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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OUR 25TH YEAR! 1984-2009

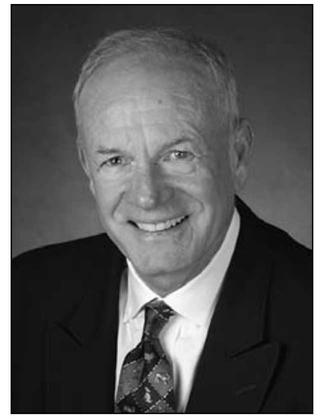
ADMINISTRATIVE/LEGISLATIVE/ JUDICIAL UPDATE

No Estate Tax on Certain US Annuities for Nonresident Aliens

The IRS has issued a Private Letter Ruling determining that a particular US annuity owned by a nonresident alien was not subject to US estate tax. The tax code (IRC 2105(b)(1)) states that amounts described in Section 871(i)(3) (i.e. "amounts held by an insurance company under an agreement to pay interest thereon") are not US situs property if any interest receivable by the decedent would be exempt from US income tax at the date of death. Under Section 871(i)(1) such interest from insurance companies is exempt from US income tax for nonresident aliens, provided it is not effectively connected with a US trade or business. The text of the Letter Ruling did not indicate whether the annuity was a "fixed" annuity (i.e. whether it paid only a fixed interest return) or whether there was an equity component. Thus the Ruling may not apply to variable annuities. (PLR 200842013).

"Automatic " Penalty for Failure to File IRS Form 5471

Readers are aware there is a potential $10,000 penalty if certain US citizens, US entities, green card holders (including those living in Canada), and other US residents, fail to timely file IRS Form 5471 to report their involvement with certain non-US private corporations. (A similar rule involving IRS Form 8865 applies in connection with an ownership interest in non-US partnerships).



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 38 YEARS.

The IRS announced that from January 1, 2009, the penalty will automatically be assessed when Form 5471 is attached to a late-filed US income tax return for a US corporation. The IRS will also automatically send a "Notice to Respond" allowing the taxpayer to ask the IRS to abate the penalty based on "reasonable cause".

IRS Reduces Tax Filing Extension Period for Two Tax Returns

The IRS has reduced from 6 months to 5 months the "automatic extension period" for filing IRS Forms 1065 (Partnership Tax Return), and 8804 (Annual Return of Partnership Withholding Tax). The "automatic extension" for these returns is obtained by filing a valid IRS Form 7004.

Electing Foreign Tax Credit Revokes Foreign Earned Income Exclusion

The "*foreign earned income exclusion*" that is used to reduce US taxable income continues in effect in future years until it is revoked by the taxpayer. If it is revoked it cannot be claimed again for 6 years unless IRS approval is formally obtained.

The IRS has advised that claiming the foreign tax credit in lieu of the foreign earned income exclusion constitutes a revocation of the exclusion. (CCA Letter Ruling 200848062)

"Nexus" Created By Independent Contractor

Dell Marketing L.P. has asked the US Supreme Court to decide whether New Mexico was correct in imposing its gross receipts tax, on an out-of state seller's sales into New Mexico, based solely on the activities of a third-party contractor that provided post-sale services to New Mexico buyers. (US Supreme Court, Dkt. 08-770, petition for certiorari filed December 15, 2008).

Certain US LLCs Owned by Canadians are Subject to FIRPTA Withholding

The IRS has clarified that a US entity that has elected to be a disregarded entity cannot avoid the 10% US “FIRPTA” withholding tax by certifying that it is a US entity/seller. (CCA 200836029).

Nexus for Income Tax

Massachusetts determined that the "physical presence" requirement for "sales tax" nexus (the Quill Corp case) does not apply for income tax and that instead the "substantial nexus" standard (the Complete Auto Transit case) applies for income tax. The court then ruled that substantial nexus can exist if a taxpayer domiciled in one State carries on business in another State through the licensing of intangible property. The taxpayer has asked the US Supreme Court to consider the case. (Geoffrey Inc. vs. Massachusetts Comm. of Revenue, US Supreme Court Dkt. 08-1207).

Reminder - Canadian Income Tax Act Section 119 Refund Deadline

Canadians moving to the US that pay Canadian departure tax may be eligible for a refund of a portion of the tax if the particular asset on which the tax was paid is later sold for an amount less than the value at the departure date. Special rules apply in the case of private Canadian corporations that paid dividends after the departure.

There is an important deadline for claiming the refund - generally six years from the original Canada Revenue Agency Notice of Assessment for the year of departure. Where relevant, some individuals may wish to consider accelerating the sale of departure assets to avoid forfeiting the refund.

CANADIAN BUSINESSES - US SALES TAX ON INTERNET SALES!

In our January 14, 2008, *International Tax Alert* (see our website) we described a recent New York State sales tax rule that can result in an out-of-state seller's sales into New York State being subject to New York sales tax as a result of commissions paid to persons in New York for referrals. The new rule imposes sales tax even if the out-of-state seller never enters New York! The New York State Supreme Court has upheld this law. (Amazon v. New York State Dept. of Taxation and Finance, January 12, 2009).

An exception may apply if the vendor can provide proof that the NY resident "commission agent" did not engage in any solicitation on behalf of the vendor that would satisfy the "nexus" requirement of the US Constitution.

Now, other States may follow New York's lead!

In Connecticut legislation has been introduced that could levy sales tax when an out-of-state seller makes sales through an independent contractor in Connecticut, provided the seller has an agreement with a Connecticut resident who directly or indirectly refers potential customers to the seller via a link on an internet website or otherwise.

The legislation essentially changes the definition of "retailer" to include businesses that make such sales, provided the cumulative gross receipts from referred sales by all such Connecticut residents, is in excess of $5,000 during the preceding four quarterly periods.

California has introduced similar legislation. Like Connecticut, it would change the definition of "retailer engaged in business" to include any seller (including out-of-state sellers) whose cumulative gross receipts from sales to customers in California who are referred pursuant to (referral agreements) with California residents, is in excess of $10,000 during the preceding four calendar quarterly periods.

Similar legislation has been introduced in Maryland, Minnesota, North Carolina, Tennessee, and Hawaii. (The Maryland legislation recently died in Committee).

Meanwhile, the Delaware Supreme Court has held that an out-of-state wholesaler's receipts derived from goods delivered into

Delaware can be subject to Delaware gross receipts tax. (Director of Revenue v. the Dial Corporation, Delaware Supreme Court, No. 109, 2008. December 8, 2008).

EFFECTIVE DATES FOR 5th TAX TREATY PROTOCOL

The 5th Protocol to the Canada-US tax treaty "entered into force" on December 15 2008. However the provisions of the treaty do not "take effect" on that date. Various provisions in the treaty have various "effective dates". (See Exhibit 1).

Generally the provisions of the treaty are effective January 1, 2009. However several important exceptions apply, as set out below.

