage, transmission and analysis, eLearning, AI, health and infrastructure. Those are here to stay regardless of who wins. Here is a short list of those growing companies you could consider for your portfolio:

Boralex
Cargojet
Docebo
Innergex Renewable Energy
Jamieson Wellness
Kinaxis
Lightspeed POS
Shopify
WSP Global

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[3] "What happens if Trump loses but refuses to concede," *The Financial Times*, September 14, 2020.

[4] National Bank Financial is an indirect wholly-owned subsidiary of National Bank of Canada. The National Bank of Canada is a public company listed on the Toronto Stock Exchange (NA: TSX). The securities or sectors mentioned in this letter are not suitable for all types of investors and should not be considered as recommendations. Please consult your investment advisor to verify whether this security or sector is suitable for you and to obtain complete information, including the main risk factors. The particulars contained herein were obtained from sources we believe to be reliable, but are not guaranteed by us and may be incomplete. The opinions expressed are based upon our analysis and interpretation of these particulars and are not to be construed as a solicitation or offer to buy or sell the securities mentioned herein.

ARE CORPORATE INCOME TAX RATES CRUCIAL TO CANADA'S COMPETITIVENESS?

By Amanda Perumal, Articling Student, Miller Thomson LLP

INTRODUCTION

The past two years have called into question the dominant theory that lower corporate income tax rates are necessary for Canada to attract foreign direct investment (FDI). Despite having a significantly higher average general federal-provincial corporate tax rate than the United States since 2018, Canada's inbound FDI has increased considerably in the past two years. It is becoming increasingly clear that the old adage 'when the United States sneezes, Canada catches cold' may not necessarily be true anymore.

While businesses consider a number of factors when deciding where to locate, corporate income tax rates are widely held to be a primary factor. With the United States set to elect their next President on November 3, 2020, Canada's tax community would be wise to consider how the outcome may impact Canada's corporate tax rates.

This article will discuss the probability of a Biden or Trump presidency and analyze the potential impact on Canada's corporate income tax. Canada's ability to attract and retain investment vis-à-vis the United States will also be discussed.

The possibilities explored in this article reveal that a Trump win could mean little changes to Canada's corporate taxes and our competitive position. However, a Biden win presents some uncertainty. Canada's corporate income tax may once again become much lower than that of the US if Biden becomes the President. However, other social and economic factors may make the United States once again attractive for investment relative to Canada. In either scenario, Canada should observe the full impact of a Biden presidency before reacting with changes to our tax scheme.

CANADA'S CURRENT RELATIONSHIP WITH THE US — TESTING THE COMMON THEORY

The current state of Canada's relationship with the United States can be described using any number of adjectives: close, tense, competitive, complicated. Despite the political aspects of Canada's relationship with our neighbours to the south, we do a great deal of business together. The closeness of Canada's relationship with the United States allows our two countries to be both mutually dependent on each other for FDI, and competitive with each other in attracting and retaining investment.

To the extent that lower corporate tax rates attract FDI and retain domestic commerce, one could infer that when either Canada or the United States lowers its corporate tax rate, the other may be forced to do the same in order to stay competitive. This is a logical theory, but the past few years illustrate that it is not well-founded.

When Congress lowered the US corporate tax rate from 35% to 21% in 2018, many expected that Canada would have to follow suit.[1] After all, prior to the US rate cut, Canada boasted an average

[1] Kevin Milligan, "What does Trump mean for Canadian taxes?," *Macleans* (January 16, 2017), online: <https://www.macleans.ca/economy/economicanalysis/what-does-trump-mean-for-canadian-taxes/>.

general federal-provincial rate of just 26.5%,[2] and losing our competitive position seemed risky at the time.[3] However, two years later, Canada's rate has remained the same and our FDI (pre-pandemic) has continued to climb. In comparison, FDI into the United States sits significantly lower than its 2015 level.[4] Thus, Canada's ability to attract FDI is not necessarily determined by which of the two nations features lower corporate tax rates.

Interestingly, Canada has become less reliant on the United States for FDI in recent years and has simultaneously increased FDI coming from other countries. In 2018, after the US dropped its corporate tax rate, non-US FDI into Canada grew by more than 300%.[5] In fact, even Global Affairs Canada has recognized that the relative importance of the US to Canada's FDI has declined over the past decade.[6] Much of Canada's growth in FDI can be attributed to our highly-skilled workforce, reputable post-secondary institutions, and abundant natural resources, among others.[7]

All of these factors call into question the traditional trope that Canada is submissive to the supposed economic and political prowess of the United States, and that low corporate taxes are our primary defence. Indeed, many factors explain why Canada has proven so attractive to investment lately. Whether Canada's appeal persists may depend on who the President-elect is on November 4, 2020.

IF BIDEN WINS

With just weeks until the United States' election day, it is anyone's guess who will win and how the world will react. Against the backdrop of COVID-19, deeply rooted racial injustice, and economic uncertainty, the next President has many major issues to address. Additionally, deep political divisions amongst politicians and the citizenry could make progress on the above issues very difficult.

At the time of writing, Joe Biden leads in the national polls with 50% to President Trump's 43%.[8] Success in the electoral college depends greatly on winning the highly revered battleground states. Current polls indicate that Biden is leading in 11 out of the 14 battleground states, seven of which are currently held by the Republicans. These figures, coupled with the Democratic party's greater financial resources, paint a bleak picture for President Trump and the Republicans.[9]

Biden's tax platform is based on making wealthy Americans and big corporations "pay their fair share."[10] He plans to raise the US corporate rate to 28%, double the tax rate on foreign-earned income for American corporations, and impose a minimum 15% tax on book income, among other measures.[11]

If the US corporate tax is raised to 28%, Canada's average general federal-provincial corporate rate of 26.5% would once again be lower than that of the United States. When this lower rate is considered with the above factors responsible for Canada's FDI growth, Canada would likely become even stronger and more competitive than before.

However, under a Biden administration, the United States may become more competitive if the current factors that deter FDI into the United States are alleviated. If Biden delivers on his election promises, the United States could become a more stable nation with a healthier, and more productive workforce. These improved social and economic factors, in conjunction with the United States' larger consumer market, may combine to form a real threat to Canada's economic position, notwithstanding our lower corporate tax rate.

How real of a threat is this? Joe Biden's election promises are just that — promises. Whether they come to fruition depends on several contingencies: that he wins the election, that he can get his tax hikes approved in Congress, and that he is able to somehow repair a country that has been socially and economically shaken to its core. Many changes would be required before the aforementioned threat to Canada materializes, which would likely take several years. Lastly, it goes without saying that the nation that more effectively manages the COVID-19 pandemic has a serious business advantage. The grave and urgent nature of this crisis almost certainly eclipses concerns about corporate taxes in boardrooms and start-ups around the country this year.

In sum, a Biden win may be good for Canada's competitive position, but it also may be problematic. A hike in the US corporate tax rate would restore Canada's original position as the country offering lower tax burdens to businesses. While this may bode well for attracting FDI and retaining domestic investment, other improvements that the Democrats implement may overshadow Canada's tax advantage. Fortunately, Canada will have the luxury of time to adjust its tax policies to these changing circumstances.

IF TRUMP WINS

President Trump lags behind Joe Biden both in national polls and the battleground states. Many factors may contribute to Trump's precarious position. From an impeachment vote, to an ineffective COVID-19 response, to stoking the flames of racism and injustice, there are plenty of reasons why voters may be unwilling to support four more years of Republican leadership.

President Trump's platform does not contain detailed tax plans. Reports indicate that he intends to transform the TCJA's (Tax Cuts and Jobs Act) temporary measures into permanent ones. The President has also expressed support for a further reduction of the US corporate tax rate to 20%.[12]

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2 Deloitte, "Corporate income tax rates (%)" (May 31, 2017), online: *Canadian tax rates archive* <https://www2.deloitte.com/ca/en/pages/tax/articles/canadian-tax-rates-archive.html>.

3 Milligan, *supra* note 1.

4 OECD, "FDI Flows," online: *OECD Data* <https://data.oecd.org/fdi/fdi-flows.htm>.

5 Ian McKay, "Why Canada Saw a 60% increase in foreign direct investment last year", *The Globe and Mail* (May 22, 2019), online: <https://www.theglobeandmail.com/business/commentary/article-why-canada-saw-a-60-increase-in-foreign-direct-investment-last-year/>.

6 Global Affairs Canada, "Stock of Foreign Direct Investment (FDI) in Canada, 2018" online: *Global Affairs Canada* <international.gc.ca/economist-economiste/statistics-statistiques/fdi-ide-2018.aspx?lang=eng>.

7 McKay, *supra* note 5.

8 BBC News, "US election 2020 polls: Who is ahead — Trump or Biden?" (September 28, 2020), online: *US Election 2020 https://www.bbc.com/news/election-us-2020-53657174>.*

9 *Ibid*.

10 "A Tale of Two Tax Policies: Trump Rewards Wealth, Biden Rewards Work," online: *Biden Harris* < https://joebiden.com/two-tax-policies/>.

11 *Ibid*.

12 Deloitte "Tax policy decisions ahead: Implications of the 2020 presidential election" (September 9, 2020), online: *Analysis* < https://www2.deloitte.-com/content/dam/Deloitte/us/Documents/Tax/us-tax-biden-trump-POV.pdf>.

While a Trump win would likely prolong Canada's political tensions with the United States, it may allow Canada to continue attracting FDI without changes to our tax scheme. It is not far-fetched to picture that a Trump win will cause international shock, widespread civil unrest, and worsening of the COVID-19 pandemic in the United States. A corporation looking to establish or expand may not be willing to take risks with this type of uncertainty.

Canada's comparatively stable political climate, relatively healthy and educated workforce, and effective COVID-19 response would likely overshadow our higher corporate tax rates and allow Canada to divert FDI from the United States. Thus, a Trump win would likely not require a reduction to Canada's corporate tax rate or create concern over our economic prospects. If the past two years are any indicator, Canada has proven that there is more to attracting business than low tax rates.

CONCLUSION

The notion that Canada competes with the United States for foreign direct investment is deeply entrenched in our country. So too is the notion that low corporate tax rates are the key ingredient to attracting said investment.

This theory was tested when the United States lowered its corporate tax rate to 21% in 2018. While many speculated at the time that Canada would do the same, we can now see that such a move was not necessary. Canada's reliance on the United States for incoming FDI has reduced over the past decade, while Canada has proven increasingly attractive for FDI from other parts of the world.

