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

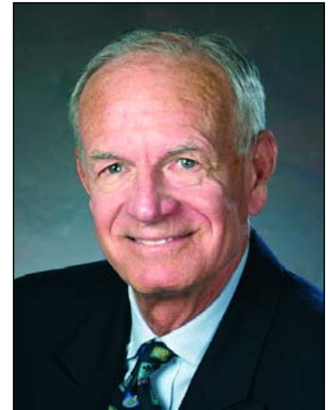
Executors of Estates of US Citizens Must be Alert to New "Portability Election"

New US estate tax law enacted in December, 2010, provides for the "portability" of certain unused "unified" estate tax credits - but the benefit must be timely elected by timely filing a US estate tax return. Therefore the executor of the estate of a US citizen (and certain Canadians) must be alert to the necessity to timely file a US estate tax return **even if one is not otherwise required**! Please see the articles ***"CANADIAN EXECUTORS FOR US CITIZENS - BEWARE NEW ESTATE TAX REQUIREMENT"*** and ***"IMPORTANT POTENTIAL NEW ESTATE TAX BENEFIT FOR CANADIANS"***.

New US Visa Proposed for Canadians and Others

US legislation has been introduced that provides for the creation of a new homeowner visa that would allow a "foreigner" who spends at least $500,000 on residential property in the US to obtain a US visa allowing him/her to live in the US. The visa would be renewable every three years, but would not put the holder on a path to US citizenship. To be eligible, a person would have to buy a primary residence of at least US $250,000 and spend a total of US $500,000 on residential real estate. The other properties could be rented. The legislation's future is uncertain.

Inflation Adjusted Figures Issued for 2012



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 40 YEARS.

The IRS issued Revenue Procedure 2012-52 setting forth the inflation adjusted figures for 2012. Some of the relevant ones for cross-border tax are as follows:

Earned Income Exclusion - $95,100

General Gift Tax Exclusion - 13,000

Gift Tax Exclusion for Gifts to a Non-US Citizen Spouse - 139,000

Estate Tax Exclusion Amount for Determining The Unified Tax Credit - 5,120,000

Expatriation Exclusion Under §877A(a)(1) - 651,000

Congressional Action On State Sales Tax

Several pieces of federal legislation have been introduced affecting State sales tax. One House of Representatives bill would require sellers to collect State sales and use tax for States in which they do not have a physical presence. Although a US Supreme Court decision presently requires such a physical presence for sales tax obligations, many States have imposed imaginative definitions of "physical presence" - witness the "click through" nexus rule previously summarized. A Senate bill with 10 bipartisan

*ADDRESSES ONLY U.S. FEDERAL ISSUES -- STATE AND LOCAL ISSUES MAY ALSO APPLY.
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sponsors would require remote sellers to collect sales and use tax unless the seller qualifies for a "small seller" exemption. (See also H.R. 3179, S. 1452, H.R. 2701, etc).

On the other hand a Senate resolution opposes any congressional action that would grant State governments the authority to impose any new burdensome or unfair tax collecting requirements on small Internet businesses and entrepreneurs. (S. Res. 309).

Any new law could significantly affect many Canadian businesses selling into the US from Canada even though they have no US presence whatsoever.

Florida Rules on Software Delivered Electronically

The sale of software that is delivered via electronic download is not subject to Florida sales tax. The taxpayer does not provide any tangible personal property to its clients in conjunction with the sale of the software. The rule apples to both canned and customized software. (Technical Assistance Advisement, No. 11A-021, Florida Dept of Revenue, July 23, 2011, released September, 2011). But note, other States may levy sales tax on canned software.

New York Says E-books not Taxable

New York has determined that the sale of electronic books (e-books) downloaded to customer's personal electronic devices, including tablets and smart-phones, is not the sale of tangible personal property and therefore not subject to State sales and use tax. (TSB-A-11(20)S, New York Commissioner of Taxation and Finance).

Potential Canadian Foreign Tax Credit for US IRA Withdrawal Penalty

The US imposes a 10% penalty on an "early" withdrawal from an IRA (Individual Retirement Arrangement) pension account. The Canada Revenue Agency has decided that this penalty qualifies as a non-business income tax for purposes of computing foreign tax credits on a Canadian income tax return. Technical Interpretation - TI 2011-039874117).

New Jersey Amends Nexus Rule

On August 15th the New Jersey Division of Taxation amended its definition of nexus for corporation business tax (CBT). The CBT will be imposed on every foreign (non-New Jersey) corporation that derives receipts from sources within New Jersey **or** engages in contacts within New Jersey in addition to doing business, employing or owning capital or property, or maintaining an office in New Jersey in a corporate or organized capacity. (N.J.A.C. 18:7-1.8, New Jersey Division of Taxation).

Limited Partners Not Subject to Louisiana Corporate Franchise Tax Or New Jersey CBT

The Louisiana Court of Appeals determined that the Louisiana corporate franchise tax did not apply to an out-of-State corporation that was a limited partner in an out-of-State limited partnership that owned property in Louisiana and did business in Louisiana. (*Utelcom, Inc. v. Bridges*, Court of Appeal of Louisiana, First Circuit, No. 2010 CA 0654, September 12, 20110).

Separately a New Jersey court held that an out-of-State company that held a 99% limited partnership interest in a New Jersey partnership was not subject to New Jersey corporation business tax (CBT) because it had insufficient nexus within the State.

Texas Protects Its Hosting Services

New Texas legislation provides that nexus will not be created in Texas for Texas sales and use tax purposes if an out-of-State entity's only contact with Texas is the use of internet hosting services purchased from an unrelated third-party provider who provides those services via the use of servers and software located in Texas.

Yacht Imported into Florida Not subject to Tax

Florida has advised that a yacht brought into Florida will not be subject to Florida use tax if:

a) The owner provides documentation sufficient to substantiate prior use of the yacht in another State for six months or longer under conditions which give rise to the taxing jurisdiction of that other State, and

b) The owner provides documentary evidence that any lawfully imposed tax was paid to such State, territory, or the District of Columbia before the boat was imported into Florida. (Technical Assistance Advisement, No. 09A-0 59, Florida Department of Revenue).

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CANADIAN EXECUTORS FOR US CITIZENS - BEWARE NEW ESTATE TAX REQUIREMENT

For 2011, US citizens and US domiciliaries are generally entitled to a unified tax credit of US $1,730,800 which exempts the first US $5 million from estate tax provided no prior taxable gifts were made. (For 2012 the unified tax credit is US $1,772,800 and the exemption is US 5,120,000). The new estate tax law enacted at the end of 2010 allows the estate of the decedent to pass on to the decedent's surviving spouse any unused portion of the unified tax credit that is not utilized in the first estate. Thus the estate of the surviving spouse could potentially have up to $3,361,600 in unified tax credits (for 2 deaths in 2011) if the first spouse had no assets.

This benefit to pass on unused unified tax credits must be elected on a timely filed estate tax return for the first spouse. However since an estate return for a US citizen or US domiciliary is generally not required unless the decedent's assets exceed $5 million for 2011 deaths, ($5,120,000 for 2012 deaths) an executor may inadvertently overlook the need to file a return in order to receive this benefit.

Thus the estates of US citizens must be alert to ensure they do not forfeit this benefit by failing to timely file a US estate tax return, **even if an estate tax return is not otherwise required!**

The return must be filed within 9 months of the date of death unless an extension is obtained. There is no particular box to be checked or specific statement to be filed. According to IRS Notice 2011-82 the election is made by timely filing the estate tax return. Please see the related article ***"IMPORTANT NEW POTENTIAL US ESTATE TAX BENEFIT FOR CANADIANS".***

IMPORTANT NEW POTENTIAL US ESTATE TAX BENEFIT FOR CANADIANS

The US estate tax legislation enacted in December, 2010, has beneficial effects for many Canadians. Please see the Winter/Spring, 2011, Taxletter. In addition to the issues described in that Taxletter, the legislation contains other provisions which will be vital for many Canadians not to overlook.