Amounts Withheld at Source on Interest (Article XI)

The protocol eliminates income tax in the source country on certain interest payments. For interest payments made to unrelated parties there is no tax at source commencing February 1, 2008. (Of course Canada unilaterally eliminated withholding on some interest as of January 1, 2008). Exceptions to the February 1st date may apply to interest that is effectively connected with a business carried on through a permanent establishment in the source country, and to certain "contingent interest".

In the case of interest payments to related parties, to the extent the payment would otherwise be subject to 10% under the treaty as it existed before the 5th Protocol, the tax rate will gradually be phased out to zero by calendar year 2010. For calendar year 2008 the rate was 7% and for calendar year 2009 it is 4%.

Residence (Treaty Article IV)

Continued Corporations. The change to the treaty in connection with the residence of "continued corporations" (i.e. corporations organized in one country that are reincorporated in the other country) is effective retroactively to continuations after September 17, 2000.

EXHIBIT 1

Effective Dates For Certain Treaty Changes (1)

	Effective Date
Interest Withholding At Source: – Zero Rate For Arm's Length	February 1, 2008
Interest Withholding At Source: – 7% For Non-Arm's Length – 4% For Non-Arm's Length – 0% For Non-Arm's Length	 January 1, 2008 January 1, 2009 January 1, 2010
Fiscally Transparent Entities Eligible For Benefits – Paragraph 6 (2)	January 1, 2009
Fiscally Transparent Entities Not Eligible For Benefits – Paragraph 7 (2)	January 1, 2010
Creating A Permanent Establishment Through Services	January 1, 2010
Election To Increase Cost Base On Emigration From Canada	September 18, 2000

(1) The 5th Protocol To The Treaty "Entered Into Force" December 15, 2008. Most Provisions Took Effect As Of January 1, 2009. However Some Provisions Have Other "Effective" Dates, As Set Out Here.

(2) See The Article ***"FISCALLY TRANSPARENT ENTITIES AND THE TREATY"*** On Page 4.

Fiscally Transparent Entities. The treaty adds paragraphs 6 and 7 to Article IV, addressing the residence of fiscally transparent entities. The provisions of paragraph 6 became effective January 1, 2009. The provisions of paragraph 7 will become effective January 1, 2010. Please see the article below entitled ***"FISCALLY TRANSPARENT ENTITIES AND THE TREATY".***

Creating a Permanent Establishment Through Services (Article V)

The Protocol added a new paragraph 9 to Article V (Definition of "Permanent Establishment"). In the case where a business does not otherwise have a permanent establishment ("PE") in one of the countries it will nonetheless be deemed to have a PE in a country if:

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

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

This provision will go into effect as of January 1, 2010.

Election to Increase US Cost Base on Emigration from Canada (Article XIII)

Article XIII of the treaty now permits nonresident aliens (as well as US citizens and US residents) to elect to have a deemed disposition of certain worldwide assets for US purposes when those assets are subject to a deemed disposition in Canada because the individual is departing from Canada. This election has always been available to US citizens but not to nonresident aliens. Now, nonresident aliens who emigrate from Canada to the US will, in effect, be able to "step up" their cost base for US purposes on these assets at the time they become US residents, thus escaping any ultimate US tax on gain that accrued prior to becoming a US resident.

This provision is retroactive to Canadian deemed dispositions that occurred after September 17, 2000. Thus it appears some individuals who moved to the US since that date and sold assets that had appreciated at the time of the move, may be able to amend prior US income tax returns and obtain US tax refunds.

FISCALLY TRANSPARENT ENTITIES AND THE TREATY

The 5th Protocol to the tax treaty adds new paragraphs 6 and 7 to Article IV (Residence) to assist taxpayers in evaluating the cross border tax status of certain "hybrids" (entities that are fiscally transparent in one of the countries and not fiscally transparent in the other country). See Exhibit 2.

Dividends paid from one country to the other are a primary type of income affected by the rules. Absent the new treaty rules, the Canadian withholding rate on dividends paid from Canada to a US recipient might be Canada's standard 25% rate if the US recipient is a fiscally transparent entity because the income might not be considered derived by a US resident.

The Protocol apparently provides that the determination of whether income derived through an entity is treated as derived by a treaty resident is made under the entity classification rules of the country of residence rather than the country of source

Simplistically, new paragraph 6 provides that Canada will give treaty benefits to payments to a US fiscally transparent entity such as a United States LLC, that is owned by US residents. Similarly the US will give treaty benefits to payments to a Canadian partnership that is considered a corporation for US purposes (for example a Canadian partnership that has made a "check the box election" in the US to be treated as a corporation in the US) if it is owned by Canadian residents. These changes are effective January 1, 2009.

Paragraph 7 of Article IV describes two separate sets of circumstances where treaty benefits will not apply to fiscally transparent entities.

Paragraph 7(a) provides that an item of income is considered not derived by a resident of a "Contracting State" (and therefore not eligible for treaty benefits) where the resident is considered under the laws of the source country to have derived the income through an entity that is not a resident of the resident's country of residence, and, by reason of the entity not being treated as fiscally transparent under the laws of the resident's country of residence, the treatment of the income under the laws of that country is not the same as its treatment would be if the income had been received directly by the resident. For example Canada would not give treaty benefits to a US owner of a Canadian Limited Partnership that has made a US "check the box" election to be taxed as a corporation in the US.

Paragraph 7(b) provides that an item of income is considered not derived by a resident of a "Contracting State" (and therefore not eligible for treaty benefits) where the resident is considered under the laws of the source country to have received the income from an entity that is a resident of the source country, and, by reason of the entity being treated as fiscally transparent under the laws

EXHIBIT 2

Examples Of Fiscally Transparent Entities And The Treaty (2) (3)

	Treaty Result
Article IV, Paragraph 6	
Dividends/Interest Received By –	
US Limited Liability Company (LLC) Owned By A US Resident (1)	Canada Will Give Treaty Benefits
Canadian Partnership Owned By Canadian Residents That Makes A US “Check The Box” Election	US Will Give Treaty Benefits
US Partnership With A US Corporate Partner Owning Proportionately 10% Or More Of A Canadian Corporation	Canada Will Give Treaty Benefits
Article IV, Paragraph 7(a)	
Dividends/Interest Received By –	
Canadian Limited Partnership Owed By US Residents That Make A US “Check The Box” Election	Canada Will Not Give Treaty Benefits
US LLC Owned By A Canadian Resident (1)	US Will Not Give Treaty Benefits
US Branch Profits Tax –	
US LLC That Has Not Made A US “Check The Box” Election That Is Owned By A Canadian Corporation	US Will Not Give Treaty Benefits For The Branch Profits Tax
Article IV, Paragraph 7(b)	
Income Paid By –	
Canadian Unlimited Liability Company (ULC) That Has Not Made A US “Check The Box” Election Owned By A US Resident	Canada Will Not Give Treaty Benefits For Dividends Paid, But Perhaps For Interest Or Royalities (3)

(1) That Has Not Made The US “Check The Box” Election.
(2) Separate Rules Apply For Treaty Article VII (Business Profits).
(3) The Rules Are Complex. Please Consult Your Tax Advisor Before Taking Any Action.

of the resident's county of residence, the treatment of the amount under the laws of the resident's country of residence is not the same as its treatment would be if that entity were not fiscally transparent under the laws of that country. For example this would affect dividends paid by a Canadian Unlimited Liability Company owned by a US resident that has not made a "check the box" election in the US to be taxed as a corporation in the US.

