BRUNTON'S

U.S. Taxletter

FOR CANADIANS

Covering U.S. Aspects of U.S. Citizens or U.S. Residents with Canadian Income or Assets, and Canadians with U.S. Income or Assets

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ADMINISTRATIVE/LEGISLATIVE/ JUDICIAL UPDATE

New Tax Treaty Protocol

On September 21st, Canada and the US agreed to a new (the 5th) Protocol to the tax treaty making several interesting changes. It may be several months before the Agreement is ratified by both Governments and goes into effect. Please see the article "***NEW TAX TREATY PROTOCOL***".

US Estate Tax Legislation

Two new separate alternative sets of legislation were recently introduced in the US House of Representatives to increase the "applicable exclusion amount" (the exemption) for US estate tax. Either one would be good news for many Canadians. Please see the article "***ESTATE TAX CHANGES - A GOOD CHANCE THIS TIME?***"

Housing Exclusion Amount

The IRS has announced the maximum "housing expenses" for 2007 for purposes of the "Housing Exclusion". Although the general maximum is $25,710, this maximum amount is increased for certain high cost locations. For example, the maximum is increased for several Canadian cities including (among others): Montreal ($56,200), Toronto ($46,000) and Vancouver ($44,600). The "Foreign Earned Income Exclusion" for 2007 is $85,700.

Rules for Corporate Estimated (Installment) Tax Payments

The IRS has issued new regulations applicable to federal corporate estimated tax requirements that, among other matters, now conform to the tax code itself. For example, if a Canadian or other corporation has taxable income for the year it must make specified estimated tax payments during that tax year. This requirement applies even if the corporation was not required to file a US tax return for the previous year. The requirement also applies if the corporation did file a US income tax return for the previous tax year but there was no tax liability for that previous year.

RICHARD BRUNTON HOLDS A MASTERS DEGREE IN TAXATION/ACCOUNTING, IN WHICH HIS PRIMARY INTEREST HAS BEEN INTERNATIONAL TAXATION. HE HAS BEEN A RESIDENT OF FLORIDA FOR THE PAST 36 YEARS.

Thus, a Canadian corporation making a one-time US tax filing due to a real estate sale will generally be subject to penalties if it does not make US federal estimated tax payments during the year of sale. (Reg. 1.6655-1(d)). Individual State tax payments may also be required.

Canadian Athletes & Musicians Performing in the US

The IRS has issued new proposed regulations governing the US tax treatment of nonresident alien athletes and musicians that perform in the US. Under the proposal such individuals would be taxed on an "event" basis - i.e. the time spent preparing and/or training for the event would be ignored. (REG-114125-07).

***ADDRESSES ONLY U.S. FEDERAL ISSUES -- STATE AND LOCAL ISSUES MAY ALSO APPLY.**
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Taxable Income from Mortgage Cancellations

Subject to exceptions, the US tax law generally triggers taxable income to the debtor when he/she obtains a full or partial cancellation of indebtedness. An example, particularly apt to some areas of the US due to present state of the real estate market, may occur if a homeowner is given relief on his/her home mortgage. For example, if the home is foreclosed upon and $20,000 of debt is forgiven, or if the mortgage is otherwise reduced by $20,000, the homeowner may be deemed to have $20,000 of taxable income. Some exceptions apply - see Internal Revenue Code ("IRC") Section 108.

However the present mortgage and real estate markets are so unusual in the some parts of the US, the President and Congress have introduced proposals to temporarily protect homeowners from this rule.

Green Card Renewals

The US Citizenship and Immigration Services ("USCIS") introduced rules on August 22nd requiring individuals holding green cards without an expiration date to replace their current cards. The new cards will have a 10-year expiration date (for the card, not the immigration status). The rule applies to green cards issued between 1977 and 1989. Cards issued before 1977 were previously recalled and issued with expiration dates. Cards issued after 1989 already contain a 10-year expiration date.

Nexus

Despite a request, the US Supreme Court has refused to decide whether the "physical presence" requirement also applies for individual State income tax or State franchise tax. As a result, legislation was introduced in the US Senate June 28th to require and define physical presence for State income and franchise tax purposes. (S. 1726).

The New Jersey Tax Court decided an out-of-state corporation had nexus in New Jersey due to the fact it licensed its patents, trade secrets and technologies to its parent corporation that had facilities in New Jersey.

The Massachusetts Appellate Tax Board has determined a Delaware corporation had nexus in Massachusetts for purposes of Massachusetts corporate income tax because it received royalty income from two affiliated entities for the licensing of trademarks, etc., which the entities used for retail business activities in Massachusetts.

US Social Security

New legislation introduced in the US House of Representatives on June 29th would deny non-US citizens any US Social Security credits earned after December 31, 2007, for purposes of computing their US Social Security benefits. (H.R. 190).

IRS Scam Warning

The IRS has warned of new email scams - one of these offers an $80 payment for participating in an online "customer satisfaction" survey!

Pending "International Tax" Legislation

In addition to estate tax, several new cross-border tax legislative proposals have been introduced. Please see ***"UPDATE ON PENDING US INTERNATIONAL TAX LEGISLATION".***

US WITHHOLDING TAX & REAL ESTATE FORECLOSURES INVOLVING CANADIANS

Readers are aware a sale or other disposition of US real estate by a non-US person generally requires a tax of 10% of the selling price to be withheld at the time of sale and remitted to the IRS. (This is the so-called "FIRPTA" withholding.) Please see Exhibit 1 for a review of the rules.

However the present status of the real estate market in some areas of the US has led to a foreclosure by the lender in some cases, and a "deed in lieu of foreclosure" in some other cases. In either case, what is the FIRPTA withholding requirement if the buyer or seller is a Canadian?

Foreclosure Sale

At the end of the foreclosure procedure, if no agreement has been reached by the lender and borrower/owner of the property, the court will normally authorize/mandate the sale of the property. At the sale, the property will be acquired either by a third party or by the lender - in the latter case usually for the amount due on the loan.

In this scenario what are the FIRPTA withholding requirements? If the "purchaser" (the

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lender or a third party purchaser) complies with certain "Notice" requirements (see below) the withholding amount can be reduced to the net proceeds, if any, (determined by a court or trustee having jurisdiction over the matter) that the borrower realizes from the foreclosure sale. (Reg. 1.1445-2(d)(3)(i)(A)).

Example: Michael, a nonresident alien of the US owns a condo in the US that is subject to a mortgage held by XYZ bank. Michael defaults on the mortgage and the unpaid balance of the mortgage is $300,000 at the time the court authorizes foreclosure. The bank sells the property in foreclosure to Roger for $315,000. Provided he complies with the "Notice" requirements, Roger is only required to withhold and remit $15,000 to the IRS on the transaction instead of $31,500 (10% of the selling price).