The US estate tax law provides for a tax credit (the unified tax credit) that has the potential to exempt US citizens and domiciliaries from estate tax on the first $5 million of taxable property (calendar year 2011). This potential tax credit is therefore US $1,730,800 (for 2011) provided no prior taxable gifts were made. Readers are aware that Canadians who are nonresident aliens of the US are entitled to a proportion of this unified tax credit, based on the proportion of their worldwide assets that are subject to US estate tax.

As described in the article ***"CANADIAN EXECUTORS FOR US CITIZENS - BEWARE NEW ESTATE TAX REQUIREMENT"*** the "new" estate tax law, effective for deaths after 2010, transfers to a surviving spouse any of this unified tax credit that is unused by the deceased spouse (referred to as the "deceased spouse unused exclusion amount"). Although IRS guidance has not yet been issued it appears nonresident aliens who are Canadian residents may be entitled to this benefit. The following example assumes this will ultimately be confirmed.

Example Sam and Sarah are husband and wife, Canadian citizens and residents, nonresident aliens of the United States, and not domiciled in the United States. They own worldwide assets of US $6 million, of which $3 million is solely owned by each spouse. Included is a US condo valued at US $750,000 which is solely owned by Sam. The US condo is Sam's only US asset.

Sam dies in 2011. All his worldwide assets pass to Sarah via his Will. Assuming there are no other estate tax factors involved, Sam's estate would be subject to US estate tax as follows:

Sam's Death

Tentative US estate tax on $750,000		US $248,300
Maximum tax treaty unified credit 750,000 / 3,000,000 x 1,730,800 =	$432,700	
Credit applied to eliminate estate tax	248,300	248,300
Estate tax payable		0
Unused unified credit	$184,400	

(This is the amount of credit attributable to the "deceased spouse unused exclusion amount").

In 2012 Sarah dies. Her worldwide assets total US $6 million, including the $3 million

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inherited from her husband, which includes the $750,000 US condo.

Sarah's Death

Tentative US estate tax on $750,000		US $248,300
Maximum tax treaty unified credit 750,000 / 6,000,000 x 1,772,800 =		221,600
Estate tax payable before considering the "deceased spouse unused exclusion amount"		$26,700
Maximum unused unified credit from Sam's Estate (above)	$184,400	
Amount of unused unified credit from Sam's estate applied to Sarah's estate		26,700
Estate tax payable on Sarah's estate		0

Thus, because all of the available credit was not utilized in Sam's estate, it appears the excess can be claimed by Sarah's estate. We are awaiting IRS confirmation.

Beware - You Must Timely Elect to Take the "Deceased Spouse Unused Exclusion Amount"

The benefit described above must be elected on a timely filed US estate tax return for the first death. The election is referred to as the "portability election". There is no particular box to be checked or specific statement to be filed. According to IRS Notice 2011-82 the election is made by timely filing the estate tax return. The return must be filed within 9 months of the date of death unless an extension is obtained.

REQUESTING AN EXTENSION OF TIME FOR RRSP & RRIF ELECTIONS

The publicity over the 2011 Offshore Voluntary Disclosure Initiative ("2011 US OVDI"- please see the Summer, 2011, Taxletter) highlighted the importance of many US tax reporting and filing requirements for US citizens and green card holders in Canada, and to the "timely-filing" requirement for most of those obligations. Please see the article ***"IMPORTANT US TAX PAPERWORK FOR US CITIZENS LIVING IN CANADA"***.

For example, readers are aware Form 8840 (Closer Connection Exception Statement, relating to obtaining an exemption from US residency), and Forms 8833/8891 (relating to the election by a US person to defer US tax on the income accruing inside an RRSP or RRIF) must be made by a specified due date or the election involved cannot be made for that year.

Failure to timely file Forms or elections can result in significant penalties or, sometimes worse - the ineligibility to actually make a particular election. So, can you obtain an "extension" to make an election?

The tax rules contain "statutory" elections and "regulatory" elections. (See Reg. §301.9100-1).

Statutory Elections. A "statutory" election is an election whose due date is prescribed by statute (the Internal Revenue Code). Rules for obtaining extensions for making "statutory elections" are set out in Reg. §301.9100-2.

Regulatory Elections. A "regulatory" election is an election whose due date is prescribed by a regulation published in the Federal Register, or a Revenue Ruling, Revenue Procedure, Notice, or Announcement published in the Internal Revenue Bulletin. Rules for obtaining extensions for making regulatory elections are set out in Regs. §§301.9100-2 and 301.9100-3.

Extensions of Time for Making the RRSP/RRIF Election

The election for US citizens and US residents to defer income accruing inside a Canadian RRSP, RRIF, Pension Plan, or Deferred Profit Sharing Plan (DPS) is a regulatory election - it is described in Revenue Procedure 2002-23. Revenue Procedure 2002-23 requires the election to be made by the due date of the return, including extensions.

Under Reg. §301.9100-2(b) an automatic extension of 6 months from the due date of a return excluding extensions is granted to make regulatory (or statutory) elections whose due dates are the due date of the return, or the due date of the return including extensions, provided the taxpayer timely filed its tax return for the year the election should have been made and the taxpayer takes corrective action as defined in Reg. §301.9100-2(c) within that 6 month period. (This rule does not apply to regulatory or

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statutory elections that must be made by the due date of the return excluding extensions).

If you do not meet the rules for an extension for your election for your RRSP/RRIF (or pension, or deferred profit sharing plan) under Reg. §301.9100-2(b) above, you may be able to request an extension under Reg. §301.9100-3. A request for an extension of an election for an RRSP or RRIF will be granted when you provide evidence (including affidavits) to establish that you acted reasonably and in good faith, and the grant of relief will not prejudice the interests of the government. (Reg. §301.9110-3(a)). This type of request is, in effect, a request for a Private Letter Ruling (PLR) from the IRS. Thus in addition to any cost for the preparation of the application, a Government fee must also be paid.

IMPORTANT US TAX PAPERWORK FOR US CITIZENS LIVING IN CANADA

During July and August, 2011, many Canadian newspapers published chilling descriptions of a US tax "amnesty" program that was being offered by the US Internal Revenue Service (IRS) to (among others) US citizens resident in Canada. The program expired September 7th. The IRS announced it received over 12,000 applications for the amnesty program.

The objective of the "amnesty" program (officially known as the 2011 Offshore Voluntary Disclosure Initiative - or 2011 OVDI) was to bring US persons that have used undisclosed foreign (non-US) accounts and undisclosed foreign entities to avoid or evade US tax into compliance with United States tax laws. However the program was, in effect, much broader than that. It provided an opportunity for US citizens and others who had not complied with US tax requirements to "become legal" with, in many cases, a substantially reduced penalty compared with what otherwise would have applied.

The enormous publicity over the program in the Canadian financial media alerted (in some cases just reminded) many noncompliant US citizens (and green card holders) living in Canada of the vast array of US tax reporting obligations, and the potentially drastic penalties which can apply in the case of noncompliance.

The requirements do not end with the need to file a US income tax return. There are numerous additional reporting requirements which are not necessarily related to the computation of tax on the tax return.

