Cross-Border Tax Insight
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Cross-Border Tax Insight

Cross-Border Tax Newsletter

Focus on US Taxation – What is new in 2006 and 2007?

Several significant pieces of legislation contributed to such changes, namely, the Taxpayer Income Prevention and Reconciliation Act of 2005 (TIPRA) enacted in 2006, and the Pension Protection Act of 2006, as well as the Energy Policy Act of 2005, which contains provisions that became effective in 2006.

Despite actual changes mentioned below, with the November 2006 change in control of the U.S. Congress, a change in direction in tax legislation may apply to 2007/2008 (to reflect the thinking of the Democrats).

Age Limit for "Kiddie Tax" Raised

For tax years beginning in 2006 and after, kiddie tax provisions apply to those under 18 years of age. The previous, age limit for the kiddie tax was 14 years of age. Under the tax, if a child has *unearned income* above a threshold amount ($1,700 in 2006 or 2007), the child's unearned income is generally taxed at his or her parents' top marginal rate if that rate results in a higher tax. A tax return in the child's name must be filed in such a case.

Alternative Motor Vehicle Fuel Credit

An alternative motor vehicle fuel credit is available starting in 2006 for several types of alternative fuel vehicles. The credit is equal to the sum of the:

(1) qualified fuel cell motor vehicle credit,
(2) new advanced lean-burn technology motor vehicle fuel credit;

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(3) new qualified hybrid motor vehicle credit; and
(4) new qualified alternative fuel motor vehicle credit.

Residential and Construction Energy Credits and Deductions

A non-refundable credit is available for amounts spent on certain residential energy improvements.

Taxpayers may take the credit for qualified photovoltaic property, qualified solar water heating property, or qualified fuel cell property placed in service in 2006 or 2007, provided that the property is used exclusively for purposes other than heating swimming pools or hot tubs. The credit is equal to 30 percent of qualifying expenditures, with a maximum credit of $2,000 for qualified photovoltaic and qualified solar water heating property expenditures, and $500 for each 0.5 kilowatt of capacity of qualified fuel cell property expenditures.

Additional tax credits and deductions generally apply in 2006 and 2007 under legislation enacted in 2005. The *non-business energy property credit* and the *residential energy efficient property credit* are available for the certain types of energy-efficient property that meet eligibility requirements.

A business tax credit is available for the construction of new energy-efficient homes substantially completed after 2005. A deduction is available for construction of energy efficient commercial buildings. A manufacturer's credit is available for energy efficient dishwashers, clothes washers, and refrigerators.

Available to all types of businesses is a solar tax credit for the cost of new property that is used to generate solar energy for electricity, heating or cooling, or for certain types of geothermal energy.

Tax-free IRA Charitable Contributions

Otherwise taxable IRA distributions may be excluded from gross income by those 70 1/2 (at year end) and older, if the distributions are qualified charitable distributions. This provision applies in 2006 and 2007. The exclusion is limited to $100,000 per taxpayer per year.

Modification to Foreign Earned Income and Employer-Provided Housing Exclusion Rules for U.S. Citizens Living Abroad

Beginning in 2006, the $80,000 maximum foreign earned income exclusion amount is indexed for inflation.

The 2006 amount is $82,400 if an individual qualified for the entire year. For 2007, the amount is $85,700.

However, also starting in 2006, taxpayers who elect to exclude foreign earned income and/or foreign housing allowances, will be subject to a higher tax rate on income in excess of the exclusion amount. Such income will be taxed for both regular and minimum tax purposes by applying the tax rates that would have applied had thetaxpayer not elected the exclusions.

A qualified individual is allowed an exclusion from gross income (or, alternatively, a deduction) for certain foreign housing costs paid or incurred by or on behalf of the individual. The amount of this housing cost exclusion is equal to the excess of a taxpayer's "housing expenses" over a base housing amount. Beginning in 2006, an individual's housing cost amount is the foreign housing expense paid or incurred during the tax year by the individual (limited to 30 percent of the individual's foreign earned income exclusion amount for the tax year), less 16 percent of the individual's foreign earned income exclusion amount for the tax year.

However, the IRS may provide for an adjustment to the 30 percent limitation based on geographic differences in housing cost relative to housing costs in the United States, setting forth higher housing cost amounts for specific locations.

Temporary AMT Relief Extended Through 2006

The alternative minimum tax exemption amount for 2006 was increased to: (1) $62,550 for married individuals filing a joint return and surviving spouses; (2) $42,500 for unmarried individuals other than surviving spouses; and (3) $31,275 for married individuals filing a separate return. The exemption amount remains $22,500 for estates and trusts.