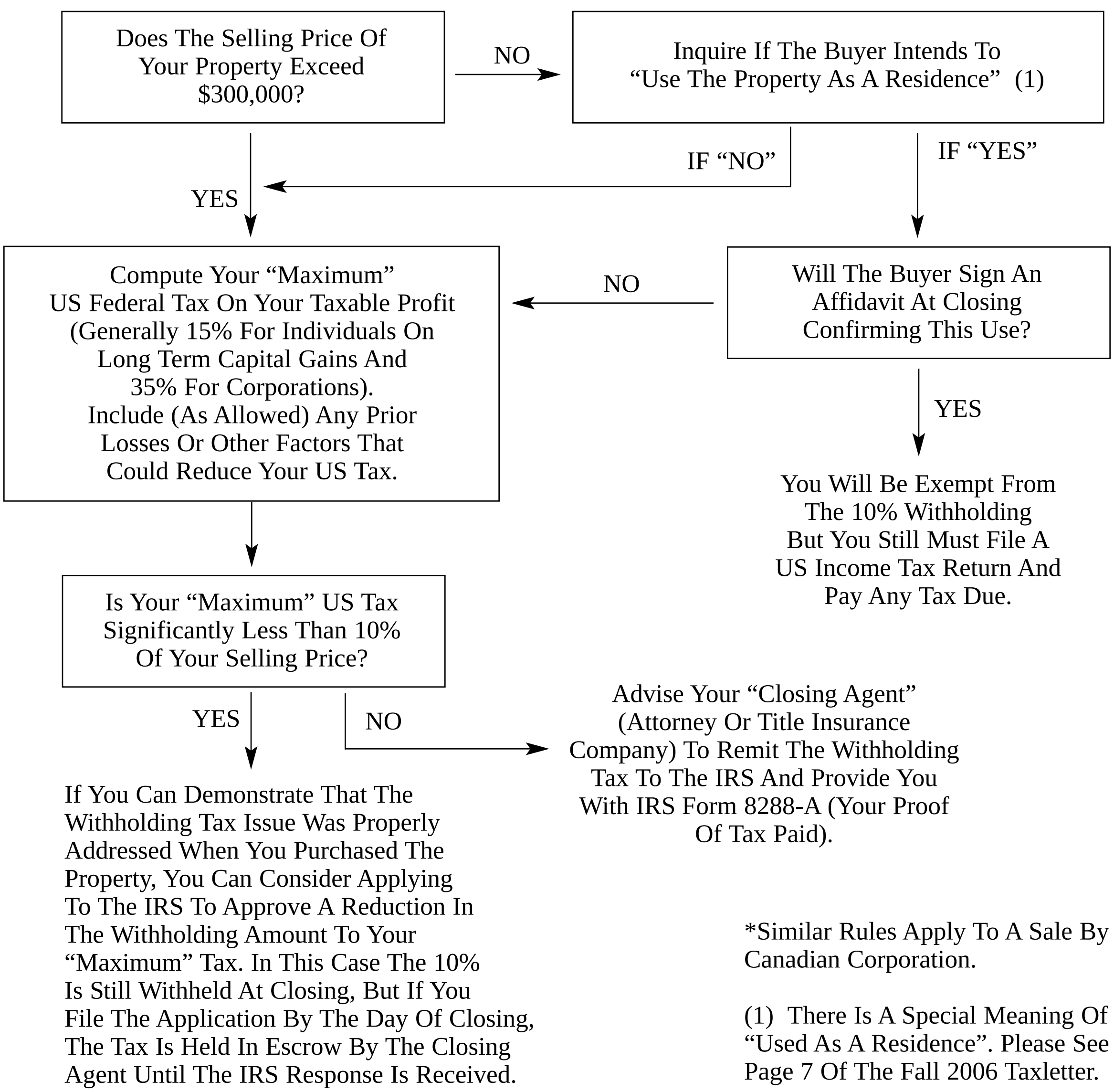
Deed in Lieu of Foreclosure

Some borrowers will "throw in the towel" and agree to simply transfer title to the property to the lender, perhaps to avoid the time and expense of the foreclosure process, and/or (if agreed with the lender) to avoid any liability for a deficiency in the amount owing.

No withholding is required in a "deed in lieu of foreclosure" transfer if three conditions are met:

EXHIBIT 1

US Withholding Tax On Nonresident Alien's Sale Of US Real Estate*



*Similar Rules Apply To A Sale By A Canadian Corporation.

(1) There Is A Special Meaning Of "Used As A Residence". Please See Page 7 Of The Fall 2006 Taxletter.

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1) The "purchaser" (lender) is the only person with a security interest in the property,

2) No cash or other property (excluding incidental fees) is paid to any person, and

3) The "Notice" requirements (see below) are complied with.

"Notice" Requirements

1) If the transaction is a foreclosure/sale the purchaser/transferee must provide Notice on the day of the transaction to the court or trustee having jurisdiction. (Regs. 1.1445-2(d)(3)(ii)(A) and 1.1445-2(d)(3)(ii)(B)).

2) In the case of either a foreclosure/sale or a deed in lieu of foreclosure the purchaser must provide Notice to the IRS within 20 days following either a final determination by the court or trustee in a foreclosure action, or a deed in lieu of foreclosure. (Reg. 1.1445-2(d)(3)(iii)(A)).

No IRS Form exists for the Notice, but the regulations describe the information to be included.

NEW TAX TREATY PROTOCOL

The recent changes to the tax treaty agreed to by Canada and the US in the 5th Protocol signed September 21st are quite extensive and complex. Thus it's understandable why the Agreement was so long in coming. The changes will not go into effect until they are ratified by both Governments. A summary follows.

Moving To the US

Under present rules, a Canadian resident moving to the US who is not a US resident or a US citizen may be faced with double tax on certain of his appreciated assets at the time of the move. This occurs, of course, because the assets that he owns at the time of the move may be subject to the "deemed disposition" departure tax in Canada, while in the US the individual will normally retain an historical cost base for purposes of the actual future sale.

The new Protocol, when ratified, will permit such an individual to make an election at the time of the move to be considered to have acquired the property at its fair market value immediately before the move to the US.

This new provision replaces the existing provision that allows US citizens (and certain individuals that were dual residents) to make such an election. Hence all individuals will be able to make the election, but in the case of US citizens and certain dual resident's the election will continue to trigger actual taxable income for US purposes if there is a net gain, (subject, of course, to applicable foreign tax credits and other factors).

Interest

Withholding tax will be eliminated on cross-border payments of interest. A phase-in will apply for certain related party payments.

Dividends

Distributions from Canadian income trusts and royalty trusts that are treated as dividends under the tax laws of Canada will be considered dividends for purposes of the treaty. (Diplomatic Notes: Annex B (3.) to the Convention).

Permanent Establishment

An important addition is made to the treaty Article defining "permanent establishment" ("PE") in the case of businesses providing cross-border services. This may be helpful to many Canadian businesses with US activities, although it may create a substantial dichotomy between the rules for US federal taxation and separate US State taxation.

Provided a business in one country is not otherwise determined to have a PE in the "other country", it will only be deemed to have a PE in the "other country" if:

a) Services are performed in the "other country" by an individual who is present in that "other country" for a period or periods aggregating 183 days or more in any 12-month period, and, during that period or periods, more than 50% of the gross active business revenues of the enterprise consists of income derived from services performed in the "other country" by that individual, or

b) The services are provided in that "other country" for an aggregate of 183 days or more in any 12-month period with respect to the same or connected project for customers who are either residents of that "other country" or who maintain a permanent establishment in that "other country" and the services are provided in respect of that permanent establishment.

Another significant addition (indirectly) to the PE Article, is contained in Diplomatic Notes: Annex B(9) to the Protocol. This paragraph states that in determining the business profits attributable to a PE, a business shall

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include only the profits derived from business assets used, risks assumed, and activities performed, by the permanent establishment. "The principles of OECD transfer pricing guidelines shall apply". ………. "In particular, in determining the amount of attributable profits, the permanent establishment shall be treated as having the same amount of capital that it would need to support its activities if it were a distinct and separate enterprise engaged in the same or similar activities".

Pensions

The cross-border taxation of pensions can be extremely complex, partly because in many cases the tax laws of one country are not respected by the tax laws of the other country, thus resulting in:

a) Earnings inside the pension plan being taxed in one country while they are not simultaneously taxed in the other country, and/or

b) Contributions to the plan being deductible for tax purposes in one country while not being simultaneously deductible in another country,

and/or

c) Distributions from the plan being taxed in different amounts in each country because of a) and b) above.

Examples are the treatment of RRSP payments for US tax, and Roth IRA payments for Canadian tax. (Please see the articles ***"US TAXATION OF NONRESIDENT ALIENS RECEIVING US PENSIONS"*** and ***"US "IRA" PENSION RECEIPTS BY CANADIANS THAT ARE NRAs OF THE US").***

Although it is complicated, the 5th Protocol is helpful, but unfortunately there is no clarification of the meaning of "periodic" pension. Following is a summary of some changes.

1) The new Protocol defines "pensions" to include US "Roth IRAs", except "from such time that contributions have been made to the Roth IRA, by a resident of (Canada) ………………(other than rollover contributions from a Roth IRA) to the extent of accretions from such time, such Roth IRA………. shall cease to be considered a pension".

2) In certain cases, contributions made to, and benefits accrued under, pension plans in one country will be deductible or excludable in computing an individual's taxable income in the other country. Several conditions must be met for the rules to apply. (Proposed new Article XVIII(8)).

3) If all the rules are complied with, a commuter for work will be able to deduct contributions in both countries, subject to limitations. (Proposed new Article XVIII(10)).

4) Contributions made to, or benefits accrued under, a plan in Canada by a US citizen who is a resident of Canada will be deductible or excludable from income in computing his/her taxable income in the United States if the individual works in Canada for a Canadian employer that is a resident of Canada, or has a permanent establishment in Canada, and the contributions and benefits are attributable to the period in which the individual performs services in Canada. (Proposed new Article XVIII(13)). Limitations apply.

5) The provisions in 2)-4) above apply to "qualifying retirement plans". A "qualifying retirement plan" does not include "an individual arrangement in respect of which the individuals employer has no involvement". (But a "qualifying retirement plan" does include certain RRSPs. For a list of the plans included please refer to Diplomatic Notes: Annex B to the Convention, paragraph 10).

6) For purposes of 2)-4) above, distributions from pensions will be sourced for income tax purposes where the plan is established. (Proposed new Article XVIII(16)).