For example if you own, or have signing or other authority, over non-US financial accounts that aggregate in excess of $10,000 during the year you must file US Treasury Form TD F 90-22.1 (Report of Foreign Bank and Financial Accounts - the so-called "FBAR"). The potential penalty is $50,000 or more for each account if the Form is not received by the US Treasury by June 30th of the following year. Such financial accounts include bank and securities accounts, RRSPS, RRIFs, LIRAs, LIFS, RESPs, TFSAs, and the like, as well as equity in life insurance policies.

Beginning with the 2011 tax year you may also be required to file new IRS Form 8938 disclosing your "Specified Foreign Financial Assets" if they exceed $50,000 in the aggregate. The law requires the Form to be filed by the due date of your return or a $10,000 penalty potentially applies. Also for 2011 the IRS will be revising Form 8621 which you may have to file for each Canadian mutual fund you own. Please see the article ***"US PERSONS! - GET READY FOR FORMS 8938 & 8621 FOR 2011.***

For those who have certain non-US trusts, IRS Form 3520 (and in some cases Form 3520-A) must be filed if you contribute to, own, or receive a distribution from, the trust. Failure to file Form 3520 by the due date of your US income tax return can result in a penalty of 35% of the amount of the contribution or distribution, or 5% of the amount in the trust. The minimum penalty is $10,000. Apart from your involvement with a "normal" Canadian trust, this requirement may affect you if you have a LIRA, LIF, RESP, or TFSA, for example.

US citizens who own a Canadian private corporation are faced with the requirements of IRS Form 5471 which attracts a potential $10,000 penalty for failure to file by the due of the US income tax return. In certain cases the contribution of property to your Canadian private corporation must be reported on IRS Form 926 or a penalty of 10% of the value of the property may apply.

The above are just examples of a few selected circumstances where US tax reporting obligations may apply to you. Please consult your tax advisor for assistance in helping you avoid unexpected penalties.

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Please see also the articles ***"FATCA COMING IN 2013" and "RENUNCIATION OF US CITIZENSHIP".***

An important side effect of the failure to file certain required IRS tax forms is the fact the statue of limitations will not commence until they are filed. Please see the article ***"YOUR TAX RETURN MAY REMAIN "OPEN" INDEFINITELY!".***

TRUST'S TERMS MUST BE RE-EVALUATED TO AVOID SURPRISES

Trusts are used for many purposes - for example by nonresident aliens of the US for US estate tax planning and by US citizens in Canada and others in Canada for Canadian estate planning. Where United States tax laws may be directly or indirectly involved such individuals should review recent US tax law changes applicable to trusts.

Some trusts have terms which provide for "discretionary" beneficiaries - e.g. the trustee has the power to select from a group of beneficiaries which one (or more) of the beneficiaries to which he/she will make a distribution from the trust. In the past this has assisted in avoiding some current US tax implications for the discretionary beneficiaries.

However, effective March 18, 2010, for purposes of Code Section 679 ("Transfers to Foreign Trusts by US Persons"):

1) If the trust has a US beneficiary that is a discretionary beneficiary, an amount will be treated as accumulated for that US person even if his/her interest is contingent on a future event. (IRC §679 (c)(1), and

2) The trust will be treated as having a US beneficiary, unless:

a) the terms of the trust specifically identify the class of persons to whom distributions may be made, and

b) none of those persons are US persons during the taxable year. (IRC §679(c)(4),

Further, if any US person who transfers property to a foreign trust is involved in any kind of agreement or understanding (written, oral, or otherwise) that may result in the income or corpus of the trust being paid or accumulated for the benefit of a US person, such agreement will be considered a term of the trust! (IRC 679(c)(5)).

In addition, "uncompensated use of trust property" by a US person will be treated as paid or accumulated for the benefit of a US person. (IRC §679(c)(6)).

Presumption of a US Beneficiary. If a US person transfers property to a foreign trust the IRS may treat the trust as having a US beneficiary, unless the person provides the IRS with certain information, etc. (See IRC §679(d)).

FATCA COMING IN 2013

Beginning January 1, 2013, new IRS Sections 1471 and 1472 will have an impact on Canadians (unless there is some cross-border political agreement in the interim). Although the law (known as the Foreign Account Tax Compliance Act - "FATCA") is intended to increase US tax compliance among US citizen living outside the US it may also indirectly affect Canadians who are not US citizens.

Under the new law a "foreign financial institution" ("FFI") - for example a Canadian bank or brokerage firm and its affiliates - must enter into an "Agreement" with the US Treasury Department, or there will be a 30% US withholding tax on the full amount of "withholdable payments" made to the Canadian bank or brokerage firm. "Withholdable payments" include interest, dividends, rents, royalties, compensation, etc., paid from US sources, and also gross proceeds from the sale of securities.

The Agreement ("FFI Agreement") will generally require the Canadian banks, etc., to:

1) Determine whether their account holder is a US person,

2) Report annually to the IRS certain information on the accounts of US persons,

3) Comply with requests from the IRS for additional information on the accounts of US persons,

4) Attempt to obtain a waiver in any case where Canadian law would prevent the reporting of the above information, and if a waiver is not obtained, close the account, and

5) Withhold 30% on payments to recalcitrant account holders or to other FFIs that have not entered into FFI agreements.

The rules will not apply to obligations outstanding on or before March 18, 2012.

Thus, unless the US modifies the rules, will Canadians who are not US citizens be required to certify that fact to the Canadian bank or other institution?

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CANADIAN EXECUTORS RESPONSIBLE FOR IRS FORM 3520

Readers are generally aware of the requirements for US persons to file IRS Form 3520 in certain cases where they are involved with a foreign (non-US) trust. However a Canadian executor of the estate of a US person may also be required to file the Form, even if the executor is not a US person. Substantial penalties may apply for late filing.

The Canadian executor may have this US filing obligation in one or both of the following general situations:

1) The decedent (a US person) created, transferred funds to, was considered the owner of, or received a distribution from, a foreign trust during his last tax year, or

2) Upon the death of the US person:

a) a foreign trust was created, or

b) funds were transferred to a foreign trust, or

c) a distribution was received from a foreign trust, or

d) any portion of a foreign trust was included in the gross estate of the decedent. (IRC §6048).

Executors are reminded there is a potential penalty for each late filing of Form 3520 of the greater of:

1) $10,000, or

2) 35% of the value of property transferred to the trust, 35% of the amount of distributions from the trust, and 5% of the value of the trust itself.

US INCOME TAX RETURN FOR A CANADIAN ESTATE

Occasionally the Estate of a deceased Canadian who was a nonresident alien and non-domiciliary of the US, must file a US income tax return. This could occur, for example, if:

1) The decedent solely owned US real estate which was sold after death,

2) The decedent solely owned US real estate which was rented out after death, or

3) The decedent solely owned US securities upon which the proper US tax was not withheld on dividends after the date of death.

Which IRS tax Form is to be used for the tax return? That may seem to be a simple question but in practice a determination may be complex. The determination depends on whether the estate is a domestic estate or a foreign estate. A domestic estate files IRS Form 1041 income tax return. A foreign estate files IRS Form 1040-NR tax return. The Forms are quite different. The Estate of a nonresident alien, (and a US citizen living in Canada) may in some cases be a domestic estate.

According to the Internal Revenue Code a domestic estate (US person) is "any estate other than a foreign estate within the meaning of Code Section 7701(a)(31)". (IRC §7701(a)(30(D)). (i.e. an estate is a domestic estate unless it is a foreign estate!).