For 2007, the exemption amount is scheduled to revert to the lower exemption amounts in effect before 2001. Continuing in 2006, and also scheduled to expire in 2007, all non-refundable personal credits can be used to the full extent of the taxpayer's regular tax and AMT.

Itemized Deduction Limitation Phaseout

The reduction in itemized deductions for high-income taxpayers starts to phase out beginning in 2006.

For years before 2010, an individual whose adjusted gross income (AGI) exceeds a prescribed amount must reduce his or her itemized deductions by an amount that depends on AGI. For years before 2006, the amount of the reduction was the lesser of 3 percent of the excess of AG1 over the applicable amount or 80 percent of itemized deductions. For 2006 and 2007, the amount of the reduction is two thirds of this amount. Note that certain itemized deductions are not subject to any deduction limitation.

For tax years beginning in 2007, the applicable amount of adjusted gross income above which the amount of a taxpayer’s otherwise allowable itemized deductions will begin to be phased out is $ 156,400 ($78,200 for a married individual filing separately). The 2006 figures are $ 150,500 and $ 75, 250 respectively.

Increased Record Keeping for Charitable Contributions

Starting with tax years beginning after August 17, 2006, to take a deduction for a cash donation to a charity, regardless of the amount of the donation, the taxpayer must have either a bank record or a written note from the charity indicating the amount of the contribution, the date of the contribution, and the name of the charity.

Restrictions on Items Contributed to Charity

Effective for tax years beginning after August 17, 2006, no deduction is allowed for contributions of clothing or household items unless the items are in good used condition or better. There is an exception for items worth $500 or more if the taxpayer includes a qualified appraisal of the property on his or her return.

IRAs, 401(k)s, and Saver's Credits

For 2007, the applicable dollar amount used to determine the contribution limit for Roth IRAs is $156,000 for a joint return, $99,000 for all other taxpayers (except for married taxpayers filing separately), and $0 for married taxpayers filing separately.

For qualified retirement contributions in 2007, the applicable dollar amount used to determine the amount of reduction for the limitation on deduction for taxpayers who are active participants and for spouses who are not active participants in certain pension plans is $83,000 for taxpayers filing a joint return, $156,000 for the taxpayer's spouse if the spouse is not an active participant, and $52,000 for all other taxpayers (except for married taxpayers filing separately), and for married taxpayers filing separately is $ 0.

Legislative changes enacted in 2006 include permanent higher contributions for 40(k)s, IRAs, and other savings vehicles. Roth 401(k)s have been made permanent and fiduciary protection for plans that offer automatic enrollment in 401(k)s and similar arrangements has been enhanced.

The 401(k) contribution limit for 2007 is $15,500. The 2006 limit is $15,000. The catch-up contribution amount for those 50 or over, although it too is indexed for inflation, remains at $5,000, the same amount as in 2006. The maximum IRA contribution amount is $4,000 in 2006 and 2007. Those who are age 50 or over may contribute an additional $1,000.

Starting in 2007, inflation adjustment of the Saver's Credit for lower income taxpayers means higher income levels will qualify (for example, joint filers will get a 50 percent credit with income up to $31,000, 20 percent up to $34,000, and 10 percent up to $52,000).

Section 179 Expensing

Current law provides that the maximum amount a taxpayer may expense under Code Section 179 is $100,000. The $100,000 amount is reduced (but not below zero) by the amount by which the cost of qualifying property placed in service during the tax year exceeds $400,000.

The $100,000 and $400,000 are indexed for inflation for years beginning after 2003 and before 2008. Legislation enacted in 2006 extends for two years (i.e., for tax years beginning in 2008 and 2009) the increased amount that a taxpayer may deduct and the other Code Section 179 rules that currently apply.

The Code Section 179 deduction limit for qualifying capital property placed in service for the tax year that would otherwise have to be depreciated is $108,000 for 2006 and $112,000 in 2007 when adjusted for inflation. As mentioned earlier, the amount generally is reduced (but not below zero) by the amount that the total cost of all Section 179 property placed in service during the year exceeds a threshold amount. For 2006 that amount is $430,000; for 2007, $450,000.

Capital Gains and Dividend Rates

Lower capital gain and dividend tax rates had been scheduled to expire after 2008. They are now extended through the end of 2010. Capital gains and dividend income are taxed at a maximum rate of 15 percent through 2010. For taxpayers in the 10 and 15 percent tax brackets, the tax rate is 5 percent through 2007 and zero from 2008 through 2010.

