Special points of interest:

- More on U.S. Mulitstate Taxation
- The Magic of the L -1 Visa
- Filing Considerations for Non-U.S. Citizens

May-June 2001

Cross-Border Tax Insight
Editor: Joseph Soussan
595 Bay Street, Suite 300
Toronto, Ontario, M5G 2C2
Tel: 416-567-1829: Fax: 416-489-6571
E-mail: jsoussan@sympatico.ca

NORTH AMERICAN TAX SERVICES

Cross-Border Tax Insight

Cross-Border Tax Newsletter

Dear Devoted Readers:

I just wanted to thank all of those practitioners from whom I received correspondence. I appreciate your interest in this newsletter. The last edition of the newsletter was issued in March 2001.

If you did not receive this last edition – please send me an email and I will send it to you. The newsletters will shortly be posted to our new web site.

We are counting on your input and continued feedback to ensure our newsletter remains of interest to you and other financial professionals.

Again, if you feel someone in your office, or a colleague, could benefit from *Cross-Border Tax Insight* - please have them forward an e-mail to me with the words "subscribe to newsletter" in the e-mail subject line.

Joseph Soussan
E-mail: jsoussan@sympatico.ca
Editor of **Cross-Border Tax Insight, 2001 © NATS**

This newsletter is generally published monthly.

More on U.S. Multistate Taxation	2
The Magical L-1 Visa	4
Filing Considerations for Non-U.S. Citizens	4
About North American Tax Services	6

More on Multistate Taxation

In the last edition of this newsletter, the reader was presented with an overview to U.S. state (and multistate) corporate taxation.

It was reported that the state in which a business is incorporated has the jurisdiction to tax such business, regardless of the volume of activity conducted within such state. Consequently, if a corporation is incorporated in state X, but is doing business in state Y, this second state may tax such corporation on the applicable portion of its income if *nexus* is present between it and the corporation.

Typically, nexus is present when a corporation derives income from sources within the state, owns or leases property in the state, employs personnel in the state, or has physical or financial capital in such state.

Public Law 86-272 limits the states' right to impose an income tax on interstate activities. This federal law prohibits a state from taxing a business whose only connection with a state is to solicit orders for sales of tangible personal property. For this law to apply, such sales orders must be approved or rejected outside of the jurisdiction of the state that wishes to levy tax. In addition, such orders must be filled or shipped by the business from a point outside the state.

Under this public law, only the sales of tangible personal property are immune from taxation. Leases, rentals, and other dispositions of tangible personal property are not protected activities. Moreover, dispositions of real property and intangible property, as well as sales of services, are not protected under such legislation.

Each state has its own definition of tangible and intangible property. Since property ownership is not a protected activity, providing company-owned fax, copy or computer equipment to an out-of-state salesperson may create nexus with a state, even though the salesperson merely solicits sales orders there.

Note that Public Law 86-272 does not define the term *solicitation*, but the Supreme Court has held that *solicitation of orders* includes any verbal requests for orders, and any speech or conduct that implicitly invites an order. The Court also created a *de minimus* rule, allowing immunity from nexus where a limited amount of solicitation occurs.

The following activities usually do not create nexus under Public Law 86-272:

- Advertising campaigns
- Carrying free samples for display or distribution only
- Owning or furnishing automobiles to sales persons
- Passing inquiries or complaints to home office
- Checking customers' inventories for reorder
- Maintaining a sample or display room for two weeks or less during the year.

Activities that would normally establish nexus:

- Making repairs or providing maintenance
- Collecting delinquent accounts; investigation of creditworthiness
- Installation or supervision of installation
- Conducting training classes, seminars, or lectures for persons other than sales personnel
- Approving or accepting orders
- Picking up or replacing damaged or returned property
- Hiring, training, or supervising personnel other than sales employees
- Carrying samples for sale, exchange, or distribution in any manner, for consideration or other value
- Maintaining an office for an employee, including an office in the home
- Owning, leasing, maintaining, or otherwise using any of the following facilities or property in the state: real estate; repair shop; parts department; employment office; purchasing office; warehouse; meeting place for directors, officers, or employees; stock of goods; telephone answering service; or mobile stores (i.e. trucks with driver-salespersons).

Allocation and Apportionment of Income

If a corporation conducts business operations in more than one state, such a *multistate* corporation must determine the portion of its net income that is subject to tax in each state.

A corporation that has established sufficient nexus with another state generally must both *apportion* and *allocate* its income.