Also, of major importance, apparently the rules of paragraph 7(b) result in the fact that Canadian corporations operating in the US through US LLCs (that have not made a check the box election to be taxed as a corporation) may not obtain treaty benefits with regard to the branch profits tax.

Paragraph 7 becomes effective January 1, 2010.

The technical explanation to the treaty also states "New paragraphs 6 and 7 are not an exception to the saving clause"..... of the treaty. "Accordingly, subparagraph 7(b) does not prevent a Contracting State from taxing an entity that is treated as a resident of that State under its tax law".

MORE ON "FBAR" (IRS FORM TD F 90-22.1) REPORT OF FOREIGN ACCOUNTS

In the Winter/Spring, 2008, issue of the Taxletter we reviewed the requirement for filing IRS Form TD F 90-22.1 ("Report of Foreign Bank and Financial Accounts").

At the time we alluded to uncertainties about the extent to which Canadians resident in Canada are subject to the filing requirement. Understanding the breadth of the law is important since the potential penalty for noncompliance is $10,000 or more.

In late 2008 the IRS issued a new version of Form TD F 90-22.1 and Instructions in which it "clarified" that the filing is required (among other circumstances) by any "*person in, and doing business in, the United States*".

A "*person*" is defined to be "*an individual, corporation, partnership, trust or estate, joint stock company, association, syndicate, joint venture, or other unincorporated organization or group, an Indian tribe, and all entities cognizable as legal personalities*". (31 CFR 103.11(z)). Thus any Canadian individual, corporation, partnership, trust, etc that is "*in, and doing business in, the United States*" must file IRS Form TD F 90-22.1 provided the person otherwise meets the requirements (i.e. some involvement with foreign (non-US) financial accounts that in the aggregate exceeded $10,000 during the year. Accordingly, self-employed Canadian nonresident aliens of the US in, and doing business in, the US, are subject to the reporting requirement and the potential penalty. This would apply even though the individual might be exempt from US federal income tax under Article VII of the tax treaty. (Former Article XIV of the treaty addressing "self-employed individuals" has been deleted).

Question whether other Canadian nonresident aliens who own interests in Canadian or US partnerships that "do business in the US" are required to file? Such investors are, themselves, deemed to be doing business in the US under US federal tax law because of their interest in the partnership. They are even deemed to have a US "permanent establishment" to the extent the partnership has a US permanent establishment. Such individuals may not be subject to the rule if they are not "in" the US. Although the legislation (31 USC 5314) and the instructions to Form TD F 90-22.1 state the person must be "in" the US, the regulations state (more broadly) that the requirement applies to any person "*subject to the jurisdiction of the United States*" (31 CFR 103.24). A Canadian partner in a partnership doing business in the US is generally required to file a US income tax return, and therefore is subject to the "tax jurisdiction" of the United States.

"Financial Interest" without "Signing Authority"

Not to be overlooked is the filing requirement where such a "*person in, and doing business in, the US*" has a "financial interest" in a non-US account, but does not have signing authority. This would occur, for example, if the individual owns directly or indirectly more than 50% of the total value of the shares of stock or more than 50% of the voting power of all shares of the stock of a Canadian corporation that has such non-US accounts. A similar rule applies to ownership interests in Canadian partnerships and Canadian trusts.

"Signing Authority" without a "Financial Interest"

Also, such a person who has signing authority over a non-US account (for example a Canadian corporate account), has a potential obligation to file IRS TD F 90-22.1 if such person "*can control the disposition of money or other property in it by delivery of a document containing his or her signature (or his or her signature and that of one or more other persons)*" (See the instructions to form TD F 90-22.1 for additional circumstances). This rule applies even if the person does not have any direct or indirect ownership interest in the account.

Of course the filing obligation for IRS Form TD F 90-22.1 described above also applies to every US citizen, green card holder (including those living in Canada), and other US residents, (and even Canadian snowbirds who meet the US "substantial presence test" but fail to file IRS form 8840), provided the individual's accounts exceed the $10,000 filing threshold.

Meanwhile the IRS has offered a temporary amnesty program for a limited time whereby delinquent filers may avoid criminal penalties and the FBAR penalty (but not taxes and other penalties)

FOOD FOR THOUGHT WHEN USING DISCRETIONARY TRUSTS FOR US ESTATE TAX AVOIDANCE

Some Canadian tax advisers recommend using a Canadian irrevocable "discretionary trust" to purchase a US residence by a Canadian nonresident alien of the United States. The "irrevocable" trust would own the residence and it would be used by the individual who funded the trust and his/her family. The potential advantages include the low long term US capital gains tax rate on the sale of the property, as well as avoidance of estate tax. We previously mentioned some worrisome issues with the procedure, including the potential for US gift tax and the "irrevocable" status of the trust.

Another problematic issue with the procedure arises through the interrelationship of the US rules for attributing ownership of stock (not real estate) owned by a trust which are set out in IRC 318(a)(2)(B), and the regulations that describe how to compute a beneficiary's actuarial interest in a trust for purposes of 318(a)(2)(B).

According to Reg. 20.2031-7, for estate tax purposes, in the case of stock of a corporation, a beneficiary of a trust is considered to own a portion of the stock owned by a trust, according to the beneficiary's "actuarial interest in the trust". When the trust is a "discretionary trust" and the beneficiary is only a "discretionary beneficiary" the IRS has ruled that the interest owned by a discretionary beneficiary would be determined "*with reference to all the facts and circumstances, including patterns of past distributions, appropriate mortality assumptions, the trustees fiduciary duties, and the relationships among the trustees and beneficiaries*".

The above rules specifically apply to stock owned by a trust. In cases where the sole asset and activity of the trust consists of the ownership of residential real estate in the US that is used solely by the individual who funded the trust (and his family), is it possible the IRS would attribute ownership of the US residence directly to the individual who funded the trust and occupied the real state, in the event of his/her death? (See PLR 9024076 and the article "***US ESTATE TAX UNCERTAINTIES FOR NONRESIDENT ALIENS***").

IS NOW THE TIME TO "FIX", OR "ESCAPE", FROM NON-US MUTUAL FUNDS?

Readers are aware of the very negative tax rules affecting US citizens, green card holders (including those who live in Canada) and other US residents, who own Canadian and other non-US mutual funds that are organized as corporations, or treated as corporations. As we mentioned previously, many mutual funds that are organized as trusts may be treated, nonetheless, as corporations for US purposes.

