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

Canada Eliminates Certain Cross-Border Withholding on Interest

In December, 2007, Canada enacted changes to Section 212(1)(b) of the Canadian Income Tax Act resulting in the elimination of Canadian withholding tax on cross-border arm's-length interest payments to nonresident recipients after January 1, 2008. An exception applies to interest on participating debt.

The change apparently preempts Canada's side of the 5th tax treaty Protocol agreed to in September, 2007, but which has not yet entered into force. The US has, for some time, had substantial exemptions on withholding on cross-border interest payments, but the exemptions on the US side will not be as broad as Canada's until the 5th Protocol enters into force.

Once the Protocol enters into force the withholding tax on interest payments to non-arm's-length recipients will also be gradually phased out, but only for those eligible for benefits under the treaty.

Receipt of Royalties May Constitute "Nexus"

A Louisiana appellate court has confirmed that a Delaware corporation's receipt of royalty income from an affiliate in Louisiana constituted "nexus" in Louisiana and therefore subjected the Delaware corporation to Louisiana corporate income and franchise tax. The Delaware corporation had no physical presence in Louisiana but nonetheless was subject to Louisiana corporate income tax on the receipt of royalty income from the use of its intangibles in Louisiana. (Bridges v. Geoffrey, Inc., Louisiana Appellate Court, First Circuit, No. 2007 CA 1063, February 8, 2008).

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Federal Legislation on "Nexus", (etc.)

The Business Activity Tax Simplification Act of 2008 (H.R. 5267) was introduced in the US House of Representatives on February 7th. It is identical to a Bill introduced in the Senate (S.1726) on June 28, 2007. Each Bill would prohibit a State from imposing a "business activity tax" on a taxpayer unless the taxpayer had a physical presence in the State for 15 days or more during the year. Presence in the State "to conduct limited or transient business activity" would not establish physical presence. The definition of "business activity tax" would include income from intangible property and services, as well as tangible goods.

US LLC'S & "S" CORPORATIONS ARE CORPORATIONS FOR CANADIAN PURPOSES

The Canada Revenue Agency has confirmed it considers US Limited Liability Companies and so-called "S" corporations to be "corporations" for Canadian income tax

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purposes. For the moment, "S" corporations are apparently eligible for the 5% Canadian withholding tax rate potentially available on dividend payments from Canadian corporations, provided the ownership requirements of the treaty are met.

Timely Filing Requirements Upheld

A United States Court of Appeals has overturned the lower (Tax Court) decision with respect to the IRS's "timely filing requirement" for income tax returns. Therefore, once again, there are important deadlines for non-resident aliens and foreign corporations to file their US income tax returns. Please see the article ***"TIMELY FILING REQUIREMENTS UPHELD – ALSO APPLICABLE TO RESIDENCY CLAIMS?"***

Florida Nexus

The Florida Department of Revenue takes the position that "physical presence" is not required to impose Florida corporate income tax. Therefore an out-of-state "financial services processing company" whose only contact with Florida was through "unrelated authorized vendors" was determined to be subject to Florida corporate income tax. (Technical Assistance Advisement, No. 07C1-007, October 17, 2007).

Kentucky Nexus

Kentucky also takes the position that "physical presence" is not required to impose corporate income tax. Accordingly, a Kentucky court has confirmed that a corporation having no physical presence in Kentucky was subject to Kentucky corporate income tax based on its derivation of income from ownership interests in partnerships doing business in Kentucky. (Franklin Circuit Court, Kentucky, No. 06-CI-00288, December 4, 2007).

Income From a New York "S" Corporation

New York has issued a personal income advisory opinion explaining how shareholders of a New York "S" Corporation compute the amount of income to report on a New York income tax return. (TSB-A-08(1)I, New York Commissioner of Taxation and Finance, January 4, 2008).

Penalties for Tax Return Preparers

Tax return preparers are subject to a penalty of the greater of $1,000 or 50% of the fee received (or to be received) with respect to preparing a tax return if there is an understatement on the tax return due to an "unreasonable position". (IRC 6694).

Legislation has been introduced to define an "unreasonable position" as a position for which there is not "substantial authority". There would be a "reasonable cause" exception if the position was appropriately disclosed, and there was "a reasonable basis" for the position. The legislation would be retroactive to May 25, 2007. (H.R. 4318).

SPECIAL RULES FOR INDIVIDUALS RENOUNCING US CITIZENSHIP OR ABANDONING GREEN CARDS

Time to Consider Expatriating?

In the Winter-Spring / 2005 Taxletter we summarized the US rules for "expatriations" (individuals renouncing US citizenship or "Long-Term US Residents" abandoning green cards). Also, the Fall, 2007, Taxletter described proposed US tax legislation (HR 2) that would impose a "departure tax" somewhat similar to Canada's. Under this rule individuals expatriating would be treated as if they had disposed of certain of their worldwide assets at fair market value just prior to their expatriation (the "mark to market" rule). Recent conversations with IRS individuals suggest an increasing likelihood that such legislation may actually be enacted!

Form 8854

Apart from the other applicable rules, an expatriating individual must file IRS Form 8854 or he/see continues to be a US citizen or US resident regardless of what other actions are taken! If any required information is missing on Form 8854 the IRS may levy a penalty of $10,000.

Coordinating the timing of the filing of Form 8854 and undertaking your expatriating act may be awkward in some cases. Your expatriation (for tax purposes) is considered to occur on the later of:

1) The date you notify the relevant US Agency (the Department of State for citizenship renunciations, and the Department of

Homeland Security for green card abandonments) of your expatriating act or termination of residency, or

2) The date you file IRS Form 8854.

Suppose you notify the relevant US Agency first and file your first IRS Form 8854 (your "initial expatriation statement") later?

On your "initial expatriation statement" you must enter your US income tax liability for the five tax years ending before the date of expatriation. Since your tax year will normally be December 31, and you will usually not know your tax liability until after December 31, this will normally mean you will have to file a "dual status" tax return for the year of expatriation. For example, if you renounced or abandoned, in December, 2007, and you file Form 8854 in, say, May, 2008, you will have to list your US tax liabilities for the five years ended December 31, 2007.

In this case, for 2008 you would be a US resident for part of the year (to May, 2008) and a nonresident for the balance. For married individuals, filing a dual status return (which must be filed separately) often results in greater tax than filing jointly, (which can only be done for an entire year).

In the above example, it appears at the moment you could not file as a nonresident of the US for the first part of 2008 under Article IV of the tax treaty, because of the so-called "later in time" rule that applies when there is a conflict between treaties and the domestic tax law.

The relevant US domestic law (IRC 7701(n)) that denies nonresident status until Form 8854 is filed went into effect "after June 30, 2004". Of course the present treaty and Protocols that are already in effect became effective prior to then, and therefore IRC 7701(n) presently governs. It remains to be seen whether the IRS will consider whether the entering into force of the 5th Protocol, when it happens later this year or next year, overrides IRC 7701(n) and allows you to make an Article IV residency claim for the entire year of expatriation.