Excise Tax Refunds

Taxpayers will be eligible to file for refunds of all excise tax they have paid on long-distance service billed to them after February 28, 2003. Interest will be paid on these refunds. Taxpayers may claim such refund on their 2006 tax returns.

Income Limitations for Foreign Tax Credit Simplified in 2007

Currently, in applying the foreign tax credit, the "separate" limitation of Code Section 904(d) is calculated for several designated categories of income, which are referred to as baskets. In determining a taxpayer's separate limits, the taxpayer must compute his or her income or loss within each basket and then apply each limit separately. For taxpayers claiming the foreign tax credit in tax years beginning after December 31, 2006, foreign taxes will be subject to separate limitations for only two categories of foreign source income: passive income and general income.

Standard Deduction

For 2007, the standard deduction amounts under Code Section 63 are: $10,700 for married individuals filing jointly and surviving spouses: $7,850 for heads of household; $5,350 for unmarried individuals; and $5,350 for married individuals filing separately. The additional standard deduction amounts for taxpayers who are at least 65 years old or blind are $1,050 for each. These amounts are increased to $1,300 if the individual is also unmarried and not a surviving spouse. Finally, the standard deduction amount for an individual who may be claimed as a dependent by another taxpayer may not exceed the greater of $850 or the sum of $300 and the individual's earned income.

Personal Exemption

The personal exemption amount for tax years beginning in 2007 is $3,400 ($ 3,300 in 2006). In 2007, for joint return filers and surviving spouses, the personal exemption amount begins to phase out when adjusted gross income reaches $234,600 and is completely phased out at $357,100. For heads of household, the phase-out begins at $195,500 and is complete at $318,000. For unmarried individuals (other than heads of households and surviving spouses), the phase out begins at $156,400 and is complete at $278,900. For married individuals filing separately, the amounts are $117,300 and $178,550.

Child Tax Credit

For tax years beginning in 2007, the value used in determining the amount of credit that may be refundable is $11,750 ($11,300 in 2006).

Adoption Credit and Assistance Programs

For 2007, the maximum credit allowed for the adoption of a child is the amount of the qualified adoption expenses up to $11,390. The maximum credit allowed in the case of an adoption of a child with special needs is $11,390, regardless of the amount of expenses (if any) paid or incurred. The available adoption credit begins to phase out for taxpayers with modified adjusted gross income in excess of
$ 170,820 and is completely phased out for taxpayers with modified adjusted gross income of $210,820.

Hope and Lifetime Learning Credits

The modified gross income taken into account in 2007 in determining the reduction of both the Hope and Lifetime Learning credits is the amount in excess of $47,000 ($94,000 in the case of a joint return). In addition, 100 percent of qualified tuition and related expenses not in excess of $1,100 plus 50 percent of such expenses in excess of $ 1,100 but not in excess of $2,200 are taken into account in determining the amount of the Hope Scholarship Credit. This credit applies to the first two years of post-secondary tuition and fees. The maximum credit for 2006 and 2007 is $1,650.

Earned Income Credit

The earned income amounts, i.e., the amounts of 2007 earned income at or above which the maximum amount of earned income is allowed, are: for taxpayers with one qualifying child, $8,390; for taxpayers with two or more qualifying children, $11,790; and $5,590 for taxpayers with no qualifying children. The maximum amount of the credit is $2,853 for taxpayers with one qualifying child; $4,716 for taxpayers with two or more qualifying children; and $428, for taxpayers with no qualifying children.

The 2007 threshold phase-out amounts, i.e. the amount of adjusted gross income (or, if greater, earned income) above which the maximum amount of the credit begins to phase out, are: for taxpayers with one qualifying child, $15,390; for two or more children, $15,390; and for taxpayers with no children, $7,000. The amounts at which the phase out is complete are $33,241 for one child; $37,783 for two or more children; and $12,590 for no children.

For married filing jointly taxpayers, the threshold phase out amounts are: $17,390 for taxpayers with one qualifying child; $17,390 for taxpayers with two or more qualifying children; and $9,000 for taxpayers with no qualifying children. The completed threshold phase-out amount for married filing jointly taxpayers with one qualifying child is $35,241; two or more qualifying children, $39,783; and no qualifying children, $14,590.

In addition, the earned income tax credit is denied if the aggregate amount of certain investment income exceeds $2,900 in 2007

Qualified Transportation Fringe Benefit Exclusion

The 2007 monthly limitation on the aggregate fringe benefit exclusion amount for transportation in a commuter highway vehicle and any transit pass is $110 ($ 105 in 2006). The 2007 monthly limitation on the fringe benefit exclusion amount for qualified parking is $215 ($ 205 in 2006).