Stock Options

Income from stock options is often treated as "compensation". The 5th Protocol itself does not address stock options. However, Diplomatic Notes associated with it state that income from stock options will generally be considered to have been derived in a country to the extent the individual's principal place of employment was in that country during the time between the granting of the option and its exercise (or the disposition of the shares). (Diplomatic Notes: Annex B (6.) to the Convention).

Fiscal Transparencies

Income will be deemed to be earned by a resident of a country if the recipient is a resident of that country, it receives the income through an entity that is fiscally transparent in that country and the income will be taxed in that country the same as if the amount had been derived directly. (Protocol Article 2(6)). This may encourage some US residents to invest in Canada through United States limited liability companies ("LLC's").

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A new rule for other 'hybrids" is contained in Protocol Article 2(7).

Also, with respect to withholding at source on dividend payments, a corporation will be deemed to own shares that it owns indirectly through a transparent entity that is not a resident of the country where the dividends are sourced. (Protocol Article 5).

Non-Discrimination

The Protocol extends the nondiscrimination provision to cover certain "entities". Thus it appears Canadian corporations may be able to make the so-called "Section 897(i) election" on the sale of US real estate. This election permits the corporation to avoid the 10% "FIRPTA" withholding tax on the sale (but not the actual corporate income tax). More on this in the next Taxletter.

New Definition

The Protocol adds a new definition to the treaty. The term "national" of a country will mean not only a citizen of the country but also any legal person, partnership or association deriving its status as such from the laws in force in that country".

US CITIZENS & RESIDENTS OWNING CANADIAN MUTUAL FUNDS

We previously mentioned certain important US tax and reporting issues applicable to US citizens and US residents (including green card holders living in Canada) that own:

1) Canadian (or other non-US) mutual funds that are trusts, and/or

2) Canadian income trusts.

(Please see the Fall, 2006, issue of the Taxletter, page 5).

It appears US citizens and US residents (including green card holders living in Canada) that own such investments must file IRS Forms 3520, 3520-A and 8082 annually for each mutual fund and income trust. (See IRC 679(a), IRC 6048, Form 3520 and the instructions to Form 8082).

The rules are troublesome because:

1) Compliance is difficult due to the extensive information required on Forms 3520 and 3520-A,

2) The penalties for noncompliance are quite substantial, and

3) Although this legislation (and the penalties) may never have been intended to apply to Canadian mutual funds and Canadian income trusts, it is clear the legislation does apply. Therefore in many cases the first inclination of the IRS may be to assess the penalty, thus leaving it up to the taxpayer to formally appeal the assessment, with uncertain results.

The annual penalty for noncompliance is 5% of the value of your investment in the mutual fund or income trust, and 35% of the income you receive.

Full compliance with the law may be difficult even if you wish to comply! The compliance procedure generally begins with page 1 of IRS Form 3520. Page 1 requires you to check off separate boxes if you:

1) Own a non-US trust (e.g. a Canadian mutual fund that is a trust or a Canadian income trust), and/or

2) Receive a distribution (e.g. a payment) from such an investment.

Ownership

If you own a Canadian or other non-US mutual fund, you may wish to ask your stockbroker or investment adviser whether the mutual fund is a trust or a corporation. If it is a trust, (or if it is a Canadian income trust), you must file IRS Form 3520 and you must check off the "ownership" box on page 1 of Form 3520. (See Code Section 679(a)).

Having checked this box you must then go to Part II of Form 3520 that requires you to submit the "Foreign Grantor Trust Owner Statement" that you received from the mutual fund or income trust. However, it is extremely unlikely the mutual fund or income trust will provide you with a "Foreign Grantor Trust Owner Statement". In this case you must prepare an additional Form - IRS Form 3520-A. Unfortunately Form 3520-A requires you to provide considerable information about the trust itself - much of which will be difficult for you to obtain.

We discussed this challenge with the relevant IRS tax lawyers in Washington. These individuals seem sympathetic to the fact that rules applicable to foreign trusts in general may not be appropriate for investments in publicly offered securities, such as Canadian mutual funds and Canadian income trusts. However they are adamant that the law does require you to file IRS Forms 3520 and 3520-A if you own an interest in a Canadian mutual fund that is a trust or a Canadian income trust.

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Receipt of a Distribution

If you received a distribution from a Canadian mutual fund that is a trust or a Canadian income trust you must check off the relevant box on page 1 of Form 3520 and then also complete Part III of Form 3520.

Unfortunately Part III asks whether you received a "Foreign Grantor Trust Beneficiary Statement" or a "Foreign NonGrantor Trust Beneficiary Statement" from the mutual fund or income trust. As indicated, it is extremely unlikely the mutual fund or income trust will provide this to you. In this case you must make a "default" calculation in Part III. This could lead to a determination that you received an "accumulation distribution" which could result in an IRS interest charge against you "as if" the tax on the current distribution was actually owed in a prior year!

The IRS has commenced a "regulations project" that is intended ultimately to give some guidance and/or simplified rules with respect to such securities. However we are told such assistance will not be forthcoming anytime soon.

Meanwhile, ignoring the law could potentially lead to the penalties described above, as well as preparer penalties for your tax preparer for "intentional disregard of rules and regulations".

If your Canadian mutual funds that are trusts are located in your RRSP or RRIF the same rules apply! However you may be able to replace them with corporate mutual funds without triggering Canadian or US income tax. (Please consult your Canadian and US tax advisors before taking any action).

Mutual funds held outside RRSPs and RRIFs may, of course, trigger tax in both countries if you attempt to replace ones that are trusts with ones that are corporations. If you do intend to make such a switch please review the US tax issues associated with Canadian mutual funds that are corporations that are described in the Articles on pages 3 and 13 of the Winter-Spring, 2007, issue of the Taxletter. In all cases, please consult your Canadian and US tax advisors before taking any action.

DIRECTORS' FEES FROM US CORPORATIONS TO CANADIAN NONRESIDENT ALIENS

Many Canadians resident in Canada are directors of US corporations and are present in the US annually to attend directors' meetings. What is their US tax status if they are nonresident aliens of the US?

Any nonresident alien that is "engaged in a trade or business" in the United States is required to file a US income tax return (Form 1040NR) for the tax year. (Reg. 1.6012-1(b)(1), subject to the limited exception in that section).

An individual is considered to be "engaged in a trade or business" in the United States" if he/she performs personal services in the US at any time during the year. (See the limited exception in IRC Section 864(b)).

Directors' fees are considered by the Internal Revenue Service ("IRS") to be self employment "trade or business" income. (Please see IRS Revenue Ruling 72-86). To the extent the service is provided in the United States the fees are "US source" income. (IRC Section 861(a)(3) - subject to the limited de minimus rule in that section).

Hence the Canadian directors of US corporations that attend meetings in the US are generally considered to be engaged in a trade or business in the US, receive "US source" income, and are therefore required to file a US income tax return (IRS Form 1040NR) for the year.

Tax Withholding Obligation of the Payer

The payer (the corporation) is generally required to withhold, and remit to the IRS, 30% of the payments to nonresident aliens for personal services performed in the US. (IRC Section 1441). The income, and tax withheld, is reported to the IRS on IRS Form 1042-S, with a copy to the recipient/director.

The withholding requirement may be waived if the Canadian recipient (the director) does not have a "fixed base" in the United States (See "Fixed Base" below). To exercise this exemption the director must provide IRS Form 8233 to the payer. (Please see the article ***"US TAX WITHHOLDING AT SOURCE ON CANADIANS").***

US Federal Income Tax Liability of the Director

The tax treaty between Canada and the US does not specifically address directors' fees. However their taxation is apparently addressed by Article XIV of the treaty ("Independent Personal Services"). That Article provides that a nonresident alien receiving

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income in respect of independent personal services is taxed in the US only if the individual has a "fixed base regularly available to him" in the US, and only to the extent the income is "attributable to that fixed base".

To exercise this exemption from US income tax (i.e. to claim there is no "fixed base" in the US) the director must still file a US income tax return (IRS Form 1040NR). However if the individual has no other income to report, the body of the tax return will include little more than the taxpayer's name and address. The tax treaty claim (IRS Form 8833) and disclosures are provided via a statement attached to the back of the tax return.

Fixed Base

Assuming a director has no other "office" in the United States, it may be reasonable to assume the occasional use of the US corporation's "board room" does not constitute a "fixed base" for the director.

ESTATE TAX CHANGES - A GOOD CHANCE THIS TIME?

Two alternative sets of estate tax legislation have been introduced in the US House of Representatives to increase the "applicable exclusion amount" (the exemption) for estate tax.