The instructions to IRS Form 1041 state "a foreign estate is one the income of which is from sources outside the US that is not effectively connected with the conduct of a US trade or business and is not includable in gross income". Since the sale of real estate and real estate rental income are not from sources outside the US and dividends from US securities are not from sources outside the US, one would tend to conclude from the IRS instructions that the estate of a Canadian decedent receiving such income would be considered a domestic estate.

However the wording of the IRS instructions conflicts with the actual wording of the Internal Revenue Code which states that a foreign estate is "an estate, the income of which, from sources outside the US which is not effectively connected with the conduct of a trade or business within the US, is not includable in gross income under Subtitle A". (IRC §7701(a)(31)(A)). Subtitle A includes the entire income tax section of the Internal Revenue Code.

Thus the Internal Revenue Code seems to say if the estate had any non-US source income which is not connected with US business and which is not subject to US income tax the estate is a foreign estate. For example if the decedent's estate had non-US bank interest or non-US dividends which were not subject to US income tax, the estate would be a foreign estate. Thus if the decedent were a nonresident alien the estate would be a foreign estate.

However tax practitioners have analyzed this in greater detail and concluded that the Internal Revenue Code described above can be read to conclude that the Code really only says that an estate is foreign **if** it is a "non-resident alien entity" and does not provide a

guideline in determining whether or not the estate **is** a "nonresident alien entity".

Separately the IRS has stated that a nonresident alien's estate that is subject only to ancillary (secondary) administration in the US not automatically a foreign estate. (Revenue Ruling 62-154).

Also it appears the nationality of the decedent and the beneficiaries are not relevant in the determination. Thus the estate of a US citizen (or nonresidential alien) resident and domiciled in Canada may, or may not, be a foreign estate for US income tax.

Rather it appears there may be three key criteria in making the determination:

1) The location of the estate's assets,

2) The country of the estate's domiciliary (primary) administration, and

3) The nationality and residency of the domiciliary personal representative (executor).

It also appears to be important whether the activities of an ancillary executor in the US constitute carrying on a business (on behalf of the estate) or are limited to paying debts and administrative expenses and to immediately thereafter distributing the estate proceeds. For example if the assets of the estate of a Canadian resident include numerous real estate rental properties located in the US, which a US executor is required to administer, the executor may be carrying on business on behalf of the estate - and thus the estate may be a domestic estate for US income tax purposes.

See Revenue Rulings 62-154 and 81-112, and Private Letter Rulings 7917087, 7925066, and 7918118.

NEW "ECONOMIC SUBSTANCE" DOCTRINE

For many years Canada has had its "General Anti-Avoidance Rule" (GAAR) which was enacted to give the Canada revenue Agency certain powers to attack what it considered tax avoidance activities or abuses of the tax system in situations where no specific anti-avoidance measures existed in the Canadian Income Tax Act.

Although the US had considerable case law involving anti-avoidance principles such as the "substance over form" doctrine and the "step transaction doctrine" the US never had specific legislation such as the GAAR - until 2010.

Effective for transactions after March 30, 2011, the US tax code now contains legislation entitled "Clarification of Economic Substance Doctrine". The term "economic substance doctrine" means the common law doctrine under which income tax benefits with respect to a transaction are not allowable if the transaction does not have economic substance or lacks business purpose. (IRC §7701(o)(5)(A)).

Generally, the law provides that in the case of any transaction to which the economic substance doctrine is relevant, the transaction will be treated as having economic substance only if:

a) the transaction changes in a meaningful way (apart from federal income tax effects) , the taxpayer's economic position , and

b) the taxpayer has a substantial purpose (apart from federal income tax effects) for entering into the transaction.

In the case of an individual, the above will only apply to transactions entered into in connection with a trade or business or an activity engaged in for the production of income. (IRC §7701(o)(5)(B)).

The IRS has issued Notice 2010-62 to provide guidance on the legislation.

PROVING DELIVERY OF IRS DOCUMENTS BY THE FILING DEADLINE

The flood of new IRS penalty provisions and the increased penalty amount of many existing provisions stimulates increased interest in what constitutes "timely filing" of a tax document.

General Summary

According to Code Section 7502(a) the "date of delivery" of a tax return to the IRS is the "date of the United States postmark" stamped on the envelope, provided it is postmarked by the due date". Otherwise, the "date of delivery", for purposes of computing penalties, is determined by the date of the actual delivery to the IRS.

Code Section 7502)(b) gives the US Treasury/IRS the authority to make regulations with respect to postmarks not made by the "United States Postal Service" (for example, foreign postmarks, postmarks of private US postage meters, electronic filing, private delivery services, etc. See also Reg. §1.7502-1.

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Returns Filed by Surface Mail

1) Postmarked by US Postal Service. - Of course any tax return filed with a postmark from the US Postal Service by the due date of the return will be considered timely-filed. In many cases it will be desirable to mail the return by certified or registered mail.

2) Postmarked by Private Postage Meter. - Reg. 301.7502-1(c)(1)(iii)(B) addresses postmarks other than the US Postal Service. It provides that if a private postage meter mark lists the due date (or earlier), the tax return will be accepted as timely filed if it is received by the IRS not later than the time when the tax return sent by the same class of mail, sent from the same location, would ordinarily be received by the IRS if it were postmarked by the US Postal Service on the due date. Of course in many cases it will be desirable to mail the return by certified or registered mail.

3) Private Delivery Service (PDS). - Code Section 7502(f) gives the Treasury/IRS authority to designate "Private Delivery Services" (PDSs) that will be treated equivalent to the US Postal Service with respect to filing dates. A private delivery services is defined as any delivery service provided by a trade or business that is "designated" as such by the Treasury/IRS. Code section 7502(f) states that any reference to a "US postmark" will be treated as including reference to any date on which packages are delivered to a private "Designated Delivery Service".

The IRS has designated the following delivery services as PDSs:

1) For Federal Express, - the Priority Overnight, Standard Overnight, Second Day Service, International Priority and International First,

2) For United Parcel Service, - Next Day Air, Next Day Air Saver, Second Day Air, 2nd Day Air A.M., Worldwide Express Plus and Worldwide Express, and

3) For DHL Express, - Same Day Service, Next Day, and 2nd Day Service.

In many cases it will be desirable to obtain evidence of delivery to the PDS by the due date.

Foreign Postmarks

Although Code Section 7502(a) states the "date of delivery" of a tax return to the IRS is the "date of the United States postmark" stamped on the envelope, (provided it is postmarked by the due date), as indicated above Section 7502)(b) gives the US Treasury/IRS the authority to make regulations with respect to postmarks not made by the "United States Postal Service".

No official regulations have been issued. However the IRS has issued a "Policy Statement" indicating that returns mailed by taxpayers from foreign countries will be accepted as "timely-filed" if they are officially postmarked in a foreign country on, or before, the return's due date. (Internal Revenue Manual 1.2.1.3.4). See also Revenue Ruling 2002-23 and CCA 200012085). Again it may be desirable to mail the return by certified or registered mail.

Electronically Filed Returns

Reg. 301.7502-1(d) provides that a document filed electronically with "an electronic return transmitter" can be deemed to be filed on the date of the "electronic postmark". Thus a return filed electronically directly with the IRS, or with a tax preparation service authorized by the IRS, will be considered timely filed if it contains a timely electronic postmark.

New IRS Regulations

New IRS Regulations issued in August 2011, provide that the only way to establish "prima facie" (the IRS expression) evidence of delivery is the proper use of registered or certified mail, or a designated private delivery service. (Reg. §301.7502-1(e)(2)).

Of course there is proof of actual delivery by the due date if, for example, the document is hand delivered to the IRS pursuant to IRS §6091(b)(4) or, when filing a document, you ask the IRS to confirm receipt, and you receive such receipt with an IRS stamp dated on or before the deadline.

