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NOTICE TO READER

The following commentary has been prepared by Parker Garber & Chesney, LLP based on information available to the public on the date of publishing.

Readers are cautioned that this commentary is informational only and that any issues specific to the reader's needs be addressed with the appropriate tax professional.

The reader is cautioned that this document is not meant to provide advice specific to the reader's particular situation and that advice cannot be given in such a manner.

Summer is over, though for those in Toronto it seems like it never began. Now it is time to start thinking about year-end tax planning. Over the next few months we will address a number of issues that should be considered and the usual tips and traps that can present themselves.

CORPORATE TAX

RESIDENCY

There is a common misconception that a corporation is resident where it is incorporated. Tax law (Canadian and other jurisdictions) and various income tax treaties as well as court decisions in many jurisdictions have determined otherwise.

Many Canadian companies doing business in foreign countries often operate as separately incorporated subsidiaries. This provides a certain amount of tax shielding as well as liability protection for the parent company. However, a foreign subsidiary may be considered a Canadian corporation for tax purposes if it's "mind and management" is located in Canada. Generally speaking that means that if all or most corporate and operating decisions are made in Canada then the company can be deemed a Canadian company for tax purposes. This may result in double taxation if the company is also considered a tax resident of the foreign jurisdiction.

Deciding factors can include the residency of the majority of the board of directors, the residency and location of key decision makers including senior officers.

If you are operating a foreign subsidiary or considering beginning operations outside of Canada a discussion with our office before establishing a structure may avoid costly tax problems down the road.

US TAX UPDATE

STATE TAX ISSUES

One of the many issues often ignored when beginning to do business in the U.S. is the impact of state income and sales tax laws that may not correspond to IRS rules. In particular it should be noted that the Canada-US Tax Treaty does not generally apply to state tax regimes so that while you may feel that the treaty provides protection from federal tax in the US the same exemption is not available for state purposes.

States use the concept of "nexus" to determine potential application of income and/or sales tax. The definition of nexus is that it is a tie, connection or link



between two parties. Different states have substantially different views of the amount of nexus required to make a business taxable in the particular states.

Some states require a permanent establishment or employees located within the state in order to create nexus. However some states are very aggressive and require very minimal activity to create nexus. New York has ruled that the solicitation of business in New York, by employees or independent contractors is enough activity to create nexus. They also consider the delivery of goods, other than by common carrier, to create nexus. Other states with interpretations include Texas and Pennsylvania.

Establishing a US subsidiary to provide services in the US and keep the Canadian operations outside of the jurisdiction of the IRS has been the preferred means in the past but states actions have worked to draw the parent company into the state tax regime by virtue of the connection. One potential resolution would be to have the US company owned by a Canadian holding company that is not also the operating company in Canada.

The states have also become quite aggressive in finding potential non-compliance by coordinating with US Customs and also checking with state transport authorities that have records of all goods transported through weigh and inspection stations.

IN THE COURTS

CHILD CARE EXPENSES

The case of Jones v. The Queen was a parent's claim that after-school gymnastics classes provided the parent with child care services eligible for the child care expense deduction. CRA has always taken the position that activities that are instructional, such as swim classes, gymnastics and music, are not child care because the main intent is the instruction and not the care.

Fortunately for the taxpayer the Tax Court found that these kinds of activities can have more than one purpose and that since the classes afforded the taxpayer the opportunity to work the child care expense deduction was available.

This case was decided before the advent of the Child Fitness Credit and it would be interesting to find out what CRA's position would be in claiming the expense in both categories.