On September 1st, legislation (H.R. 3475) was introduced to:

1) Increase the "applicable exclusion amount" (the exemption) for US estate tax to $5 million, for deaths after December 31, 2009, and

2) Repeal the one-year (Year 2010) termination of estate tax.

On November 1st, a second proposal (H.R. 4042) was introduced to:

1) Increase the "applicable exclusion amount" (the exemption) for US estate tax $3.5 million for deaths after December 31, 2007, and

2) Accelerate the elimination of the top tax rates.

Both proposals add a cost of living index.

Nonresident aliens that are resident in Canada are entitled to a portion of the "applicable exclusion amount".

There may be better prospects for estate tax legislation actually being enacted this time because:

1) Both political parties seem to believe, in general, that the present exemption should be raised,

2) Both of the current proposals are more "modest" than some of the Republican proposals made in early 2006, and

3) New legislation must be enacted before 2011. Otherwise the "applicable exclusion amount" will then drop from $3.5 million (2009) and an unlimited amount (2010) to $1 million in 2011 - an amount both political parties seem to agree is too low.

In the case of real estate jointly owned by spouses resident in Canada that are nonresident aliens of the United States, a change, if enacted, will eliminate US estate tax on the first death in most cases when the worldwide assets of the decedent do not exceed approximately US $10 million under H.R. 3475 and approximately US $7 million under H.R. 4042.

Please see Exhibit 2 for examples of the estate tax impact in certain specific cases if the proposed legislation under H.R. 3475 is enacted.

UPDATE ON PENDING US "INTERNATIONAL TAX" LEGISLATION

Many important changes to international tax laws are currently pending before the US Congress. Some are mentioned below. Legislation introduced in the US House of Representatives is identified with the prefix "H.R.". Legislation introduced in the US Senate is identified with the prefix "S".

Expatriation of Individuals

H.R. 2, introduced in the House of Representatives in January, 2007, would impose a departure tax similar to Canada's on covered expatriates. There would be an exemption on $600,000 of gains (indexed for inflation) and covered expatriates would be permitted an irrevocable election to defer the tax on realized gains until the later of actual disposition of the property, or the death of the expatriate.

Tax Havens

H.R. 2136 and S. 681 (The "Stop Tax Haven Abuse Act") is chilling. Among other matters, it enacts a new code section 7492, which establishes certain rebuttable presumptions. The first presumption is that a United States person who directly or indirectly transfers assets to, was a beneficiary of, or receives money or property from, an entity formed in

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EXHIBIT 2

Some Examples Of Exposures To US Estate For Nonresident Aliens Resident In Canada For Deaths After December 31, 2009 If Recently Proposed Legislation (H.R. 3475) Is Enacted (1)

	US Property Subject To Tax	Worldwide Property	US Estate Tax Before Tax Credit	Potential Unified Tax Credit	Potential Net Tax If No Surviving Spouse	Potential Marital Tax Credit If A Surviving Spouse Exists	Potential Net Tax If All US Property Passes To A Surviving Spouse
1	500,000	3,900,000	155,800	155,800	0	0	0
2	500,000	5,000,000	155,800	155,800	0	0	0
3	500,000	7,500,000	155,800	142,053	13,747	13,747	0
4	750,000	4,500,000	248,300	248,300	0	0	0
5	750,000	7,500,000	248,300	213,080	35,220	35,220	0
6	750,000	10,000,000	248,300	159,810	88,490	88,490	0
7	1,000,000	4,500,000	345,800	345,800	0	0	0
8	1,000,000	7,500,000	345,800	284,107	61,693	61,693	0
9	1,000,000	10,000,000	345,800	213,080	132,720	132,720	0
10	1,000,000	12,000,000	345,800	177,567	168,233	168,223	0
11	1,000,000	15,000,000	345,800	142,053	203,747	142,053	61,694
12	1,500,000	10,000,000	555,800	319,620	236,180	231,180	0

(1) Assumes There Are No Tax Factors Other Than Those Listed. Assumes The Decedent (And Surviving Spouse, If Applicable) Are Nonresident Aliens. The Determination Of “US Property Subject To Tax”, And “Worldwide Property” Can Depend On The Proportion Of Contribution By Each Spouse, In The Case Of Property Jointly Owned By Spouses.

This Is A Summary Of A Few Examples Only. Many Exceptions Apply. Please Consult Your Tax Advisor Before Taking Any Action.

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an "Offshore Secrecy Jurisdiction" (see below) would be deemed to exercise control over the entity. Among other circumstances, this may affect:

1) the operation of so-called "Letters of Wishes" and/or "Trust Protectors", and

2) tax planning for individuals moving to the US .

In addition, there would be a further rebuttable presumption that any amount or thing of value received by a United States person from a non-publicly traded entity in an "Offshore Secrecy Jurisdiction", would constitute the income of such person in the year of receipt. Any amount paid or transferred to the entity would represent previously unreported income!

The legislation would establish a list of "Offshore Secrecy Jurisdictions". The proposed legislation lists 34 countries in an initial list. Switzerland and Costa Rica are included.

Financial institutions that open bank, brokerage, or other financial accounts in an "Offshore Secrecy Jurisdiction" for US persons, or who create non-publicly traded entities for a US person in such a jurisdiction, would be required to report the transaction to the IRS. Banks, securities firms and other withholding agents would be required to report the US beneficial owners, and US source income, with regard to non-publicly traded entities in which US persons have an interest.

S. 681 and H.R. 2136 would also treat a grantor of a foreign trust as holding any power held by any "trust protector" associated with the trust. A person receiving a distribution from a foreign trust would be treated as a beneficiary regardless of whether the person is a named beneficiary, except where fair market value was paid.

S. 396 would treat controlled foreign corporations ("CFCs") that are "tax haven" CFCs as US corporations for all purposes of the US tax code. An exception would apply in the case of an active business in the relevant tax haven country. The legislation lists 40 countries that would be treated as "tax haven" countries.

Dividend Tax Rate

H.R. 1672 and S. 1006, introduced in March would deny the 15% US maximum dividend tax rate to certain foreign corporations if the dividend is allowable as a deduction under the law of the foreign country, or if it is otherwise creditable against the tax imposed by the foreign country.

Foreign Earned Income Exclusion

S. 1140, proposed in April, would eliminate the limitation on the amount of "foreign earned income" that a US citizen or resident can elect to exclude from US gross income.

Economic Substance Doctrine

H.R. 2345, named "The Abusive Tax Shelter and Taxpayer Accountability Act", (May, 2007), proposes to codify the "economic substance" doctrine. A transaction would have economic substance only if "the transaction changes in a meaningful way (apart from tax effects) the taxpayer's economic position", and the taxpayer has a substantial non-tax purpose for entering into such transaction, and the transaction is a reasonable means of accomplishing such result".

Taxation of CFCs

S. 96 would change the taxation of CFCs (controlled foreign corporations) such that all income of the CFC would be subject to tax in the United States except for "active home country income".

Definition of US Corporation

S. 96 also provides that the definition of a US domestic corporation would be expanded to include any corporation whose stock is regularly traded on an established securities market and is managed and controlled primarily in the United States. The latter could occur when substantially all the executive officers and senior management are primarily located in the US.

CROSS -BORDER TAXATION OF US STOCK OPTIONS

We previously summarized some of the US domestic tax rules associated with US corporate stock options - please see the Fall, 2005, issue of the Taxletter.

However, special considerations may be present when there is a cross-border element to the option circumstances. Different results may occur depending upon the citizenship and residency of the recipient and whether all or a portion of the work was performed in the United States. (Also please see the article

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"NEW TAX TREATY PROTOCOL (Stock Options)").

Nonresident Aliens

Subject to tax treaty rules, the US taxation of stock options is generally subject to the US "source' rules and, to the extent applicable, the rules for compensation.

Alien Who Never Worked in the US. An individual who never was a US citizen or US resident and never worked in the US is generally not subject to US tax on the income from exercising US corporate stock options.

Alien Who Did Work in the US. An alien who worked in the US prior to exercising his/her option rights could be subject to US income tax on the "spread". The taxable portion would be determined by applying the source rules. If the stock option plan was a multi-year arrangement the income would be sourced between countries on the basis of workdays starting on the date of the grant and ending on the "vesting date". (Reg. 1.861-4(b)(2)(ii)(F)).

a) If the stock option plan is a "qualified" plan (an incentive stock option plan) and all the requirements are complied with, the recipient will normally have a capital gain when the stock is sold as long as the stock is held for the requisite time period. If the recipient is a nonresident alien resident in Canada at the time of sale there would be no regular US income tax, but please check the rules for US alternative minimum tax.