IRS Form 8854 also requires you to list your assets and liabilities at your date of expatriation. Normally it is difficult on any given day to know your exact assets and liabilities on that day, thus further complicating the timing issue.

In view of this timing issue it might occur to you to file Form 8854 first and notify the relevant US Agency later. Unfortunately, in this case, according to the instructions to Form 8854, you must file an amended IRS Form 8854 after you have notified the relevant Agency.

DUE DATES FOR US FEDERAL CORPORATE INCOME TAX RETURNS

Foreign (non-US) Corporations

Corporations with no office or place of business in the US - the due date for the federal income tax return (IRS Form 1120-F) of a foreign corporation that has no office or place of business in the US is the 15th day of the 6th six month after the end of the tax year. (Reg. 1.6072-2(b)).

The corporation can obtain a six months extension of the due date for filing the return (to the 12th month) by filing IRS Form 7004 provided all tax has been paid by the original due date – i.e. paid by the 6th month. (Reg. 1.6081-3(a). Otherwise, penalties and interest run from the 6th month. (See also the Instructions to Form 1120-F).

Corporations with an office or place of business in the US - According to Reg. 1.6072-2(a) the due date for the US federal income tax return for a foreign corporation that has an office or place of business in the US is the 15th day of the 3rd month following the end of the year. However Reg. 1.6081-5(a)(3) grants an automatic extension to the 15th day of the 6th month if the corporation has an office or place of business in the US.

To claim this 3 months extension, the corporation should attach to its tax return a statement showing that it is eligible for the extension (i.e. it is a foreign corporation with a US office).

This extension of time to file (to the 6th month) applies to the payment of tax also. (Regulation 1.6081- 5(a). Although there would be no penalty for late filing, or late paying, interest would still apply on any tax not paid by the original due date (the 3rd month). (See also the Instructions to Form 1120-F).

A 6 months extension of the time to file and to pay (to the 9th month) can potentially be obtained by filing IRS Form 7004 by the original due date if all tax has been paid by the original due date - the 3rd month. (Reg. 1.6081-3 (a)).

Domestic Corporations

Tax returns for domestic corporations are due the 15th day of the third month. (Reg. 1.6072-2(a)).

Exception. For domestic corporations which transact their business *and* keep their records and books of account outside the United States and Puerto Rico, an automatic extension of the normal due date (the 15th day of the 3rd month) is provided to the 15th day of the 6th month. (Reg. 1.6081-5(a)(2)). Although there would be no penalty for late filing, or late paying, interest would apply on any tax not paid by the original due date (the 3rd month).

A 6 months extension of the time to file and to pay (to the 9th month) can potentially be obtained by filing IRS Form 7004 by the original due date if all tax has been paid by the original due date - the 3rd month. (Reg. 1.6081-3 (a)).

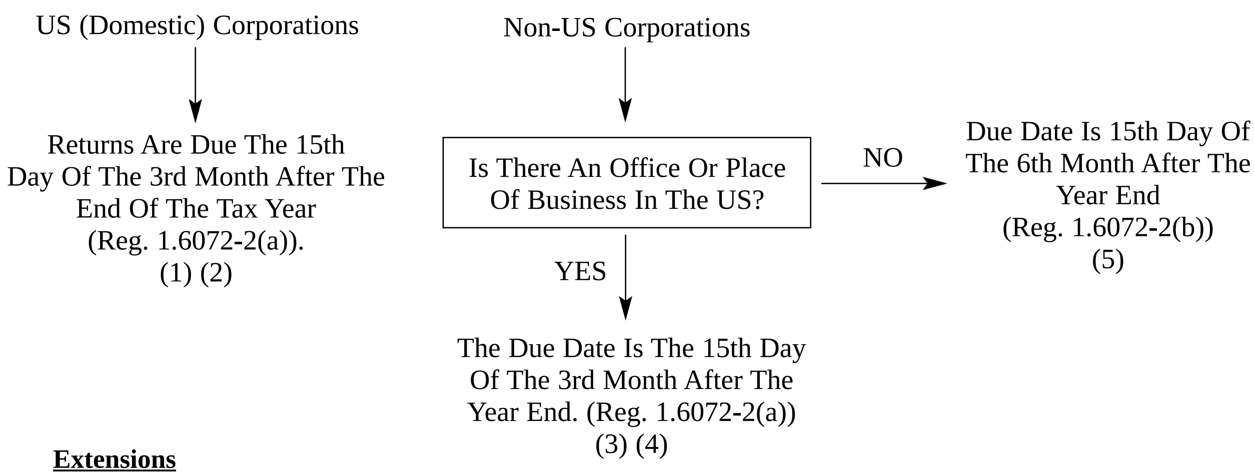
Please refer to Exhibit 1 and also see the article ***"TIMELY FILING REQUIREMENTS UPHELD – ALSO APPLICABLE TO RESIDENCY CLAIMS?"***

INHERITING A RRIF

Readers are aware, if an individual possessing a Canadian "Registered Retirement Income Fund" ("RRIF") dies, and the RRIF passes to his/her surviving spouse, there is generally no Canadian income tax on the RRIF until the surviving spouse receives withdrawals from the RRIF.

EXHIBIT 1

Due Dates For Filing US Federal Corporate Income Tax Returns



Extensions

(1) For US (Domestic) Corporations Which Transact Their Business And Keep Their Books And Records Of Accounts Outside The US And Puerto Rico, An Automatic Extension Of The Normal Due Date (15th Day Of The 3rd Month) Is Granted To The 15th Day Of The 6th Month. (Reg. 1.6081-5(a)(2)). However Interest, But Not Penalties, Accure From The 3rd Month.
Thus, This Rule Is Somewhat Parallel To That Applicable To US Citizens And Residents That Are Abroad On The Due Date Of Their US Income Tax Return).

(2) Filing IRS Form 7004 Provides An Automatic Six Months Extension To The 9th Month, If All The Tax Has Been Paid By The Original Due Date. (The 3rd Month). (Reg. 1.6081-3(a)).

(3) However An Automatic Extension Is Granted To The 15th Day Of The 6th Month If A Statement Is Attached To The Tax Return Showing That The Corporation Has A US Office, Etc. (Reg. 1.6081-5(a)(3)). But Interest Applies After The Original Due Date.

(4) For A Non-US Corporation With A US Office Or Place Of Business, Filing Form 7004 Provides An Automatic Six Months Extension From The Original 3rd Month If All The Tax Has Been Paid By The Original Due Date (3rd Month). (Reg. 1.6081-3(a)).

(5) For A Non-US Corporation Without A US Office Or Place Of Business, Filing IRS Form 7004 Provides An Automatic Six Months Extension From The Original 6th Month If All The Tax Has Been Paid By The 6th Month Due Date. (Reg. 1.6081-3(a)). Otherwise Penalties And Interest Run From The Original Due Date. (See Also The Instructions To Form 1120-F).