Interest on Education Loans

In 2007, the $2,500 maximum deduction for interest paid on qualified education is reduced when modified adjusted gross income exceeds $55,000 ($110,000 for joint returns), and is completely eliminated when modified adjusted gross income is $70,000 ($140,000 for joint returns). Note that in 2006, a $2,500 maximum deduction for interest still applies, but the thresholds re the phase out are somewhat lower than as indicated in 2007 (e.g. $ 50,000 with full phase out at $ 65,000 of AGI, or for MFJ filing status the amounts are $ 105,000 and $ 135,000 respectively).

Income From U. S. Savings Bonds

For 2007, the exclusion for income from United States savings bonds for taxpayers who pay qualified higher education expenses begins to phase out for modified adjusted gross income above $98,400 for joint returns and $65,600 for other returns. This exclusion completely phases out for modified adjusted gross income of $128,400 or more for joint returns and $80,600 or more for other returns.

Long Term Care Insurance Premiums

For 2007, the amount of long-term care premiums eligible to be deducted as medical care expenses is set at $290 for an individual age 40 or less at the close of the tax year; $550 for an individual over age 40 but not over age 50; $1,110 for an individual over age 50 but not over age 60; $2,950 for an individual over age 60 but not over age 70; and $3,680 for an individual over age 70.

Annual Exclusion for Gifts

For 2007, the first $12,000 of gifts to any person (other than gifts of future interests in property) is not included in the total amount of taxable gifts made during that year.

Other Items

The dollar amount used to determine interest on estate tax payable in installments is $1,250,000.

The attorney fee award limitation is $170 per hour for 2007.

The $5, $25, and $50 guidelines for disregarding the value of insubstantial benefits received by a donor in return for a fully deductible charitable contribution are, in 2007, $8.90, $44.50, and $89, respectively.

Temporary Professional Workers under Canadian & U.S. Immigration Law

These days, the word "immigration" no longer conjures up images of the Statue of Liberty and its welcoming "open policy" inscription. With ongoing debates on anti-terrorism and border sealing policy initiatives, it appears that neither Canada nor the United States are as eager as they once were to welcome the world's tired and poor wretched refuse from teeming shores. Yet statistical reports confirm that both Canada and the U.S. are facing increasingly severe labour shortages due to an aging population and a falling birth rate. In an effort to address these labour shortages, both countries have refined and created new temporary worker visa categories. These temporary visa categories allow foreign nationals, pursuant to a job offer from a U.S. or Canadian employer, to enter the country to perform work for certain prescribed periods of time.

At first glance, there appear to be many similarities between the Canadian and U.S. temporary visa categories available to professional workers. While many of the visa categories are comparable in their procedures and eligibility requirements however, they often differ significantly in 1) the privileges they confer regarding the possibility of permanent immigration ("dual intent" vs. "nonimmigrant intent" visas) and 2) the relative ease of the permanent immigration process available to the temporary worker ("self-sponsorship" vs. "employer-dependent sponsorship"). This article will examine the Intra-Company Transfer Visa and the NAFTA Professional Visa categories, two popular Canadian and U.S. temporary worker categories, and draw some conclusions as to the policy motivations that might be fueling these differences.

The Intra-Company Category

While they may have slightly different nomenclature (the "Intra-company Work Permit" in Canada vs. the "L1 Visa" in the U.S.), these two visa categories are almost identical in that both allow for foreign nationals who have worked at a company abroad to transfer to the Canadian or U.S. branch for a temporary period in either a managerial/(L1A) or in a specialized knowledge/(L1B) position.

(i) Dual intent" vs. "Nonimmigrant intent"

In Canada, almost all work permits confer a "dual intent". A dual intent visa allows a temporary worker to seek admission for a temporary nonimmigrant purpose while also possessing an intention to immigrate permanently to the country. In the U.S., on the other hand, only a few visas available to temporary workers allow for a dual intent. The remainder are strictly "nonimmigrant" intent visas and therefore do not allow a temporary worker to adjust his or her status to a permanent resident from within the country. Both the Canadian Intra-Company Work Permit and the U.S. L1 Visa are dual intent visas and therefore allow for Permanent Immigration.

(ii) Permanent Immigration: Self-sponsorship vs. Employer-dependent sponsorship

Workers who are eligible to apply for Permanent Residency ("PR") in Canada do so under the Skilled Worker category, which relies on a flexible points-based skill assessment of the candidate's age, education, work experience and employability. The process is one of self-sponsorship and does not rely on a Labour Market assessment of the temporary worker's current job position, nor does it require the Canadian employer to act as the sponsor. While L1 Visa holders are also eligible to apply for U.S. Permanent Residency ("Green Card"), this is obtained through one of the employment-based categories, which is dependent on the U.S. Employer's willingness to act as the sponsor.