Gain on the sale of such mutual funds may be treated as ordinary income (not capital gain) and taxed at the maximum US individual income tax rate at a specified time, and subject to an interest charge depending on the period of time the mutual fund was owned. A similar rule may apply to "an excess distribution" from a non-US mutual fund. IRS Form 8621 must be filed if you sell or receive a distribution (dividend) from such a mutual fund.

At the moment there is apparently no penalty for failure to file Form 8621. But given the other recent expansion of compliance rules and increases in penalties, this (oversight?) may not last for long. If, and when, a penalty for failure to file Form 8621 is initiated it will tend to highlight many people who presently own non-US mutual funds. (Please see the article "***NEW LEGISLATION INTRODUCED ATTACKING TAX HAVENS AND SWITZERLAND***").

However various elections are available that can provide for better tax treatment for future capital gains and/or distributions (dividends). With stock markets currently depressed, now may be the time for action.

NEW LEGISLATION INTRODUCED ATTACKING TAX HAVENS AND SWITZERLAND

New proposed identical legislation has been introduced simultaneously in the US House of Representatives and the US Senate which would likely have a dramatic effect on so-called "offshore secrecy jurisdictions", (34 or more countries, including Switzerland). (H.R. 1265 and S. 506). Some elements of the proposed legislation are set out below.

Presumptions Pertaining to "Offshore Secrecy Jurisdictions"

1) The law would create a rebuttal presumption that a US person who formed, transferred assets to, was a beneficiary of, had a beneficial interest in, or received money or property or the use thereof from an entity in an "offshore secrecy jurisdiction", exercised control over the entity.

2) There would be a second rebuttal presumption that anything received from such an entity would constitute income in the year of receipt,

3) A third rebuttal presumption would provide that anything transferred to such an entity would be treated as "previously unreported income".

Publicly traded entities would be exempt from the provisions.

Presumption Related to Foreign Financial Accounts

US law 31 USC 5314 (regarding "FBAR" - Form TD F 90-22.1 - Reporting Foreign Accounts) would be amended to provide a rebuttal presumption that any account in an "offshore secrecy jurisdiction" would be large enough to require the filing of Form TD F 90-22.1. Please see the article "***MORE ON "FBAR" (IRS FORM TD F 90-22.1) REPORT OF FOREIGN ACCOUNTS***".

Enforcement of FBAR (Form TD F 90-22.1)

The requirement for FBAR is presently derived under US federal law that is not part of the Internal Revenue Code. The proposed legislation would clarify that the requirement is to be considered an internal revenue law.

New Reporting Required By Withholding Agents & Financial Institutions

1) If a "withholding agent" (e.g. a bank or stockbroker) has withheld tax from US source income payable to a "foreign entity" and it determines that a US person has any beneficial interest in the foreign entity, or in the account, the proposed legislation requires the withholding agent to report the details to the IRS.

2) Any financial institution opening an account, or forming an entity, in an "offshore secrecy jurisdiction" on behalf of a US person would be required to report the details to the IRS.

Passive Foreign Investment Companies (PFICs)

Any US person investing in a PFIC or who receives income from a PFIC would be required to report it to the IRS. Note that it is possible many (perhaps all) Canadian mutual funds are PFICS. (Please see the article "***IS NOW THE TIME TO "FIX", OR "ESCAPE", FROM NON-US MUTUAL FUNDS?***".

Foreign Trusts

1) A grantor of a trust would be treated as holding any powers held by a trust "protector" or "enforcer".

2) Any US person receiving cash or property from a foreign trust would be treated as a beneficiary (unless fair market value is paid).

Limitation on Legal Opinion Protection

An opinion of a tax advisor could not be relied on to establish "reasonable cause" to avoid penalties if an underpayment of tax is attributable to an entity or transaction in an "offshore secrecy jurisdiction".

Prohibited Fee Arrangement

Any person who provides services in connection with the revenue laws would be subject to a penalty if the fee is calculated according to, or dependent upon the amount of tax savings or benefits, or losses which can be used to offset other income.

US ESTATE TAX UNCERTAINTIES FOR NONRESIDENT ALIENS

The present (2009) US estate tax rules, and their application under the Canada-US tax treaty to nonresident aliens living in Canada, result in little or no exposure to US estate tax if the worldwide assets of the decedent do not exceed approximately US $3.5 million at the date of death (approximately $7 million on the first death in some cases when the US situs property passes to a Canadian surviving spouse, and an unlimited amount if the property passes to a US citizen surviving spouse).

However for individuals exceeding these thresholds, US estate tax planning can be complex. This is made more problematic due to the uncertainty of the "estate tax status", of certain assets. Generally, US "situs" assets are subject to US estate tax. But what is the status (situs) of the following assets for US estate tax purposes - i.e. are they taxable?

1) Partnership interests,
2) Beneficial interests in trusts and estates,
3) Stock options and retirement plans, and
4) Commercial annuities issued by US insurance companies.

Partnership Interests

It would be beneficial for example, if an interest in a Canadian partnership were not considered to be a US situs asset. This would enable Canadian nonresident aliens of the United States to purchase their US real estate through a Canadian partnership and secure two US tax benefits, namely: exemption from US estate tax, and the benefit of the low long term capital gains tax rate applicable to individuals.

Unfortunately the Internal Revenue Code is silent as to the situs of partnership interests. Also, the regulations do not specifically address their situs. However, the IRS takes the position that the situs of a partnership interest may be the place where the partnership does business. (See Revenue Ruling 55-701). But many tax commentators believe the question of "situs" of a partnership interest is very much undecided.

There are likely four possible possibilities for the situs of a partnership interest:

1) The situs is based on the location of the partnership's business,
2) It is based on the domicile of the holder of the partnership interest,
3) It is based on the location of the partnership assets, or
4) It depends, like corporate stock, on whether the partnership is a domestic or foreign partnership.

One factor is whether the partnership interest is "intangible personal property" or whether it is a "chose in action" which is more like a debt.

Although many commentators agree with the IRS position that such interests have a situs at the place of establishment and/or place of doing business, other commentators prefer the position taken by the US Supreme Court in Blodgett v. Silberman (277 US 1 (1928). In this case the court decided that the partnership interest was "intangible personalty" under the rule of "mobilia sequunter personam", the latter being a common law rule of convenience meaning that the situs of personal property is the domicile of the owner, unless there is a statute to the contrary. Perhaps some Canadians, with genuine operating partnerships in Canada, would obtain the estate tax exemption regardless of which of these latter two theories prevailed, and thus could purchase US real estate through such an entity. Please consult your Canadian and US tax advisors before taking any action.

Beneficial Interests in Trusts and Estates

Of course the US situs assets held in a "grantor trust" are subject to US estate tax on the death of the owner. But, like the case of partnership interests, there is generally no legislation or regulations addressing the US estate tax status of beneficial interests in non-grantor trusts, or estates. However there are case law and IRS positions.