On the other hand, if the RRIF passes to someone other than the surviving spouse (or certain children or grandchildren) the decedent may be subject to a deemed disposition, and immediate Canadian tax. Please consult your Canadian tax advisor.

However, suppose the surviving spouse is a US citizen or US resident. What are the United States income tax implications? What is the result if the beneficiary of the RRIF is a US estate, rather than a surviving spouse?

Further, what is a spouse? Please see the article ***"IS YOUR "COMMON-LAW" PARTNER A "SPOUSE "FOR US TAX PURPOSES"?***

RRIF Passes to a Surviving Spouse that is a US Citizen or US Resident

If the surviving spouse (and beneficiary of the RRIF) is a US citizen or US resident, there generally would be no immediate United States tax just as there would be no immediate Canadian tax. However, assuming Code Section 72(w) applies, as payments are made from the RRIF to the US spouse there would be taxable income to the spouse in the US as the payments are made. (IRC 691). If the surviving spouse is a resident of the United States there would be Canadian withholding tax at the time of any remittance.

RRIF Passes to a US Estate

Circumstances may arise where the decedent was resident in the United States at the time of death, and the RRIF was willed to the Estate.

Decedent was Married. If the decedent was married, the Estate and beneficiaries may elect to have the RRIF inherited by the surviving spouse instead of the Estate. Please consult your Canadian tax advisor. See Canadian Income Tax Act Section 146(8.91), Canadian guidance RC4178 and CRA Form T1090. In this scenario the Canadian and US and tax results would be similar to that described above under ***"RRIF Passes to a Surviving Spouse that is a US Citizen or US Resident"***. If this election is not made, the US tax results would be similar to that described below under "Decedent was Unmarried".

Decedent was Unmarried. If the decedent was unmarried, he/she would normally may be subject to a deemed disposition, and immediate Canadian tax on the RRIF, absent the child or grandchild exception. Therefore it is likely there would be 25% Canadian tax withheld when the RRIF is paid to the US Estate. The tax on the full amount in the RRIF may be payable no later than January 15th of the following year (or earlier if the distribution is paid from the RRIF prior to that).

The US Estate, in turn, would receive a lump sum distribution, net of the 25% Canadian withholding tax. In this case, any amount that is paid as a bequest of a specific sum of money according to the Will, and which is paid all at once or in not more than 3 installments is not taxed to the recipient of the bequest. (IRC 663). Thus the RRIF amount is taxed in the Estate and not to the beneficiary and the Estate is entitled to a foreign tax credit under Sections 27 and 901.

In cases where the payments do not qualify for IRC 663 treatment the regular US income tax rules for Estates would apply. Assuming Code Section 72(w) applies, the Estate would pay income tax on the gross RRIF amount to the extent the income is not distributed to a beneficiary. (IRC 691). The beneficiary would be taxed on any amount received, and each would receive a proportional foreign tax credit for the Canadian withholding tax, despite the fact the Canadian tax was levied on the decedent, and not on the US Estate or US beneficiary (IRC 691(b)).

Please consult your Canadian and US tax advisors before taking any action. Meanwhile we thank international tax attorney E. Gordon Cleland for his assistance with this matter.

IS YOUR "COMMON LAW" PARTNER A "SPOUSE "?

Under US tax law there are often tax benefits available to married individuals. For example, certain married individuals can file a joint US income tax return which often results in less aggregate income tax than filing separately.

Perhaps more important for nonresident aliens, are certain benefits under the US estate and gift tax rules and the tax treaty.For example:

Estate Tax. The potential "exemption" from US estate tax available under the treaty to nonresident aliens of the US resident in Canada is approximately doubled if the US property subject to tax goes to a surviving "spouse" that is a resident of Canada or the US.

Gift Tax. The annual exclusion on gifts of US real estate between nonresident aliens is increased from $12,000 to $125,000 (2008) if the recipient of the gift (the donee) is the "spouse" of the donor.

So, what is a "spouse"?

In the US, the determination of whether an individual is a "spouse" is made under State law. The State may have one set of criteria for determining whether an individual is a spouse for one set of laws and another set of criteria for another set of laws. For example, an individual may be deemed a spouse for purposes of collecting health insurance benefits but not for tax purposes. For a nonresident alien, resident in Canada, the determination of whether there is a marriage for US tax purposes is determined under the applicable jurisdiction of the individuals in Canada.

"Common-Law" Marriages.

In the US, the Internal Revenue Service (IRS) position is that if a couple is married according to "common-law" in their country, they will be treated as being married for US tax purposes. In fact they will apparently even be treated as being married if they subsequently move to the US. (See Revenue Rulings 58-66, and 76-55, and TAM 200132004).

However to obtain the spousal benefits, the individuals may have to prove they have contracted for a common-law marriage in their jurisdiction, and not just for cohabitation. Thus they may be required to prove they have adhered to each element of the common-law marriage rules of their particular jurisdiction. Some US States, but not all, also recognize common-law marriages.

Same-gender domestic partners apparently do not qualify as "spouses" for federal tax purposes. The Defense of Marriage act (P.L.104-199) states that the word "marriage" means only a legal union between one man and one woman as husband and wife, and the word "spouse" refers only to a person of the opposite sex who is a husband or wife".

TIMELY FILING REQUIREMENTS UPHELD – ALSO APPLICABLE TO RESIDENCY CLAIMS?"

For many years the IRS has been concerned that some nonresident aliens and foreign corporations that are required to file US income tax returns are not complying. They believe some such taxpayers await a "request to file" from the IRS, and ignore filing if such a request never arrives.

Therefore, several years ago the IRS promulgated regulations that set a deadline for nonresident aliens and foreign corporations to file their US income tax returns. If the returns were not filed by the deadline, the taxpayers would not be allowed to deduct their expenses.

If the IRS came upon a taxpayer that had not filed a required return, and the deadline had passed, the taxpayer could be subject to tax on gross income without a deduction for expenses. The deadline applied to nonresident aliens and foreign corporations but not to US persons.

In January, 2006, the US Tax Court invalidated these regulations, eliminating the deadline's "timely filing" requirement. Thus it appeared from January, 2006, (and retroactively before that date), such taxpayers could claim deductions regardless of how late the tax return was filed.

However as we warned back then, the IRS appealed the decision, and on February 21, 2008, a US Court of Appeals reversed the decision of the US Tax Court. (Swallows Holding Ltd., CA-3, February, 2008). Hence the timely filing regulations (deadlines) for filing US income tax returns are now back in place.

The deadline for nonresident aliens is 16 months after the regular due date for the tax return. The regular due date for nonresident aliens is 5 1/2 months after the end of the tax year (3 1/2 months if there are wages subject to US withholding).

The deadline for corporations is 18 months after the regular due date for the tax return. Please see the article ***"DUE DATES FOR US FEDERAL CORPORATE INCOME TAX RETURNS".***

Is There Significance for Article IV of the Treaty?

