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The U.S. TAXFAX

TOPIC: FREQUENTLY ASKED QUESTIONS

This edition of the U.S.TAXFAX discusses the frequently asked questions regarding individual taxation that we hear most often in our practice. Stay tuned for a future edition which will cover questions relating to corporations. Visit our website at www.kvdb.com for a complete list of the U.S.TAXFAXes, many of which address the following issues in greater detail.

Do U.S. citizens living in Canada have to file a U.S. return even if they are filing a Canadian return?

The answer is yes if their income exceeds a minimum threshold based upon the taxpayer's filing status. U.S. citizens, regardless of where they reside, must file an annual U.S. individual income tax return. This return is the same as that filed by a person living in the United States and must include worldwide income.

The IRS provides relief for those people who have not filed past returns and voluntarily file returns before being requested to do so by the IRS. They normally require that 6 past due returns be filed.

Do U.S. green card holders have to file a U.S. return even if they no longer reside in the United States?

The answer is yes as long as they want to maintain their green card. A valid green card holder must file a tax return based upon worldwide income in the same manner as a U.S. citizen.

Why do I owe tax on my U.S. return when my only income is from Canadian sources and Canadian taxes are definitely higher than U.S. taxes?

In most cases it is because of the U.S. Alternative Minimum Tax (AMT). AMT may be payable in certain situations as the maximum foreign tax credit allowable for AMT purposes is restricted to 90% of the AMT liability. This means that AMT can be due regardless of the Canadian tax paid. Bear in mind that the AMT can oftentimes be reduced or eliminated with proper planning.

I am a Canadian resident who earns consulting income from the U.S. Am I required to file a U.S. tax return?

A U.S. nonresident tax return is generally required. The Canada - U.S. Tax Convention (Treaty) provides that self-employed consultants are not subject to federal taxation as long as the U.S. income is not earned through a fixed base in the United States. The catch is that a tax return must be filed in order to claim a benefit under the Treaty. Penalties may be assessed for failure to file a tax return and claim a Treaty position.

A State income tax return may also be required. As many states do not honor the Treaty, there may be a state tax liability even though there is an exemption from Federal tax under the Treaty. Alabama, California, Connecticut, Hawaii, Kansas, Maryland, New Jersey, and Pennsylvania are among the states that do not currently recognize the Treaty in whole or in part.

I own a rental property in the U.S. that operates at a loss. Am I required to file a U.S. tax return? Will I owe tax?

The default rule is that a nonresident who earns rents from U.S. sources is subject to 30% tax on gross rents without the benefit of deductions. However, an individual may elect to file a U.S. tax return and pay tax on a net rental basis after deduction of all allowable expenses including depreciation. Any losses from the rental activity can be carried forward to offset any gain on future disposition.

I own a rental property in Hawaii that is losing money and was told that I owe Hawaii Tax. Can this be true?

As mentioned above, a nonresident will generally elect to file a Federal return and report rents on a net basis. An Hawaii nonresident individual tax return must also be filed on a net rental basis. No Hawaii income tax will result if the property operates at a loss.

However, Hawaii has two other taxes that are often overlooked by nonresidents owning rental real estate in Hawaii. These taxes are the Transient Accommodations Tax and the General Excise Tax and are applied to gross rents. This means that they are payable even if the property is operating at a loss. The Hawaii Department of Revenue takes a very aggressive approach against taxpayers that are in non-compliance.

I have owned a rental property in the U.S. for years and have never filed returns. I have never heard one word from the IRS so why should I file returns now?

The day of reckoning usually comes when the property is sold. In situations where the vendor of real estate is a nonresident, U.S. law requires the purchaser of the property to withhold 10% of the gross proceeds of sale and remit this amount to the IRS. An income tax return must be filed to recover any excess tax withheld. If returns from previous years have not been filed, losses (if any) from those years may not be used to reduce the gain on sale.

A U.S. return is also required by CCRA before they will allow an individual to claim a foreign tax credit for the U.S. taxes paid. The information slip showing the 10% tax withheld on the gross sales proceeds is not sufficient. If the U.S. return is not filed, CCRA will disallow any foreign tax credit. This often forces an individual to come forward and file a return.

Many states also force nonresidents to file State income tax returns by withholding taxes on the gross sale proceeds (e.g. California and Hawaii).

I won money in the U.S. and they withheld 30% tax from my winnings. Can this tax be recovered?

All of the tax can be recovered if: Gross losses for the calendar year from certain specified gambling activities exceed gross winnings, A U.S. Individual Taxpayer ID number (ITIN) is obtained from the IRS and A U.S. income tax return is filed.

If winnings for the year exceed losses, only the taxes withheld in excess of 30% of the net winnings will be recoverable by filing a return.

The difficult part in most cases is determining the amount of winnings and losses for the year, as receipts are often not available.

We have held U.S. stocks forever and just recently our broker requested that we complete a form that discloses information about us to the IRS. What is this form and must it be completed?

The IRS requires that all payors of income such as dividends, interest, rents and royalties withhold taxes of 30% on the gross payments unless the recipient can verify that they are either exempt, or eligible for a reduced rate of withholding under the Treaty. The forms that accomplish these tasks are either Form W8-BEN or Form W-9.

Please remember, the information presented is general in nature and does not constitute professional advice. It is recommended that accounting, legal or other professional advice should be sought before acting upon any of the information contained.