The winner of the November 3, 2020 US presidential election will undoubtedly be of interest to Canada and the rest of the world. Each candidate has differing views on appropriate corporate tax policy. Trump's continuation of the TCJA may offer an even lower corporate tax rate to businesses, but that will likely not be sufficient to divert FDI from Canada to the United States.

However, a Biden win may be more challenging for Canada's ability to attract FDI. His proposed hike in corporate tax rates may not dissuade corporations from investing in the United States if Mr. Biden can restore the economic and political landscape that made the United States a global powerhouse to begin with. However, the magnitude of change that is needed in order to create a fertile business environment is likely many years away.

When it comes to tax policy, Canada has many issues to address, but it is clear that Canada does not need to lower its corporate tax rate to compete with the United States. The United States may be sneezing, but Canada is feeling just fine.

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THE BIDEN PLAN: A NECESSARY COMPROMISE FOR AMERICA, AN OPPORTUNITY FOR CANADA

By Anish Kamboj, Articling Student, Miller Thomson LLP

Drafted in conjunction with Senator Bernie Sanders and Alexandria Ocasio-Cortez, the 110 page Biden Plan takes the aggressive approach of increasing tax revenue by approximately $3.8 trillion[1] over the next 10 years.[2] With primary increases to the corporate tax rate, the highest individual tax bracket, the capital gains rate, and the estate tax,[3] the Biden-Harris campaign has focused its efforts on the richest Americans. In a country where the top 1% continue to accumulate wealth while the bottom 99% riot for basic human rights, the Democrats are proposing a plan that may be necessary for both economic and social reform.

With a pandemic plagued economy suffering through a recession, increasing taxation may not be the economist-recommended solution. The $3.8 trillion increase will translate into $3.2 trillion in revenue after factoring in the resulting decline in the US economy. Estimates indicate the GDP will reduce by 1.5% in the long run, the capital stock will shrink by 3.23%, and there will be a reduction in full-time jobs by 585,000.[4] But what option does the country have?

On one hand, the American public can vote to increase taxation on high-income earners. This could result in long-term change as wealth is redistributed amongst the middle and lower class. On the other hand, they can re-elect a President who claims to 'Make America Great Again' by placing the interests of the top 1%[5] at the forefront of his campaign.

In 2017, President Trump signed into law the Tax Cuts and Jobs Act ("TCJA"), a controversial tax reform that rewarded high-income earners. The TCJA reduced the highest individual tax rate from 39.6% to 37% for individuals with taxable income above $400,000, replaced the gradual corporate tax rate with a flat 21% rate, and doubled the estate tax exemption from $5 million to $11.58 million in 2020.[6] President Trump's proposed tax plan for the election is unclear. It may keep the TCJA intact with few changes.[7]

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1 All dollar figures in this article are in USD.

2 Committee for a Responsible Federal Budget, "Understanding Joe Biden's 2020 Tax Plan" (30 July 2020), online: *Committee for a Responsible Federal Budget* <http://www.crfb.org/papers/understanding-joe-bidens-2020-tax-plan> [CRFB].

3 Alexander Marino and Jennifer Silvius, "Trump Vs. Biden: Who Should the US Citizen Expat be Rooting for "Tax-Wise"?" (7 August 2020), online: *Mondaq* <https://www.mondaq.com/unitedstates/tax-authorities/974192/trump-vs-biden-who-should-the-us-citizen-expat-be-rooting-for-tax-wise?login=true> [Trump Vs. Biden].

4 Taylor LaJoie, Huaquin Li and Garrett Watson, "Details and Analysis of Former Vice President Biden's Tax Proposals" (29 April 2020), online: *Tax Foundation https://taxfoundation.org/joe-biden-tax-plan-2020/> [Tax Foundation]*.

5 An Income of $538,936 is considered to be among the top 1% of income earners in the United States: Samuel Stebbins and Evan Comen, "How much do you need to make to be in the top 1% in every state? Here's the list" (1 July 2020), online: *USA Today* <https://www.usatoday.com/story/money/2020/07/01/how-much-you-need-to-make-to-be-in-the-1-in-every-state/112002276/>.

6 Ken Berry, "Election 2020: Comparing the Biden and Trump Tax Plan" (1 September 2020), online: *CPA Practice Advisor* <https://www.cpapracticeadvisor.com/tax-compliance/news/21152588/election-2020-comparing-the-biden-and-trump-tax-plans> [Comparing the Biden and Trump Tax Plan].

7 *Ibid*.

A detailed comparison of the TCJA, President Trump's proposed taxation scheme, and the Biden Plan is outlined in the table below:[8]

	Current law	Donald Trump	Joe Biden
Individual Income Tax Rate	• Top marginal rate of 37%	• Possible 10% rate cut for middle-income taxpayers	• Raise the top marginal rate to 39.6% for individuals with taxable income over $400,000
Corporate Tax Rate	• Flat 21% tax rate and no Alternative Minimum Tax	• No proposed change	• Raise to 28% tax rate • Reinstate the 15% Alternative Minimum Tax on profits over $100 million
Global Intangible Low-Taxed Income Rate ("GILTI")	• 10.5% tax rate	• No proposed change	• Double the tax rate to 21%
Capital Gains and Dividends	• 0% tax on capital gains and dividends between $0 and $40,000 • 15% tax on capital gains and dividends between $40,001 and $441,450 • 20% tax on capital gains and dividends of $441,451 and above	• Potential reduction in capital gains rate and index gains for inflation	• Tax all capital gains at 39.6% for a taxpayer with income above $1 million • Eliminate the long-term capital gains rate
Estate Tax	• $5 million estate tax exemption increased to $11.58 million in 2020 • Basis in inherited property adjusted to fair market value at the time of the donor's death • Capital Gains are not taxed until the property is sold	• Extend more generous estate exemptions and maintain the step-up basis for property received by inheritance	• Reduce the estate tax exemption to $5 million with further reductions to come • Eliminate the step-up in cost basis to fair market value for property received by inheritance at the time of the donor's death • Tax accumulated gains in inherited assets at the time of transfer, regardless of whether or not the property is sold by the recipient
High-Income Social Security Payroll Tax	• No Social Security payroll tax on income above $137,000	• No proposed change	• 12.4% Social Security Payroll Tax on income in excess of $400,000

THE IMPACT ON THE UNITED STATES

Analysis by a range of American groups, including the Tax Policy Center, the Penn Wharton Budget Model, the Tax Foundation, and the American Enterprise Institute, estimate the impact of the Biden Plan on the top 1% of earners to be a tax increase of 13% to 18% of after-tax income compared to President Trump's TCJA. Middle-class earners and other groups will only see indirect tax increases of 0.2% to 0.6%.[9] These figures indicate his policies are aimed to primarily impact the wealthy.

The Biden Plan will increase federal tax revenue by approximately $3.8 trillion between 2021 and 2030. The 28% corporate tax rate will contribute $1.3 trillion, the largest gain in revenue. Combined with the 21% Global Intangible Low-Taxed Income ("GILTI") tax and the 15% Alternative Minimum Tax, business tax increases will contribute to approximately half of the total revenue gain. The 39.6% income tax on high-income earners with over $400,000 of taxable income will contribute $1.2 trillion over 10 years, while social security tax will contribute another $800 billion.[10]

Even with this aggressive increase in taxation and short-term economic decline, the American public continues to favour Biden as the 46th US President. The Biden Plan was released in June, allowing Americans ample time to digest its impact.[11] Yet as of late September, the democratic nominee continues to lead national polls by over seven points.[12]

One consideration for the willingness of voters to compromise on taxation is the record deficits and the range of crises facing the nation. After the Covid-19 pandemic and multiple waves of economic stimulus, the Committee for Responsible Federal Budget estimates increasing deficits will cause debt to grow from 79% of GDP before the crises to 101% this year. By 2030, it is estimated to grow to between 118% and 130% of GDP.[13] Analysts have suggested this would add $6 trillion to the US federal deficit over time.[14]

As Congress continues to approve stimulus, increased taxation will be necessary to curb the increasing deficit. If the projections are accurate, even with Biden's aggressive plan, the federal deficit will exceed federal tax revenue by $2.2 trillion over the next decade.

8 Table figures and tax rates obtained from: Sean Crowley et al, "Proposed tax plans of the 2020 presidential candidates" (28 July 2020), online: *Thompson Coburn LLP* <https://www.thompsoncoburn.com/insights/publications/item/2020-07-28/proposed-tax-plans-of-the-2020-presidential-candidates>; Comparing the Biden and Trump Tax Plan, *supra* note 6.

9 CRFB, *supra* note 2.

10 Tax Foundation, *supra* note 4.

11 Trump Vs. Biden, *supra* note 3.

12 Kevin Breuninger, "Biden holds steady polling lead over Trump ahead of first debate" (24 September 2020), online: *CNBC* < https://www.cnbc.com/2020/09/24/biden-holds-steady-polling-lead-over-trump-ahead-of-first-debate.html>.

13 Committee for a Responsible Federal Budget, "Updated Budget Projections Show Fiscal Toll of Covid-19 Pandemic" (24 July 2020), online: *Committee for a Responsible Federal Budget* <http://www.crfb.org/papers/updated-budget-projections-show-fiscal-toll-covid-19-pandemic>.

14 Chris Edwards, "Crisis May Add $6 Trillion Federal Debt" (21 April 2020), online: *Cato Institute* <https://www.cato.org/blog/crisis-may-add-6-trillion-federal-debt>.

Biden's proposed policies are a clear shift from President Trump's approach to taxation. If the democratic plan receives approval, it will clearly raise taxes on the top 1%. However, it may not be realistic to conclude that all of the proposed policies will come into force. Not only will the plan have to go through a lengthy process to be approved by Congress, but Biden will have to follow through with his promises. Twelve years ago, when Barack Obama ran for President, his platform promised to raise taxes on the wealthy and repeal Bush-era tax cuts. Yet after he was elected, Obama made many of his Republican predecessor's tax cuts permanent, including those for high-income earners.[15]

Similar to his former running mate, Biden may fall short on some of the proposed tax increases. This is not necessarily fatal. His progressive approach to taxation is indicative of a shift in governance. Working with Bernie Sanders, Alexandria Ocasio-Cortez, and other members of the democratic party on his tax plan reflects the cooperative approach necessary to lead the American population.

THE IMPACT ON CANADA

The impact of the Biden Plan on the Canadian economy is largely positive. Increased taxation south of the border paves the way for increased investment and overall competitiveness in Canada.