RENUNCIATION OF US CITIZENSHIP

(And Abandonment of a Green Card)

The 2011 Offshore Voluntary Disclosure Initiative - "2011 OVDI" (please see the article ***"IMPORTANT PAPERWORK FOR US CITIZENS LIVING IN CANADA"***), presented a substantial dilemma for many US citizens (and green card holders) living in Canada who (among others) had not filed US income tax returns for several years. In some cases US

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citizens had never filed US income tax returns - having moved to Canada as infants or adolescents with their parents, many years ago. Their consternation is often increased when they become aware of the reporting requirements for Canadian banks and stockbrokerage firms which will be gradually implemented beginning in 2013. (Please see the article "***FATCA COMING IN 2013***").

Many such individuals wonder whether they should simply renounce US citizenship or, in the case of green card holders, formally abandon the green card. These thoughts stem not only from concern over past skeletons, but also the prospect of extensive US filing requirements and related costly US tax preparation fees, if they were to "get on board" in the future. However people wonder if renunciation of citizenship or abandonment of their green card will trigger an IRS investigation.

Common questions are:

1) "If I renounce US citizenship (or give up my green card) will the IRS ask me if I have complied with US filing requirements?", and

2) "If I renounce US citizenship (or give up my green card) will the IRS discover that I have not complied with US filing requirements and levy all the applicable penalties?" and

3) "Should I file a few future US tax returns to place myself in good standing before I renounce US citizenship (or give up my green card)?".

As mentioned in prior Taxletters, the renunciation of citizenship, or the abandonment of a green card by a "long-term resident" involves compliance with rules administered by both the US Bureau of Citizenship and Immigration (a division of the **US Department of State**) and the **Internal Revenue Service** (a division of the US Department of the Treasury).

If you telephone a US consulate to ask about the procedure to renounce US citizenship it appears in many cases they will mail you a package containing:

1) A cover sheet (Information Record Of American Citizen Services) containing the heading "COMPLETE ALL FORMS AND BRING THEM TO THIS OFFICE WITH YOUR MOST RECENT US PASSPORT, BIRTH CERTIFICATE ETC".

2) Form DS 4079 *("Request for Determination of Possible Loss of United States Citizenship")*,

3) Form DS-4080 *("Oath/Affirmation of Renunciation of Nationality of United States")*, and

4) Form DS-4081 *("Statement of Understanding Concerning the Consequences of and Ramifications of Relinquishment or Renunciation of US Citizenship")*.

Form DS- 4079 - Request for Determination of Possible Loss of United States Citizenship. The individual renouncing US citizenship must provide the information required on this five-page Form, and have it sworn, generally, in the presence of an officer of a US embassy or Consulate.

The Form asks (page 3, Question 13(e) on the current version) ***"Do you file US income or other tax returns? If yes, please explain".***

The Form also asks (page 4, Question 17), "***Describe in detail the circumstances under which you performed the act or acts in Questions 8-16***". (i.e. including question 13(e) above).

Form DS-4080 - Oath/Affirmation of Renunciation of Nationality of United States. The individual renouncing US citizenship must swear the oath, generally in the presence of an officer of a US embassy or Consulate. The Form does not require the individual to provide any information regarding compliance with respect to US tax matters, including tax reporting matters such as the FBAR.

Form DS-4081 - "Statement of Understanding Concerning the Consequences of and Ramifications of Relinquishment or Renunciation of US Citizenship. This form was mentioned in the Summer, 2011, issue of the Taxletter. It does not require the individual to provide any information regarding compliance with respect to US tax matters, including tax reporting matters such as the FBAR.

Your renunciation of citizenship is effective only upon approval by the US Department of State and the issuance of a "Certificate of Loss of Nationality ("CLN"). However when approved, the loss of citizenship occurs as of the date of swearing the above "Oath/Affirmation of Renunciation of Nationality of United States".

Income Tax Implications

IRS Form 8854 for Income Tax. Although you may not be faced with tax

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questions by the Department of State there are Department of Treasury (US income tax) implications to the renunciation of US citizenship. Anyone who renounces US citizenship must file IRS Form 8854. Please see the article "***US TAX AWKWARDNESS FOR CERTAIN FORMER GREEN CARD HOLDERS***".

Form 8854 specifically asks "*Do you certify under penalties of perjury that you have complied with all of your tax obligations for the 5 preceding years*"?

A penalty of $10,000 technically applies for failure to complete and file Form 8854 by the due date, if you expatriated after June 16, 2008.

US Expatriation Rules for Income Tax. Although some may consider the $10,000 penalty for late filing (or non-filing) of Form 8854 an acceptable "cost of doing business", the consequences of the renunciation of citizenship do not end there. The renunciation may subject you to the US "expatriation" tax rules" if you are a "covered expatriate". We summarized these rules in the Summer, 2008, Taxletter. Simplistically, with exceptions and an exemption, a "covered expatriate" is subject to a deemed disposition of his/her worldwide assets at fair market value, on the day before the expatriation if the expatriation was after June 16, 2008. A "covered expatriate" includes an individual who does not file IRS form 8854. (IRC §877A(g)(1)).

Thus, renouncing US citizenship without proper US tax compliance may leave an unsettling skeleton.

Abandoning a Green Card

A "long-term" resident who wishes to abandon his/her green card must complete US Department of State Form I-407. Please see the Summer, 2008, Taxletter for the definition of "long-term" resident. Form I-407 does not ask any questions with regard to income tax. However, as in the case of the renunciation of citizenship above, you are required to complete IRS Form 8854 by a deadline or a $10,000 penalty potentially applies. As indicated, Form 8854 asks whether you have complied with all your tax obligations for the preceding 5 years. In addition, as in the case of renunciation of US citizenship described above, if you are a long-term resident you may be subject to the US "expatriation" tax rules if you meet either the income tax test or the net worth test described in the Summer, 2008 Taxletter, **or if you do not file IRS Form 8854**! (IRC §§877A(g)(1) and 877(a)(2)(C)). Please see the article "***US TAX AWKWARDNESS FOR CERTAIN FORMER GREEN CARD HOLDERS***".

Can the IRS Pursue You in Canada for Tax and Penalties?

If you live in Canada and you renounce your US citizenship (or abandon your green card) without complying with US tax requirements, can the IRS "chase you down" in Canada.

Taxes

Under the Treaty. Readers are aware the tax treaty between Canada and the United States provides for the exchange of tax information between the two countries. However the treaty also requires one country to collect tax, interest and penalties for the other country in limited circumstances. Please see Article XXVI(A) "Assistance in Collection". Nonetheless, the IRS generally cannot request CRA to collect tax, interest, or penalties, from you relating to a taxable period in which you were a citizen of Canada. Those who were not citizens of Canada during the relevant tax period may not have this protection.

Civil Court. Apparently Canadian courts have decided the IRS cannot pursue US tax debts in Canadian civil courts regardless of the citizenship of the debtor.

FBAR Penalties

Under the Treaty. Since the FBAR penalty is not a "tax" it is apparently uncertain whether the provisions of the treaty would require CRA to collect FBAR penalties on behalf of the IRS. Of course, as above, individuals who were citizens of Canada at the time of the infraction would be protected.

Civil Court. Apparently it is highly unlikely the IRS could pursue penal debt in Canadian civil courts regardless of the citizenship of the debtor.

Also, please see the article "***MORE ON RENOUNCING US CITIZENSHIP***".