Many Canadians that are resident in Canada are also (perhaps inadvertently) residents of the US for US income tax. This can happen, for example, if a Canadian snowbird (that is not a US citizen) meets the substantial presence test and does not file IRS Form 8840 timely. Also many green card holders are full time residents of Canada, (notwithstanding the US Department of Homeland Security's rules), and are therefore also US residents for income tax.

In both cases such individuals are required to file a US income tax return. Technically, the individual may be qualified to make a claim under Article IV of the tax treaty to compute his/her US income tax as a nonresident of the US.

However the way the US regulations are written describing how to make the Article IV tax treaty claim, it can be argued the IRS does not have to accept the claim if the relevant tax return is filed after the due date.

Not everyone agrees with this interpretation. However it can be seen the IRS would have the same concern here, as in the case of the timely filing issue mentioned above for deductions for expenses. That is, such individuals may delay filing their US return until the IRS demands a tax return, and then make the tax treaty claim at that time. Absent the IRS demand, the individual might never file the required US income tax return.

We are unaware of such a (late filed) tax return ever being audited. However in the event of an audit by a sophisticated IRS examiner, we believe the IRS might deny such a claim if the tax return were filed late and there was sufficient financial benefit to the IRS to deny the claim.

HOW DANGEROUS FOR CANADIANS IS US TREASURY FORM TD F 90-22.1?

Beware if you have a business activity in the US!

Certain individuals and entities are required to annually file by June 30th a US report on their foreign (non-US) accounts. (See US Treasury Form TD F 90-22.1). The civil penalty is $10,000 for non-willful failure to file - i.e. simple negligence in failure to file. The penalty is $100,000 for willful failure to file. There may also be a potential criminal penalty with prison time.

There is no provision for filing an extension as in the case of an income tax return. Hence the penalty may apply if you file after the due date. The penalty may be abated if you can demonstrate "reasonable cause".

On Form TD F 90-22.1 certain individuals and entities must report whether they have a financial interest in, or signature authority, or other authority, over any financial accounts including bank, securities, or other types of financial accounts in a country other than the US, if the aggregate value of such accounts exceeds $10,000 anytime during the calendar year.

Does it apply to you if you are a Canadian corporation or individual with business activities in the United States? Does it apply to you if you have rental real estate in the US?

Who Must File?

The exact scope of the individuals and entities that are required to file is apparently unclear. Form TD F 90-22.1 applies to "United States persons". The instructions to the current edition of the Form, (dated July, 2000) states that "United States person" means:

1) a citizen or *resident* (see the unusual definition below) of the United States,
2) a domestic partnership,
3) a *domestic (see below)* corporation, or
4) a domestic estate or trust.

"Resident" of the United States - Although the IRS is apparently charged with the duty of administering issues associated with this form, Form TD F 90-22.1 is actually a US Treasury form, not an IRS form and is mandated by US law separate from the Internal Revenue Code. Therefore it appears one must review US Treasury rules rather than IRS rules to determine the meaning of "resident" in this context. We thank international tax attorney Thomas St. G. Bissell, Esq. for assisting us in researching this issue.

The section of the US law that mandates Form TD F 90-22.1 states that it applies to *"a resident or citizen of the United States, or a person in, and doing business in, the United States".* (31 US Code 5314). Further, the Regulations state that the rules apply to "each person subject to the jurisdiction of the United States (except a foreign subsidiary of a US person)". (31 CFR 103.24). Thus it appears Canadian corporations and nonresident aliens doing business in the United States might have a requirement to file Form TD F 90-22.1.

A draft revised Form TD F 90-22.1 and accompanying revised instructions (all dated January, 2007) that were circulated in 2006, confirmed that a branch of a foreign entity doing business in the US is required to file. These revised documents have not been finalized and issued.

The IRS has an online service to respond to questions concerning Form TD F 90-22.1. You can direct questions to FBARQUESTIONS@irs.gov We asked "Is a foreign corporation or nonresident alien engaged in US business required to file Form TD F 90-22.1"? The response was "The foreign corporation and the nonresident alien do not have to file the report, the US business must file". We then asked for a working definition of "US business". The response was "Any business operating on US soil".

Thus it seems possible - if you are engaged in US business you could be subject to the penalty $10,000 or more if you do not file a required Form TD F 90-22.1.

What other alien individuals might be required to file? The draft revised Form TD F 90-22.1 and accompanying revised instructions mentioned above, define a "resident" as a permanent resident or any person treated as a resident under the income tax laws.

Thus it appears likely that green card holders, regardless of where they live, are required to file, even those that claim Canadian residence under Article IV of the tax treaty. Others that are resident aliens under the substantial presence test likely must file unless they file a valid IRS Form 8840 by the due date. Individuals that hold US non-immigrant visas might be required to file Form TD F 90-22.1, on the basis they are "subject to the jurisdiction of the United States".

What is the status of "snowbirds". Is it possible that an individual regularly present in the US would be subject to the Form TD F 90-22.1 filing requirement? Mr. Bissell indicates the definition of "resident" for purposes of Form TD F 90-22.1 might even lead to an examination of definitions in the US securities laws.

MORE PAPERWORK & PENALTIES FROM THE US DEPT OF COMMERCE

The US Department of Commerce is authorized to collect information on foreign "investment" in the United States. (See 22 USC 3101-3108, and 15 CFR 806.4).

Unfortunately the definition of such "investment" includes Canadians purchasing rental real estate in the US. The penalty for noncompliance is a minimum of $2,500 and maximum of $25,000.

The rules require an initial filing when the investment is first made (Form BE-13 or BE-14), an annual filing (Form BE-15), and a special filing every 5th year (Form BE-12).

Initial Filing

When you make an investment in the US, including buying US real estate or purchasing a US business you must file a report with the US Department of Commerce. ("D of C"). Normally this is filed on the four-page Department of Commerce *Form BE- 13*.

However if your "investment" is the purchase of US real estate held exclusively for personal use, or a "small business" (including rental real estate) with consolidated assets less than 3 million and less than 200 acres of US land, you can instead file a simple two-page "Exemption Claim" on Department of Commerce *Form BE-13 Supplement C*. Corporate ownership of a personal use residence apparently qualifies for the "personal use" exemption.

Evidently the penalty of $2,500-$25,000 even applies if you are entitled to file the BE -13 Supplement C Exemption Claim but you do not do so. (However a D of C representative has suggested to us informally that a penalty would likely not be levied for failure to file BE-13 Supplement C for a residence that was held strictly for personal use.

If you are completing Form BE-13, Supplement C, you would normally complete Box 3 for a personal use residence or Box 4 for a "small business" enterprise, including rental real estate. The Form does not seem to lend itself to direct real estate rental investments. But if the "investment" consists of rental real estate you would apparently complete page 2, line 7a. The owner's name and Canadian address would be entered (along with a notation "US real estate"). (The Department of Commerce suggests that an owner other than a Canadian owner should use a US address as a contact address).

It appears the due date for BE-13 Supplement C is 30 days or 45 days after the purchase. (We received conflicting information from the D of C). There is no specific form to request an extension of time for filing, but the D of C suggests you can request an extension if the request is made prior to the due date.

