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TaxNewsFlash

Canada

Highlights of New U.S. Tax Measures

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Canadian companies that do business in the United States, Canadian individuals with assets in the United States, and U.S. individuals living in Canada should determine how they will be impacted by new U.S. tax changes. These new rules, many of which take effect on January 1, 2026, were enacted following the approval of the U.S. budget reconciliation bill (commonly known as the "One Big Beautiful Bill"). Although the United States ultimately removed some tax measures from the bill that were expected to increase taxes on U.S.-source income for Canadian corporations and certain other investors, many taxpayers will still be affected by these significant U.S. changes, including certain corporate tax measures that were made permanent, such as the higher EBITDA cap on the deduction for interest and 100% bonus depreciation. The United States has also enacted personal tax measures to increase the lifetime estate, gift, and generation-skipping transfer tax exemption and increase the Alternative Minimum Tax (AMT) exemption amounts, among other changes.

For more details on the U.S. budget reconciliation bill, see the following publication from KPMG's member firm in the United States, "KPMG reports: Tax subtitle for "One Big Beautiful Bill".

Background
The United States proposed new tax legislation in a recent budget reconciliation bill that was signed into law on July 4, 2025. Note that, before the bill passed, certain proposals were removed that would have addressed what the United States considers to be "unfair foreign taxes" applied by many countries, including Canada. Generally, these measures would have potentially increased taxes on Canadian-owned U.S. corporations and

imposed additional withholding taxes on U.S.-source income of Canadian individuals and corporations.

Business tax changes — Highlights

Permanent reinstatement of 100% bonus depreciation

The United States has permanently reinstated the 100% first-year depreciation deduction for qualified property acquired and placed in service after January 19, 2025, and specified plants planted or grafted after such date. As a result of this change, taxpayers will have the ability to elect out of bonus depreciation, and a transitional election is available that allows taxpayers to apply a reduced bonus depreciation percentage of 40% for qualified property placed in service by the taxpayer during the first tax year ending after January 19, 2025 in lieu of the 100% bonus depreciation that would otherwise apply.

KPMG observation
Canadian businesses that operate in the United States may generally benefit from this change. When making capital investments in the United States, these businesses should consider modeling the impact of available depreciation methods to understand how depreciation might impact the ability to claim other deductions, such as net operating loss carryovers or the Foreign-Derived Deduction Eligible Income (FDDEI)deduction (discussed below).

Extension of the qualified business income deduction

The United States has extended the qualified business income deduction that allows certain individuals, trusts, and estates to deduct 20% of their business income, qualified Real Estate Investment Trust (“REIT”) dividends, and Publicly Traded Partnership (“PTP”) income. This change also increases the phase-in limits to $75,000 (from $50,000) and to $150,000 for joint filers (from $100,000). The United States also introduced a new minimum deduction of $400 for taxpayers who “materially participate” in a trade or business that has qualified business income of at least $1,000 (both the $400 and $1,000 are increased by cost-of-living adjustments).

KPMG observation
U.S. individuals living in Canada that earn certain U.S. business income will likely benefit from this extension.

Expansion of QSBS Gain Exclusion

The United States has expanded eligibility for the Qualified Small Business Stock (QSBS) gain exclusion. Specifically, the United States has increased the per issuer limitation to $15 million (from $10 million), with the $15 million amount to be increased by an inflation adjustment for tax years beginning after 2026. In addition, the United States has increased the aggregate gross assets threshold to $75 million (from $50 million), with the $75 million amount increased by an inflation adjustment for tax years beginning after 2026. This rule now generally provides for the exclusion of 50% of the gain on QSBS held for at least three years, and 75% of the gain on QSBS held for at least four years. Shares of QSBS held five years or more would continue to qualify for the 100% exclusion.

KPMG observation
This capital gain exclusion applies to newly issued U.S. C corporation shares.