Generally under the IRS approach, any trust is treated as a "look through" for purposes of "situs" analysis. Thus, any Canadian beneficiary of any trust owning US situs assets may be subject to estate tax on his/her proportionate ownership of the underlying

US situs assets. Of course this may have implications, for example, for Canadians owning Canadian mutual funds organized as trusts that own US securities if, in fact, the US treats the "trust" as a trust for US tax purposes.

Not addressed in the cases or IRS positions is the situation where an individual is an income beneficiary, but the trust imposes strict spendthrift provisions. Similarly not addressed is the situation where an individual is only a potential beneficiary among a list of potential beneficiaries in a discretionary trust. (However see PLR 9024076 that provides, in completely different circumstances, for attribution from a discretionary trust "with reference to all the facts and circumstances"). Also, an individual holding a reversionary interest in an irrevocable trust is deemed to own the trust assets directly. (Revenue Ruling 82-193).

The analysis of situs for a decedent's interest in an estate is apparently more uncertain. However it is possible a specific legacy or devise would have situs where the property situs would be if the decedent had owned the property directly.

Stock Options and Retirement Plans

Again there is no clear guidance in either the tax code or regulations. With regard to stock options, however, it is possible their situs would be resolved with respect to the source rules for intangibles, and thus whether the option is issued by a domestic or foreign corporation. It appears retirement benefits from a pension trust would likely be given situs under the "debt obligation rules" so that the situs would be where the pension trustee resides.

Commercial Annuities Issued by US Insurers

The situs of the full range of commercial annuity contracts is also uncertain. Under Internal Revenue Code Section 2105(a) "*the amount receivable as insurance on the life of a nonresident not a citizen of the United States shall not be deemed property within the United States*". However since the code provision does not use the word "life insurance contract" or refer to Code Section 7702 (the definition of life insurance) the scope of section 2105(a) is unclear.

But there appears to be recent good news for "fixed income" annuities at least - see "***No Estate Tax on Certain Annuities for Nonresident Aliens***", set out above under "***ADMINISTRATIVE/LEGISLATIVE/JUDICIAL UPDATE***".

TAX RETURN "ACCURACY" PENALTIES AND HOW TO AVOID THEM

The Internal Revenue Code provides tax return "accuracy-related" penalties for tax returns if there has been:

1) Negligence or disregard of rules or regulations in the preparation of the tax return, or

2) A substantial understatement of income tax on the tax return, or

3) Certain substantial valuation misstatements on the tax return, or

4) Any substantial overstatement of pension liabilities.

(See IRC 6662).

The penalty is 20% of the tax underpayment (40% of any portion of tax underpayment attributable to valuation misstatements that exceed a certain amount). Of course interest charges could also apply.

However you can generally avoid the understatement penalty if the position:

1) Has at least a reasonable basis, and

2) Is adequately disclosed on the tax return.

The "reasonable basis" standard is not satisfied by a return position that is merely "arguable".

There are two different forms to be used for the disclosure, depending on whether or not the position is contrary to Treasury regulations - i.e. IRS Forms 8275-R and 8275.

IRS Form 8275-R

IRS Form 8275-R is used to "adequately disclose" positions taken on the tax return that are contrary to Treasury regulations. If you properly complete and attach this Form to the tax return you can generally avoid the accuracy-related penalty due to disregard of regulations or substantial understatement of income tax, if the return position has a reasonable basis, and you acted in good faith in taking that position. It does not apply to "tax shelter" items. Also it does not apply if you failed to keep proper books and records or failed to substantiate items properly.

IRS Form 8275

IRS form 8275 is used to "adequately disclose" items or positions that are not otherwise adequately disclosed on the tax return (other than positions contrary to Treasury regulations) to avoid penalties. It is also used to avoid the "accuracy-related" penalty due to disregard of rules, or to a substantial underpayment of income tax for non-tax shelter items, if the return position has a reasonable basis.

The penalty will not be imposed if there was "reasonable cause" for the position and you acted in good faith in taking that position. However you cannot avoid the penalty by the disclosure if you failed to keep proper books and records, or failed to substantiate items properly.

Beware Separate (Additional) Tax Preparer Penalty

If a tax return preparer prepares a tax return and there is an understatement of liability due to an "unreasonable position", the preparer is subject to a penalty of the greater of $1,000 or 50% of the income from preparation of the return. (IRC 6694).

A position is an "unreasonable position" unless there is, or was, "substantial authority" for the position. The penalty might be avoided if Form 8275 or 8275-R as described above is filed and there is a "reasonable basis" for the position. No penalty is imposed if there is reasonable cause for the understatement and the tax return preparer acted in good faith. A separate rule applies to tax shelters and "reportable transactions".

PENSIONS AND THE TAX TREATY

The 5th Protocol to the Canada-US tax treaty made broad changes to the cross-border tax rules affecting pension contributions and pension payments. The changes noted below are effective from January 1, 2009. (Please see Exhibit 3). To implement the changes a new definition "Qualifying Retirement Plan" is created.

Qualifying Retirement Plan (QRP)

According to Article XVIII(15) a "qualifying retirement plan" in a country is a trust, company, organization, or other arrangement that (a) is a resident of that country, generally exempt from income taxation in that country, and operated primarily to provide pension and retirement benefits; (b) is *not* an individual arrangement in respect of which are the individual's employer has no involvement; and (c) the Competent Authority of the other country agrees generally corresponds to a pension or retirement plan established in and recognized for tax purposes in that other country.

Generally, United States IRAs, Canadian RRSPs, and Canadian Retirement Compensation Arrangement (RCA)s are *not* QRPs. However certain plans, including certain RRSPs and certain IRAs that are established pursuant to legislation introduced after September 21, 2007 may qualify as QRPs.

US Roth IRA

A "Roth IRA" is a US "pension plan" under which qualified individuals can make a non-deductible contribution, and if all requirements are met the ultimate withdrawal is tax-free in the US.

Residents of Canada can make an election on a Canadian income tax return (under Article XVIII(7)) to defer current taxation in Canada on income earned inside a Roth IRA. Also, because of Article XVIII(1) the withdrawal of funds from a Roth IRA will generally be tax free in Canada. Therefore potentially no portion of a Roth IRA will be subject to tax in Canada.

However an exception may apply if a resident of Canada makes a contribution to a Roth IRA while a resident of Canada, other than certain rollover contributions. In this case the Roth IRA will cease to be considered a pension with respect to contributions and accretions from such time, and increases from such time will be subject to tax in Canada in the year withdrawal. (Article XVIII(3)).

(Note that, for the moment, payments from regular US IRAs are subject to Canadian tax when received by a Canadian resident, subject to Article XVIII(1)).

Workers on Short-Term Assignments in the Other Country

If certain requirements are met, contributions made to a QRP in an individual's home (resident) country will be deductible or excludable when computing the individual's income in the country in which he/she is temporarily working (the "host country"). A number of requirements must be met for this rule to apply. Among other requirements:

1) The remuneration must be taxable in the host country.