US Real Estate Agents/Attorneys/Title Insurance Agents. If you are assisted in your purchase of US real estate or a US business by a US real estate broker or other US intermediary (including a lawyer or title insurance agent), that individual or entity is required to file Department of Commerce Form BE-14. Again, the penalty of $2,500-$25,000 applies for noncompliance. An exception applies if a US person files Form BE-13. The requirement does not apply to the purchase of a personal use residence.

US Persons Entering into a Joint Venture. A US person who enters into a joint venture with a foreign person to create a US business enterprise, including the purchase of real estate, must also file BE-14 or the penalty applies (unless a US person files Form BE-13). The due date for BE- 14 is no later than 45 days after the investment.

Annual Filing

There is a 20 page Form BE-15(LF) you must file annually with respect to your investment unless you qualify for the "short form" BE–15(SF) (10 pages) or Form BE–15(EZ) or Form BE- 15 Supplement C which is 3 pages.

If neither assets, sales, gross operating revenues, or net income or loss exceeded $30 million during the year you are likely eligible to file form BE- 15 Supplement C. You enter the owners name and address in Box A on page 1, check off "yes" on page 1 Box I, "no" in Box V and complete items 1a through 1h on page 2.

The due date is May 31st each year. The penalty is $2,500-$25,000 for noncompliance. The Department of Commerce tells us it is their policy to automatically send out BE-15 forms annually to individuals or entities that previously filed the initial form (BE-13). However the D of C has also advised us if you filed BE-13 Supplement C (Exemption Claim) in the first year you must also continue to file a BE-15 annually.

"Benchmark" Filing

Every 5th year (a "benchmark year") the Department of Commerce requires you to file a BE-12 "Benchmark Filing" instead of the normal annual BE-15. The year 2007 was a "benchmark year" and the related filings are due in 2008.

BE-12(LF) is 26 pages, whereas BE-15(LF) is only 20 pages. However you may qualify to file short form BE 2(SF), BE Bank, BE-12 Mini (2 pages) or "BE-12 Claim for Not Filing" (2 pages).

You can file BE-12 Mini (2 pages) if none of the following exceeded $40 million: US total assets, US gross revenue, or US net income. Most Canadians with a US personal use residence, or US rental real estate can file BE-12 Mini. You enter your name and address on page 1 Box A, and complete lines 1 through 12 on page 2.

Again, failure to file can result in a penalty of $2,500-$25,000. The due date for the 2007 Form BE-12-Mini is May 31, 2008.

As above, if you filed a BE-13 Supplement C (Exemption Claim) in the first year you apparently must also file a BE-12 in the Benchmark year.

For more information please go to the applicable Department of Commerce website http://www.bea.gov/surveys/fdiusurv.htm.

As a precautionary gesture, if you own US real estate or a US business (and you are not a "US person") you should consider filing the above Department of Commerce forms annually.

US CITIZENS IN CANADA WITH CFC'S - BEWARE "PERSONAL SERVICE "CONTRACTS

A somewhat recent change in the Internal Revenue Code could present a hazard for certain professionals, including consultants, who are US citizens or US residents living in Canada and conducting business through their private Canadian corporation.

Readers are aware such individuals who own a private Canadian corporation might be taxed annually in the United States on certain passive income retained in the corporation, (depending on the extent of such income and other factors), regardless of whether it is actually paid to them (so called section 951 income). However the rule is also applicable to "personal service" contracts.

If you are a "US shareholder" in a "controlled foreign corporation" (CFC) you may be taxed personally in the US on "personal service contract income" received by the corporation and not distributed to you. (IRC 954(c)(1)(H)).

"Personal Service" Contracts

For this purpose, personal service contract income consists of fees received under a contract under which your corporation is to furnish personal services if:

1) some person other than the Corporation has the right to designate (by name or by description) the individual who is to perform the services, or

2) the individual who is to perform the services is designated (by name or by description) in the contract.

The rule applies for a particular contract only if sometime during the taxable year 25% or more of the value of the stock of the corporation is owned, directly or indirectly by or for the individual who has performed, is to perform, or a may be designated as the one to perform, the services.

US ESTATE TAX PLANNING WITH CANADIAN TRUSTS - A WRINKLE?

Some tax advisors have recommended that certain Canadians purchase their US real estate through a Canadian irrevocable trust. This advice is based on the fact that US real estate genuinely owned by a valid irrevocable trust is exempt from US estate tax.

However, ensuring the trust is truly irrevocable may be problematic in some cases. If the trust is not irrevocable US estate tax may apply. Therefore, in the event of the death of an individual that formed such a trust and caused it to purchase the US real estate, the trust may be subject to some scrutiny.

If the individual that formed the trust dies, the trustees and others involved in the ultimate disposition of the property may have some contingent liability for the US estate tax that would apply if the IRS were ever to claim the trust was revocable. Such individuals may therefore be nervous about distributing funds out of the trust to beneficiaries or others. We have heard of one case where the trustee required the potential US estate tax (i.e. the estate tax that would apply if the trust is ultimately deemed revocable by the IRS) to be paid to the trustee and held in escrow for several years.

FOREIGN TAX CREDITS AND "OVERALL FOREIGN LOSSES"

US citizens and residents filing a US income tax return (IRS Form 1040) can, of course, reduce their US tax by all, or a portion, of their Canadian tax - i.e. by "foreign tax credits". The amount of foreign tax credits that can be deducted against US tax depends in part upon the ratio of the individual's foreign (non-US) source income to his/her worldwide income. Thus, in order to deduct foreign tax credits it is necessary to have foreign source income and, (in this respect at least), the more the better.

If there is an overall foreign source loss for the year, there will of course be no foreign tax credit available in the US. But there are further ramifications to such a loss. If you have an overall foreign source loss for any taxable year, a portion of your foreign source income in subsequent years may be treated as US source income. In other words, the accumulated foreign source losses must be offset against US source income on the current or future tax returns, when computing your foreign tax credits.

In each succeeding year you must re-characterize as US source income, the lesser of 50% (or a larger percent if you choose) of your foreign source taxable income for that year or the amount of the remaining overall foreign loss. Apparently the reason for this is to prevent the amount of foreign source income equal to the amount of foreign source losses that offset US source income from escaping US tax through the use of foreign tax credits.

Generally, an overall foreign loss is the amount by which your gross income for the year from foreign sources is exceeded by the sum of deductions properly allocated to that income.

Thus, for US citizens and US residents the US tax rules for "overall foreign losses" may occasionally create a circumstance where it is preferable to take fewer itemized deductions on the US tax return than you are otherwise entitled!

Simplified Example:

Sarah is a US citizen residing in Canada. Her 2007 worldwide income consisted of all Canadian source income of $85,000 of wages and $7,000 of capital gains from Canadian publicly traded securities, for a total of US $92,000. Because only 50% of such capital gains are taxed in Canada, the amount of Canadian (foreign) taxes allocable to the capital gains could be insufficient to offset the $7,000 capital gains in the U.S.