Business interest deduction

The United States has effectively increased the interest deduction base. The deduction for business interest expense is currently limited to 30% of the sum of adjusted taxable income (ATI), business interest income and floor plan financing interest. Under present law, ATI is calculated in a manner similar to earnings before interest and taxes (generally referred to as “EBIT”). The United States has reinstated and made permanent the determination of adjusted taxable income (ATI), in a manner similar to earnings before interest, taxes, depreciation and amortization (generally referred to as “EBITDA”) (i.e., without regard to the deduction allowance for depreciation, amortization, or depletion) effective for taxable years beginning after December 31, 2024. The United States has also expanded the definition of floor plan financing to include trailers and campers that provide temporary living quarters for recreational, camping, or seasonal use and designed to be towed by, or affixed to, a motor vehicle. In addition, the United States modified the definition of ATI for tax years beginning after December 31, 2025 to disregard from the computation of ATI certain items of income such as subpart F income, Net Controlled Foreign Corporation (CFC) Tested Income (formerly known as Global Intangible Low-Taxed Income (GILTI) and any associated gross-up for non-U.S. taxes, certain non-U.S.-sourced dividends, and a portion of deductions related to Net CFC Tested Income and its associated gross-up.

KPMG observation
Taxpayers with capital-intensive businesses stand to significantly benefit from this permanent reinstatement of calculating ATI using EBITDA as opposed to EBIT in combination with the permanent reinstatement of 100% first-year bonus depreciation.

Modifications to FDII

The United States has made numerous changes to the FDII provisions. Very generally, under current law, businesses can take a FDII deduction for income derived from certain export activities. A 37.5% deduction is provided yielding an effective tax rate of 13.125% on qualifying income. The deduction rate was scheduled to be reduced to 21.875% for tax years beginning after December 31, 2025 (resulting in a 16.406% rate). Among other changes, the United States provided a permanent 33.34% FDII deduction (renamed to

Foreign-Derived Deduction Eligible Income ("FDDEI"), that results in a 13.9986% rate, applicable to tax years beginning after December 31, 2025. In addition, the United States has amended the determination of deduction eligible income under these provisions.

KPMG observation
Taxpayers with export-related activities in the United States may benefit from the changes made to the FDDEI regime. Taxpayers should model the interaction of the bonus depreciation deductions and the FDDEI mechanics to maximize deductions each tax year. Taxpayers will also likely welcome the changes to the determination of deduction eligible income.

Modifications to GILTI

The United States has introduced several notable changes to the GILTI regime, which requires a U.S. shareholder of a CFC to annually include in income a GILTI inclusion based in part of the CFC's tested income, regardless of whether the income is repatriated to the U.S. shareholder. GILTI is currently taxed at a rate of 10.5% by means of a 50% deduction for U.S. shareholders that are corporations, or for U.S. shareholders that are individuals who made a section 962 election. A foreign tax credit may be available for 80% of the foreign taxes paid by the CFC. The 50% deduction related to GILTI was scheduled to be reduced to 37.5% for tax years beginning after December 31, 2025 (resulting in a 13.125% rate for GILTI). The United States has made permanent a 40% GILTI deduction (resulting in a 12.6% tax rate) applicable to tax years beginning after December 31, 2025. In addition, the United States made various changes to how GILTI is calculated and increased the foreign tax credit limitation to 90%.

KPMG observation
Because of these changes, it is much more likely that certain U.S. shareholders with GILTI inclusions will not be subject to residual U.S. tax. In particular, a U.S. shareholder with a Canadian CFC that is subject to a Canadian corporate tax rate of 14% or more in the year may benefit from this change.