Since President Trump reduced the corporate tax rate from 35% to 21% under the TCJA, Canada was not as negatively impacted as previously feared. Canada's average combined federal-provincial corporate tax rate is 26.5%, yet investment in the country remained stable through the previous presidential term.[16] Biden's proposed 28% corporate rate provides Canada with the opportunity to attract more foreign direct investment from the US and internationally.

Possibly the most promising opportunity for Canada is the increase in the capital gains tax. The 39.6% rate for high-income earners taxes capital gains at the same rate as other income, effectively eliminating the tax benefit of investing in eligible property.[17]

With increases in the estate tax, the effects of the capital gains tax could be compounded. By reducing the tax exemption from $11.58 million to $5 million, estates valued above the lower threshold could be taxed as high as 40%.[18] Removal of the step-up in cost basis on inheritance at the donor's death is also proposed. Currently, the cost basis steps up to the fair market value of assets. Biden's proposal would cause beneficiaries to retain the donor's original cost basis, a presumably lower value. This would create a larger capital gain for inherited assets. Traditionally these assets would be taxed upon their sale, but Biden also proposes taxing capital gains at the time of the transfer.[19]

The combined effect of doubling the capital-gains tax rate, cutting the estate tax exemption in half, and removing the step-up in cost basis will surely favour the Canadian economy.[20] With taxation on only 50% of capital gains in Canada, investments in real estate, stocks, bonds, and other capital property can be expected to see a significant increase by national and international investors.

A drawback to these policies is that they will apply to Canadians with US sourced assets and those living abroad. These groups will be subject to the higher capital gains rate and estates tax. However, if they chose not to own these US holdings personally, but instead in a cross-border irrevocable trust, a corporation, or partnership structure, they may be able to avoid unfavourable tax treatment.[21]

The GILTI tax could also negatively impact the Canadian economy. Before 2018, profits earned by a Canadian subsidiary would not be taxed until they were repatriated by the parent US company. The GILTI tax was introduced under TCJA to tax foreign subsidiaries that exceed a certain rate of return. Biden not only plans to keep the tax, but he proposes doubling the rate from 10.5% to 21%. Although US corporations could mitigate the impact by claiming a Canadian tax credit, many may favour repatriation of profits to the US.[22] This would certainly impede the growth of Canadian industries that heavily rely on foreign direct investment from the United States, including manufacturing, oil and gas, and research and development.[23]

On a broader scope, a Biden presidency signals stability in cross-border relations. The Trump and Trudeau administrations have not seen eye-to-eye on many issues over the past four years, causing cross-border relations to suffer. In August, Trump's recent proposal for an increased tariff on some aluminum imports from Canada was not taken lightly by Parliament. Canada proposed it's own $3.6 billion retaliatory tariffs at a dollar-for-dollar rate, halting the American trade measure.[24] With Biden in the White House, relations between the two countries will likely be cooperative and stable.[25] This will favour both countries on economic and social levels.

CONCLUSION

The Biden Plan will be beneficial for both Canada and the United States. With higher taxes on the top 1%, wealth will be redistributed amongst Americans plagued with economic and social issues. The population will be supported by a government that once again takes their interests into account. For Canadians, this is an opportunity to increase the competitiveness of their economy and to build stronger cross-border relations. A stable and cooperative ally will prove beneficial in the long-run. The fate of both countries will be determined by voters on November 3, 2020. Until then, we must simply wait and watch.

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15 Albert Van Santvoort, "Biden-Harris Tax Changes could be good news for Canada" (19 August 2020), online: *Business Intelligence for B.C.* <https://biv.com/article/2020/08/biden-harris-tax-changes-could-be-good-news-canada> [Biden-Harris].

16 *Ibid*; OECD Data, "FDI Flows" (2020), online: *Organization for Economic Co-operation and Development* <https://data.oecd.org/fdi/fdi-flows.htm>.

17 Biden-Harris, *supra* note 15.

18 David Altro and Avi Guttman, "Will the current presidential election change U.S. estate tax for Canadians?" (3 May 2020), online: *Globe and Mail* <https://www.theglobeandmail.com/investing/personal-finance/taxes/article-will-the-current-presidential-election-change-us-estate-tax-for/> [U.S. Estate Tax].

19 Katie Deal, "Higher tax rates expected in Biden Administration" (23 July 2020), online: *Canadian Investment Review* <http://www.investmentreview.com/expert-opinion/higher-tax-rates-expected-in-biden-administration-11777>.

20 Philip DeMuth, "The Biden Tax Hike Would be Severe" (14 July 2020), online: *Wall Street Journal* <https://www.wsj.com/articles/the-biden-tax-hike-would-be-severe-11594767531>.

21 U.S. Estate Tax, *supra* note 18.

22 Biden-Harris, *supra* note 15.

23 Canadian International Development Platform, "Canadian FDI by Sector" (2020), online: *Canadian International Development Platform* < https://cidpnsi.ca/canadian-fdi-by-sector/ >.

24 Beatrice Britneff, "How the tariff battle between Canada and the United States will impact Canadians" (7 August 2020), online: *Global News* <https://globalnews.ca/news/7257039/how-tariff-battle-canada-united-states-will-impact-canadians/>.

25 Biden-Harris, *supra* note 15.

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TAX STRATEGIES FOR COO'S, HUMAN RESOURCE EXECUTIVES, AND EMPLOYMENT & IMMIGRATION LAWYERS DEALING WITH FLEXIBLE WORKING ARRANGEMENTS DURING AND AFTER THE PANDEMIC

By David S. Kerzner, Ph.D. (Law), Kerzner Law and Max Reed[1], Polaristax Tax Counsel

INTRODUCTION TO THE OPPORTUNITY AND THE CHALLENGES OF WORKING REMOTELY

Prior to the COVID-19 pandemic a new type of flexible work arrangement was already a reality, transcending traditional brick and mortar offices and national boundaries. With the advent of technological solutions available from the internet for communications and information sharing, many traditional functions of the old style office may be replaced with flexible and remote working arrangements from home. A typical example may involve a technology company formed in the United States or Canada with the C-suite and operations spread between different countries on three continents. The question of a business owner or employee setting up shop in a jurisdiction different from the main company base or place of formation is now almost a routine occurrence we are seeing.

The opportunity to attract and maintain a talented workforce and to provide leadership during the time of the pandemic can and should remain vital considerations for the C-suite. The challenge which, sad to say for many investors and businesses will be a catch up one, is to understand the cross border regulatory issues which operations, finance, and legal management need to know about. The downside of remote flexible workforces that cross national boundaries is that without timely and proper strategies, the potential risk of penalties and reputational knockdowns can swamp business profits in the short run, and derail strategic financial prizes that may attend a financing or M&A opportunity.

CORPORATE INCOME TAXATION

Foreign businesses may have an obligation to file a tax return in Canada or the US, and also to pay taxes on their net business income. As explained in the Business Profits chapter of *The Tax Advisor's Guide to the Canada-U.S. Tax Treaty,*[2] both Canada and the US have reporting obligations for foreign businesses that are carrying on business in their respective jurisdiction. Without getting into the technical rules, the threshold for meeting these requirements to file a corporate return are quite low and may even be counter intuitive (for example, where a return is required by the IRS of a Canadian company whether or not it had US source income from its trade or business, and whether or not that income is exempt under the treaty).

Depending on whether the foreign business meets certain tax nexus requirements, known as 'permanent establishments', a business formed in one of the treaty contracting states may have an obligation to pay taxes on its net income earned in the other contracting state. Even where a so-called branch may give rise to such nexus, but is unprofitable, the CRA or IRS may attribute a profit to the activity under transfer pricing guidelines. The penalties (direct and indirect) for non-filing and non-payment of taxes are numerous and complex. Prevention is the best cure. These concepts are explained in the accessible tax case study, *La Brienza Winery, Tax Trouble in Wine Country.*[3] Separately, business managers and their professional advisors must also become informed, as much in advance as possible, regarding state tax compliance. Some jurisdictions like California can be particularly complex and invasive. Regarding Canada, excise tax regimes, including the GST must also be considered.

EMPLOYER TAX & LEGAL OBLIGATIONS

Another foundation of regulatory compliance for businesses with flexible work arrangements across the 49th parallel (or other international boundary) deals with legal obligations under federal and state tax law regarding employees. Compensation to personnel needs to be evaluated under the applicable guidance to determine the proper classification of a worker as an employee or independent contractor. Very onerous obligations arise in the form of trustee duties to the taxing authorities for filing and remitting appropriate withholding income and social security and unemployment taxes. Sanctions can potentially include civil and criminal penalties for non-compliance. Additionally, a multitude of key non-tax regulatory compliance obligations at both the federal and state levels arise in connection with the remote working arrangements that unfortunately cannot be covered in this brief article. But you can easily remember to take care of these corporate duties when you think of the famous Italian chef, Marcella Hassan. In Italian cooking, her holy trinity was olive oil, parsley, and garlic, ours is tax, business law, and immigration law.

FINDING FINANCIAL WELLNESS FOR REMOTE EMPLOYEES

For employees working in one country for an employer in another, an ounce of prevention is truly worth a ton of cure. Critical issues requiring advance attention may include one or more of the following: residence taxation; withholding; executive compensation plans (e.g., stock plans, options, phantom stock); relocation planning (pre-immigration/pre-emigration); double taxation and foreign tax credits; treaty considerations (including elections); retirement planning; government pension and social security planning; investments; and healthcare.[4]

CONCLUSION

There is no one size fits all or cookie cutter solution. In managing the cross border operations for funds and public and private companies

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[2] Kerzner, et al., Thomson Reuters, loose-leaf 2008/Taxnetpro, online, at Article VII Business Profits.

[3] A. Cockfield, D. Kerzner, Thomson-Reuters, in *International Tax: Core Concepts*, 2017.

[4] See for example, M. Reed, *A Tax Guide for American Citizens in Canada* (Toronto: Thomson Reuters, 2013).

for a long time, the indispensable factor for success is creating a joint process driven by the lawyer and the client that is multi-disciplinary and multijurisdictional to create solutions which meet the needs of the business and its workers.

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ONTARIO MOVING TO ELECTRONIC FILING OF PROBATE APPLICATIONS AND OTHER ESTATE LAW UPDATES

By Lucinda Main, Editor of *Taxes & Wealth Management*, and Partner at Beard Winter LLP; and
Lori Isaj, Associate at Beard Winter LLP

In the May 2020 edition of *Taxes & Wealth Management*, we discussed the temporary measures introduced to allow for the remote and virtual execution of wills and powers of attorney in Ontario. Although the reality and the associated social distancing measures of the COVID-19 pandemic remain unchanged, a few welcome developments have taken place in the area of wills and estates in Ontario.