So Sarah decides to exclude the Canadian wages of $85,000 from her US taxable income using the "foreign earned income exclusion", and offset the remaining $7,000 with her itemized deductions and exemption. Assuming that her itemized deductions totaled $10,000, there would be a $3,000 foreign source loss before exemptions. The foreign source loss is calculated as follows:

	Sarah Claims Itemized Deductions	Sarah Claims The Standard Deduction
Salary	85,000	85,000
Capital gains	7,000	7,000
Foreign earned income exclusion	(85,000)	(85,000)
Adjusted Gross Income:	7,000	7,000
Less:		
Itemized Deductions:	(10,000)	
Standard Deduction:		5,350
	(1) (3,000)	1,650
Personal exemption	(3,400)	(3,400)
Taxable income	0	0

1) This amount constitutes the overall foreign loss. As you can see in this case, it would be better for Sarah to claim the standard deduction of $5,350 and have $1,650 of income, before the personal exemption. The latter would provide a further reduction and eliminate the taxable income.

CANADIANS LIVING IN THE US & OWNING PRIVATE CANADIAN INVESTMENT CORPORATIONS

Nonresident aliens of the US with private Canadian investment corporations or holding companies who contemplate moving to the US would normally consult their Canadian and US tax advisors prior to the move. Certain reorganizations or other changes prior to the move may be beneficial in reducing the long-run aggregate worldwide income tax.

However often the move occurs without such advance planning. In that case, what options are available after the move, if the corporation's income is solely passive investment income?

Canadian Tax Considerations

Please consult your Canadian tax advisor. If, at the time of departure from Canada, your Canadian corporation had retained earnings (referred to as "accumulated earnings and profits" in the US) and/or the market value of the shares of your corporation exceeded your cost base (referred to as "adjusted basis" in the US) it is possible Canadian "departure tax" applied at the time you left Canada.

Now, as a resident of the US, you may still be subject to Canadian tax such as:

1) Canadian corporate income tax on the annual profit in the corporation, and

2) Canadian withholding tax on the payment of dividends to you in the US from the Canadian corporation.

You may be subject to further US tax on the receipt of the dividend, even after the foreign tax credit you would be allowed in the United States.

When presented with this you may consider, among other scenarios, either:

1) liquidating the Canadian corporation, or

2) reincorporating ("continuing") your Canadian corporation into a US corporation.

Liquidation

Liquidating the corporation may cause Canadian tax on the basis of a dividend in the amount of the retained earnings. This "deemed" dividend may be subject to Canadian tax of 15% (5% in limited cases). However it is possible this tax could be carried back to the year of departure and offset against the tax attributable to the deemed disposition of the shares in that year. (Income Tax Act Section 119). CRA has suggested informally that perhaps this tax can not be carried back further than six years!

The computation of the tax attributable to the deemed disposition in the year of departure may be problematic if there was considerable other taxable income in that year. In this case, how do you compute the Canadian tax attributable to the deemed disposition? Is it determined based on the average tax rate, or by deducting from the total tax the amount of tax that would have applied without the deemed disposition? Section 119 of the Income Tax Act sets out the rules.

Reincorporation

Another alternative, reincorporating in the US via a State statute, (i.e. a corporate expatriation from Canada) may result in Canadian tax of 5% to the extent the value of the assets of the corporation exceeds the liabilities and share capital. (ITA 219.3).

Please consult your Canadian tax advisor before taking any action.

United States Tax Considerations

Given that the Canadian corporation's sole income is passive investment income, the undistributed profits of the Canadian corporation may be subject to substantial aggregate worldwide tax — i.e. Canadian corporate income tax, and then US income tax at ordinary tax rates (under section 951) without the benefit of any foreign tax credit in the US for the Canadian corporate tax. An exception may apply if the Canadian corporation is a Nova Scotia or Alberta "Unlimited Liability Company". Also, an exception may apply to the Section 951 inclusion if the corporation has "high taxed income".

Liquidation

If the Canadian corporation is liquidated in a form that is treated as a dividend for US purposes there would be a maximum tax of about 15% in the US (under present law) on the taxable amount. In most cases, there may be 15% Canadian tax paid on approximately the same amount, (see "Canadian Tax Considerations" above), and therefore the US tax would normally be reduced (offset) by the Canadian tax, with little (if any) additional US tax payable.

Reincorporation

If planned and executed properly, there is apparently no US tax event at the time of the reincorporation in the US. However then any US tax liability arising on account of "dividends" or "liquidation" of the (now-US) corporation apparently cannot be offset by the Canadian expatriation tax since the corporation's transactions are now "US source".

Thus, absent other planning with other investment assets, the benefit of using the Canadian tax as a foreign tax credit in the US may be lost, (although it could perhaps be deducted as an "itemized deduction").

Further, unless the corporation makes the so-called "S" election, there may still be double tax on the corporation's earnings — namely US corporate income tax, and personal (shareholder) tax at the time the remainder is distributed. The US does not have the corporation- shareholder tax integration that exists in Canada.

The US shareholder could make the "S" election so that the corporate income is taxed instead at the shareholder level. However a special US "S" corporation rule exists if the corporation had "accumulated earnings and profits" at the time of the reincorporation. In this case, because the corporation's income is passive investment income, the "S" election would be automatically terminated after three years. (IRC 1372). Perhaps worse, again because of its passive income, there would be an annual tax on the corporation's profit, in addition to the shareholder level tax. (IRC 1375).

Election to be Taxed at US Corporate Rates

Another alternative may exist, although rarely practical, in cases where it is decided to neither liquidate nor reincorporate the Canadian corporation.

Section 962 of the US tax code permits the US individual shareholder of the Canadian corporation to elect annually to be taxed at US corporate rates on the "Section 951" income. This election enables the US individual shareholder to take a foreign tax credit in the US for the Canadian corporate income tax.

However, when a future distribution of that particular Section 951 income exceeds the amount of **tax** previously paid on that income, the excess is taxed again to the individual shareholder. The US tax on the distribution would be fully or partially offset by a foreign tax credit for the related Canadian withholding tax, but the individual shareholder is, still, subject to two levels of tax on the section 951 income.

Thus, the shareholder is taxed once as a corporation and once as a shareholder, in order to put the structure in similar circumstances to that which would exist if the Canadian corporation were a subsidiary of a US corporation owned by the US shareholder.

As a result, the election would seem to be the most useful when there is no present intention of distributing the Section 951 income. In that case the current tax savings (i.e. little or no US tax on the Section 951 income after the foreign tax credit for Canadian corporate tax) may outweigh the present value of the additional tax costs at the time of the ultimate distribution. Unfortunately these circumstances would not seem to apply if the US resident shareholder desires to use the corporate income for current living expenses.

Please see also the article ***"IMMIGRANTS TO THE US CAN ARRANGE A STEP-UP IN US "COST BASE""***

IMPORTANT TRAVEL INSURANCE SERVICE AVAILABLE FOR CANADIAN "SNOWBIRDS"

It may often be difficult to find objective advice when you are contemplating an important purchase. However residents of Canada about to visit the US and looking for independent, factual, and current information on travel health insurance may find a new service offered by Milan Korcok very helpful.