Modifications to BEAT

The United States has permanently set the Base Erosion and Anti-Abuse Tax (BEAT) rate at 10.5%, effective for tax years beginning after December 31, 2025. BEAT, which is similar to a corporate minimum tax, applies to large corporations with average annual gross receipts of at least $500 million over the preceding three years, and a base erosion percentage of 3% or more (2% for taxpayers that are members of an affiliated group that includes a bank or registered securities dealer). Corporations that make significant deductible payments to non-U.S. related parties may be subject to additional BEAT on these payments to limit erosion of the U.S. tax base. The BEAT rate was scheduled to increase from 10% (11% for banks and other financial entities) to 12.5% for tax years beginning after December 31, 2025.

KPMG observation
The BEAT changes, which now no longer include the provisions meant to address what the United States considers to be "unfair foreign taxes", results in a favorable outcome for tax years beginning after December 31, 2025 because the rate will only increase to 10.5% (rather than the originally planned increase to 12.5%). To manage the potential impact of these BEAT changes, large Canadian-owned U.S. companies should assess the impact of the BEAT and consider the interaction of other One Big Beautiful Bill changes (e.g., research and experimental ("R&E") expensing (discussed below), bonus depreciation, and interest deductibility restrictions).

Permanent reinstatement of immediate expensing for "domestic" (i.e. U.S.) research and expenditures

The United States has permanently reinstated immediate expensing of "domestic" (i.e., U.S.) research and experimental (R&E) expenditures for tax years beginning after December 31, 2024. Under these expensing rules, which were previously in force until 2021, R&E expenditures are not subject to capitalization or amortization requirements. Previously, R&E expenditures incurred as part of a taxpayer's trade or business after 2021 were required to be capitalized and amortized over a five-year period (or a 15-year period for research conducted outside the United States). Additionally, the United States has enacted an election to allow taxpayers to capitalize and amortize certain expenditures. For non-U.S. R&E expenditures, the requirement to capitalize and amortize these costs over 15 years remains unchanged.

The United States has also introduced transitional rules, including:

- An election allowing certain small taxpayers to retroactively apply immediate expensing of R&E expenditures for tax years beginning after December 31, 2021
- An election permitting the deduction of certain unamortized R&E amounts for expenditures incurred in taxable years beginning before January 1, 2025.

KPMG observation
Taxpayers with U.S. R&E expenditures may recognize significant benefits as a result of this permanent reinstatement. These taxpayers should model the impact of available elections.

Personal tax changes — Highlights

Increased lifetime exemption estate, gift, and generation-skipping transfer tax

The United States has increased the lifetime exemption amount per individual to $15 million (from $13.99 million, though originally scheduled to be reduced to $5.6 million indexed) and made it permanent, for estates of decedents dying, gifts made, and generation-skipping transfers made after 2025. The exemption amount would be indexed for inflation such that the $15 million amount would increase for transfers in 2027 and beyond.

KPMG observation
U.S. individuals in Canada and Canadian resident individuals with U.S. assets (such as real estate or stocks) may welcome this increased threshold, as the tax treaty confers on them a portion of the general exemption to apply against U.S. estate tax on U.S. assets. This change also introduces some certainty in estate planning, as the changes are made permanent.

Extension and enhancement of reduced rates

The United States has extended the regular income tax rate schedules for individuals, estates, and trusts enacted in 2017, effective for tax years beginning after December 31, 2025. This includes the modified income breakpoints applicable to the net capital gain and qualified dividends tax rates. As a result, the top marginal rate will remain at 37% (instead of the originally scheduled 39.6% rate).

The United States also increased the standard deduction (instead of the reductions that were originally scheduled) and modified the cost-of-living adjustment for the standard deduction (using chained CPI for 2024 as opposed to 2017) for tax years after 2025.

KPMG observation
U.S. individuals in Canada whose U.S. tax rate is higher than their Canadian rate could end up paying a lower U.S. tax rate than originally scheduled on certain income. This may apply, for example, on short term capital gains, stock options, capital dividends, capital gains eligible for the Canadian lifetime capital gain exemption, or years with Canadian loss carryforwards.

