KPMG

TaxNewsFlash

Canada

U.S. Looking to Increase Taxes for High-Income Individuals

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U.S. individuals living in Canada should prepare to determine the effect of possible new U.S. tax changes. The United States recently released details of planned personal income tax proposals, including to:

- Raise the top individual income tax rate to 39.6% (from 37%)
- Raise the tax rate on capital gains and qualified dividends for households with income over $1 million to 39.6% (from a maximum 20%)
- Extend the child tax credit expansion through 2025 and make the child tax credit fully refundable on a permanent basis.

Note that these potential measures may face legislative challenges due to the Democrat's narrow control of U.S. Congress. It's not yet clear how these challenges may affect any forthcoming legislative proposals or the enactment process.

For further details, see a recent alert from KPMG's U.S. member firm: "United States – American Families Plan Revealed with Tax Increases on High-Income Individuals".

KPMG observations
While U.S. citizens who reside in Canada may have to consider the effect of these changes, Canadian multinationals with U.S. assignees are unlikely to be affected. Specifically, since the Canadian personal tax rate for high income earners will generally remain higher than the U.S. personal tax rate, equalization payments are unlikely to be affected.

U.S. citizens living in Canada who are high-income earners will need to be mindful of the incremental difference between the proposed U.S. capital gain rate of 39.6% and Canada's taxable capital gain rates (for example, 26.76% for a resident of Ontario in the highest tax bracket). While capital gains are typically sourced to the country of residence under the cross-border rules, high-income earning U.S. citizens in this situation will not have enough Canadian foreign tax credits to claim on their U.S. tax return to fully offset the difference between the Canadian rate and the new proposed rate of 39.6%. Ultimately, these individuals will be subject to the proposed U.S. 39.6% capital gains rate.

Where U.S. citizens living in Canada receive U.S. qualified dividends, these individuals can claim a maximum foreign tax credit amount of 15% on their Canadian tax returns. Under the Canada-U.S. treaty, these individuals should be able to claim a deduction from income under subsection 20(11) for the incremental U.S. tax paid in excess of the 15% credit. As before, the IRS would also allow individuals to claim an additional foreign tax credit on their U.S. tax return for the Canadian tax paid on the U.S. dividend (for U.S. citizens only). This additional U.S. foreign tax credit will increase as a result of the higher U.S. tax rate, so that U.S. citizens don't pay more combined tax than they otherwise would pay.

Where U.S. citizens living in Canada receive Canadian source dividends, these amounts are also likely treated as qualified dividends for U.S. purposes. However, depending on the province of residence, the Canadian dividend tax rate on these dividends could be close to the U.S.'s proposed 39.6% rate (for example, the eligible dividend rate in Ontario is currently 39.34%). Given this similarity, individuals may not have a foreign tax credit shortfall on their U.S. tax return for Canadian taxes paid on these dividends.

We can help

Your KPMG adviser can help you assess the effect of the U.S. tax changes on your business and personal tax situations. For more details, contact your KPMG adviser.