Mr. Korcok is a veteran medical journalist and lecturer and is a recognized authority on international healthcare and travel insurance. He writes for many publications, and is chief North American correspondent for the International Travel Insurance Journal and a long-time contributor to the Canadian Medical Association Journal. He has recently set up a website to provide a clearinghouse for travel insurance news and commentary.

His website contains current articles and tips on the travel insurance industry and also contains an extensive list of "frequently asked questions", such as; Who needs travel insurance, *What does travel insurance cover, How much does insurance cost, What types of plans are there, Do you need insurance for cruises, and a multitude of other issues.*

Also you can personally ask Milan your own questions on travel insurance. Go to www.travelinsurancefile.com, and click on "Ask Milan" at the top.

IMMIGRANTS TO THE US CAN ARRANGE A STEP-UP IN US "COST BASE"

The article ***"CANADIANS LIVING IN THE US & OWNING PRIVATE CANADIAN INVESTMENT CORPORATIONS"*** describes some of the tax issues facing individuals that move to the US while owning private Canadian corporations whose income is solely passive investment income. Where practical, steps can be taken in advance of the move to the US to alleviate some of the negative effects of those issues. Please consult your Canadian tax advisor.

In the US, an objective of the pre-move planning is often to obtain a "step-up", i.e. "increase" in the "cost base" of the shares of the corporation (or assets thereof). This has often been accomplished by undertaking some form of corporate reorganization in Canada. The corporate reorganization may take a form that would have been a taxable event in the United States, if the shareholder had been a US citizen or US resident at that time. The taxable event may trigger an increase in the cost base of the shares, (or assets) for US purposes, notwithstanding the fact the shareholder was not a US citizen or US resident at the time of the transaction, (and therefore not subject to US income tax on the transaction).

Certain Canadian corporate reorganizations are treated as "tax-free" reorganizations or so-called "nonrecognition" transactions for US purposes. Therefore, in order to try to ensure a "step up" occurs, you must ensure the reorganization in Canada does not constitute a "tax-free" reorganization ("nonrecognition" transaction) for US purposes.

A simplified example, which may not be applicable in many circumstances, pertains to Section 351 of the US Internal Revenue Code. In certain circumstances a transfer of assets to a corporation controlled by the transferor is a "nonrecognition" transaction - i.e. there is no tax triggered and no increase in cost base. Exceptions apply, for example, if a US citizen or US resident transfers assets to a foreign corporation, (IRC 367), or a nonresident alien transfers US real estate to a foreign (non-US) corporation (IRC 897).

Under Section 351, the "nonrecognition" treatment is automatic (mandatory) if the transaction corresponds with the specific requirements of Section 351. There is a lengthy list of IRS promulgations and court cases addressing circumstances involving attempts by taxpayers to meet, or fail, the Section 351 rules. One particular portion of the rule limits the "nonrecognition" treatment when there is an issuance of "non-qualified preferred stock", as part payment for the property transferred to the corporation. (IRC 351(g)).

Your Canadian tax advisor will have other additional suggestions on how to reorganize your private Canadian corporation prior to becoming a US resident, possibly involving the use of a Nova Scotia or Alberta Unlimited Liability Company.

Caution

If a transaction or series of transactions is undertaken solely for tax purposes it is possible the IRS may disregard the transaction(s). Please see the article in the Fall, 2007, Taxletter entitled ***"SOME SPECIAL US TAX LAW "DOCTRINES""*** which describes "sham transaction", "economic substance", "step transaction", "business purpose" and other concepts.

REMOVING YOUR US RESIDENCE FROM YOUR CANADIAN "SINGLE PURPOSE" COMPANY

The 1995 change in the tax treaty estate tax rules (the 3rd Protocol) and the major changes in domestic US estate tax rules since then, have significantly reduced the US estate tax exposure for many Canadians with a US residence. This has caused some Canadians who own their US residence through a "grandfathered" Canadian "single purpose company" to question whether they should now remove the residence from the corporation and dissolve the corporation.

The decline in US real estate values in many areas and the decline in the US dollar have further stimulated interest in making the change. However, since there are US and Canadian income tax implications to the removal, please consult your Canadian and US tax advisors before taking any action.

US Income Tax Implications to Removal

The US income tax implications depend in part on how the removal is undertaken - i.e. by sale of the property to the shareholder, or transfer to the shareholder in exchange for an existing loan, (or some combination thereof), or by a "distribution" of the property to the shareholder (with or without a simultaneous liquidation of the corporation).

Regardless of which method is adopted, the corporation will be considered, for US corporate income tax purposes, to have disposed of the property at fair market value. Thus there will be taxable gain (or loss) based on the difference between the fair market value and the corporation's cost basis in the property. Certain other deductions may be available - please see the Fall, 2007, issue of the Taxletter.

The corporation's taxable income will be subject to US federal (and perhaps State) corporate graduated income tax at rates from 15% to about 35 -40% depending on the amount of gain. The US income tax return to report the sale must be filed by the due date to avoid penalties if there is tax due (see the article ***"DUE DATES FOR US FEDERAL CORPORATE INCOME TAX RETURNS"***) and by the deadline date (see the article ***"TIMELY FILING REQUIREMENTS UPHELD – ALSO APPLICABLE TO RESIDENCY CLAIMS?"***) to qualify for certain additional deductions.

Installment tax payments may be required before the end of the tax year to avoid penalties. The US branch tax (an additional tax) can potentially be avoided by filing a valid IRS Form 8848 with the income tax return.

US Withholding Tax Requirements. The US "FIRPTA" withholding tax requirements apply regardless of which method of removal is chosen.

If the transaction is structured as a sale or exchange, the withholding is 10% of the "amount realized" - normally 10% of the fair market value. Of course you can apply for a "withholding certificate" from the IRS to reduce the withholding if that is justified by the facts. If the fair market value of the property does not exceed $300,000 you may be exempt from withholding in accordance with the "use as a residence" rule.

If the transaction is structured as a distribution of the property, the "FIRPTA" withholding is 35% of the corporation's gain – i.e. 35% of the difference between fair market value and the corporation's cost base.

Expenses for the Removal

A significant State land transfer tax will normally apply when the property is sold to, or exchanged with, the shareholder(s). Depending on the individual State involved, there may similarly be a land transfer tax if the property is distributed to the shareholder.

Where applicable it could be beneficial to obtain a new "title insurance" policy, since any existing policy will be in the name of the corporation which may be dissolved.

Attorney's fees will normally apply for preparation and recording of the new deed, and accountant's fees will apply with respect to addressing the IRS "FIRPTA" issue and preparing the Canadian and US income tax returns.

Canadian Income Tax Implications to Removal

Please consult your Canadian tax advisor before taking any action.