Termination of deduction for certain personal exemptions

The United States has permanently reduced the amount of the personal exemption to $0, effective for tax years beginning after December 31, 2025. This change does not include the new temporary $6,000 senior exemption, which applies for the years 2025 to 2028, but subject to phaseout.

KPMG observation
U.S. individuals in Canada whose U.S. tax rate is higher than their Canadian rate could end up paying a slightly higher U.S. tax rate than originally scheduled on certain income. However, lower income seniors for years 2025 to 2028, which could be end up paying a slightly lower U.S. tax.

Limitation on individual deductions for certain state and local taxes

The United States has increased the cap on the state and local tax (SALT) deduction for tax years 2025 through 2029. Beginning with the 2025 tax year, the SALT limitation amount will increase to $40,000 ($20,000 for married filing separately), subject to a phasedown based on Modified Adjusted Gross Income (MAGI). For tax years 2025 through 2029, the SALT limitation amount will be reduced by 30% of the excess of MAGI over a threshold amount, but not below $10,000 ($5,000 for married filing separately). For tax year 2025, the threshold amount is $500,000 ($250,000 for married filing separately). For tax years 2026 through 2029, the SALT limitation amount and the MAGI threshold amount will increase by 1% each year. For tax years 2030 and beyond, the SALT cap will permanently revert to the current $10,000 limit and would not be subject to a phasedown. These changes also deny a deduction for personal non-U.S. real property taxes.

KPMG observation
Canadian individuals that have U.S. income or property may still be subject to a SALT deduction cap.

Limitation on tax benefit of itemized deductions

The United States has reduced the amount of the otherwise allowable itemized deduction by 2/37 of the lesser of:

- The amount of allowable itemized deductions, or
- The amount by which the taxpayer's taxable income (increased by the taxpayer's itemized deductions) exceeds the threshold at which the 37% rate of tax applies to the taxpayer.

This change is effective for tax years beginning after December 31, 2025.

KPMG observation
As a result of this change, U.S. individuals living in Canada may be subject to reduced itemized deductions, effectively reducing a 37% effective tax reduction to 35%.

Partial deduction for charitable contributions

The United States has reinstated and extended the partial deduction for cash charitable contributions for individuals who do not itemize their deductions. The maximum deduction is $1,000 (or $2,000 for married taxpayers filing jointly), effective for tax years beginning after December 31, 2025.

KPMG observation
U.S. individuals in Canada whose U.S. tax rate is higher than the Canadian rate (see

examples above), could thus end up paying a slightly lower U.S. tax than originally scheduled

AMT changes

The United States has extended the increase to the AMT exemption amounts and reverted the exemption phaseout thresholds to $500,000 (or $1 million for taxpayers filing a joint return). In addition, the United States has increased the rate at which the AMT exemption phases out to 50% (from 25%), so that the exemption amount is reduced more quickly as income increases beyond the applicable phase out threshold.

Trump Account for children

The United States has introduced a new Trump Account for children under 18. Parents can contribute, on an after-tax basis, $5,000 per year to the account, starting in 2026, and can also receive a one-time $1,000 grant for children born between 2025 and 2028. The earnings and grant are taxable to the child on withdrawal, but are free of U.S. tax until withdrawn.

KPMG observation
In the future, individuals who come to Canada who have Trump Accounts would be subject to Canadian tax and reporting, similar to individuals with a U.S. 529 plan.

Excise tax for remittances

The United States has imposed a new 1% excise tax for remittances transferred to a recipient who is located in a non-U.S. country, effective for transfers made after December 31, 2025. This tax only applies to cash payments made to non-financial institutions and not those withdrawn from a financial institution.

We can help

Your KPMG adviser can help you assess the effect of the U.S. tax legislation on your business and personal tax situations. Canadian corporations should consider the impact of the U.S. changes on their financial statement income tax provisions. For more details on U.S. tax changes and their possible impact, contact your KPMG adviser.

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