CONTINUING WITH THE EXECUTION OF WILLS AND POWERS OF ATTORNEY VIA AUDIO-VISUAL COMMUNICATION

The provisions allowing a testator (for a will) and a grantor (for a power of attorney) to execute complete, identical copies of wills and powers of attorney in counterpart using audio-visual communication technology before two witnesses have been extended. While previously under the *Emergency Management and Civil Protections Act*,[1] the government of Ontario introduced Ontario Regulation 129/20: Signatures in Wills and Powers of Attorney under *Re-opening Ontario (A Flexible Response to COVID-19) Act*.[2] Regulation 129/20 extended the virtual method of execution until October 22, 2020, and the provisions are expected to be extended even further as Ontario enters the anticipated Fall second wave of the pandemic.

INTRODUCING REMOTE COMMISSIONING OF AFFIDAVITS

The introduction of remote commissioning measures under the *Commissioners for Taking Affidavits Act*[3] in Ontario has been a key change for all lawyers and not just estate law practitioners. Effective August 1, 2020, a deponent or declarant making an oath or declaration is no longer required to be in the physical presence of the commissioner or notary public, if both the deponent or declarant and the commissioner or notary public follow the procedure set out in Regulation 431/20: Administering Oath or Declaration Remotely ("Regulation 431/20")[4] under the *Commissioners for Taking Affidavits Act*. First, the oath or declaration must be administered by electronic communication where the commissioner or notary public and the deponent or declarant are able to see, hear, and communicate with each other in real time throughout the entire transaction. Second, the commissioner or notary public must confirm the identity of the deponent or declarant. Third, the document being signed ought to contain a modified jurat that specifies that the oath or declaration was administered in accordance with Regulation 431/20 and identifies the location of both the commissioner or notary public and of the deponent or declarant at the time of the transaction. Lastly, the commissioner or notary public must keep a record of the transaction.

For wills and estates practitioners, remote commissioning of affidavits means that for clients executing their wills in counterpart or remotely by arranging their own witnesses, the witnesses to the wills can swear affidavits of execution immediately after the client has signed the will. This ensures efficiency and that an important step of the will execution process is not overlooked or forgotten. On the estate administration side, Regulation 431/20 now also allows executors to sign probate documents remotely.

IMPLEMENTING ELECTRONIC FILING OF PROBATE APPLICATIONS

Continuing the implementation of technology in wills and estates, the government of Ontario introduced online filing for Certificates of Appointment of Estate Trustee ("probate applications"). Effective October 6, 2020, Ontario courts are accepting probate applications filed electronically by email to the Superior Court of Justice email address for the court where the probate application is being filed. Electronic filing is an alternative to and not a substitute for paper filing.

The *Consolidated Notice to the Profession, Litigants, Accused Persons, Public and the Media*[5] updated on October 6, 2020 ("the Practice Direction") provides the procedure for electronic filing of probate applications. Specifically, the documents to be filed by email include application forms and supporting documents such as affidavits, consents, proof of death, renunciations, draft certificates, and motions. Original documents including wills, codicils, bonds, and ancillary certificates must still be filed in hard copy by mail or courier. Similarly, any filing fees or estate administration tax payments must be delivered to the court office by mail or courier. Once the court has processed the probate application, the court will electronically issue and deliver the Certificate of Appointment of Estate Trustee with or without a Will ("Certificate of Appointment") by email.

The Practice Direction also introduces an Information Form that must be completed and emailed to the court, together with the probate application. The Information Form requests information about the person filing the application, the deceased, the documents being filed, the application, and statements with which the filer must agree with or confirm.

In addition, the Practice Direction provides detailed instructions with respect to submitting the documents, including the informa-

1 R.S.O. 1990, c E.9.
2 S.O. 2020, c. 17.
3 R.S.O. 1990, c C.17.
4 O. Reg. 431/20, August 1, 2020.
5 Online: <https://www.ontariocourts.ca/scj/notices-and-orders-covid-19/consolidated-notice/#6_Email_Processes_for_Certificates_of_Appointment_of_Estate_Trustee_Probate>.

tion in the subject line, as well as the format, size, and naming of the documents to be added as PDF attachments.

Probate applications filed prior to October 6, 2020, can be re-filed by email. Such probate applications will (so we are told) retain their original position in the queue to be processed. The court will rely on the electronically submitted documents rather than any paper copies previously submitted.

The Practice Direction's electronic filing guidelines are a welcome change to the probate application process. Where processing times could be up to eight months in certain jurisdictions, the stated objectives of the new electronic filing procedure are to ensure a more efficient and timely processing of Certificates of Appointment to allow executors to move forward with the administration of estates. The burden of the work of processing applications and the significant backlog in some jurisdictions (e.g., Toronto) is now to be more easily shared amongst Ontario courthouses. In addition, in the lingering pandemic and the continued social distancing protocols, electronic filing should reduce the number of individuals personally attending at the court filing counters, making it safer for applicants, agents, and court staff.

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ESTATE FREEZE: THE TIME IS NOW

By Raymond G. Adlington, Partner, Miller Thomson LLP, and M. Elena Hoffstein, FEA, Lawyer, Miller Thomson LLP

The COVID-19 pandemic is currently causing over half our global population to be living under some form of self-isolation. Provincial and territorial government directives are properly constricting business and social activity across Canada to protect our collective health and safety. The resulting economic uncertainty is impacting consumer confidence and behaviour, and causing businesses to rapidly shift their workforce planning and methods for delivery of goods and services to their customers.

Investors and business owners have unfortunately seen the value of their holdings drop precipitously since late February. During March, the S&P / TSX composite index declined approximately 20%. Small and medium-sized privately owned businesses in Canada are being disproportionately affected by the forced slowdown of economic activity. Although uncertain how long these conditions will prevail, we all expect a new normal to eventually emerge for our businesses and our economy.

Worth remembering during these difficult times is the North American economic performance following the 1918 influenza pandemic. Over the course of the following decade, North American stock market indexes multiplied several times. The decade became known as the roaring 20s, featuring an incredible level of political and social change as mass market innovation drove the creation of value for entrepreneurs. This makes now the perfect time to implement an estate freeze.

An estate freeze is an accepted tax planning technique to reduce future capital gains tax payable by the individual implementing the freeze (the "freezor") on, for example, the death of the individual. The freezor transfers assets to a private corporation (or partnership) in exchange for an interest in the corporation (or partnership) having a fixed value equal to the value of the assets at the time of transfer. The common shares of the corporation (or partnership common units) are owned, directly or indirectly (often through a trust) as situations dictate, by related individuals or employees or prospective purchasers. The freeze may be complete, with the freezor receiving a fixed-value interest, or partial, with the freezor receiving both a fixed-value interest and a common share interest.

Consider the present value of implementing an estate freeze now on an unregistered investment portfolio of publicly traded securities. Let's assume that the value of the portfolio at the beginning of March was $500,000 and has fallen to $400,000 now. Let's also assume that this amount, together with other sources of income such as registered investments and pensions, is sufficient to meet your anticipated financial needs. Finally, let's assume that the value of the portfolio doubles to $800,000 over the next decade.

Freezing now means avoiding capital gains tax on this future growth in value. At current marginal income tax rates and at the current 50% inclusion rate for capital gains, the expected future tax saving after 10 years is $89,000 to $108,000 depending upon province or territory of residence. The present value (using a 5% discount rate) of this future tax saving of approximately $55,000 to $66,000 wildly exceeds the implementation cost of the freeze, but waiting until the value of the portfolio rebounds to pre-pandemic levels sacrifices 25% of this value. The time to freeze is now and the return on this investment will be among your best investments. These principles apply equally to entrepreneurs operating active businesses as they do to those in or near retirement with the investment portfolio described above.

Those who have already implemented an estate freeze may consider a "refreeze" if the total value of the corporation is now less than the value at the time of the original freeze.

With eight estate freeze techniques available and important compliance requirements to meet in the implementation of each, please seek advice on which technique is best for you. We will also work with you to ensure you maintain a level of control and cash flow you desire after the freeze and that the shares related individuals acquire are protected from future claims. Structured properly, we can also set up your freeze so it can be thawed if your future financial needs exceed your current expectations.

The time is now for your estate freeze. We're happy and ready to set up a video conference to learn about you, your family, your business and your future plans so we can recommend an estate freeze that works for you.

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DON'T FORGET ABOUT INTERNATIONAL INFORMATION RETURNS – IT COULD COST YOU (DEARLY)!

By Paul Bercovici, LL.B., Principal, Marks Paneth LLP

INTRODUCTION

In recent years, the IRS had placed significant emphasis on offshore issues, including taxpayers' obligations to file certain international information returns. As a general rule, certain US persons are required to report ownership interests in foreign entities such as controlled foreign partnerships, foreign corporations and foreign entities that are treated as disregarded entities for US federal income tax purposes. In addition, US persons are generally required to report ownership interests in foreign financial accounts and transactions or dealings with certain foreign trusts and estates. Failure to timely file complete and accurate international information returns can result, in certain cases, in the imposition of significant penalties.

Moreover, in recent years, the IRS has come to view such penalties as "low-hanging fruit", which they are more than happy to harvest. Anecdotal evidence suggests that the IRS is most likely to issue penalty notices when a taxpayer ceases to file a particular international information return which they have filed in the past, despite the fact that the IRS could not possibly know whether the taxpayer is still required to file the particular return in question.

Historically, significant numbers of US citizens have lived in Canada. In addition, many Canadians and others who hold valid "green cards"[1] also live in Canada. Recall that for US federal income tax purposes, green card holders are treated the same as US citizens. That is, green card holders are subject to US federal income tax on their worldwide income and are generally obligated to file annual US federal income tax returns. Many such individuals may not be aware that they are required to include certain of the above-noted international information returns with their annual US federal income tax returns and that failure to do so may result in the imposition of significant penalties.

The following article considers the filing obligations and penalty implications associated with the failure to timely file complete and accurate versions of some of the more common international information returns required to be filed by natural persons. Many of the filing requirements that apply to natural persons also apply to domestic entities such as corporations, partnerships and trusts. However, for the purposes of this article we will consider only the obligations of natural persons to file these returns. For the remainder of this article, the term "US person" includes US citizens, lawful permanent residents of the US (i.e., green card holders) and individuals who are not citizens of the US or green card holders but who do meet the "substantial presence test"[2] for a particular tax year.