If the stock is not held for the required period, the recipient will be subject to US income tax on the "spread" at graduated tax rates (as compensation) based on the portion of the income allocated to the US under the source rules mentioned above.

b) If the stock option plan is a "nonqualified" plan, the recipient will be subject to US income tax on the spread, at graduated tax rates (as compensation) based on the portion of the income allocated to the US under the source rules mentioned above. Also, in this case the US source portion will be subject to US wage withholding.

The existing tax treaty between Canada and the US and the 5th Protocol signed September 27, 2007, do not specifically address stock options. However notes to the 5th Protocol state that in allocating income from employment between countries, in the case of exercise or other disposal of a stock option, "*the individual shall be deemed to have derived, in respect of employment exercised in a Contracting State, the same proportion of such income that the number of days in the period that begins on the day the option was granted, and that ends on the day the option was exercised or disposed of, on which the individual's principal place of employment for the employer was situated in that Contracting State is of the total number of days in the period on which the individual was employed by the employer*".

US Citizens

The Fall, 2005, issue of the Taxletter summarized the US taxation of US citizens and US residents that receive stock options. However a special situation may arise where a US citizen was granted a "nonqualified" stock option while he was residing and working in a foreign country for a foreign subsidiary of a US corporation.

Since the taxable "spread" on a nonqualified option is treated as compensation, the employee may be able to exclude a portion of the income under the rules for the "foreign earned income exclusion". If the individual later transfers to a US parent or subsidiary of the same corporation, it may be necessary to allocate the taxable income on the option between time worked abroad and time worked in the US.

US RESIDENCY FOR CANADIANS

The Fall, 2006, Taxletter included a brief review of the rules, (including the "substantial presence test") for determining whether an individual (that is not a US citizen) is a resident of the United States for US income tax purposes.

Most Canadians who consistently spend over 4 months annually in the US, will meet the substantial presence test, at least by the third year. In this case, if they are qualified, they must file IRS Form 8840 ("Closer Connection Exception Statement") to avoid being classified as a US resident for US income tax. This does not apply to a US citizen, or an individual that either holds a green card, or has applied for one.

Some individuals have been concerned that filing Form 8840 would place them in IRS computers and result in various negative US tax consequences for them at some future date. However, in cases where Form 8840 has been validly filed, we are not aware of any

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negative consequences resulting in the approximately 15 years the requirement has been in effect. We are also unaware of the IRS questioning any Form 8840 that was filed.

Canadians' reluctance to file Form 8840 may be "too conservative" because such individuals generally have nothing to fear from the IRS if the 8840 filing is valid and any US taxable income is reported and the tax paid. Filing Form 8840 likely commences the "statute of limitations" and prevents the IRS from ever questioning that year once the 3 year (generally) statute has run its course.

On the other hand, it is the failure to file Form 8840 (if you meet the substantial presence test) that could lead to the negative US tax consequences - i.e. you could be classified as a US resident for income tax for that year, with a potential US tax "skeleton" now in place. (For example, please see the article ***"US CITIZENS & RESIDENTS OWNING CANADIAN MUTUAL FUNDS").***

Please review Worksheet 1, to determine if you met the substantial presence test for 2007, and thus to determine if you should file IRS Form 8840 for calendar year 2007 to avoid US residency.

Worksheet 1

Year 2007 Substantial Presence Test Worksheet

(Use this worksheet to determine if you met the substantial presence test for 2007)

Number of days in the US in 2007 (1)	______
1/3 the number of days in the US in 2006	______
1/6 the number of days in the US in 2005	______
Total	______

If the total equals or exceeds 183 days and you spent more than 30 days in the US in 2007 you met the substantial presence test for 2007. In counting days, you may be able to exclude days you were present as an "exempt person", days you could not leave because of a medical condition that arose in the United States, or certain days commuting to work or traveling in transit to another country. In some cases you must make a US filing to obtain the exclusion.

(1) Note that you are disqualified from filing Form 8840 for 2007 if you are treated as having spent 183 or more days in the US in 2007.

US INDIVIDUALS - FOREIGN TAX CREDITS AND ITEMIZED DEDUCTIONS

When a US citizen or US resident calculates a claim for foreign tax credits on a US income tax return, it is necessary to make an allocation of various expenses to various categories of income.

(An allocation of expenses to categories of income is also required to determine "taxable income" when a Canadian enterprise is "engaged in business" in the US through a "permanent establishment" in the US. Please see the article ***"COMPUTING US DEDUCTIONS FOR CANADIAN BUSINESSES WITH A US PERMANENT ESTABLISHMENT")***.

For a US citizen or US resident (including a green card holder living in Canada) your net US tax liability can be affected by your interpretation of the US rules for the computation of the foreign tax credit. Your interpretation may even affect the Canadian tax liability due to the circularity in some computations if you are a Canadian resident.

For most individuals, the computation of the foreign tax credit on the US income tax return for 2007 and later years involves determining whether the non-US income and related non-US tax should be categorized as "passive income" or "general income".

As part of that computation, your expenses must also be categorized, so that your "taxable income" from each category can be determined - i.e.

1) Taxable income that is "passive income,

2) Taxable income that is "general income", and

3) Taxable income that is "US source" income.

Often the categorization of expenses is self-evident. For example, the expenses of a Canadian sole proprietorship operating only in Canada are categorized the same as the related income - usually as "general". The expenses of a single small rental property located in Canada are categorized the same as the related rental income - usually (but perhaps not always) as "passive".

However the categorization of many other expenses is less obvious, especially in the case of "itemized deductions". For example, how should you categorize:

a) Taxes and interest on a personal-use residence in Canada (or in the US),

b) Taxes on investment property in either country that produces no income (for example vacant land), or

c) Interest paid in a securities account where the income is from both Canadian and US sources.

To determine the taxable income associated with each item of gross income you first deduct from that income the expenses, losses, and other deductions properly apportioned or allocated to that income. Then you deduct from that income a "ratable part" of any other expenses, losses, or deductions that cannot be definitely related to another item of income. (Reg. 1.861-1(a)(1)(2)).

Expenses that are generally considered as "not related to any gross income" are as follows:

1) Interest expense. Special rules apply to interest - see "***Interest Deduction***" below.

2) Real estate taxes on a personal residence,

3) Sales tax on items purchased for personal use,

4) Medical expenses, and

5) Alimony (See Reg.1.861-8(e)(9)).

In order to "ratably apportion" the expenses you must apportion them (for better or worse) on the basis of gross income rather than taxable income. (Regs. 1.861-8(a)(2) and 1. 861-8(c)(3)).

Charitable contributions are similarly ratably apportioned to all the gross income. (Reg. 1.861-8(e)(12).

Example: Sarah (a US citizen resident in Canada) has $100,000 of Canadian employment income and $10,000 net income from a Canadian condo rental ($30,000 of gross condo rental income and $20,000 of condo expenses). She paid $5,000 for property taxes on her principal residence. The property tax expense of $5,000 is apportioned on the basis of gross income ($130,000) as follows:

To Salary (general income) :	
$5,000 x 100,000 /130,000 =	$3,846
To Rental income (passive income)	
$5,000 x 30,000/130,000 =	1,154
	$5,000

Interest Deduction - US Individuals

US individuals whose foreign source income does not exceed $5,000 may consider all the interest as "US source". (Reg. 1.861-9T(d)(1)).

Apart from that rule, interest is allocated as follows:

Personal Residence Interest. If the interest is "qualified personal residence interest" it is "ratable apportioned" under the gross income method as mentioned above. (Reg. 1.861-9T(d)(1)(i)).

Investment Interest. Investment interest would be categorized with the investment income but to the extent it is sourced in different countries it must be apportioned "on the basis of the investment assets". (Reg. 1.861-9T(d)(1)(ii).

Business Interest. Business interest would be categorized with the business income, but to the extent it is sourced in different countries it must be apportioned "using an asset method by reference to your business assets". (Reg. 1.861-9T(d)(1)(i).

US TAXATION OF NONRESIDENT ALIENS RECEIVING US PENSIONS

As in the case of stock options, (See "***CROSS -BORDER TAXATION OF US STOCK OPTIONS***"), the taxation of pension payments is generally subject to "source" rules. Thus, among other factors, the US taxation of pension payments made from a tax-qualified US corporate pension plan to a nonresident alien depends on:

1) Whether the individual ever worked in the United States, and

2) Whether a tax treaty governs the result.

The IRS apparently believes the pension payments should be divided into 3 categories:

1) The portion attributable to contributions related to services rendered in the US,

2) The portion attributable to earnings accumulated inside the pension plan, and

3) The portion attributable to contributions related to services rendered outside the US.

See Revenue Rulings 79-388 and 79-389, and also the new tax treaty changes in the article "***NEW TAX TREATY PROTOCOL (Pensions)***".