2) The individual must have been in the plan (or it's predecessor) immediately before performing services in the host country,

3) The individual must not have been a resident of the host country immediately before he began performing services in the host country,

4) There are time limits, and

5) The benefits (contribution amounts) are limited, (Article XVIII(8) and (9).

Cross-Border Commuters

An individual who is a resident of one country (the "residence country") may be able to deduct in that country, contributions to a QRP in the other country (the country in which he/she is working - i.e. the "services country").

Many requirements must be met. Among others:

1) The remuneration must be taxable in the "services" country,

2) The remuneration must be borne by an employer who is a resident of the "services" country or by a permanent establishment the employer has in the services country, and

3) There are limits to the contribution amounts based on the separate limits in each country (Article XVIII(10, (11),and (12)).

US Citizens Resident in Canada

If the requirements are met, contributions made to a QRP in Canada will be deductible or excluded in computing the individual's taxable income in the United States.

Among other requirements:

1) The US citizen must perform services as an employee in Canada, the remuneration from which is taxable in Canada and is borne by an employer that is a resident of Canada or by a permanent establishment the employer has in Canada, and

2) Limits on the amount of contributions apply. (Article XVIII(13) and (14)).

Source Rule

Paragraph 16 of Article XVIII provides that, for the purposes of Article XVIII, the distribution from a pension or retirement plan that is reasonably attributable to a contribution or benefit for which a benefit was allowed under any of the three special rules above, will be deemed to arise in the country in which the plan is established. Thus, the country in which the plan is established will generally have the right to tax the gross amount of the distribution, even if a portion of the

EXHIBIT 3

Rules For Cross-Border Contributions To Qualifying Retirement Plans (QRPs) (1) (2)

(A)	(B)	(C)
Canadians With A Short Term Assignment In The US	*Canadians Commuting To A Job In The US*	*US Citizens Resident In Canada*
Contributions To A Canadian QRP Are Deductible In The US (And In Canada) (1)	Contributions To A US QRP Are Deductible In Canada (And In The US) (1)	Contributions To A Canadian QRP Are Deductible In The US (And In Canada). (1) (Apparently This Benefit Does Not Apply To Green Card Holders Living In Canada.)
Article XVIII(8) And (9)	Article XVIII (10-12)	Article XVIII (13) And (14)

(1) A Complex Set Of Requirements Must Be Met To Qualify For The Deductions.

(2) Of Course The Rules In Columns (A) And (B) Above Apply Reciprocally, - i.e. To US Citizens Or Residents Working Temporarily In Canada Or Commuting To Work In Canada.

services to which the distribution relates were not performed in that country.

Partnerships

Article XVIII(17) provides that an individual who is a member of a partnership can be treated the same as the relationship between an employer and employee.

ELECTRONIC COMMERCE GENERALLY

Electronic commerce can perhaps be separated into three broad areas:

1) Business-to-business communications other than sales transactions,

2) Electronic ordering of tangible products sold over the Internet which are delivered in the conventional way (common carrier, surface mail, etc.) and

3) Electronic ordering and downloading of digitized information.

Taxpayers involved in e-commerce in the US may often be faced with evaluating four or more different sets of tax rules to determine their exposure to US tax:

1) US federal income tax rules, and

2) Individual US State income, sales, and franchise tax rules.

Evaluating the cross-border impact of federal income tax rules can involve a determination of:

1) The nature of the transaction, (see below),

2) The "source" (country) of the income, for income tax purposes, and

3) The effect of "agents", if any, and tax treaties, on the tax impact.

Nature of the Transaction

Determining the nature of a transaction involving "digitized information" is important in the international context because of each country's rules for withholding at source on certain types of transactions, tax treaty rules for business activities and services, and other factors.

For example:

1) Is the transaction:

i) The sale of a product, ("business income")

ii) The provision of services, (generally "business income"),

iii) Royalty or copyright income,

iv) The renting or leasing of property, or

v) Some other kind of transaction.

A common issue in the evaluation of the tax impact in connection with the downloading of digitized information in e-commerce from one country to another may be the requirement to distinguish between business income or services on the one hand, and royalties on the other hand. Business income and services income may be taxed similarly and therefore the main distinction is between that type of income and royalty income.

If you are the "seller", the result of having a sale classified as "royalty" or "copyright" income is the potential requirement for withholding tax at source by your customer, and the contingent tax liability for your business for tax in the other country if the correct tax is not withheld. If you are the "buyer" of royalty or copyright income, you may be required to withhold tax from your supplier.

The IRS has issued regulations to assist in distinguishing between business income and royalties in connection with the downloading of computer programs. (Reg. 1.861-18)).

Computer Software Rules.

IRS regulations generally require transactions relating to the transfer of computer software programs be classified within one of the following categories:

1) The owner has made a "transfer of a copyright *right*" in the computer program (i.e. the owner has transferred the right to: a) Make copies of the software for distribution (sale, lease, rental or lending of the copies), b) Make derivative programs from the copyrighted program, c) Make a public performance of the program, or d) Display the program, or

2) The owner has made a "transfer of a copyrighted article" (e.g. a transfer of a copy of a computer program) where none of the above mentioned copyright rights is being transferred, and where there is not more than a de minimus service component, or

3) The owner has provided "know-how" relating to computer programming techniques, or

4) The owner has provided "services" for the development or modification of the computer program.

The online sale of a computer program is normally the "transfer of a copyrighted article" and is ordinarily characterized as business income. In other words, as long as a buyer of the computer program does not receive the right to commercially exploit the rights of the copyright holder, the payment is not a royalty.

However if computer software is downloaded in an e-commerce transaction the revenue could be considered royalty income (rather than business income) if it is a partial "transfer of a copyright right" (as described above) that does not constitute alienation of the entire right.

It appears these general principles governing the payments for computer software programs can apply to the downloading of other digitized products such as music or video images, and other forms of digitized information and content, not involving computer programs.

Thus, as long as a buyer of a digitized product does not receive the right to commercially exploit the rights of the copyright holder, it appears the payment is not a royalty.

Distinguishing the "Sale of a Product" from a "Services" Transaction

The basic distinction between the sale of a product and a services transaction is whether the customer actually acquires property. If the "seller" transfers the possession of "property rights" including electronic data, digitized music or video images, or other digitized content, then it is characterized as a transfer of property (either a sale or rental income) but not a services transaction.

Although online consulting is normally "services income", if the customer receives a copy of digitized information that was created for customers generally, it may be the sale of a product.

Regardless of whether an online transaction involves the sale of a product or services, it would apparently be categorized normally as "business income".

Distinguishing "Service Contracts" from Leases"

A "limited duration" license to use software or a digitized product may be rental income, whereas a "single-use" license may be services income. Rental income may require tax withholding at source. The tax code sets out circumstances when the IRS will consider a service contract to be a lease arrangement instead. "*A contract which purports to be a service contract shall be treated as a lease of property if such contract is properly treated as a lease of property, taking into account all relevant factors*". (IRC 7701(e)).