FORM 8865

Return of US Persons with Respect to Certain Foreign Partnerships

IRS Form 8865 is used by US persons to report the information required to be reported under Internal Revenue Code ("IRC") Sections 6038[3], 6038B[4] and 6046A[5].

A US person who meets one or more of the descriptions of categories of filers set out below is required to provide the information set out in the chart entitled "Filing Requirements for Categories of Filers" in the Instructions for Form 8865. The filing requirements can be quite onerous and may include items such as a balance sheet, income statement, reconciliation of income or loss per books with income or loss per return and an analysis of partners' capital accounts. Form 8865 is to be attached to the taxpayer's federal income tax return and is due by the due date (including extensions) for the filing of the taxpayer's return.

Categories of Filers

Category 1: A category 1 filer is a US person who "controlled" the "foreign partnership"[6] at any time during the year. For these purposes, the term "controlled" means owning, or being attributed, directly or indirectly, at least 50% of the capital interest, 50% of the profits interest, or 50% of the deductions or losses of the foreign partnership.

Category 2: A category 2 filer is a US person who owned at least 10% of the capital or profits interest in the partnership, or who was allocated at least 10% of the losses and deductions of the partnership (referred to as a "10% partner") and the partnership is controlled by one or more US persons each of whom is a 10% partner.

No person is required to file as a category 2 filer if a foreign partnership had a category 1 filer at any time during the tax year.

Category 3: A category 3 filer is a US person who contributed property during the person's tax year to the foreign partnership in exchange for an interest in the partnership.

Category 4: A category 4 filer is a US person who acquired or disposed of a "significant interest"[7] in a foreign partnership, or whose direct proportionate interest in the partnership changed.

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1 Individuals who hold green cards are entitled to live permanently in the US. Such individuals are technically known as "lawful permanent residents" of the US.

2 In determining whether or not an individual meets the substantial presence test for a particular tax year, the individual must be physically present in the US on at least 31 days during the current year, and 183 days during the three-year period that includes the current tax year, the first preceding tax year and the second preceding tax year, counting: all of the days that the individual was physically present in the US in the current tax year, 1/3 of the days that the individual was physically present in the US in the first preceding tax year and 1/6 of the days that the individual was physically present in the US in the second preceding tax year.

3 Information Reporting with Respect to Certain Foreign Corporations and Partnerships.

4 Notice of Certain Transfers to Foreign Persons.

5 Returns as to Interests in Foreign Partnerships.

6 The term foreign partnership is defined in IRC Section 7701(a)(5) to mean a partnership which is not "domestic". IRC Section 7701(a)(4) defines a domestic partnership as a partnership which was created or organized in the US or under the law of the US or of any state.

7 The rules for determining what constitutes a significant interest can be quite complex. For more information as to what constitutes a significant interest, see the Instructions for Form 8865.

Application of Constructive Ownership Rules

It is extremely important to note that certain "constructive ownership" rules must be applied in determining whether a particular taxpayer meets the definition of filer for a particular category. These constructive ownership rules are also sometimes referred to as "attribution rules". In general, the constructive ownership rules will attribute ownership interests in controlled foreign partnerships which are held by certain family members and certain types of entities to a US person. It is beyond the scope of this article to delve into the constructive ownership rules in detail. However, it is fair to say that the application of the constructive ownership rules can, in certain circumstances, be extremely complex. Therefore, it is essential that preparers of Form 8865 be aware of the potential application of the attribution rules in preparing the form for their clients.

FORM 5471

Information Return of US Persons With Respect to Certain Foreign Corporations

Form 5471 is used by US persons who are officers, directors and/or shareholders of certain foreign corporations to satisfy the reporting requirements of IRC Sections 6038[8] and 6046,[9] and the related regulations. For these purposes, the term "foreign corporation" means a corporation that was not created or organized in the US or under the laws of the US or of any state.[10] US persons who meet one or more of the descriptions of categories of filers set out below are required to provide the information set out in the chart entitled "Filing Requirements for Categories of Filers" in the Instructions for Form 5471. As a general rule, the ownership percentage threshold for having to file Form 5471 is 10%. There is a summary filing procedure for foreign corporations that meet the conditions for filing as a "dormant foreign corporation".[11]

As with Form 8865, the Form 5471 filing requirements can be quite onerous and may include items such as a balance sheet, income statement, reconciliation of accumulated earnings and profits ("E&P") and information regarding the global intangible low-taxed income ("GILTI") of the foreign corporation. Form 5471 is to be attached to the taxpayer's federal income tax return and is due by the due date (including extensions) for the taxpayer's return.

Categories of Filers

Category 1: For the period 2004 to 2017, this category of filer had been repealed. For the 2018 and subsequent tax years, this category applies to a "US shareholder" of a foreign corporation that is a "specified foreign corporation" ("SFC").

For these purposes an SFC is:

1. A "controlled foreign corporation" ("CFC"):[12] or
2. Any foreign corporation with respect to which one or more domestic corporations is a US shareholder

Category 2: A category 2 filer is a US person who is an officer or director of a foreign corporation in which a US person (not necessarily the officer or director) acquires:

1. Stock which meets the 10% stock ownership requirement with respect to the foreign corporation; or
2. An additional 10% or more (in value or voting power) of the outstanding stock of the foreign corporation

Category 3: A category 3 filer is a US person who acquires or disposes of amounts of stock in the foreign corporation which causes them to exceed or drop below the 10% stock ownership threshold for having to file Form 5471.

Category 4: The category 4 filing requirement applies to a US person who had "control" of a foreign corporation during the annual accounting period of the foreign corporation

For the purposes of category 4, the term control means ownership of stock possessing:

1. More than 50% of the total combined voting power of all classes of stock of the foreign corporation entitled to vote; or
2. More than 50% of the total value of shares of all classes of stock of the foreign corporation

Category 5: For the 2017 and prior tax years, the category 5 filing requirement applied to a US shareholder who owned (directly, indirectly or constructively) 10% or more of the total combined voting power of all classes of stock of a CFC. For the 2018 and subsequent tax years, the Category 5 filing requirement applies to a US shareholder who owns (directly, indirectly or constructively) 10% or more of the total combined voting power of all classes of voting stock of a CFC or 10% or more of the total combined voting power or value of shares of all classes of stock of the CFC at any time during any tax year of the CFC and who owned the stock on the last day in that year on which it was a CFC.

Application of Constructive Ownership Rules

As with Form 8865, certain constructive ownership rules apply in determining whether a particular US person fits within the definition of a particular category of filer for the purposes of Form 5471. In fact, different categories of filers of Form 5471 may be subject to different attribution rules.[13] The comments regarding the application of the constructive ownership rules vis-à-vis the obligation to file Form 8865 which appear earlier in this article also generally apply regarding the obligation to file Form 5471.

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8 See footnote 3.

9 Returns as to Organization or Reorganization of Foreign Corporations and as to Acquisitions of Their Stock.

10 IRC Section 7701(a)(4) and (5).

11 See Rev. Proc. 92-70.

12 The term controlled foreign corporation is defined in IRC Section 957(a) as any foreign corporation if more than 50% of the stock (by vote or value) is owned by "US shareholders". For these purposes the term US shareholder means a US person who owns, directly, indirectly or constructively, 10% or more of the total voting power or the total value of all classes of stock of the CFC. See also Reg. 1.957-1(a).

13 For example, for category 2 and 3 purposes there is attribution between siblings but there is no such attribution for the purposes of categories 4 and 5.

FORM 8858

Information Return of US Persons With Respect to Foreign Disregarded Entities (FDEs) and Foreign Branches (FBs)

Form 8858 is used by US persons who are owners of a foreign disregarded entity ("FDE") or a foreign branch ("FB") to satisfy the reporting requirements of IRC Sections 6011,[14] 6012,[15] 6031,[16] 6038,[17] and the related regulations.

A US person that operates an FB as a "tax owner" of an FDE or that owns certain interests in tax owners of FDEs is required to file Form 8858 and Schedule M.[18] The term FB is defined in Treas. Reg. 1.367(a)-6T(g) as "an integral business operation carried on by a US person outside the United States".[19] An FDE is an entity that is not created or organized in the US and that is disregarded as an entity separate from its owner for US federal income tax purposes. The tax owner of an FDE is the person that is treated as owning the assets and liabilities of the FDE for the purposes of US income tax law. In most cases, FDEs are created as a result of the owner of the foreign entity making an entity classification election (commonly known as a "check-the-box" election) on IRS Form 8832[20] to treat the foreign entity as an FDE for US federal income tax purposes.

The information required to be reported on Form 8858 includes an income statement, balance sheet, IRC Section 987 gain or loss information and answers to certain complex questions regarding the operations of the FDE or FB.

FORM 8938

Statement of Specified Foreign Financial Assets

An individual is required to file Form 8938 if:

- they are a "specified individual";
- they have an "interest" in "specified foreign financial assets"; and
- the value of those assets is more than the applicable reporting threshold

US citizens meet the definition of specified individual for the purposes of determining whether an individual is required to file Form 8938. An individual is considered to have an "interest" in a specified foreign financial asset if any income, gains, losses, deductions, credits, gross proceeds, or distributions from holding or disposing of the asset are or would be required to be reported, included, or otherwise reflected on their income tax return.

For the purposes of Form 8938, the term "specified foreign financial asset" includes financial accounts maintained by a foreign financial institution, stock or securities issued by someone that is not a US person, any interest in a foreign entity and any financial instrument or contract that has an issuer or counterparty that is not a US person.[21] The reporting threshold for a particular taxpayer depends upon their federal tax filing status and whether they live inside or outside the US.[22]

It is important to note that where a taxpayer's ownership interest in a foreign entity or in a foreign trust is reported on Forms 5471, 8865, 3520, 3520-A[23] or 8621,[24] the taxpayer is permitted to report such ownership or trust interests in Part IV of Form 8938 (Excepted Specified Foreign Financial Assets) and does not have to also report the ownership or trust interest in Part VI (Detailed Information for Each "Other Foreign Asset" Included in the Part II Summary) of Form 8938.