The first two portions are US source income and therefore the part of the pension payment attributable to those portions would be subject to US tax. (IRC 871(a)). An exception may apply. If the individual performed no services in the US, 90% of the plan participants are US citizens or US residents and certain other requirement are met, there is no US tax payable. (IRC 871(f)). The third portion is non-US source income and not normally subject to US tax.

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Withholding at Source. The entire US source portion of the payment is subject to US tax withholding at source. (Reg. 1.1441-4(b)(1)(ii)). The US tax rate would be a flat 30% subject to a lower treaty rate. Of course the treaty rate for residents of Canada is 15% for "periodic" pension payments. The US pension plan trustee may not have adequate records to determine the portion attributable to work performed outside the US, and hence may withhold US tax on the entire pension payment.

Actual US income Tax Liability. Although tax is withheld at source this may not necessarily be the actual tax liability on the payment. The IRS has suggested in Publication 519 and instructions to Form 1040NR that the payment may be taxed as "effectively connected income" and therefore at graduated tax rates instead of the flat treaty rate, for pension payments associated with contributions made after 1986. The part of the payment attributable to earnings accumulated inside the pension plan would still be taxed at a flat 30% or lower treaty rate.

Based on these rules it is apparent that a nonresident alien who never worked in the US may still be subject to US tax on part of the pension payment (i.e. that part attributable to earnings accumulated inside the pension plan - that is, 2) above).

For guidance on how payments received from defined benefit plans are to be allocated to the three categories, please see Revenue Procedure 2004-37.

Treaty Tax Rate

The treaty rate of 15% on pension payments to nonresident aliens that are residents of Canada technically only applies to "periodic" payments. We previously mentioned the definition of "periodic" is uncertain. Although a single lump sum payment does not appear to be "periodic", in some cases it may qualify as such.

The US Treasury's Technical Explanation of its September 1996 Model Income Tax Treaty provides that a lump sum distribution will be considered a "pension or similar distribution" (i.e. "periodic") if the alien worked for the worldwide group for five years, has reached age 55, and other requirements are met. Also various IRS Private Letter Rulings treat a lump sum payment as being "in the nature of a periodic payment".

SOME SPECIAL US TAX LAW "DOCTRINES"

The US tax law contains some special rules or "doctrines" that may override other rules in the Internal Revenue Code. Some of these rules originate in the Internal Revenue Code ("IRC") itself. Others ("doctrines") stem from case law.

Three of them are:

1) The "Tax Benefit" Doctrine,

2) The "Assignment of Income" Doctrine , and

3) The "Economic Substance" Doctrine.

The "Tax Benefit" Doctrine

The US Internal Revenue Service (IRS) does not have a "Fairness Committee", per se, to:

1) Forgive tax or penalties, or

2) Review the tax liability of a taxpayer that seems to have been subject to an unreasonable application of the tax law.

However, the tax code itself does contain a provision to partially ameliorate some circumstances where taxpayers seem to be unreasonably taxed.

Under Code Section 111 ("Recovery of Tax Benefit Items") a taxpayer can exclude from income any recovery or refund of an amount deducted in a prior year, to the extent the deduction claimed in the prior year did not reduce the tax liability in that prior year.

The "Assignment of Income" Doctrine

The "Assignment of Income" doctrine determines which taxpayer is liable for the tax on income that has arisen. The "assignment of income" doctrine stems from court decisions, (case law) not the Internal Revenue Code. Under this doctrine there are two main rules:

1) Income from property must be included in the income of the person who beneficially owns the property, and

2) Income from personal services must be included in the income of the person who performed the services.

Income From Personal Services. For example, if services are performed by Michael, and Michael tells his customer to pay Roger, then Michael is taxable on the income even if Roger receives the payment, keeps it, and pays tax on it. It may not even change the result if Michael is required to pay Roger by court order, provided the income represents compensation for services performed by Michael.

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An important aspect of this rule is the "contract" between the taxpayer providing the services and his/her customer. For example, a basketball player was required to pay tax personally on income paid to his corporation because the contract for services was in his name. (78 T.C. 882 (1982)). Also, a real estate agent was required to include commissions in personal income, rather than in the corporation in which it was deposited, because the contract was in the name of the individual. (Evatt, 63 T.C.M. 3142).

As indicated below, a special tax code exception to the "assignment of income" doctrine applies to a "personal service corporation" ("PSC"). If three conditions are satisfied, the IRS can allocate the income of a PSC to its employee-owners, even if the PSC genuinely earned the income. (See IRC 269).

A "personal service corporation" means a corporation the principal activity of which is the performance of personal services and such services are substantially performed by employee-owners.

The three conditions are:

1) Substantially all of the services of the corporation are performed for (or on behalf of) one other entity,

2) The principal purpose of forming, or availing of, such corporation is the avoidance or evasion of federal income tax by reducing the income tax of, or securing the benefit of any expense deduction, credit, exclusion, or other allowance for, any employee-owner, which would not otherwise be available, and

3) The allocation must be necessary to prevent avoidance or evasion of federal income tax or to clearly reflect income of the corporation or its employee-owners.

Tax Code Override

As alluded to above, the Internal Revenue Code overrides the "assignment of income" doctrine - i.e. the tax code applies, not the doctrine, for taxation of the following entities:

1) "Grantor" trusts,
2) Partnerships,
3) "S" corporations,
4) Personal Service Corporations, (as described above), and
5) For certain related parties (i.e. IRC 482).

The "Economic Substance" Doctrine

The US Internal Revenue Code contains some specific targeted anti-abuse rules to prevent taxpayers from abusing the laws to obtain tax benefits. However at the moment the law does not contain a general rule. This may change if proposed legislation on the "Economic Substance Doctrine" is adopted. (See "***UPDATE ON PENDING US "INTERNATIONAL TAX" LEGISLATION***").

However various general anti-abuse doctrines have been applied by the US courts such as: Sham Transaction, Substance Over Form, Economic Substance, Step Transaction, and Business Purpose.

Naturally some overlapping in the definitions occurs.

Sham Transaction. In some cases, taxpayers may present misleading, incomplete or even false information, about a transaction or structure. In such cases the IRS may declare the transaction or structure to be a sham and deny the related tax benefits.

Substance Over Form. Beginning in 1935 the US courts decided that as a general rule the incidence of taxation depends upon the substance rather than the form of a transaction. Since then the courts have disallowed tax benefits arising out of transactions when the form differed from the substance.

Economic Substance. Under this doctrine, if a transaction does not result in a meaningful change in the taxpayer's economic position, other than with respect to taxes, the courts may deny the related tax benefits.

Step Transaction. The step transaction doctrine is a variation of the "substance over form" doctrine. Under this doctrine, separate transactions or "steps" may be undertaken to accomplish tax results that cannot be accomplished directly. In such cases individual steps may be disregarded for tax purposes.

An example of the step transaction doctrine might be as follows:

Stephen, a resident of Canada and nonresident alien of the United States gives $500,00 cash to a newly created Canadian discretionary trust for the purpose of purchasing a US residence. The trust immediately purchases the residence. Under the step transaction doctrine the IRS and the US courts might disregard the first step (the gift of cash to the trust) and determine that the series of transactions was tantamount to Stephen buying and giving the US residence to the trust. Such a gift of real estate by Stephen might give rise to US gift tax - perhaps $150,000 on a gift of $500,000.

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Business Purpose. The business purpose doctrine naturally focuses on whether there is a business purpose for a transaction, or whether it is simply tax motivated.

US TAX WITHHOLDING AT SOURCE ON CANADIANS

The US imposes a withholding tax at source, at varied rates, when certain payments are made from US domestic sources to certain residents outside the US. A number of full or partial exemptions apply and several different IRS tax Forms are used to obtain the reductions or exemptions. Exhibit 3 sets out the Forms applicable in some of these circumstances. Other Forms apply in other complicated circumstances, including IRS Form W-8IMY that applies, for example, when so-called "intermediaries" are involved - i.e. where the payment is being made to an entity that is not the "owner" of the payment.

Often troublesome is the fact that a US payer may incorrectly demand one of these US Forms from a Canadian business even when no Form is required and no Form exists for the circumstances. This may even occur when a US payer makes a payment to a Canadian business when the only US connection of the Canadian business was a one-time shipment of goods to the US payer. The US payer may even threaten to withhold tax on the payment to the Canadian business if a "Form" is not provided. Please see Exhibit 3.

EXPENSES THAT CAN BE DEDUCTED IN THE US BY NONRESIDENT ALIENS

A nonresident alien can only deduct expenses on a US income tax return if he/she is "engaged in a US trade or business", (or treated as such). To be deductible, the expenses must be "effectively connected" with your US trade or business. Special rules apply to interest expense and carrying charges. (See "***Interest Deduction***", and "***Carrying Charges***" below).