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US PERSONS! - GET READY FOR FORMS 8938 & 8621 FOR 2011

Form 8938

We previously mentioned new Internal Revenue Code Section 6038D which will require many US persons to attach new IRS Form 8938 ("Statement of Foreign Financial Assets") to their timely filed US income tax return for the 2011 tax year. A penalty of 10,000 will potentially apply for late filing.

Form 8938 (of which only a draft has so far been issued) will partially duplicate the information required on Form TD F 90-22.1 (the "FBAR"). However Form TD F 90-22.1 continues in effect. Thus, to a considerable degree there will be a duplication in filing requirements. Form TD F 90-22.l (the FBAR) must be filed separately with the US Treasury by June 30 each year or penalties could apply. Form 8938 will be required to be attached to your timely filed US income tax return.

For "Foreign Deposit or Custodial Accounts", (e.g. Canadian banks or brokerage firms) you must report on Form 8938 information similar to Form TD F 90-22.1, but you must also state the foreign currency in which the account is maintained, the exchange rate used to translate to US dollars, and the source you used to obtain the exchange rate used, if not from the US Treasury Management Service!

For "other" foreign assets you must list the asset (e.g. Canadian private corporations) except where the asset is otherwise reported, such as on Forms 3520, 5471, 8865, 8858, etc. However in such cases you must also list on Form 8938 the exact number of Forms 3520, 5471, etc. that you have filed.

Also you must provide a summary of the income you received from each type of asset, showing the exact line item on your tax return that you reported the income!

Obviously this will be a significant addition to the income tax return burden for many US citizens and green card holders for the 2011 tax year, unless its implementation is delayed.

Form 8621

New Code Subsection 1298(f), requires every US citizen and green card holder or other US resident who owns a PFIC (e.g. most Canadian mutual funds and certain non-CFC private Canadian corporations whose only assets and income are passive) to file IRS Form 8621 annually with their US income tax return, (beginning with their 2011 tax return).

However the legislation requires the reporting rules to be implemented only when regulations are promulgated by the Government. At the time we went to press such regulations had not been issued and may not be issued by the beginning of the filing season for 2011 tax returns. See IRS Notice 2011-55. The statute of limitations will not commence for a tax year until any required Form 8621 for that year has been filed. (IRC §6501(c)(8)). Please see the article "***YOUR TAX RETURN MAY REMAIN "OPEN" INDEFINITELY!***".

The IRS has indicated that when reporting guidance is issued it will contain provisions to avoid duplicate reporting on Forms 8621 and 8938.

US RESIDENCE OWNED BY A CANADIAN CORPORATION

Readers are aware that US estate tax may be avoided on your US residence if it is owned by a properly operated non-US corporation. However the Canada Revenue Agency (CRA) will generally assess a taxable shareholder benefit to the shareholder of a Canadian corporation who uses, for personal purposes, a residence owned by his/her Canadian corporation. Exceptions exist if:

1) The corporation is a grandfathered "single purpose" corporation - i.e. a corporation that existed and met Canada's rules to avoid such shareholder benefit inclusions, at the time such rules were terminated for subsequently formed structures, or

2) Fair market rent is paid to the corporation by the shareholder for use of the residence.

A Canadian federal court previously determined that where it is difficult to determine the fair market value of the rent for the residence then a method based on "return of capital", (calculated on the greater of cost or fair market value of the property), and the operational expenses incurred by the corporation, should normally be used to calculate the taxable benefit.

Since interest rates are now quite low, some have wondered if such a structure should again be considered to avoid US

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estate tax, and CRA was asked how the "return of capital" method should be applied in the current environment.

CRA replied that when the fair market value of rent cannot be determined (especially if this rent does not provide a reasonable rate of return to the corporation on the cost or value of the property), the shareholder benefit would be determined by multiplying the cost or value of the property by a "normal rate of return". CRA stated the "normal rate of return" would vary with the circumstances of each case but the following factors should be considered:

1) The rate of return the corporation could otherwise receive on the capital invested, and

2) The "market" rate of interest the shareholder would have paid to an arm's length lender to buy the property.

ARE YOU A US CITIZEN?

As previously mentioned, the 2011 Offshore Voluntary Disclosure Initiative - "2011 OVDI" (please see the article "***IMPORTANT PAPERWORK FOR US CITIZENS LIVING IN CANADA***"), presented a substantial dilemma for many US citizens (and green card holders) living in Canada who (among others) had not filed US income tax returns for several years.

Question - are you a US citizen? Many Canadian citizens are also US citizens and do not realize it.

Assuming you have not renounced US citizenship and received a Certificate of Loss of Nationality (CLN) you are a US citizen if:

1) You were born in the US,

2) You became naturalized as a US citizen, or

3) In certain cases you were born outside the US to a US citizen parent.

Born Outside the US to a US Citizen Parent

The rules to determine whether you are a US citizen based on birth outside the US to a US citizen parent are complex. The result may depend on the year you were born, whether one or both of your parents were US citizens, and whether you or your parent resided in the US. You may even be a US citizen if you had a grandparent who was a US citizen. Please consult an immigration lawyer to evaluate your specific circumstances.

CURRENCY TRANSACTIONS - EXCHANGE GAINS AND LOSSES

An occasional issue that arises when making tax computations involving different currencies is the question of how to determine gains or loss when a taxpayer has a debt transaction in a currency other than his/her "functional" currency - for example a US citizen living in Canada buys and sell bonds of a Canadian corporation.

The US tax rules for foreign (non-US) currency transactions can perhaps be divided into two broad categories:

1) Rules for taxpayers whose "functional currency" is the US dollar, and

2) Rules for taxpayers whose "functional currency" is not the US dollar,

A US citizen's functional currency is generally the **US** dollar, regardless of whether he/she lives in the US or Canada. (IRC §985(b)(1)(A)).

If the individual is engaged in a trade or business, an exception may apply for that business if the business is a "qualified business unit" ("QBU"). (IRC §§985(b)(1)(B) and 989(a) and Regs. 1.989(a)-1(b) and (c)). Activities engaged in as an employee do not by themselves constitute a trade or business. (Regs. §1.989-1(a), 1(b) and (c)). However activities conducted as a sole proprietor may be treated as a QBU.

It is possible that investing in securities could constitute a trade or business for an individual if related expenses are deductible under Code Section 212 (excluding Section 212(3)).

A QBU with its principal place of business in the US must use the US dollar as its functional currency. (Reg. §1.985-1(b)((1)(iii)). A QBU with a functional currency other than the US dollar may elect to use the US dollar as its functional currency. (IRC §985(b)(3)).

In the Fall, 2008, Taxletter we summarized some of the currency translation rules affecting certain entities.

This article only summarizes some rules addressing circumstances where a US citizen (or green card holder) resident in Canada buys and sells Canadian debt instruments and whose functional currency in connection therewith is the US dollar. For example this could apply to the purchase and sale of notes or bonds of Canadian corporations or

governments by the individual. These rules are found for the most part under Section 988 and the related regulations. This article describes hypothetical transactions of a US citizen resident in Canada whose functional currency for investment transactions is considered to be the US dollar.

Under Code Section 988(a) foreign currency gain or loss (on a Section 988 transaction) is ordinary gain or loss (not capital gain or loss). The foreign currency gain is any gain from the (988) transaction to the extent such gain does not exceed gain realized by reason of changes in exchange rates. (IRC §988(b)(1)). Foreign currency loss is any loss from the (988) transaction to the extent such loss does not exceed loss realized by reason of changes in exchange rates. (IRC §988(b)(2)).