FORM 3520

Annual Return To Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts

US persons who engaged in one or more of the following transactions in a particular tax year are required to file Form 3520:

- Transferred, directly or indirectly, money or other property to a foreign trust;
- Held an outstanding obligation of a related foreign trust;
- Was the executor of the estate of a US decedent;
- Was the "owner"[25] of all or any portion of a foreign trust;
- Received a distribution from a foreign trust;
- Was the US owner or beneficiary of a foreign trust which made a loan to the US person, or to a person to whom the US person was related, of cash or marketable securities;
- Was the US owner or beneficiary of a foreign trust which provided the US person, or a person to whom the US person was related, with the uncompensated use of trust property; and
- Received certain gifts or bequests from a foreign person

In my personal experience, some of the most outrageous examples of IRS overreach in seeking to assert penalty claims involve claims

14 General Requirement of Return, Statement, or List.
15 Persons Required to Make Returns of Income.
16 Return of Partnership Income.
17 See footnote 3.
18 Transactions Between Foreign Disregarded Entity (FDE) or Foreign Branch (FB) and the Filer or Other Related Entities.
19 Treas. Reg. 1.367(a)-6T(g) goes on to state that "[w]hether the activities of a U.S. person outside the United States constitute a foreign branch operation must be determined under all the facts and circumstances. Evidence of the existence of a foreign branch includes, but is not limited to, the existence of a separate set of books and records, and the existence of an office or other fixed place of business used by employees or officers of the U.S. person in carrying out business activities outside the United States."
20 Entity Classification Election.
21 This is only a small sample of the types of assets which are considered to be specified foreign financial assets for the purposes of Form 8938 reporting. Reference should be had to the Instructions for Form 8938 and the IRS release entitled "Comparison of Form 8938 and FBAR Requirements" for a more complete listing of the types of assets which the IRS considers to be specified foreign financial assets. This release was last reviewed or updated on December 20, 2019.
22 For example, married taxpayers who live in the US and who file a joint return satisfy the reporting threshold only if the total value of their specified foreign financial assets is more than $100,000 on the last day of the tax year or more than $150,000 at any time during the tax year.
23 Annual Information Return of Foreign Trust With a U.S. Owner.
24 Information Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund.
25 The owner of a foreign trust is the person that is treated as owning any of the assets of a foreign trust under the grantor trust rules.

that an individual failed to file Form 3520 when they were required to do so. For example, I am aware of a case where the IRS asserted total penalties of $160,000 where a taxpayer failed to report an interest in a Canadian Registered Education Savings Plan ("RESP") that had a balance of just over $5,000.[26] The IRS's position was based on the dubious claim that the RESP constituted a "foreign trust" for US federal income tax purposes. The taxpayer's attempts to have the penalties abated turned into a real-life nightmare for which they were ultimately able to obtain only partial relief.

APPLICATION OF PENALTIES FOR FAILURE TO TIMELY FILE COMPLETE AND ACCURATE INTERNATIONAL INFORMATION RETURNS

As a general rule, for all of the IRS forms referred to above, significant monetary penalties can be imposed for failure to timely file complete and accurate versions of the particular form. In addition, in certain circumstances, other types of penalties, such as the reduction of otherwise available foreign tax credits, the extension of the otherwise applicable statute of limitations and certain criminal penalties, may also be imposed. A detailed discussion regarding the application of penalties to particular categories and types of filers is beyond the scope of this article. Suffice to say that the analysis of potentially applicable penalties in certain circumstances can by painstaking and laborious.

SEEKING ABATEMENT OF PENALTIES BY ASSERTING REASONABLE CAUSE

Many of the penalties referred to above can be abated or eliminated where the taxpayer is able to demonstrate that their failure to file a particular international information return was due to "reasonable cause".[27] It should be noted that for different types of penalties, the concept of reasonable cause may also be slightly different. The concept of reasonable cause has largely been developed by the courts and is very fact specific.

As a general rule, a taxpayer is considered to have reasonable cause when his or her conduct justifies the non-assertion of penalties. In order to demonstrate reasonable cause, a taxpayer is required to make an affirmative showing of facts supporting reasonable cause. A taxpayer will generally be found to have reasonable cause when he or she can demonstrate that they exercised "*ordinary business care and prudence*" in determining their tax filing obligations, but nonetheless were unable to comply with those obligations. Any reason that demonstrates that the taxpayer exercised ordinary business care and prudence is supposed to be considered by the IRS in making their determination. It is well settled that the ordinary business care and prudence standard requires taxpayers to make reasonable efforts to determine their tax obligations.

Whether a taxpayer had reasonable cause for a particular failure is to be determined in light of the specific facts and circumstances surrounding the alleged failure of a taxpayer to fulfill their tax filing obligations. Section 20.1.1.3.2.(3)a of the Internal Revenue Manual (the "IRM")[28] provides that,

> For those penalties where reasonable cause can be considered, any reason which establishes that the taxpayer exercised ordinary business care and prudence, but nevertheless was unable to comply with a prescribed duty within the prescribed time, will be considered.

In addition, Section 20.1.1.3.2.(3).c of the IRM provides that,

> An acceptable explanation is not (emphasis added) limited to those given in IRM section 20.1. Penalty relief may be warranted based on an "other acceptable explanation," provided the taxpayer exercised ordinary business care and prudence but was nevertheless unable to comply within the prescribed time.

The determination of what constitutes reasonable cause has been the subject of numerous court decisions over the years. Some of the more common reasons or explanations that have been recognized by the courts over the years as constituting reasonable cause include:

- Reasonable reliance on a competent tax advisor;
- Death, serious illness or unavoidable absence;
- Unavailability of records; and
- The receipt of incorrect advice from the IRS

As noted earlier, convincing the IRS that a particular taxpayer had reasonable cause for his or her failure to file a complete and accurate international information return can be an extremely difficult exercise. Nonetheless, in appropriate circumstances, the IRS has been willing to accept that a taxpayer had reasonable cause for their failure to file a complete and accurate international information return and have agreed to waive or abate otherwise applicable penalties.

FinCEN FORM 114

Report of Foreign Bank and Financial Accounts

Unlike the IRS forms referred to above, the FinCEN 114 form (commonly known as and hereinafter referred to as the "FBAR") is a Treasury Department form and not an IRS form. Compliance issues pertaining to the FBAR are, however, administered by the IRS. The FBAR has been around in one form or another for decades, but (much like the IRS forms referred to above) has become a much more significant point of compliance emphasis in the recent past. FBARs are filed through the Financial Crimes Enforcement Network's BSA[29] e-filing system.

As a general rule, a "United States person" is required to file an FBAR if:

i. They had a "financial interest in" or "signature authority" over "foreign financial accounts"; and

ii. The aggregate value of the "foreign financial accounts" exceeded $10,000 at any time during the calendar year.

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[26] The penalty amount asserted by the IRS was calculated as $10,000 per year for eight years, for both the individual who established the RESP and the beneficiary of the RESP.

[27] The abatement of certain penalties, for example the penalties imposed in connection with the failure to file complete and accurate Forms 3520, requires the taxpayer to demonstrate that their failure to comply was due to reasonable cause and not due to willful neglect. For these purposes, the term "willful neglect" has been interpreted to mean a conscious, intentional failure or reckless indifference.

[28] The Internal Revenue Manual is an official compendium of internal guidelines for IRS personnel.

[29] Bank Secrecy Act.

For FBAR purposes, the term "United States person" includes US citizens, US residents and domestic entities. For FBAR purposes, the term "financial account" includes, but is not limited to, a securities, brokerage, savings, demand, checking, deposit, time deposit, or other account maintained with a financial institution (or other person performing the services of a financial institution). The term "foreign financial account" means a financial account located outside of the US.[30] The term "signature authority" means the authority of an individual (alone or in conjunction with another individual) to control the disposition of assets held in a foreign financial account by direct communication (whether in writing or otherwise) to the bank or other financial institution that maintains the financial account.

A United States person is deemed to have a financial interest in a foreign financial account for which the owner of record or holder of legal title is a partnership in which the United States person owns directly or indirectly:

i. An interest in more than 50% of the partnership's profits (e.g., distributive share of partnership income taking into account any special allocation agreement); or

ii. An interest in more than 50% of the partnership capital.

Similarly, a United States person is deemed to have a financial interest in a foreign financial account for which the owner of record or holder of legal title is a corporation in which the United States person owns directly or indirectly:

i. More than 50% of the total value of all shares of stock; or

ii. More than 50% of the voting power of all shares of stock[31]

Potential Penalties for Failure to Timely File an FBAR

As noted earlier, the FBAR is a form that is issued by the Treasury Department and not by the IRS. As a result, the rules regarding the application of and potential abatement of penalties are different than the rules applicable to the IRS international information returns referred to earlier in this article.

The penalty for "non-willful" failure to timely file an FBAR is $10,000 per violation.[32] However, where the failure to timely file an FBAR was "non-willful" and the taxpayer is able to establish reasonable cause, no penalty for failure to timely file an FBAR is to be imposed.[33] For FBAR penalty purposes, in very general terms, the term reasonable cause has been interpreted to mean that the taxpayer exercised "ordinary business care and prudence" in attempting to ascertain and fulfill their FBAR filing requirements.

Where the failure to timely file an FBAR was "willful", the penalty is equal to the greater of $100,000 or 50% of the balance in the account at the time of the violation.[34] Willful violations may also subject the taxpayer to criminal penalties. Per IRM Section 4.26.16.6.5.1, the test for willfulness is whether there was a "voluntary, intentional violation of a known legal duty". The burden of establishing willfulness is on the Service.[35] Per IRM Section 4.26.16.6.5.1(4), "willfulness is shown by the person's knowledge of the reporting requirements and the person's conscious choice not to comply with the requirements." In the FBAR context, the person only need know that a reporting requirement exists. If a person has such knowledge, the only intent needed to constitute a willful violation of the requirement is a conscious choice not to file the FBAR. Per IRM Section 4.26.16.6.5.1,(5), under the concept of "willful blindness," willfulness is attributed to a person who made a conscious effort to avoid learning about the FBAR reporting and recordkeeping requirements.

The IRM also provides that the mere fact that a person checked the wrong box, or no box, on Schedule B[36] of IRS Form 1040 is not sufficient, in itself, to establish that the FBAR violation was attributable to willful blindness.[37]

Penalty Mitigation

IRM Section 4.26.16.6.6.(1) provides that the statutory penalty computation provides a ceiling on the FBAR penalty but that the actual amount of the penalty is left to the discretion of the examiner. Per IRM Section 4.26.16.6.6.1(1), for most FBAR cases, if the IRS determines that a person has met four threshold conditions, then that person may be subject to less than the otherwise maximum FBAR penalty depending on the amounts in the accounts.