Apportionment is a method by which a corporation's business income is divided among the states in which it conducts business. Under an apportionment procedure, a corporation determines allowable income and deductions for the company as a whole. It then apportions (i.e. it assigns) some of its net income to a given state, according to a pre-approved state formula.

Under an *allocation* procedure, in contrast to apportionment, allocable (or nonapportionable) income is directly assigned to a specific state (or states). Such income generally consists of non-business or investment income. In general, such income includes:

a) income or losses derived from the sale of non-business real or tangible property,
b) income or losses derived from rentals and royalties from non-business real or tangible personal property.

In sum, income is normally allocated to the state in which the property that generated the income or loss is located. Procedurally, total allocable (non-apportionable) income or loss typically is removed from corporate net income before the specific state's apportionment percentage is applied. The non-apportionable income or loss assigned to a specific state is then combined with the income apportionable to that state, to arrive at total income subject to tax in that particular state.

In the next edition of this newsletter, the following will be considered:

More on allocation and apportionment
Factors used in apportionment formula – sales, payroll and property
Unitary theory and other issues.

THE MAGIC OF THE L-1 VISA

The L-1, or INTRACOMPANY Visa is a temporary, non-immigrant visa with a highly desirable amount of flexibility.

As the name implies, it is available when a Canadian corporation wishes to send a senior or executive employee to a U.S. subsidiary, affiliate or parent company.

There are two thresholds: 1) there must be common ownership of the two entities which is best demonstrated by proof of common shareholders and incorporators; 2) the employee to be transferred must be an executive, a senior manager or a "specialized knowledge" person.

One might assume that this is open to only large international companies and, initially, that was the target. However, over time and with the advent of NAFTA, this is an avenue that is accessible to even a modest-sized business. The Canadian corporation may incorporate in the U.S., and then send one or more key personnel to establish the new business and oversee start-up. Without going into great detail, under the right circumstances, this can lead to a Green Card for that person(s).

The paperwork for this is substantial, particularly when the U.S. enterprise is new. INS will need to be persuaded that the Canadian parent is solid and capable of sustaining the new subsidiary during the first year. Applications that project the creation of new jobs for U.S. citizens or permanent residents are always looked upon more favourably.

Special Note: While such applications must be funnelled through a U.S. Service Center, as Canadians we have a wonderful advantage. Once the application package has been perfected, a Canadian may apply right at the port of entry and receive the visa on the spot.

Janice P. Warren is a Toronto-based lawyer whose practice is limited to immigration law. She is a member in good standing of the Canadian Bar Association and the Law Society of Upper Canada. Janice can be reached at the following co-ordinates: phone - 416-323-7767 or e-mail: warren@total.net. Her practice is located on St. Clair Avenue and Yonge Street in Toronto.

U.S. Sojourners – Special Filing Considerations for Non-U.S. Citizens

In the last edition of this newsletter, filing requirements for U.S. citizens living in Canada were briefly discussed.

However, there are many other categories of persons, who are not U.S. citizens but who spend considerable time in the U.S., who may have very specific filing requirements. Failing to file in certain circumstances, may be costly for such persons. Thus, if you do have clients with ties to the U.S., you may want to consult with a U.S. tax specialist, prior to finalizing any applicable Canadian tax returns, or implementing a personal tax plan.

As an example of the type of scenarios contemplated – consider the following:

a) Mary is a retired single Canadian with a permanent home in Canada, spends the following number of days at her daughter's home in California, and she commutes back to Canada regularly. Mary does not have any U.S. income whatsoever.

2000 – 175 days, 1999 – 60 days, 1998 – 35 days.

Under U.S. domestic tax law, two tests will generally require individuals to file a U.S. 1040 Resident income tax return. Recall from our last newsletter, that U.S. residents are taxed on a worldwide basis, as is the case in Canada.

The first test, i.e. the *Green Card Test*, requires that lawful U.S. permanent residents (including green card-holders) and immigrants file such a Resident tax return (Form 1040). The second test, referred to as the *Substantial Presence Test*, specifies that an individual who meets certain criteria will also be treated as a U.S. resident. To meet this latter test, the person must be physically present in the U.S. for at least 31 days in the current year (assume current year is 2000), and at least 183 days during the period 2000, 1999 and 1998, counting all the days of physical presence in 2000, but only 1/3 the number of days of presence in 1999 and only 1/6 the number of days of presence in 1998.

In Mary's specific case, she would be considered a resident under the general application of the *Substantial Presence Test,* because she definitely has more than 183 days of physical presence for the three-year period in question. Without further consideration, one would think a U.S. resident tax return is automatically due. Two possible exceptions apply, to avoid having Mary report her worldwide income to the U.S. tax authorities (or having to file Form 1040).