Furthermore, L1B Visa holders, like all other temporary workers wishing to apply for a Green Card, must have their U.S. employer obtain a Labour Certification from the Department of Labour confirming the unavailability of qualified U.S. workers for the position. L1A Visa holders are unique in that they are exempt from the Labour Certification step.

The NAFTA Professional Category

Another commonly-used work visa category for temporary professionals is the one issued under the NAFTA (North American Free Trade Agreement), which allows for Canadian, U.S. and Mexican citizens to enter Canada or the U.S. to perform temporary work under one of the 63 professions identified in its Appendix 1603.D.1. This visa is referred to as the NAFTA Professional Work Permit in Canada and as the TN Visa in the U.S.

(i) Dual intent" vs. "Nonimmigrant intent"

The similarities between these two types of visa categories are less apparent when we examine them in light of whether they permit or hinder the temporary worker from applying for permanent residency. While the Canadian NAFTA Work Permit confers dual intent, the U.S. equivalent is classified as a "nonimmigrant intent" visa. TN Visa holders are therefore ineligible to apply for an employment-based Green Card, as this would contradict their temporary nonimmigrant intentions with respect the United States.

(ii) Permanent Immigration: Self-sponsorship vs. Employer-dependent sponsorship

Unlike their TN Visa counterparts, NAFTA Professional Work Permit holders in Canada are eligible to apply for Permanent Residency under the Skilled Worker category which, as it was discussed above, is neither dependent on obtaining a sponsor nor on obtaining a Labour Market assessment.

As the brief examples above have demonstrated, both Canada and the U.S. provide comparable temporary foreign worker categories to alleviate their short-term professional labour shortages. However, unlike Canada, only a few of the visa categories available to temporary professional workers in the U.S. confer a dual intent. Where employment-based permanent immigration is allowed, the process is dependent, with a few exceptions, on the U.S. Employer's willingness to act as the sponsor and on a favorable assessment from the Department of Labour. In Canada, most temporary professional workers can self-sponsor themselves under the Skilled Worker class and a Labour Market assessment is not required.

Immigration policies are designed, at least in part, to address a country's demographic and labour challenges. For Canada, a country grappling with its economic competitiveness on the global scale, a pervasive "brain-drain" phenomenon, and a low population, it appears that assessing potential immigrants solely on their ability to fill specific labour shortages is ineffective. A potential immigrant's education, work experience and employability seem to be given far more important consideration. For the U.S., on the other hand, a country with a greater population but where skills shortages and outsourcing trends pose the biggest workforce threats, permanent admission of its skilled temporary foreign workers *at the expense of its own citizens*, unless the temporary workers could be shown to be filling the country's labour shortages, would be counter-productive. In light of these different challenges, Canada and the U.S.'s disparate approaches towards permanent immigration for temporary professionals is not surprising.

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2006 US Tax Filing Deadine

US taxpayers will have until Tuesday, April 17, 2007, to file their 2006 returns and pay any taxes due according to a recent Internal Revenue Service announcement.

Taxpayers will have extra time to file and pay because April 15 falls on a Sunday in 2007, and the following day, Monday, April 16, is Emancipation Day, a legal holiday in the District of Columbia.

This means the entire country has an April 17 deadline. Previously, the April 17 deadline applied just to individuals in the District of Columbia and six eastern states who are served by an IRS processing facility in Massachusetts, where Patriots Day will be observed on April 16.

The April 17, 2007 deadline will apply to any of the following:

- 2006 federal individual income tax returns, whether filed electronically or on paper.
- Requests for an automatic six-month tax-filing extension, whether submitted electronically or on Form 4868.
- Tax year 2006 balance due payments, whether made electronically (direct debit or credit card) or by check.
- Tax-year 2006 contributions to a Roth or traditional IRA.
- Individual estimated tax payments for the first quarter of 2007, whether made electronically or by check.
- Individual refund claims for tax year 2003, where the regular three-year statute of limitations is expiring.

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His firm is dedicated to providing both U.S. (primarily) and Canadian tax expertise (as applicable to international tax situations), tax–related educational services, and technical writing assistance to Canadian accounting and law firms. Joseph has lectured for several organizations and companies on cross-border tax matters. Furthermore, Joseph is the author of "*Cross-Border Tax Insight*" – a tax based newsletter that is sent to other tax practitioners in North America and is made available on his website at www.usatax.ca.

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Call Joseph today and find out how he can be of help to your firm or clients!

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