The four threshold conditions are:

A. The person has no history of criminal tax or *Bank Secrecy Act* ("BSA") convictions for the preceding 10 years, as well as no history of past FBAR penalty assessments;

B. No money passing through any of the foreign accounts associated with the person was from an illegal source or used to further a criminal purpose;

C. The person cooperated during the examination (i.e., the IRS did not have to resort to a summons to obtain non-privileged information; the taxpayer responded to reasonable requests for documents, meetings, and interviews; and the taxpayer back-filed correct reports); and

D. The IRS did not sustain a civil fraud penalty against the person for an underpayment for the year in question due to the failure to report income related to any amount in a foreign account.

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30 The BSA Electronic Filing Requirements For Report of Foreign Bank and Financial Accounts (FinCEN Form 114) provide that an account maintained with a branch of a US bank that is physically located outside of the US is a foreign financial account and that an account maintained with a branch of a foreign bank that is physically located in the US is not a foreign financial account.

31 Similar rules also apply to trusts in which a United States person has a greater than 50% present beneficial interest in the assets or income of the trust.

32 31 U.S.C. Section 5321(a)(5)(B)(i). Per IRM 4.26.16.6.4.1(1), in most cases, examiners will recommend one penalty per open year, regardless of the number of unreported foreign accounts. However, for multiple years with nonwillful violations, examiners may determine that asserting nonwillful penalties for each year is not warranted. In such cases, examiners may assert a single penalty, not to exceed $10,000 for one (emphasis added) year only. See IRM 4.26.16.6.4.1(2)

33 IRM 4.26.16.4.11(4).

34 31 U.S.C. Section 5321(a)(5)(C)(i)..

35 IRM 4.26.16.6.5.1(3).

36 Schedule B of Form 1040 is entitled Interest and Ordinary Dividends. The question referred to in the IRM in the 2019 version of Schedule B is "[A]t any time during 2019, did you have a financial interest in or signature authority over a financial account (such as a bank account, securities account, or brokerage account) located in a foreign country?

37 IRM Section 4.26.16.6.5.1(5)

CONCLUSION

In recent years, the IRS has placed significantly increased emphasis on international tax compliance issues. Among the points of emphasis has been IRS scrutiny of a taxpayer's obligation to file certain international information returns and FBARs. The reporting requirements associated with the filing of international information returns and FBARs can be quite onerous. However, failure to timely file complete and accurate international information returns and FBARs may result in the imposition of very significant penalties. In addition, the IRS is generally not particularly receptive to taxpayers' assertions of reasonable cause in an attempt to have such penalties abated or reduced. As a result, it behooves taxpayers who are obligated to file international information returns and FBARs to ensure that they are complete and accurate and that they are filed on a timely basis.

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NEW TIGHTENED CMHC LENDING RULES FOR HOME BUYERS

By Tina Tehranchian, MA, CFP®, CLU®, CHFC®, MFA-P™ (Philanthropy) is a senior wealth advisor and branch manager at Assante Capital Management Ltd.

Canada Mortgage and Housing Corp. (CMHC), that provides insurance for high ratio mortgages, announced in early June that it will ban the use of borrowed funds for a down payment, require a higher credit score (at least 680 instead of 600) from borrowers and try to ensure that homeowners have enough income to pay their mortgages and other debts by lowering gross debt service ratio and total debt service ratio levels.

This toughening of rules by CMHC would make it harder for riskier borrowers to get mortgage insurance and would reduce demand from these types of borrowers and keep real estate prices in check during uncertain economic times.

The new rules took effect on July 1, 2020, and by making it impossible for borrowers who are less likely to make their payments to qualify for CMHC coverage, could reduce demand for homes at a time when real estate sales have dropped due to the recession caused by the COVID-19 pandemic.

According to CMHC's latest quarterly results, nearly 20% of its insured mortgage holders would not have met at least one of its new criteria. These changes are most likely to affect first-time home buyers.

According to CMHC chief executive, Evan Siddal, in a statement accompanying the new rules:

> COVID-19 has exposed long-standing vulnerabilities in our financial markets, and we must act now to protect the economic futures of Canadians. These actions will protect home buyers, reduce government and taxpayer risk and support the stability of housing markets while curtailing excessive demand and unsustainable house price growth.

CMHC has forecast that home prices could drop as much as 18% over the next 12 months.

The stricter requirements apply only to CMHC insurance, which is required for home buyers with a down payment of less than 20%. Borrowers can still get insurance from private insurance companies such as Genworth MI Canada Inc. and Canada Guaranty Mortgage Insurance Co. However, it usually costs more than CMHC coverage. It is not clear at this point whether those private insurers would be adopting CMHC's new criteria.

For new home buyers, it is important to monitor and know their credit scores. Your credit score can range between 300 to 850 and is determined by an algorithm that uses information from your credit report. Paying your bills on time and how much credit card debt you carry can affect your credit score. Lenders use your credit score to approve you for a loan and to decide what interest rate to charge you and how much credit to extend to you which determines your credit limit.

Equifax and TransUnion are two agencies that determine credit scores for Canadians and provide credit reports to lenders. They also offer credit reports, and monitoring for consumers for a price. You can get a free credit score and credit report using websites such as Borrowell (for Equifax) and Credit Karma (for TransUnion).

It is also good to know about gross debt service (GDS) ratio and total debt service (TDS) ratio before you apply for a mortgage.

The GDS and TDS ratios are used by lenders to qualify mortgage applicants and determine if a borrower can manage monthly mortgage or debt payments and repay their loan.

The lender can find out what percentage of your monthly income goes towards paying your housing costs by using the GDS ratio and it can find out what percentage of your income is used to pay debts and other obligations, including rent, credit card bills, child support and car loans.

To qualify for a CMHC mortgage you need a GDS ratio of 35% or less and a TDS ratio of 42% or lower.

To determine your GDS ratio, you can add together your monthly rent/mortgage cost (principal only), the related interest payments, your property taxes and your heating costs and divide by your gross monthly income. For example, if you earn $10,000 in gross monthly income and pay $3,000 per month in rent and $150 per month for heat, then your GDS ratio is $3,150/$10,000 or 35%.

To determine your TDS ratio, you can add together your rent/mortgage principal, related interest, your property taxes, your heat, and other debt obligations and divide the resulting amount by your gross income.

You can also use CMHC's debt service calculator that can be found on CMHC's web site.

Given the new tightened mortgage rules, it is wise to monitor your credit score and to calculate your GDS and TDS ratios before you apply for a mortgage to ensure that you will qualify.

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HOW LONG CAN THE CRA HOLD A NET TAX REFUND BEFORE ASSESSING?

By Molly Luu, Partner, Miller Thomson LLP, and Colleen Ma, Associate, Miller Thomson LLP

When a business (referred to as a "registrant" in the context of the *Excise Tax Act* ("ETA")[1] makes a taxable supply (e.g., a sale) in Canada, the registrant is generally required to collect GST/HST from the recipient of the supply (e.g., a customer). In filing its GST/HST returns, the registrant may deduct certain amounts from the amount of GST/HST that was collected or collectible in the particular reporting period, such as input tax credits, in calculating its "net tax" for the period. Where net tax is positive, the registrant must remit that amount to the CRA. However, where net tax is negative, the registrant is entitled to a net tax refund from the CRA.

Some registrants are perpetually in a position to expect a net tax refund, such as businesses that export goods or real estate development outfits. For example, a registrant that regularly purchases taxable goods in Canada for export is generally not required to collect GST/HST on the sale. This may be because the sale falls into a zero-rating provision in Part V, Schedule VI of the ETA or the good is delivered or made available outside Canada and is not a taxable supply "made in Canada" and is thus outside the scope of the GST/HST. However, the registrant is entitled to claim input tax credits for those goods that it purchased or other expenses that it incurred in the course of its commercial activities. Where the amount of GST/HST paid for goods and other expenses exceeds the amount of GST/HST collected or collectible, the registrant's net tax is negative and the registrant is entitled to receive a net tax refund.

When a registrant is entitled to a net tax refund, section 229 of the ETA states that the Minister shall pay the refund to the person "with all due dispatch after the return is filed". Businesses that find themselves in a net tax refund position often rely on the CRA's quick payment of these refunds to sustain their business operations. Unfortunately, in the writers' experience, a business that finds itself in a perpetual net tax refund position may become a CRA audit target. Audits involving high value net tax refunds can go on for years, posing an existential crisis to the registrant.

Can the CRA hold back the net tax refund amount pending the conclusion of the audit? If the CRA does withhold the refund, potentially for months or years, what tools does a registrant have to compel the CRA to progress faster?

The usual means of responding to the CRA (e.g., sending letters to the audit division to prod the audit along or making a service complaint through the Office of the Taxpayers' Ombudsman) can sometimes (on rare occasions) resolve the issue. However, businesses should consider seeking a remedy in Federal Court by bringing an application for a writ of *mandamus* to compel the Minister to process the GST/HST return and pay the net tax refund.

WRIT OF MANDAMUS TO COMPEL

Using a writ of *mandamus* to compel,

(i) the Minister to process the GST/HST return and issue a notice of (re)assessment, and

(ii) pay the net tax refund.

The requirements that must be satisfied before a writ of *mandamus* will be issued were summarized in *Apotex Inc. v. Canada (Attorney General)*:[2]

(1) there must be a public legal duty to act;

(2) the duty must be owed to the applicant;

(3) there is a clear right to performance of that duty

  (a) the applicant has satisfied all conditions precedent giving rise to the duty;

  (b) there was

    (i) a prior demand for performance of the duty;

    (ii) a reasonable time to comply with the demand unless refused outright;

  and

    (iii) a subsequent refusal which can be either expressed or implied, e.g. unreasonable delay;

(4) where the duty sought to be enforced is discretionary, several rules apply;

(5) no other adequate remedy is available to the applicant;

(6) the order sought will be of some practical value or effect;

(7) the court in the exercise of its discretion finds no equitable bar to the relief sought; and

(8) on a "balance of convenience" an order in the nature of *mandamus* should (or should not) be issued.

One hurdle that an applicant may face in seeking a writ of *mandamus* to compel the Minister to pay the net tax refund is whether there is a clear right to performance. A clear right of performance involves an examination of whether the Minister has taken a reasonable amount of time to carry out its duties in administering the ETA and ITA. Stated simply, has the Minister been auditing for too long? It's up to the court to decide based on the facts before it.

The courts have, on occasion, considered issuing an order in the nature of *mandamus* to compel the Minister to take certain action under the ETA and the ITA.

In *Nautica Motors Inc. v. Minister of National Revenue*,[3] the court granted a *mandamus* order to the registrant and compelled the Minister to issue a notice of assessment to the registrant. However,

1 R.S.C., 1985, c. E-15.

2 (1993), [1994] 1 F.C. 742 (Fed. C.A.).

