TaxTalk

2024 YEAR-END TAX PLANNING FOR CANADIAN BUSINESSES AND INDIVIDUALS WITH OPERATIONS AND FILINGS IN THE U.S.

As the year-end approaches, it offers a strategic opportunity for businesses to review their tax planning strategies. Now is the time to review your company's and your personal situation to ensure that you have maximized your 2024 tax planning. Your tax planning should take into consideration a new administration coming into office in 2025 and possible tax changes on the horizon.

Summary

This summary addresses the key federal tax and state tax considerations for 2024 year-end tax planning for individuals and Canadian businesses conducting business in the U.S.

Also highlighted below are tax planning strategies you can use to minimize your tax burden for 2024 - 2025.

Control the Timing of Income and Deductions to your Tax Advantage

Smart timing of income and expenses can reduce your tax liability and poor timing can unnecessarily increase it. When you are expecting a loss in the current year, deferring income to next year and accelerating deductible expenses into the current year may be a good idea. Why? Because it will defer current tax, which is usually beneficial. As indicated above, it is expected that tax laws will change in 2025. The new Trump administration is proposing a 15% corporate tax rate for manufacturing companies as opposed to the current 21% federal rate for all companies. For this reason, the idea of accelerating expenses in the current year is beneficial for manufacturing companies because the benefit of the tax deduction is higher at 21% versus the proposed lower 15% rate. (the lower rate is not enacted as yet).

Depreciation Tax Planning

Capital Asset Purchases and Tax Depreciation

Purchasing equipment and other qualified assets has been a valuable tool for reducing taxable income for businesses for years, but the Tax Cuts and Jobs Act (TCJA) that went into effect in 2018 (and still impacts current tax planning) further enhanced these opportunities by expanding bonus depreciation and expensing of qualified capital assets.

Section 179 Expensing

If you are a small business, the Section 179 deduction is one of the most important tax codes you need to be familiar with in 2024. It lets you deduct all, or part, of the cost of equipment that is purchased or financed and placed in service before the end of 2024. For 2024, businesses can elect to expense (deduct immediately) the entire cost of new and used assets, such as equipment and furniture (see Qualified Property below) up to a maximum of US$1,220,000 for the first $3,050,000 of property placed in service by December 31, 2024. Note that the Section 179 deduction cannot exceed net taxable business income and create a tax loss. The deduction is phased out dollar for dollar on amounts exceeding the $3,050,000 threshold and eliminated above amounts exceeding $4,270,000 for tax years beginning in 2024.

Bonus Depreciation

Under bonus depreciation, businesses were allowed to immediately deduct 100% of the cost of eligible property placed in service after September 27, 2017 and before January 1, 2023. Starting on January 1 of 2023, the 100% bonus depreciation started dropping by 20% each year and will be fully phased out at the end of 2026. As such, the deduction is 60% in 2024, 40% in 2025, 20% in 2026, and 0% rate will apply in 2027 and later years).

The immediate expensing and bonus depreciation provisions are intended to increase business expansion in the U.S. These changes will also provide an incentive to Canadian businesses that want to expand their activities in the U.S. via a U.S. structure, or enter the U.S. market for the first time.

It is important to note that when both the 60% bonus depreciation and the Section 179 deduction are available for the same asset, it is generally more advantageous to claim the bonus depreciation, because there are no limits on it.

Leasehold Improvements

As indicated below, leasehold improvements are qualified property for purposes of Section 179. Note that you can take 60% bonus depreciation on leasehold asset additions if they are placed in service by December 31, 2024.

Qualified Property

Qualified property for Section 179 and bonus tax depreciation is defined as property that was placed in service during the tax year and used predominantly (more than 50%) in a U.S. trade or business. Property that was placed in service during the tax year and then disposed of in the same year does not qualify for the deduction. Similarly, property converted to personal use in the same tax year that it was acquired, will not qualify for the deduction.

Qualified property includes computer systems, computer software, vehicles, machinery, equipment, and office furniture. Leasehold improvements are also qualified property.

Note that the above U.S. tax depreciation rules are applicable to both U.S. domestic and foreign-owned entities.

Maximize Business Interest Expense Deduction

The TCJA is applicable for tax years beginning after December 31, 2017, imposes a limitation on business interest expense of many taxpayers, with exceptions for small businesses (those with three-year average annual gross receipts not exceeding $30 million in 2024). For each tax year, businesses are required to compute their adjusted taxable income to determine their eligibility to deduct business interest expense paid during the year. The deductible business expense is limited to 30% of the computed adjusted taxable income, and the computation for adjusted taxable income (ATI) includes an addback for tax depreciation and amortization. For tax years beginning on or after January 1, 2022, ATI is roughly equivalent to earnings before interest and taxes (EBIT).

Any business interest expense disallowed as a deduction in the current year is carried forward indefinitely.

Maximize Business Net Operating Loss Deductions

A net operating loss exists if a company's deductions exceed taxable income. Net operating losses (NOL) are valuable deductions that can benefit a company by reducing taxable income in future years.