Some (not all) factors indicating the existence of a lease include:

1) The service recipient is in physical possession of the property,

2) The service recipient controls the property,

3) The service recipient has a significant economic or possessory interest in the property,

4) The service provider does not bear any risk of substantially diminished receipts or substantially increased expenditures if there is non-performance under the contract,

5) The service provider does not use the property concurrently to provide significant services to entities unrelated to the service recipient, and

6) The total contract price does not substantially exceed the rental value of the property for the contract.

Once the "Nature of the Transaction" has been determined it is necessary to determine:

1) The source country of the income,

2) Whether the taxpayer is engaged in US business,

3) Whether the income is effectively connected with the US business, and

4) Whether the business has a US "permanent establishment".

For a summary of these issues please see the article ***"OTHER CONSIDERATIONS IN THE TAXATION OF E-COMMERCE".***

DEDUCTIONS FOR CANADIAN INTANGIBLE DRILLING COSTS (US CITIZENS IN CANADA)

Many US citizens (and "US residents", including green card holders that live in Canada) invest in Canadian resource properties. However the difference between the Canadian and US tax rules for tax deductions for such investments may result in adverse US tax results for the individual.

Under US rules an investor's interest in such property is normally either an "operating interest" or a "non-operating interest". An "operating interest" bears the costs of the project. A "non-operating interest" generally receives only a royalty.

Like Canada's rules, an owner of an operating interest ("operator") may generally elect to deduct intangible drilling and development costs ("IDCs") for oil and gas wells, on his/her US income tax return, rather than capitalizing them. This election is a special concession to the oil and gas industry, since such soft costs would otherwise have to be capitalized. Only a person who holds an "operating interest" (also called a "working interest") has the right to make the election. (IRC 263(c) and Regs. 1.612-4(a) and 1.612-5(a)).

Foreign Wells

However under US rules, if the oil, gas, or a geothermal wells are located outside the United States (foreign wells) the operator must elect to either:

1) Capitalize the IDCs, or

2) Deduct them ratably over the 10-year period beginning with the year in which the costs are incurred.

If the operator elects to capitalize IDC's, the costs are generally recovered through depletion, based on the number of units produced and sold during the taxable year in relation to the total estimated recoverable reserves. The IRS provides an elective "safe harbor" procedure for purposes of computing cost depletion. (See Revenue Procedure 2004-19). If the operator elects to deduct the IDCs over a 10-year period the IDCs are a preference item for purposes of US alternative minimum tax.

Thus the IDCs for such wells generally cannot be immediately expensed. (IRC 263(i). An exception applies (the IDCs can be expensed currently) with respect to non-productive foreign wells. (IRC 263(i)).

In view of the above, a US citizen resident in Canada investing in Canadian oil wells, may have a discrepancy between the taxable income reported on the Canadian income tax return compared with the taxable income reported on the US income tax return. Double tax may result, except to the extent foreign tax credits apply on the US side in future years.

OTHER CONSIDERATIONS IN THE TAXATION OF E-COMMERCE

As indicated in the article "***ELECTRONIC COMMERCE GENERALLY***", once the "nature of your transaction" has been evaluated in an e-commerce transaction you must determine the source country of the income, whether you are engaged in US business, whether the income is effectively connected with your US business, and whether your business has a US "permanent establishment".

Source Rules

There are no special US "source rules" for e-commerce. The regular source rules in the Internal Revenue Code apply.

Sale of Personal Property. Income from the sale of inventory property is sourced where the title, or risk of loss, passes. Under this rule it is usually clear where title passes in the case of online sales of tangible property that are delivered by traditional means.

However the rule is obviously difficult to apply in the case of the sale of digitized information delivered electronically. In this case the two parties can agree where title passes, or the seller can consider stipulating in the sales contract where it passes.

In the case of the sale of non-inventory property --for example the complete disposition of a copyright - the income is sourced at the residence of the seller. (Please see the article "***SOURCE RULES FOR SECURITIES SALES***").

Income from the Use of Property (Rents and Royalties). The Internal Revenue Code provides that income from the use of property is sourced where the property is used. Rental income for digitized information is apparently sourced at the location of the computer on which it is installed. Income from royalties is apparently sourced where it is used - i.e. where the goods or services that utilize the property are provided to consumers.

Income from Services. The normal rule of the tax code, that service income is sourced where the services are provided, may be difficult to apply in the case of services provided electronically. Apparently this income is to be sourced "where value is created", which is the "location of the activity". If the service provider is at location A, the server on which these services provided is at location B, and the customer is at location C, the determination of "source" may be difficult.

Where a customer pays for data access or processing services the source may be the location of the server. However the location of the server is not the sole determinant. The location of people that operate and maintain it are also relevant. In some cases agents may contribute to the activity and their location may also be relevant. There may be some circumstances where the activities of an agent are taken into account in determining the source of service income generated by the principal.

The determination of source is important because in inbound situations (US source income) the issue is whether the income is US source effectively connected income, (potentially subject to US graduated tax rates) or "fixed or determinable" income (potentially subject to the flat 30% withholding rate or a reduced treaty rate). In outbound cases the issue is how to apply the foreign tax credit limitations.

Are you Engaged in US Business?

If an online business providing digitized information is subject to tax in the US it will be taxed either as business income (so-called "effectively connected income") at graduated tax rates (absent treaty protection) or as "fixed or determinable income" at a flat 30% or lower treaty rate. So, it is necessary to determine whether your business is "engaged in US business".

Normally online sales will not cause a Canadian business to be "engaged in US business" (for federal purposes) if electronic goods or services are delivered directly to US customers and you have no employees, agents, or physical presence in the US.

If your computer hardware is owned and located in the US, and it is used to engage in "considerable, continuous and regular" activity for your business, there may be some risk of your being "engaged in US business".

If You Are Engaged in US Business Is Your Income "Effectively Connected"?

Readers are aware if you are engaged in US business, your income from the business is only taxed in the US to the extent that it is "effectively connected" with your US business. If you *are* engaged in US business, any US source business income is automatically considered "effectively connected". Hence this is one example of the importance of the "source" rules.

However non-US source income may *also* be "effectively connected" to your US business if your business has a US office or other fixed place of business to which it can be attributed.

The mere "visibility" of a website in the US would not be an office or fixed place of business. Similarly a website hosted by an independent third party in the United States apparently would likely not (at the moment) be considered an office or fixed place of business. However if you own a server located in the US it may be a "fixed facility". But then it is still necessary to evaluate if you are "engaged in US business". (If you are simply using the computer hardware as a communications device it may not cause you to be "engaged in US business").

Permanent Establishment

A website itself apparently cannot be a permanent establishment (PE) because it is intangible and does not have a location that can constitute a place of business.

However, a web server might be a PE. This can only be determined based on all the facts and circumstances.