MOVING TO THE US WITH A MUTUAL FUND "PFIC"

We previously mentioned the drastic US tax rules that may apply when a US citizen or resident alien sells for a profit a non-US corporate mutual fund. For example please see the Winter-Spring, 2007, and Fall, 2007, issues of the Taxletter.

To potentially alleviate the US tax issues that may arise, such individuals may consider making the "mark to market" election annually. In addition, Section 1296 (l) of the US tax code provides that any individual becoming a United States person (after December 31, 1997) will have a cost base in the mutual fund for US purposes of the greater of:

1) The value of the mutual fund at the time of the move to the US, or

2) The actual cost base (generally the purchase price) of the mutual fund, for purposes of the mark to market election only.

Thus, if you have a substantially appreciated mutual fund and you begin making the mark to market election in your first year of US residence, in general you will never be taxed in the US on the appreciation that occurred prior to your becoming a US person. On the other hand, without the "mark to market" election, you may ultimately be taxed in the US on any gain on the sale at the highest US individual tax rate based on your original purchase price.

THE NEW (5TH) TAX TREATY PROTOCOL & TREATY BENEFIT LIMITATIONS

Since tax treaties often provide tax benefits not otherwise available in the absence of the treaty, there could be a tendency for individuals or entities in a third (non-treaty) country to set up an entity in a treaty country to exploit the benefits of the treaty. Hence there are often rules (Articles) in tax treaties to prevent this "treaty shopping". This "Article" in a tax treaty is generally referred to as the "Limitation on Benefits" Article.

The present tax treaty between Canada and the United States contains a "Limitation on Benefits" Article but it applies solely for purposes of the application of the treaty by the United States.

However the new (5th) tax treaty Protocol signed in September 2007, and expected to enter into force sometime soon, contains a "Limitation on Benefits" Article that affects application of the treaty by both Canada and the United States.

Thus, tax practitioners addressing cross-border taxation must review these provisions to ensure assumed treaty benefits are, in fact, actually available.

WORRIED ABOUT AN IRS AUDIT?

By Robert S. Blumenfeld, Esq., (Tax Attorney), tel. 954-384-4060.

"Worried about an IRS audit? Avoid what's called a red flag. That's something the IRS always looks for. Say you have some money left in your bank account after paying your taxes. That's a red flag." Jay Leno.

Each year, either to calm you down or to worry you more, I publish a list of things that the IRS is projected to look at in the next year's audit (examination) cycle. In the year 2000, there were approximately 600,000 examinations. By the year 2004, we had reached a point where we had approximately 1,000,000 examinations. For the year 2007, 1,400,000 examinations are projected. This means that roughly 1 out of each 100 taxpayers will be audited by the Internal Revenue Service.

Many of these examinations will simply be letters from the IRS asking you why some particular facet of your return does not match the information given to it by a bank, brokerage house, or employer. Then "you say or you pay".

People with incomes in excess of $1 million a year have about a 9% chance of being examined. People in the $100,000-$1,000,000 range also have a higher probability of examination than most, the probability diminishing as the income decreases from $1 million per year.

As Jay Leno mentioned in his quote, the IRS has certain red flags which, based on statistical probabilities, cause an increased chance for examination within a particular business or industry. These red flags change from year to year; the most recent list includes:

Travel expenses - why is it so important that every executive (and his/her spouse) needs to attend a conference in Hawaii? The IRS may ask about this one. You couldn't have held it in Youngstown, Ohio? How did your spouse's presence enhance the conference?

Hobbies - several months ago, I addressed this issue in one of my monthly articles. If the IRS is convinced that there is no profit motive to a particular "business", the IRS will disallow the losses generated by that business.

Two particular targets that the IRS focuses on are horse farms and photography.

Undocumented charities - in the last few years, if you give anything but cash to a charity, the IRS has devolved a complex record keeping system and a requirement that any noncash item given to a charity above a certain minimum must be accompanied by an appraisal. Fail to comply and you could lose the deduction.

Cash businesses - here the IRS perceives that many business owners who receive a lot of cash as part of their income do not bother to report all of it on their income tax returns. The restaurant business, for example, may be suspect. The IRS is also vigorously enforcing the filing requirement for Form 8300. If you, as a business owner, receive a cash payment in excess of $10,000, you are required to fill out and file this form with the IRS. If you don't, trouble may follow.

Some owners and high-level executives may be derelict in reporting certain fringe benefits they receive which are non-cash in nature; use of a business car (or plane), stock options, certain types of insurance payments etc. are of interest to the IRS.

Certain industries are keyed in by IRS audit specialists; - two heavily scrutinized areas are the construction business and farms.

Salaries in family businesses - many owners take too much salary (to avoid corporate level tax) or too small a salary (to avoid paying Social Security and Medicare tax). The IRS will be cracking down in these areas.

Robert Blumenfeld spent 32 years as a senior attorney with the Internal Revenue Service, most of it in Washington, DC. He can be reached at 954-384-4060 or rblumenf@aol.com.

"RESIDENCY" OF A CORPORATION

For US income tax, the country of "residence" of a corporation is relevant for, among other things, the application of the "Limitation on Benefits" Article in the tax treaty, (see the Article ***"THE NEW (5TH) TAX TREATY PROTOCOL & TREATY BENEFIT LIMITATIONS"***). For example it applies in the determination of whether dividends from a Canadian corporation are entitled to the maximum 15% US tax rate when received by US individuals.

Canadian Domestic Rules

Canada has both statutory and common-law rules affecting the determination of the residence of a corporation. Apparently the statutory rules override the common-law rules. Please consult your Canadian tax advisor.

The statutory rule deems each corporation that is incorporated in Canada after April 26, 1965 to be a resident of Canada. (ITA 250(4)(a)). Under the common-law rule, for example, a corporation might be deemed to be a resident of Canada if Canadians provide the "mind and management" of the corporation from Canada. Please consult your Canadian tax advisor before taking any action.

United States Domestic Rules

Similarly, under US law, the residence of a corporation depends on where it is incorporated. The US refers to corporations organized in US jurisdictions as "domestic corporations" and other corporations as "foreign corporations". (IRC 7701(a)(4) and (5)).

The US does not have a counterpart to Canada's "common-law" rule. Foreign (non-US) corporations are taxed in the US only on their income effectively connected with a US trade or business and on certain other US source income.

Tax Treaty Rules

Article IV (1) of the tax treaty states that a corporation is a "resident" of a country if it is liable to tax in that country "by reason of the corporation's domicile, residence, citizenship, place of management, place of incorporation, or any other criterion of a similar nature".

Article IV(3) states that where a company is a resident of both countries (because of the rule in Article IV(1)) it will be deemed to be a resident of the country where it was created.

A company that was created in one country that is resident in both countries but that has been "continued" ("reincorporated") in a country other than where it was created, will be deemed to be a resident of the country in which it has been continued. (For comments on the concepts of "continued" and "reincorporated" please see the article ***"CANADIANS LIVING IN THE US & OWNING PRIVATE CANADIAN INVESTMENT CORPORATIONS"***).