Real Estate

Real estate rental activities are considered to be a "trade or business" if the activities are sufficiently extensive. If not, the individual can still elect to treat the rental activity as a business. Most expenses that are "effectively connected" with rental real estate are self-evident.

Once elected, future expenses may be deductible even if no further income is generated, provided the property does not become used exclusively for personal purposes. For example, if you own vacant land that produces rental income and you make the requisite election, you may be able to continue to deduct real estate tax on the land in future years even if there is no future rental income.

Also, the gain from the sale of real estate is automatically treated as business income and therefore you can deduct year of sale expenses such as property tax, interest, insurance, and maintenance, etc.

Employees & Self Employed Individuals

If you are an "employee" and work in the US you are considered to be "engaged in US business", unless:

1) You work for a non-US employer that is not engaged in a trade or business in the US, or,

2) In certain (not all) cases if you spend 90 days or less in the US during the year, and earn $3,000 or less in the US.

The deductions allowed for employees, are set out on Schedule A of the tax return (IRS Form 1040NR). Schedule A provides employees a deduction for the following expenditures:

1) State and local income taxes,
2) Charitable gifts,
3) Casualty and theft losses,
4) Job expenses,
5) Tax preparation fees, and
6) Certain "other expenses"

As previously indicated, expenses, including those for employees are only deductible to the extent they are "effectively connected with a US trade or business". This rule can be applied as follows in the case of the above expenses:

State and Local Income Taxes. You can deduct State and local income taxes that were withheld on your salary.

Charitable Gifts. You can deduct contributions to qualified US organizations, but the deduction is limited based on your US business income or your US source salary.

Casualty and Theft Losses. Expenses that may be deductible (if they are "effectively connected" with your US business or your

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EXHIBIT 3

US Forms To File To Avoid US Withholding At Source
For A Nonresident Alien Or Canadian Corporation, Resident In Canada, Receiving US Source Income (1)

You Are An Individual Or Corporation And You:

Receive Interest, Dividends, Certain Pensions Or Annuities (Not Connected With US Businesses) From A US Payer.	Receive US Interest, US Dividends Or US "Effectively Connected" Income From A Partnership. (2)	Receive US "Effectively Connected Income" From A Partnership. (2)	Receive Income That Is "Effectively Connected" With A US Business.	Receive Business Income From The US But You Are Not "Engaged In Business" In The US.
File IRS Form W-8BEN With The Payor And Complete Part I, And Part II, Lines 9a And 10 And Part II, Lines 9c And 9d, As Appropriate. (Except Part II Not Required For Bank Interest And Certain "Portfolio Interest". Form W-8BEN Is Specifically Not Used For Income Effectively Connected With US Business Unless It Is Allocated To You Through A Partnership (See Form W-8BEN Instructions). The Instructions To Form W-8BEN State That You Require A US Taxpayer Number If You Are Making A Treaty Claim.	File IRS Form W-8BEN With The Payor And Complete Part I, And Part II, Lines 9a And 10. And Part II, Lines 9c And 9d, As Appropriate. The Instructions To Form W-8BEN State That You Require A US Taxpayer Number If You Are Making A Treaty Claim. (See Reg. 1.1446-1)	File IRS Form W-8ECI.	File IRS Form W-8ECI.	Technically No Withholding Is Required Because This Is Not US Source Income. However, There Is No IRS Form To Officially Advise The Payer As Such. If The Payer Is Adamant On Withholding, Consideration Can Be Given To The Results Of Filing Form W-8ECI.

You Are An Individual And You:

Receive Compensation For "Independent" Or "Dependent" Personal Services Performed In The US But You Do Not Have An Office In The US Regularly Available To You.	Are A Public Entertainer Or A Certain Category Of Athlete And You Perform In The US.	Are A Director Of A US Corporation.
File IRS Form 8233.	Form 8233 Can Be Submitted. However, The Tax Treaty (The Basis On Which The Withholding Would Be Reduced Via Form 8233.) Only Exempts The First $15,000. The Entertainer Or Athlete Can, However, Apply For Reduced Withholding At 30% Of Projected Net Income. (See Rev Proc 89-47.) The Treaty And Form 8233 Do Not Apply To Employees Of A Team In A League With Regularly Scheduled Games.	File Form 8233 If You Do Not Have A "Fixed Base" In The US.

(1) This Is A Simplied Version Of The Rules. Other Forms Apply In Other Circumstances. Please Contact Your Tax Advisor For Additional Information.

(2) Apparently An Overlap Exists Between The Rules Of Sections 1441/1442, On One Hand, And The Rules Of Section 1446. Although The Instructions To W-8ECI Indicate It Is Appropriate To File That Form With A Partnership, It Is Difficult To See How A Partnership Would Reduce The Withholding On "Effectively Connected" Income. Perhaps This Would Be Relevant When The "Effectively Connected" Income Is So Minimul That The Section 1446 Rate Would Be Less Than The Standard 30% Withholding Rate.

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US employment) are: Losses from theft, vandalism, fire, storm, car, boat and other similar accidents. Limitations apply.

Job Expenses. If you are employed in the US, certain expenses genuinely attributable to your job may be deductible, such as certain travel expenses. Limitations apply.

The tax treaty contains rules that exempt certain employees and self-employed individuals from US tax.

Interest Deduction

Separate rules apply to your deduction for interest expense. Nonresident aliens are generally only allowed to deduct expenses to the extent they are "effectively connected with a US trade or business".

Interest will only be considered "effectively connected with a US trade or business". to the extent the related debt is:

1) Entered on the books of the US trade or business when incurred, or

2) Secured by assets that generate "effectively connected" income. (Reg. 1.861-9T(d)(2)(i)).

However interest is not considered "effectively connected" to the extent the related debt exceeds 80% of the gross assets of the US business. Interest related to debt secured by specific assets other than US business assets is not considered "effectively connected".

As a result, interest on mortgages on US rental property is generally deductible. Also, interest on debt acquired in Canada:

1) To purchase US property,

2) That is not secured by any asset, and

3) That is entered on the US books when the property is purchased, may be deductible, but other US tax issues may arise.

Carrying Charges

Certain carrying charges that are otherwise deductible may be capitalized instead - i.e. added to the cost base.

This would apply to property taxes, interest, and other carrying charges of unimproved and unproductive real estate. Thus, in the case of the vacant land example above, in years following the receipt of rental income and the making of the appropriate election, it would be possible in some cases to capitalize subsequent expenditures and thus reduce the gain on the ultimate sale.

This rule also applies to interest on improved real estate.

COMPUTING US TAX DEDUCTIONS FOR CANADIAN BUSINESSES WITH A US "PERMANENT ESTABLISHMENT"

A Canadian enterprise that is engaged in US business through a US "permanent establishment" ("PE") must file a US income tax return and determine what income and expenses are "effectively connected" with that PE, so that the taxable income of the PE can be determined. We previously mentioned the criteria used for determining when a Canadian business must file a US federal income tax return. Exhibit 4 is a revised flowchart setting out a decision process.

In many cases it is self-evident what income is connected with the US PE but it may not always be obvious what expenses are "effectively connected". To make the determination the enterprise must first allocate its expenses to classes of gross income. Some examples of classes of gross income are:

Business income,
Rents,
Gains from dealing in property,
Partnership income, and
Compensation for Services
(See Regs. 1.861-8(a)(2)) and
1.861-8(b)(1)).

A special rule is used for the deduction for interest expense. For corporations it is allocated under the previously mentioned rules of Reg. 1.882-5. See also Schedule I in new draft IRS Form 1120F for 2007.

Except for interest expense, within each class of income, expenses must be apportioned between "statutory groupings" and "residual groupings". (See. Reg. 1.861-8T(c)). See also Schedule H on new draft IRS Form 1120F for 2007.

Remaining expenses that are "not definitely related to any class of gross income" are "apportioned ratably" between the statutory grouping and the residual grouping. (Reg. 1.861-8(c)(3)). The regulations provide the following example: (Reg. 1.861-8(g), Example 21).

Example:

Facts: X, a foreign Corporation doing business in the United States, is a manufacturer of metal stamping machines. X has no United States subsidiaries and no separate division to manage and oversee its business in the United States. X manufactures and sells

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these machines in the United States and in foreign countries A and B and has a separate manufacturing facility in each country. Sales of these machines are X's only source of income.