For example, according to commentary of the Organization for Economic Cooperation and Development (OECD):

1) Generally, if an enterprise's website is hosted by an independent internet service provider (ISP), the server is not a physical location of the enterprise, and does not constitute a PE of the enterprise, even if the fees charged by the ISP are based on the amount of disk space being used, because the enterprise has no dominion or control over the server hardware.

2) Even if dominion or control of the server is found to exist, there will be no PE unless the ISP is a dependent agent with contracting authority.

3) If, however, the server is at the disposal of the foreign vendor and the vendor manages and maintains the server (as contrasted with a situation where the web server is run by an independent ISP), it may constitute a PE if it stays at a fixed location for a sufficient period of time.

For the evaluation of status as a PE it is not necessarily relevant whether there are employees at the website. However, to be a PE the server must carry on core activities, not just preparatory or auxiliary activities, such as advertising or displaying a catalog of products.

Of course, if a Canadian enterprise does not have a PE in the US the enterprise may be exempt from US federal tax under Article VII of the treaty. A US income tax return must be filed to claim this benefit of the treaty. Beware however, - individual State income, sales, or franchise tax may apply.

Attribution of Profits to a Web Server

If the enterprise does have a PE in the US, due to its connection to a server in the US, it is necessary to determine which US source income (and possibly which non-US source income) is to be attributed to the US PE and therefore taxable in the US.

SOURCE RULES FOR SECURITIES SALES

In the Summer, 2008 Taxletter, we described some of the "source rules" that must be used in cross- border taxation. These rules generally determine which country has the primary right to levy tax.

Under US source rules, income from the sale of securities (e.g. shares in corporations) are generally sourced in the United States if the securities are sold by a "United States resident". (IRC 865(a)).

This rule seems confusing since we usually think of a "United States resident" being an individual who meets the "green card" test, "substantial presence" test, or who elects to be a US resident.

However in the context of source rules, a "United States resident" means any individual who:

i) Is a United States citizen or resident alien and does not have a "tax home" in a foreign country, or

j) Is a nonresident alien who has a tax home in the United States. (IRC 865(g)).

We previously described the meaning of "tax home". Generally, it is the place where you work. If you do not work it may be your "regular place of abode".

Thus a US citizen or green card holder living and working in Canada who sells publicly traded securities will normally have Canadian source income on those sales.

IRS FORM 5471 AND ATTRIBUTION FROM TRUSTS

Subscribers are aware a US citizen, a green card holder (including those living in Canada) and other US residents must file IRS Form 5471 if there is a specified ownership or other involvement with a private Canadian or other non-US corporation.

An extensive set of rules defines whether or not such an individual does, in fact, have the requisite ownership or involvement. Among these rules is a requirement that such individuals consider themselves as owning certain shares of the corporation that are owned by other persons, including other corporations, trusts, and estates. Among other aspects, these (attribution) rules describe when, and the extent to which, such an individual is deemed to own the shares of a corporation that are owned by a trust.

Section 318 (a) (2) (B) of the Internal Revenue Code provides that stock owned by a trust will be considered owned by its beneficiaries in proportion to the actuarial interest of the beneficiary in the trust. Reg. 20.2031-7 sets out how this actuarial interest is calculated.

In cases where a beneficiary of a trust is a "discretionary beneficiary" the rules set out in Reg. 20.2031-7 cannot be practically applied. In cases like this the IRS has given guidance in PLR 9024076 on how to make the determination. This is to be done with reference to "all the facts and circumstances". Please see also the article ***"FOOD FOR THOUGHT WHEN USING DISCRETIONARY TRUSTS FOR US STATE TAX AVOIDANCE".***

US CAPITAL GAINS TAX ELIMINATED (TEMPORARILY) FOR CERTAIN NONRESIDENT ALIENS

The US has relatively complicated rules that apply to the sale of real estate that is owned for more than one year. In the US all of the gain is generally taxable (i.e. there is not an exclusion for 50% of the gain). However there are four applicable capital gains tax rates, namely 5% (reduced to 0% for 2008, 2009 and 2010), 15%, and 25%. A maximum rate of 28% applies to certain gains other than real estate, including certain "collectibles".

Nonresident Aliens with Realty Sales Only

For nonresident aliens selling US real estate there is a special bonus for the years

2008-2010, when the only US income is real estate gain. The portion of the gain that would normally be taxed at a rate less than 25% under the graduated tax rate schedule will instead be taxed at a 0% - i.e. it will be tax-free in the US! (Depreciation recapture is taxed at 25% and therefore may be subject to tax). Also, alternative minimum tax may apply.

Accordingly for nonresident aliens whose US "long term" gain on the sale of a personal use "only" residence does not exceed approximately $35,000 (per spouse) there will be no US tax payable on the gain. Thus, if the property is owned jointly by the spouses, in general there will be no US tax if the gain does not exceed approximately $70,000.

For gains in excess of $288,000 for single nonresident aliens, and gains in excess of $410,000 on property jointly owned by spouses, there will be alternative minimum tax in addition to the regular tax.

The above rule terminates (sunsets) after December 31, 2010.

DANGER - BEWARE!

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

Several years ago, I wrote a column warning American citizens and residents with overseas bank/securities accounts that they were facing a world of hurt if they failed to comply with the simple requirements of the Internal Revenue Service relative to reporting their existence;

1) On schedule B of form 1040, it is necessary, at question 7, to check the box "yes" if you have foreign accounts (in excess of $10,000) and name the country where the account is held. Either a pure bank account or any securities account can trigger the requirements.

2) On schedule B, report the amount of interest or dividend income you received from the foreign accounts; on schedule D, report capital gains and losses.

3) By June 30 of each year, one must file a form TDF 90-22.1 with the United States Treasury Department.

This is fairly simple to comply with. The problem is, if you don't comply, you may be committing fraud with regard to your income tax return, and you may be facing criminal sanctions for failure to file the TDF form (the "FBAR" form). The penalties for failing to file the FBAR can be severe; up to five years in prison with a fine of $250,000 for a criminal conviction, and civil fines of $10,000 or 10% of the maximum amount held in the foreign account up to 50% of the amount of the foreign account. The account need not be in your name - if you have signature authority over a particular account, that's enough to trigger the requirements.

If you are currently in violation of the FBAR rules, the IRS has an amnesty program based on voluntary compliance. If you come forward to the IRS before they send out any type of inquiry, generally you end up paying the tax and a minimal penalty. If they come to you first, however, be prepared for the worst. The IRS is stepping up the compliance in this area. You will soon be reading about UBS clients who failed to comply and the sanctions which will be applied to them. The IRS has identified some 19,000 Americans with accounts at one particular foreign bank. Only 1,100 of these clients are compliant with FBAR. One Swiss bank, UBS, has agreed to pay a $780,000,000 fine for its wrongdoing. If you have such an undisclosed account either with UBS or another foreign entity, it would be wise to come forward and comply with the statute on a voluntary basis rather than to wait for the IRS to come knocking at your door!

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