3 2002 FCT 422 (Fed. T.D.).

the court did not order that the Minister release the refund. The registrant made the application after the Minister had withheld the net tax refunds (for earlier reporting periods) for several years, pending the conclusion of an audit that continually expanded to include additional reporting periods.

The court granted an application for a writ of *mandamus* in *McNally v. Minister of National Revenue*,[4] to compel the Minister to assess the applicant's income tax return. In this case, the Minister had admitted that its main reason for the delay was to discourage participation in an offensive (in the CRA's view) charitable tax donation scheme. The court found that "Mr. McNally's rights [had] been trampled upon for extraneous purposes."

RECENT MANDAMUS DECISIONS

In two 2020 decisions, the courts have refused to grant an order in the nature of *mandamus*.

In *Express Gold Refining Ltd. v. Canada (National Revenue)*,[5] an application was made several months following the filing of the GST/HST return claiming a tax refund of just over $9 million and the appeal was heard approximately one year following the original reporting period. Express Gold's business is primarily in the scrap gold industry, which involves a high volume of transactions with multiple third parties. The court found that, given the complexity of the audit, Express Gold (the registrant) had applied prematurely. Importantly, the court found that section 229 of the ETA does not create a "pay first, audit later" regime. Instead, the Minister is entitled to take a *reasonable* amount of time to carry out its assessment duties. In deciding what is reasonable, the court looked to the *Apotex* test's third factor, namely:

(3) there is a clear right to performance of that duty

(a) the applicant has satisfied all conditions precedent giving rise to the duty;

(b) there was

(i) a prior demand for performance of the duty;

(ii) a reasonable time to comply with the demand unless refused outright;

and

(iii) a subsequent refusal which can be either expressed or implied, e.g. unreasonable delay.

In *Express Gold*, the relevant dates are:

- On September 6, 2018, the return was filed.
- On October 4, 2018, the registrant was advised that an audit had commenced.
- On November 7, 2018, the registrant wrote to the CRA to demand that the net tax refund be paid.
- On December 6, 2018, the registrant launched its mandamus proceeding.

The court decided that based on those dates, a reasonable time had not yet passed to allow the CRA to assess and the application was denied.

Similarly, in *Iris Technologies Inc. v. Minister of National Revenue*,[6] an application for an interim mandatory injunction was made in respect of an application for a writ of *mandamus*. The registrant sought the interim *mandamus* order because of the heightened need for funds and serious impact that the withholding of the net tax refund (being $63.2 million) had on its commercial activities. The FCA agreed with the reasons in *Express Gold* that the obligation to pay a net tax refund "with all due dispatch" does not displace the Minister's obligation to verify that the refund is in fact payable under the ETA and that section 229 does not create a "pay now and ask questions later" system. In *Iris* the following dates were at issue:

- On October 30, 2019, the registrant was audited for reporting periods commencing January 1, 2019 and ending February 29, 2020. The CRA withheld net tax refunds pending the audits.
- In February 2020, the registrant requested that the CRA release its net tax refunds twice.
- In March 2020, the registrant requested that the CRA release its net tax refunds a third time.
- On March 2, 2020, the registrant commenced an application seeking a *mandamus* order.
- On March 30, 2020, the registrant then commenced an interim order for the release of the net tax refunds.
- On April 9, 2020, before the hearing of this motion, the Minister reassessed the registrant's January to August 2019 reporting periods and assessed the September to November 2019 reporting periods.

The FC declined to grant the interim order. The FCA agreed with the FC that a reasonable amount of time had not yet elapsed and the Minister "is entitled to a reasonable amount of time in which to assess these returns"[7] and held that the registrant had "failed to show a strong prima facie case"[8] that it is entitled to an order in the nature of *mandamus*.

However, consistent with *McNally,* the FCA did state that where there is an allegation that the audit is not completed on a timely basis due to an "ulterior purpose or in bad faith",[9] the court may grant an order in the nature of *mandamus*.

So how long is too long for the CRA to withhold net tax refunds? In *Nautica,* the registrant was successful. In that case, for the oldest reporting period, the CRA had audited the registrant for almost three years without making an assessment. In *Express Gold*, the applicant was not successful. The CRA had been auditing the registrant for a matter of months without making an assessment. It appears that the court will not allow a three-year audit without an assessment, but thinks that a few months is not enough time for the CRA to conduct a complex audit. The courts take into account all the factors pertaining to each applicant/registrant, including the

4 2015 FC 767 (F.C.).
5 2020 FC 614 (F.C.).
6 2020 FC 532 (F.C.), affirmed 2020 FCA 117 (F.C.A.).
7 2020 FC 532, para. 56; and 2020 FCA 117, para. 37.
8 2020 FCA 117, para. 48.
9 2020 FCA 117, para. 51.

number of transactions that must be reviewed and the complexity of the business and its underlying documentation.

The Federal Court released decisions for both *Express Gold* and *Iris Technologies* after COVID-19 was declared a global pandemic. Cash is king, especially when ordinary business operations grind to a halt. At this time, businesses were all treading water and slashing their operating expenses.

In this environment, the CRA ought to revisit its policies to hold net tax refunds pending protracted audits. An "audit first, pay later" system will result in the CRA withholding large amounts of cash from businesses that rely on the timely payment of refunds to operate and will result in financial hardship, layoffs, and/or the closing of the business altogether, especially for Canada's precious small and midsized businesses.

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LETTERS TO THE EDITOR

Editor's Note: *The Editorial Board wishes to point out that the subject matter of the letter below is highly complex. Anyone with concerns similar to those expressed in the letter should seek professional advice.*

TAX RESIDENCY AND THE PRESIDENTIAL ELECTION: A NEW YORK CITY BUSINESSPERSON'S POINT OF VIEW

By Rashid G., New York, New York. "Rashid G" is an experienced business person who did not want further information disclosed.

Many states and localities are raising taxes, presumably due to COVID-19. However, even before COVID-19, the handwriting was on the wall that many cities and states did not have the political will to reign in their spending, nor look to reduce their pension obligations, medical benefits and salaries of teachers, police and other workers.

In New York City ("NYC"), our mayor, Bill De Blassio, has been vitriolic, stating that ". . .. There is plenty of money, its just in the wrong hands. . .."; a comment that can only mean, let's tax the rich and redistribute the wealth. Our NYC politicians, when times were good, blocked Amazon from opening a warehouse in Queens that would have brought thousands of jobs to NYC. Just this month, the politicians blocked a major redevelopment of the Brooklyn Navy Yards under the pretense that gentrification would drive out citizens who could not afford to live there anymore; totally eviscerating what many locals thought would be their golden nest egg and drive down crime. We now have politicians further veering to the left (such as Alexandria Cortez) with a socialist agenda that would bring a tear of pride to Nicolas Maduro, the strongman of Venezuela.

This essay is about my personal journey on seeking residency in a lower cost tax state. I do not want to be the last person standing, having to bear the brunt of an ever increasing tax structure. My story is being played out by thousands, or tens of thousands of people, who will seek a lower tax jurisdiction and perhaps, even a better life style.

My journey started out in 2018 when upon hitting the age of 63, with a daughter in Florida, my wife and I decided to buy a condominium down there. I did not set out to change my residency and lower my taxes; but rather, I wanted to just enjoy life with my wife, children and grandchildren.

After consulting my tax attorney as to whether to own property personally or in a trust, he advised me that perhaps I should seek residency in Florida. He further advised that if I wanted to declare residency in Florida, my house in Florida would need to be similar in value to my NYC home, which was very substantial. This was my first hurdle, in that I thought it would be a starter apartment/condo, but ended up being a major cost item. When changing residency you can't be cute. If you are a big earner, NY State/NYC will audit you. Do not think that by buying a one-bedroom apartment in Florida, but having a four-bedroom apartment in NYC, the tax authorities will deem that your "home" is in Florida. The revenue authorities will look at the size of your apartment in Florida and determine whether it is indeed your home or not based on its value, size and other factors.

Currently, I am a NYC resident for tax purposes, but I have many businesses that are outside of New York State. Under the NY State and NYC tax code, I am a resident of NY State/NYC if my "home" is in NY State/NYC. Contrary to what many people believe, the first test of residency is not whether I live out of state for over 50% of the year, but rather, where my "home" is. Such considerations are: where do I return when I come back from an extended vacation, where is my art collection, where is my jewelry vaulted, where are my marriage photo albums, where do I attend the mosque, the church or the synagogue, where do I golf, where do I spend my birthdays, etc..

After a tax payer has cleared the first hurdle of where their "home" is, then the time spent in NY State/NYC versus another state, will come into play. There are many other nuances in the tax laws regarding residency, but the first steps to determine where to live should be 1) do I want to live in another state (personal enjoyment) , and 2) can I conduct my affairs (personal or business) while living in this new jurisdiction.

All of this discussion above brings me back to NYC. I love the city. It is wonderful for entertainment, dining, walking in Central Park and shopping. Why would I or anyone want to leave this place? Well frankly, the answer is about saving around 13% on taxes (state and city) and that is today. There is no way with the budget deficit NYC is facing, that taxes will not be going up. The Mayor (De Blassio) and our Governor (Andrew Cuomo) both acknowledge massive budget deficits. I remember when President George Bush (the first) said " . . . read my lips, I will not raise taxes. . .", but then proceeded to raise the taxes. I don't blame Bush for doing that. In fact, I don't blame De Blassio or Cuomo for the need to raise taxes; but, I do blame the politicians for not actively trying to trim the budget rather than appease their constituency.

The 13% was tolerable when state and city taxes were deductible from the Federal Taxes. But, the Trump rewrite of the federal tax code lowered some taxes but took away the deductibility of state and city taxes. I asked my accountants to study my tax structure of various entities and compare NY State/NYC residency against Florida residency, and they found out that I could reduce my taxes by close to $500,000. And that is when I made the decision to go full blast and find a way to become a Florida resident.

So how does that Presidential Election affect my taxes and my residency decision. Well to tell you the truth, not very much. From my view, if Trump wins, my taxes will stay low, but I will not be able to deduct the state and city taxes. If Biden wins, my taxes will go up, but I (presumably) will be able to deduct the state and city taxes.

I have not commissioned a study to find out if I am better under Trump or better under Biden as it regards my taxes; but either way, the 13% hurdle of lower taxes in Florida is just too much to pass on.

So my bottom line regarding residency and taxes is that it does not really matter who gets into the White House; the bigger question is how are large tax states going to compete against low tax states. I have not seen or heard anything from either political camp that would lead me to change my beliefs.