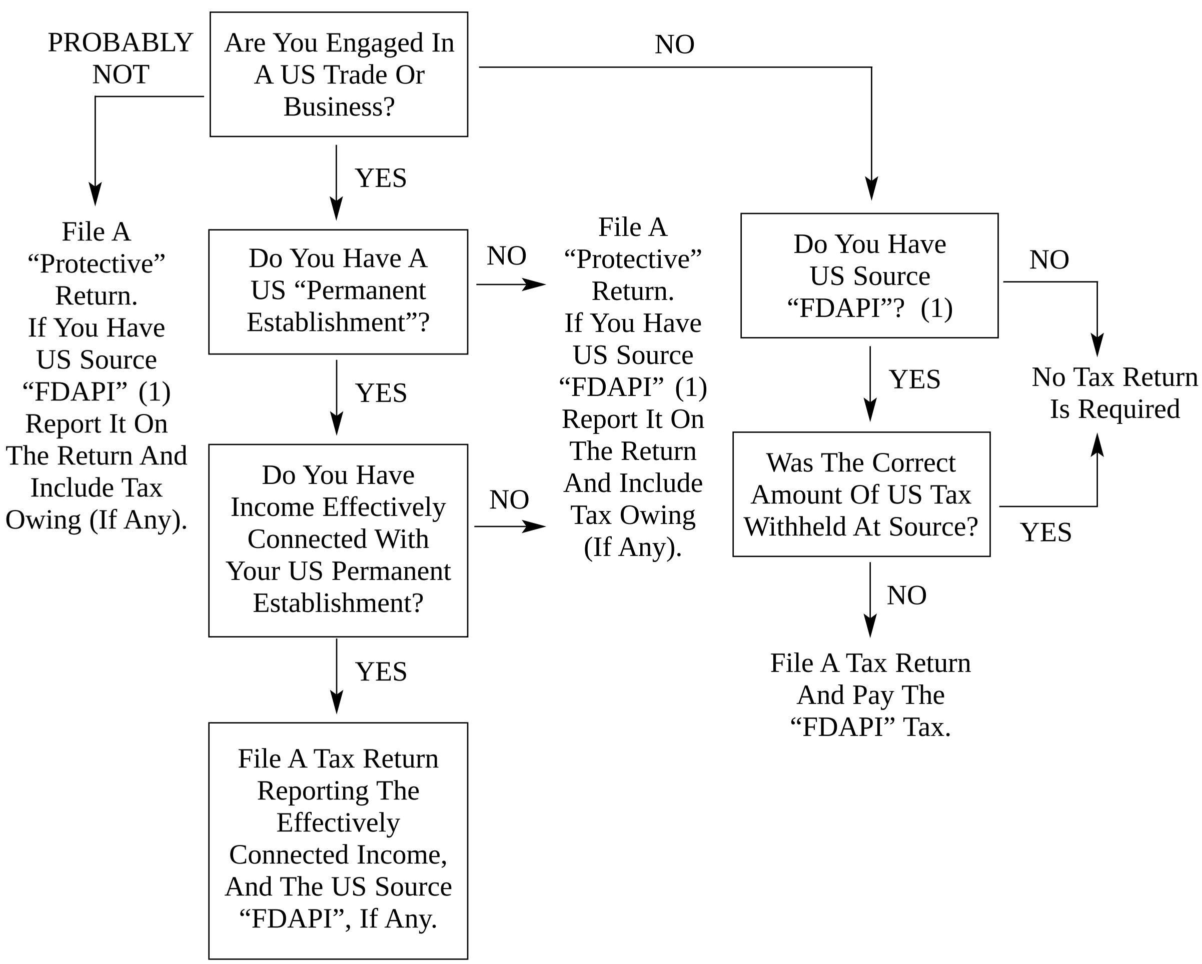
X incurs general and administrative expenses related to both its US and foreign operations of $100,000. It has machine sales of $500,000, $1 million and $1 million on which it earns gross income of $200,000, $400,000, and $400,000 in the United States, Country A, and Country B, respectively. The income from the manufacture and sale of the machines in countries A and B is not effectively connected with X's business in the United States.

Allocation. The $100,000 of general and administrative expense is definitely related to the income to which it gives rise, namely a part of the gross income from sales of machines in the United States, in country A, and in country B. The expenses are allocable to this class of income, even though X's' gross income from sources outside the United States is excluded income since it is not effectively connected with the US trade or business.

Apportionment. Since X is a foreign corporation, the statutory grouping is gross income effectively connected with X's trade or business, namely gross income from sources within the United States, and the residual grouping is gross income not effectively connected with a trade or business in

EXHIBIT 4

Evaluation Of US Federal Income Tax Filing Requirements For Nonresident Aliens & Foreign Corporations



(1) "FDAPI" = "Fixed Or Determinable Annual Or Periodic Income". This Would Include Any Of The Following That Are Not Effectively Connected With Your US Business: Interest, Dividends, Royalties, (And Rents, Unless It Is Considered A Business Or An Election Is Made). An Exception May Apply For Bank Interest And Certain "Portfolio Interest".

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the United States, namely gross income from countries A and B. Since there are no facts which would require a method of apportionment of the $100,000 other than on the basis of sales or gross income, the amount may be apportioned between the two groupings on the basis of amounts of gross income as follows:

Amount apportioned to US source income: -

$$100{,}000 \times \frac{200{,}000}{200{,}000+400{,}000+400{,}000} = \$20{,}000$$

Thus, $20,000 of the total general and administrative expenses would be deductible on the US corporate income tax return.

(Note also the changes to be incorporated in Article V (Permanent Establishment) of the tax treaty pursuant to the 5th Protocol. Please see the article ***"NEW TAX TREATY PROTOCOL (Permanent Establishment)".***

US "IRA" PENSION RECEIPTS BY CANADIANS THAT ARE NRAs OF THE US

Regular IRAs

An "Individual Retirement Account" (IRA) is a US pension-type vehicle somewhat similar to a Canadian RRSP. Employees generally receive a tax deduction for allowable contributions and are fully taxed on withdrawals. Canadians that are nonresident aliens of the US often acquire IRAs, either by having lived and worked in the US, or through inheritance.

In the United States. Under US domestic law a 30% US withholding tax normally applies to IRA payments made to nonresident aliens. This tax rate is reduced to 15% under the tax treaty for residents of Canada if the payments are "periodic". As indicated in the article ***"US TAXATION OF NONRESIDENT ALIENS RECEIVING US PENSIONS"***, even a single lump sum payment may qualify as "periodic", in some cases. Also, all or a portion of the payment may be taxed at graduated tax rates. Please see the aforementioned article.

In Canada, A regular US IRA is apparently regarded as a "foreign retirement arrangement" (please see Letter Document No. 2006 - 0186661M4 issued by the Minister of National Revenue), and therefore payments received by an individual resident in Canada are taxed in Canada without any treaty benefit in Canada. Of course a foreign tax credit may be available in Canada for the US tax. Canada's interpretation of these rules may have changed from time to time. Therefore please contact your tax advisor before taking any action.

Roth IRAs

A "Roth IRA" is a separate pension-type vehicle in the US that is the opposite of a regular IRA. Contributions are not deductible, but valid amounts that are contributed, along with accumulated earnings, can be withdrawn tax-free. Thus it is a method of making an "after tax" investment that grows tax-free. Note that the new Protocol to the tax treaty defines "pensions" to include Roth IRAs.

In the United States. A regular IRA can be converted to a Roth IRA but tax is payable on the amount converted. The conversion can only be made if the "modified adjusted gross income" of the taxpayer does not exceed $100,000 and, if married, the taxpayer must be filing a joint US income tax return. The converted account must be held for 5 years before it can be withdrawn tax-free.

In Canada. Apparently a Roth IRA may not be regarded as a "foreign retirement arrangement". See Letter Document No. 2006 - 0186661M4. Therefore payments received by a resident of Canada may not be taxable in Canada. However the annual earnings within the Roth IRA may be taxable annually in Canada to a Canadian resident. Changes to Canadian ITA 94 or new Canadian legislation may alter the result. It is possible a "protective" claim under Article XVIII(7) of the treaty can be made to defer current taxation of the annual earnings until a distribution is received. See Letter Document No. 2006 - 0186661M4 and No. 2002-0152515(E). Canada's interpretation of these rules may have changed from time to time. Therefore please contact your tax advisor before taking any action.

Rollover from an IRA to a Roth IRA

Should Canadian residents rollover their IRA to a Roth IRA? Given the US requirement that, if married, a joint tax return must be filed, the rollover is not available to most residents of Canada since joint returns cannot be filed by nonresident aliens. Of course U S citizens and green card holders living in Canada can make the rollover assuming they meet the other requirements. Also certain individuals moving from one country to the other during the tax year might meet the requirements.