Closer Connection Exception

An exception in the U.S. Internal Revenue Code exists for persons present in the U.S. for less than 183 days in the current year, providing such persons have a closer connection to a foreign country. In essence, this closer connection exception requires that such a person both have a tax home outside of the U.S., as well as having a closer connection to such a foreign country than to the United States. Mary, in the above example, may very well meet the requirements of this exception. Assuming she has a permanent home in Canada, maintains both significant personal belongings in Canada, as well as social, cultural and religious ties with Canadian based organisations - she would be considered to have a closer connection with Canada than with the United States.

Despite this wonderful filing exception, Mary avoids reporting her worldwide income to the U.S. tax authorities with one catch – she must still file Form 8840 (Closer Connection Exception for Aliens) to the IRS by June 15, 2001 (with respect to the 2000 tax year). Form 8840 basically supports the applicant's closer connection position. It lists a series of questions attempting to confirm that the person's social, primary residential and tax ties were, in fact, located outside of the U.S.

Note the potential adverse consequences if Mary decides not to bother filing Form 8840 on timely basis, assuming the above fact pattern applies – she will not be able to claim the closer connection exception and she may be treated as a U.S. resident. Mary will not be penalized if she can demonstrate that she took reasonable steps to become aware of the relevant filing requirements, as well as steps to fulfil such filing requirements.

Like all good complicated tax legislation, note that there is an exception to the exception. If Mary actually took steps to apply to become a lawful permanent U.S. resident in 2000, and spent time in the U.S. as indicated above, she would not be able to rely on a closer connection exception. Consequently, she would meet the substantial presence test, which would in turn require her to report her worldwide income to the U.S. tax authorities.

Exception for Dual Status Taxpayers

Consider a situation where Mary actually spent 185 days in the U.S. in 2000. All other facts as indicated above are still applicable.

North American Tax Services

595 Bay Street, Suite 300
Toronto, Ontario
M5G 2C2

Phone: 416-567-1829
Fax: 416-489-6571
Email: jsoussan@sympatico.ca

In such a case Mary would not be able to rely on the closer connection exception to avoid filing a U.S. resident tax return. Mary, however, could potentially be considered as a *dual resident taxpayer*. The consequence of such a position would enable her to be treated as a nonresident for U.S. tax purposes.

A "dual resident taxpayer" is an individual who is considered both a resident of the United States pursuant to its domestic tax laws and also a resident for tax purposes of another treaty country.

Let's assume for a moment, that the only U.S. income that Mary has in 2000, is some U.S. interest income. Mary may have the Canada-U.S. Tax Convention apply so that she is considered a resident of Canada and not of the U.S. (Article IV, paragraph 2). These rules are typically known as the *tie-breaker* rules and are typical in many tax treaties.

If Mary decides to go this route, she must determine her U.S. tax liability as if she were a nonresident alien. She is required to file Form 1040NR on or before June 15th 2001. Unlike U.S. residents and citizens, nonresident aliens of the U.S. do not pay tax on their worldwide income, but rather are subject to tax only on U.S. source income.

Attached to any applicable 1040NR, Mary may be required to disclose the fact that she is relying on a specific treaty-based position to avoid being treated as a U.S. resident. A fully completed Form 8833 (Treaty-Based Return Position Disclosure Under Section 6114 or 7701(b)) will be considered adequate disclosure. If Mary is required to file such a disclosure, and fails to do so, a penalty of $ 1000 may be applicable.

The bottom line is that failure to comply with Uncle Sam, may be a costly proposition for your clients. Obtaining timely professional advice in such circumstances may be prudent.

Joseph Soussan founded ***North American Tax Services*** in 1998. Since 1997, he is a member of the Certified General Accountants' Association of Ontario. He completed the CICA In-Depth Tax Course in 2000, and obtained CPA certification in 1998 from the state of Delaware. 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.

He currently practices exclusively in the areas of both cross-border corporate and personal taxation. He has, to date, provided extensive consulting and compliance services to the following firms in Toronto and Montreal: Deloitte and Touche, Ernst and Young, I.T.S.G, Cross-Border Tax Services, Horwath Orenstein LLP, and other local CA firms. If he can be of assistance to your firm, please do not hesitate to contact him (Tel: 416-567-1829).

Cross-Border Tax Insight is published by ***North American Tax Services*** as an information service to clients and friends of the firm. This publication should not be used as substitute for professional advice. Qualified professional tax or legal advice should be sought prior to applying tax or other types of law to a particular set of facts. Comments and questions are welcome.