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AMERI-CAN TAX TALK NEWSLETTER

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SURFACE TRANSPORTATION AND VETERANS HEALTH CARE CHOICE IMPROVEMENT ACT

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The President signed a Bill on July 31 with not much fanfare. "The Surface Transportation and Veterans Health Care Choice Improvement Act of 2015" was signed into law and otherwise wouldn't give much indication that there were a number of tax provisions buried in a law which extends transportation spending and deals with Veterans issues.

However, there are a number of US tax law changes that are extremely important to understand and the changes to some return due dates will affect many if not most US citizens living outside of the United States.

The first most noticeable change is that partnership returns (Form 1065) are now due on the 15th day of the third month, i.e. March 15th for calendar year partnerships. The former date of April 15th was not practical for many partners as they would receive a report of their proportionate share of income and expenses (Form K-1) on or after April 15th when their individual tax return which would include such amounts was also due April 15th. This would cause many taxpayers to necessitate filing an extension for the submission of their personal tax return to include the K-1 amounts when received.

This is a similar problem in Canada with T-3 returns being due on the same date as the income reporting slips are due (T3, etc.). This causes much frustration in completing T-3 returns when the reporting slips with the amount of income may not have been received by the Trust at the due date of the return. However, in Canada there is no opportunity to file an extension for the returns missing information as in the United States.

The Corporate tax returns (Form 1120) have historically been due 2.5 months after the year end (i.e. March 15th for a calendar year corporation). This law changes that date to the 15th day of the 4th month (April 15th). However, for tax years that end on June 30th, it will continue to be September 15th until December 31, 2025 when it will change to October 15th.

The section of the new law of most importance to US citizens in Canada is the bank account reporting known as FBAR (FinCin Report 114). The return was normally due on June 30th with no extension and the possibility of extremely severe penalties for late filing. The new date is April 15th. However, there is now an extension available of up to 6 months.

The other modifications to the extensions are as follows: Form 1041 (Trusts) 5½ months, Form 990 (charities) 6 months, Form 3520-A (Foreign trusts) 6 months, and Form 3520 (Beneficiaries of foreign trusts) 6 months.

The other change in the law relates to the statue of limitations on when the IRS can audit or examine a tax return. Unlike Canada these rules are very strictly enforced and the IRS will not win if they review a return outside of the Statute, unless the IRS asked for and received permission from the taxpayer to extend the Statute.

The general rule is that the returns may be examined 3 years from the due date or from the date the return was filed, whichever is later. There is no limitation on returns that were never filed or fraudulently filed (which the IRS has the burden of proving civil fraud).

However, there is a 6-year limitation period if more than 25% of gross income was omitted on the return. The IRS lost a case where a taxpayer in error had incorrect basis on assets that were sold in excess of 25% and the IRS claimed that overstating the basis of assets was the same as omitting gross income. The US Supreme Court disagreed. The new law clarifies that "An understatement of gross income by reason of a overstatement of unrecovered cost or other basis is an omission from gross income"

Also to note that any income earned from foreign assets (e.g. Interest earned on foreign bank accounts) that was omitted in excess of $5,000 will also get the same 6-year statute of limitation treatment for examination or audit of the entire tax return.

The law also adds an important estate tax rule. For US tax purposes when someone passes, the basis of property they held will jump, with no income tax consequence, to the fair market value at the moment of passing (or 6 months after by election). So if a decedent had shares that they purchased in 1985 for $1,000 and were now worth $100,000, the beneficiary of the shares would take them at an adjusted basis of $100,000. If they then sold them for $120,000, they would only pay tax on the $20,000 gain. The estate tax to the decedent is based on the fair market value (in this case $100,000), not the $99,000 gain. This is different than a gift during the owner's lifetime, which has carryover basis (i.e. $1,000 in our example).

The new rule change is that the adjusted basis to the beneficiary of an estate cannot be different than the amount that is reported on the decedent's estate tax return if an estate tax return was filed. Again in our example, if $100,000 was reported on the estate tax return as the fair market value, the basis to the beneficiary must be $100,000. Alongside this rule is a requirement of the estate that is required to file an estate tax return to report this fair market value/basis to any beneficiary who receives property from that estate.

Quite a lot of tax changes in a Transportation bill, but some of which are crucial changes to laws and deadlines dating back generations.

Another regulation, not part of this law, snuck in during June 2015 regarding estate tax returns.

Generally, a US citizen is given a credit against the estate or gift tax that can be used during their lifetime or at death against the estate tax, and the tax is based on the fair value of the excess, net of any transfers to a US citizen, spouse, or charity. The current credit would permit the transfer of $5,430,000 for 2015. Generally a decedent would not need to file an estate tax return if their gross estate was less than the available credit.

Assume the example where a decedent spouse has $4,000,000 of assets and the surviving spouse has $3,000,000 of assets before the marital transfer of assets from the decedent as was in their will.

The estate tax return would not need to be filed as the amount of assets of the decedent would be below the allowable credit. The issue is that the unused portion of the $5.43 million credit would be wasted. The surviving spouse in this example would have $7 million in assets and assuming they didn't remarry, only their own $5.43 million credit to use against the tax.

The same situation could occur if the decedent spouse had $10 million in assets and transferred them all to the surviving spouse. There would be no taxable estate, and thus the credit would not be used.

A change in law now permits a decedent spouse to move their unused credit to the surviving spouse, called the "portability rules". In the above examples, using this portability option would result in the surviving spouse having a large enough combined credit to negate the estate tax at their death.

The new regulation clarifies how this portability rule can be elected. There was discussion of having a short form to make the election. This new regulation though states that the decedent spouse must make the election on a full estate tax return, with some exceptions (values for property transferred to US spouses or charity may be excluded).

This is significant because estates with below the $5.43 million exemption were previously not required to file a return, which is a substantial undertaking. Now if the portability option for the unused credit is to be elected, then the full return needs to be completed.

For more information, please contact:

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