Of course there may be a gain or loss on the purchase and sale apart from the change in exchange rates. For example an individual may purchase CAD 100,000 bonds of the Province of Quebec in the open market for 99,500 and ultimately sell them for CAD 101,000 because of their increase in value due to falling interest rates. Thus, for a US citizen resident in Canada, there may be two components to the "total" gain or loss for US income taxation - namely the "exchange" gain or loss and the "market" gain or loss. When the two are opposite they must be netted to determine the resulting currency gain or loss or market gain or loss. See Regs. §§1.988-2(b)(5) and 1.988-2(b)(8) and examples at §§1.988-2(b)(9).

Example 1: Sydney (a US citizen resident in Canada) purchases CAD 100,000 Province of Ontario bonds for CAD 102,000 at time when CAD 1 = USD 0.95. (USD 96,900). The funds for the purchase are transferred from his US dollar account. Some years later he sells the bonds for CAD 95,000 when CAD 1 = USD 0.98. (USD 93,100).

Expressed in US dollars, Sydney has an exchange gain of USD 3,060. (CAD 102,000 x (0.98-0.95). However Sydney's total loss on the transactions is USD 3,800. (93,100 - 96,900).

Therefore Sydney would net the two amounts and report on his US income tax return only a market loss of USD 740. (3,800-3,060).

Example 2: Sydney (a US citizen resident in Canada) purchases CAD 100,000 Province of Ontario bonds for CAD 95,000 at time when CAD 1 = USD 0.90. (USD 85,500). The funds for the purchase are transferred from his US dollar account. Some years later the bonds mature and Sydney receives CAD 100,000 when CAD 1 = USD 1.20. (USD 120,000).

Expressed in US dollars, Sydney has an exchange gain of USD 2,850. (CAD 95,000 x (1.20 - .90). The "total" gain was USD 34,500. (USD 120,000 - USD 85,500).

Therefore Sydney would report on his US income tax return an exchange gain of USD 2,850 and a market gain of USD 31,650 (34,500-2,850).

Example 3: Sydney (a US citizen resident in Canada) purchases CAD 100,000 Province of Ontario bonds for CAD 90,000 at time when CAD 1 = USD 1.00. (USD 90,000). The funds for the purchase are transferred from his US dollar account. Some years later the bonds mature and Sydney receives CAD 100,000 when CAD 1 = USD .95. (USD 95,000).

Expressed in US dollars, Sydney has an exchange loss of USD 4,500. (CAD 90,000 x (0.95 - 1.00). The "total" gain was USD 5,000. (USD 95,000 - USD 90,000).

Therefore Sydney would net the two amounts and report on his US income tax return a market gain of USD 500. (5,000-4,500).

Example 4: Sydney (a US citizen resident in Canada) purchases CAD 100,000 Province of Ontario bonds for CAD 102,000 at time when CAD 1 = USD 1.00 . (USD 102,000). The funds for the purchase are transferred from his US dollar account. Some years later he sells the bonds for CAD 95,000 when CAD 1 = USD .95. (USD 90,250).

Expressed in US dollars, Sydney has an exchange loss of USD 5,100. (CAD 102,000 x (1.00 - 0.95). The "total" loss was USD 11,750. (USD 102,000 - USD 90,250) .

Therefore Sydney would report on his US income tax return an exchange loss of USD 5,100 and a market loss of USD 6,650 (11,750-5,100).

Assuming Sydney is a cash basis tax payer, in all cases he would translate interest payments at the spot rate when received. He would not realize exchange gain or loss on the interest received. (Reg. §1.988-2(b)(2)(ii)(B)).

The rules here only describe rules applicable to the sale of certain debt instruments. These rules do not apply, for example, to the sale of stock or real estate.

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US TAX EFFECTS OF CANADIAN CORPORATE REORGANIZATIONS

Canada and the US each have their own rules describing the requirements to be met for a corporate reorganization to be considered a tax-deferred transaction. Of course the rules are different and therefore a reorganization that is tax-deferred or tax-free in one country may not be tax-deferred or tax-free in the other country.

This was particularly painful for many US citizens and US residents who held shares of BCE Inc when it distributed shares of Nortel Inc many years ago. The US citizens and US residents owning BCE generally had huge US tax liabilities (just before Nortel shares collapsed) while residents of Canada who were not US citizens or residents had no tax liability at all.

This also becomes relevant, for example, when a Canadian corporation with US real estate, undergoes a reorganization in Canada for Canadian tax reasons unrelated to the ownership of the US real estate. If the corporation's tax advisors are not careful, the Canadian reorganization can result in a deemed disposition of the US real estate at fair market value for US tax purposes.

However a few years ago the IRS issued Temporary Regulations describing the circumstances under which reorganizations of foreign corporations would qualify as tax-deferred reorganizations for US purposes. The IRS has now finalized those regulations with some modifications. (See Treasury Decision (TD) 9526).

SHOULD US PERSONS CONSIDER A RETROACTIVE US ELECTION FOR THEIR PRIVATE CANADIAN CORPORATION

Subscribers are aware of the difficulties to which US persons may be exposed if they own a private Canadian corporation which is not a "controlled foreign corporation" and which earns only investment income and therefore is classified as a passive foreign investment company (PFIC) for US purposes.

In the case of publicly traded PFICs such as some Canadian mutual funds, the owner can "mark to market" his/her shares annually for tax purposes, and thus avoid the worst of the US PFIC tax regime.

However US persons who are owners of private corporations that are PFICs rarely have the "mark to market" option because there is no "market" for the shares. But such persons have another potential option. They can elect for the corporation to be a "flow-through" entity (referred to as a "Qualified Electing Fund" - QEF).

The US owner of a QEF reports on his/her US income tax return the income or loss that occurs inside the QEF. This can avoid double tax to the US person - i.e. Canadian corporate tax on the income and US Section 951 income to the US shareholder on the corporation's income. The QEF election is often not practical for PFICs that are publicly traded (e.g. certain Canadian mutual funds) because the owner generally does not have sufficient information on the transactions inside the mutual fund. However such information would usually be available for a private PFIC.

The QEF election must be made by a deadline or unfortunate results can occur. However the IRS recently approved a retroactive election. (See PLR 201120009).

STATE REQUIREMENTS FOR CORPORATE INSTALLMENT TAX PAYMENTS

In the Fall, 2010, Taxletter, we set out the US federal tax rules for corporations to make installment tax payments during the tax year.

Of course each State with a corporate income tax has its own unique requirements. In Florida, for example, an "Estimated Tax Declaration", (Form F-1120-ES), and tax installment must be made if the Florida tax liability will exceed $2,500. The requirement applies regardless of whether the corporation is a domestic or foreign corporation, and it applies even if it is the first Florida tax filing for the corporation.

Under F.S. 220.34(2)(d), if a required declaration and appropriate tax installments are not made, the penalty for underpayment of estimated tax is based on a computation using an amount of tax equal to the lesser of:

1) The amount equal to 90% of the tax finally due for the taxable year, or

2) The amount of tax at current rates computed on the amount of income shown on a return for the prior year. This paragraph 2. only applies if a return was actually filed for

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the prior year and, generally, if it was for a 12 month period. (Florida Administrative Code 12C-1.034(9)(b)(1a.))

There is no automatic first year exemption from filing the declaration and making estimated tax payments. (Florida Administrative Code 12C-1.034(3)(e)). Therefore if Florida real estate is sold and no prior State tax return was filed it is important to be alert to determine whether a State tax installment payment should be made immediately.

Also, there is no provision for "annualizing" the income and computing the penalty accordingly. (Florida Administrative Code 12C-1.034(6)).