For tax years beginning in 2022, businesses that incur an NOL will only be allowed to carry the loss forward (as opposed to carrybacks for NOLs before 2021) to be used in future years. While these losses can be carried forward indefinitely, they can only be used to offset 80% of taxable income of the business in the carry forward years.

Research and Development

For tax years beginning after December 31, 2021, research and development costs must be capitalized and amortized. Research and Development (R & D) costs incurred in the U.S. will have an amortization period of five years, while those costs incurred outside the U.S. will have an amortization period of 15 years. This tax treatment is different from the way businesses accounted for these costs prior to 2022, where businesses could either deduct these costs or choose to capitalize and amortize them.

Prior to the recent U.S. election, Congress had proposed a credit for R & D expense as opposed to a deduction. Generally, a credit is more beneficial than a deduction because the credit will reduce taxes payable dollar for dollar. (We have to wait for the new U.S. administration to take office in 2025 to see if they will pursue the R & D credit proposal).

Bad Debts and Worthless Stock Deductions

Bad debts resulting from a trade or business in the U.S. may be deducted in the year the debt becomes worthless.

For U.S. tax purposes, business bad debts can be wholly or partially written off. If a business bad debt is only partially worthless, and is recoverable in part, then the worthless portion is deductible to the extent it is written off during the tax year in the accounting records. A complete write-off requires that the debt is wholly uncollectible as of the end of the year.

Whether a debt is wholly or partially worthless is a question of fact, requiring consideration of all the relevant evidence, including the debtor's financial condition and the value of the collateral secured by the debt. A debt becomes worthless when there is no longer any chance the amount will be collected.

Note that in order to claim losses for worthless stock of a subsidiary, the subsidiary must be at least 80% owned.

Net Investment Income Tax (NIIT)

The NIIT rate is 3.8% on the investment income and typically applies only to high-income taxpayers. The tax applies to individuals, estates and trusts, but certain income thresholds (depending on filing status) must be met before the tax takes effect. For example, the tax applies to all investment income reported on a U.S. return.

Investment income includes interest, dividends and capital gains. It can also include income from rental properties, capital gain distributions from mutual funds and even royalty or annuity income.

Note that the NIIT does not include wages, self-employment income, unemployment compensation, social security benefits, or alimony.

Beneficial Ownership Information Reporting (BOI Reporting)

Starting in 2024, you may be required to report certain information on the beneficial owners of your company to the U.S. Department of the Treasury's Financial Crimes Enforcement Network (FINCEN). Certain types of corporations (including foreign-owned registered to do business in any state), limited liability companies (LLC's), trusts, and similar entities created in, or registered to do, business in the U.S. must report information about their beneficial owners - the persons who ultimately own or control the company to FINCEN.

For clarity, Canadian incorporated companies that are registered to do business in a U.S. state will have to report if the beneficial ownership requirement below is met. For example, a Canadian company that is registered to do business as a branch in any state will have to file the BOI report.

The purpose of the BOI reporting is to help prevent money laundering, tax fraud, and other illicit activities.

For purposes of BOI reporting, a beneficial owner is any individual who owns or controls at least 25% of the ownership interest or has substantial control over the reporting entity.

The filing deadlines are as follows:

- Entities existing before January 1, 2024, must file their initial BOI report by January 1, 2025.
- Entities created or registered after January 1, 2024, must report their initial BOI report within 90 days of their formation or registration.
- From January 1, 2025, onward, newly formed or registered entities must file their initial BOI report within 30 days of formation.

Note that on December 3, 2024, a U.S. District Court placed a preliminary nationwide injunction on BOI reporting, which halts BOI reports. We will monitor the legal developments in the U.S. and advise accordingly.

The BOI reporting is usually done by law firms, generally the firms that were involved with the incorporation of your company. If you do not have a U.S. lawyer, we can introduce you to Lippes Mathias, LLP, a law firm based in Buffalo that we have a relationship with.

Further note that non-compliance with the BOI reporting may result in fines up to US$500 per day, criminal penalties of up to US$10,000, imprisonment, or both.

Further note that BOI reporting is not an annual requirement. A report only needs to be submitted once, unless the filer needs to update or correct information.

State Nexus

Canadian companies with operations in the U.S. should determine if they have Nexus with any state. Nexus is defined as a presence or connection in a state that is sufficient to be subject to state tax and state tax filings. Nexus for income tax is different from Nexus for sales tax and the Nexus rules for each state are also different.

You should review your company's activities in each state in which the company is doing business to determine if you have any state tax exposures for income and/or sales tax.

Note that state and local taxes imposed on businesses are deductible expenses for federal income tax purposes.

We Can Help

Your MG advisor can help you review your personal or business tax situation and help you decide which steps you can take before the year-end to help you with the taxes that you will pay in 2024.

Offices: First Canadian Place
100 King Street West, Suite 5700
Toronto, Ontario M5X 1C7
Phone: 416-362-0515

1900 Minnesota Court, Suite 116
Mississauga, Ontario L5N 3C9
Phone: 905-451-4788
Fax: 905-451-3299

TaxTalk is prepared by our Tax Group (taxtalk@mgca.com). Please visit our web site at www.mgca.com.

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