Unlike the federal rule where a foreign (e.g. Canadian) postmark will constitute the actual date of filing, for Florida purposes only a US post office mark may constitute the date of filing. (Florida Administrative Code 12C-1.0222(1)(a)).

Thus, if you have a corporation selling US real estate, (or otherwise having an individual US State tax filing requirement) you may wish to check the individual State's "estimated tax" payment rules at an early date.

As a separate matter, the due date for the Florida corporate income tax return (Form F-1120) is on or before the last day of the 3rd month after the end of the tax year. An extension is available provided a tentative amount of tax is paid that results in an ultimate underpayment of tax no greater than the greater of $2,000 or 30% of the tax ultimately shown on the return.

YOUR TAX RETURN MAY REMAIN "OPEN" INDEFINITELY!

Very generally, if you file a US income tax return the IRS has only 3 years from the date you file the return to object to it. (IRC §6501). If there is a 25% understatement the period is extended to 6 years, and in the case of fraud the IRS has an indefinite period to attack the return.

However in 2010 the Congress enacted legislation extending the time period if certain required forms are not included with the tax return (or separately filed, as the case may be). Thus the 3 year statute (or 6 years as the case may be) will not commence at all, until any of the following required IRS Forms are actually filed (IRC §6501(c)(8)):

Form 8621 (PFICS). IRC §1298(f).

Form 8621 (PFIC QEF Election). IRC §1295(B).

Form 5471 (Certain Ownership of Foreign Corporations). IRC §§6038 and 6046.

Form 8865 (Certain Ownership of Foreign Partnerships). IRC §§6038 and 6046A.

Form 5472 (Certain Domestic Corporations that are Foreign Owned). IRC §6038A.

Form 926 (Certain Transfers to Foreign Corporations or Partnerships). IRC §6038B.

Form 8938 (Statement of Foreign Financial Assets). IRC 6038D.

Form 3520 (Transfers to, Ownership of, and Distributions from, Foreign Trusts). IRC 6048.

(Note that Form 5472 for foreign corporations engaged in US business (IRC §6038C) is not included).

MORE ON RENOUNCING US CITIZENSHIP

As indicated in the article "***RENUNCIATION OF US CITIZENSHIP***" the unrelenting effort by the US Congress to monitor US citizens around the world has stimulated many such individuals living outside the US to consider renouncing their US citizenship. Many would be quite satisfied if, in fact, they had been considered by the US Government to have already renounced their US citizenship!

It is necessary to perform an "expatriating act" in order to renounce US citizenship. However prior to November 18, 1986, the US Immigration and Nationality Act in effect at the time did not expressly state the requirement that an expatriating act must be performed with the intention of relinquishing US citizenship. Hence US citizenship could be lost even if it was not the intent to lose citizenship. Thus many US citizens acquiring Canadian citizenship before that date could be considered to have performed an expatriating act and perhaps lost US citizenship.

A 1988 amendment to the Immigration and Nationality Act provided that individuals could lose their US citizenship if they voluntarily performed certain acts expatriating acts with the intention of relinquishing US citizenship.

Thus, originally, an individual could lose US citizenship unintentionally. The subsequent law required that it be his/her intent to lose citizenship. In any event then, and now, an individual does not officially lose US

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citizenship until a Certificate of Loss of Nationality (CLN) is obtained from the US Department of State.

The change in the immigration law caused many individuals who had lost US citizenship based on the pre-November, 1986, law to apply for re-instatement of citizenship. In many cases this was granted, which in turn required the IRS to issue guidance on the US tax treatment of such individuals.

As a result the IRS issued Revenue Ruling 92-109 outlining four fact scenarios and stating the tax result in each. Thus:

1) An individual who obtained a CLN prior to the 1986 change and had it retroactively restored prior to January 1, 1993, would not be subject to US income tax between the date they lost US citizenship and the end of the year preceding the year it was retroactively restored.

2) An individual who obtained a CLN prior to the change and has not yet applied to have citizenship retroactively restored, will be subject to US income tax as a US citizen from January 1, 1993, if he/she chooses to have citizenship restored.

3) If an individual performed an expatriating act (which did not have one of its purposes the avoidance of federal income, estate, or gift tax) but did not receive a CLN, the individual would not be eligible for the relief in 1) and 2) above.

However pursuant to IRS policy statement P-5-133, the IRS designated for special relief certain individuals who did not file federal tax returns as US citizens because they had a reasonable, good faith, belief that they had lost their US citizenship, (even though they did not intend to relinquish citizenship). For example would this apply to an individual who obtained Canadian citizenship and presumed he/she had lost US citizenship even though there was no intention to give up US citizenship?

Among the factors that are considered under P-5-133 to determine whether relief will be granted, the IRS will determine whether the individual acted in a manner consistent with a good faith belief that he/she had lost citizenship by, among other things, not affirmatively, exercising any rights of US citizenship during the period when they did not file federal tax returns as a United States citizen. P-5-133 contains other factors that will be considered. This is perhaps the origin of the famous 6 year filing rule.

4) If an individual never performed an expatriating act (and hence never received a CLN), the individual is not entitled to relief under Revenue-Ruling 92-109, but might be entitled to relief under P-5-133.

US TAX AWKWARDNESS FOR CERTAIN FORMER GREEN CARD HOLDERS

There appear to be many individuals who abandoned their green cards before June 17, 2008 but have not filed Form 8854 and have not filed US income tax returns since then. Individuals who abandoned their green cards after June 3, 2004, and before June 17, 2008, and have not filed Form 8854 are still US residents with respect to US income taxes. The questions on Form 8854 may require you to file 5 years of prior US income tax returns.

(Similarly individuals who renounced US citizenship and have not filed Form 8854 are still US citizens with respect to US income taxes).

If you abandoned your green card after June 3, 2004, and before June 17, 2008, and you have not filed Form 8854 the Form 8854 filing requirements may be confusing. It appears you must file IRS Form 8854 for the year you actually abandoned the green card and on that Form you must list your assets and liabilities as of the year end you expatriate for tax purposes. You must also file Form 8854 for the year you are abandoning the green card. Confusion is possible because the instructions to the Form use the words "date of expatriation" - in some cases this means the date you gave up the green card, (expatriation for immigration purposes), in others it means the date you are filing Form 8854 (expatriation for tax purposes).

Form 8854 asks you:

1) To list your US tax liability for the previous 5 years, and

2) To state (under penalty of perjury) that you have complied with all your US tax obligations for the previous 5 years.

Thus if you abandoned your green card after June 3, 2004, and before June 17, 2008, and stopped filing US income tax returns thereafter, you may have to file up to 5 years of tax returns before you can file Form 8854.

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CAN'T PAY ALL YOUR US TAX IMMEDIATELY?

If you cannot pay all your US tax that is due you can file IRS Form 9465 ("Installment Agreement Request") to request a monthly installment plan. Generally you can have up to 60 months to pay. In certain circumstances you can have longer to pay, and/or your agreement can be approved (rarely) for an amount that is less than the amount of tax you owe.

Your request for an installment agreement cannot be declined by the IRS if the tax you owe does not exceed $10,000 and all three of the following apply:

1) During the last 5 years, you (and your spouse if filing a joint return) have timely filed all US income tax returns and paid any income tax due, and have not entered into an installment agreement for payment of income tax,

2) The IRS determines that you cannot pay the tax owed in full when it is due, and you give the IRS any information needed to make that determination, and

3) You agree to pay the full amount you owe within 3 years and comply with the tax laws while the agreement is in effect.

As an alternative to Form 9465 you can request an online payment agreement at www.irs.gov. Use the pull down menu under "I need to…. ". and select "Set Up a Payment Plan".

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