A WORD ABOUT CANADIAN TAXES

With the weakening of the US dollar against the Canadian dollar, the owning of recreational property or other real estate in Canada is not as common as it was several years ago. However, many people still own a recreational property that is used during the year or used personally and rented out at times during the year. In some areas Canadian tax rules appear to mirror the internal revenue code. However, there are many significant differences that owners of taxable Canadian property should be aware of. Taxable Canadian property includes real property (i.e. land and buildings) situated in Canada.

In Canada, the residency of the taxpayer usually determines personal taxation. However, there are special rules when non-residents own real estate in Canada and either dispose of it or earn rental income from the property. Both of these situations require the filing of the special Canadian personal tax return for the year in question. While the normal Canadian return requires the reporting of worldwide income, these special returns require only the reporting of the capital gain in Canada or the real income earned in Canada.

In the case of an American citizen who owns a vacation property in Canada and uses it only for personal purposes, there is no tax filing required until the property is disposed of. There is no rollover of capital gains for principal or other residences in Canada. Therefore, in the year of disposition, the owner of the property must report the disposition and the capital gain or loss. Special rules require tax to be withheld at the time of sale pending the filing of the actual tax return.

In the case of rental income being earned from these investment properties, the legislation requires the income to be reported annually on a calendar year basis on the special tax return. Unless a special election is made, the tenant must withhold and remit taxes to the government based upon the monthly rental payment. Any treaty between Canada and the country of the owner determines the percentage of the withholding. Again, special elections are available that can substantially reduce these withholdings or eliminate them if the owner commits to a filing of a personal income tax return annually.

The rules are relatively easy to follow, but if they are not followed the penalties can be harsh and the late filing of elections or requests for waivers of certain rules are not usually accepted.

If you have any questions, or would like more information, please contact your ATA representative.

SAVE THE DATE—NADA 2006 CONVENTION

LET THE COUNTDOWN BEGIN:

AutoTeamAmerica

13TH ANNUAL CEO/CFO FORUM

Friday, February 2, 2007; 2:00 p.m.

Paris Las Vegas; Las Vegas, NV

Cocktail reception sponsored by *Comerica* will immediately follow the program.

Media Resource: *WD&S Publishing,* Publishers of *Dealers Edge*

Watch your mail for registration information or contact your ATA firm to receive an invitation.

HOW MUCH DO YOU KNOW ABOUT *TIPRA*?

Earlier this year, Congress passed the Tax Increase Prevention and Reconciliation Act (TIPRA). Still pending tax legislation is the extension of many taxpayer-favorable income tax provisions, including the DC empowerment zone wage credit and related provisions, as well as attempts to repeal or modify the estate and gift tax rules.

It is believed that three provisions of TIPRA will have broad application to many taxpayers: an extension of the 15% tax rate on long-term capital gains and qualified dividends; an increase in the age of children for whom the *kiddie tax* rules apply; and the elimination of the income ceiling for converting an individual retirement account (IRA) to a Roth IRA.

Extension of 15% Tax Rate

TIPRA was enacted in May 2006 and provided an extension of the 15% maximum tax rate for individual taxpayers on long-term capital gains and qualified dividend income through 2010. With the 15% tax rate extended two more years, investors have more certainty about future tax rates on investment income.

However, not all dividends and capital gains qualify for the 15% rate. Capital gain income on the sale of collectibles continues to be taxed at a maximum 28% tax rate and short-term capital gains are taxed at the taxpayer's ordinary income tax rates, which is a maximum rate of 35%. The holding period definition remains unchanged at more than 12 months for long-term treatment and 12 months or less for short-term.

Kiddie Tax – Age Increase

Under the *kiddie tax* rules, a dependent child's unearned income is taxed at the parent's Federal income tax rates (which can be as high as 35% or 15% for long-term gains and dividends) instead of at the child's lower rates (which can be as low as 10% or 5% for long-term gains and dividends).

Before 2006, the *kiddie tax* applied to dependent children under the age of 14. Under the new law, effective for 2006, the *kiddie tax* rules apply to dependent children under 18. For 2006, the *kiddie tax* applies when a child's unearned income exceeds $1,700. The child's first $850 of unearned income is not taxed at all, the next $850 of unearned income is taxed at the child's tax rate and the child's unearned income above $1,700 is taxed at the parent's marginal tax rate.

As part of their investment planning, whether it is solely income tax planning in connection with a college savings plan or for estate planning, many parents use the unearned income threshold (i.e., $1,700 for 2006) as a guide for identifying assets to transfer to their children. Assets transferred to children under the age of 18 are generally held in custodial accounts.

As an alternative, you may want to consider other more tax-favored ways of building a college fund, including Section 529 qualified tuition programs. The 529 plan earnings are exempt from income tax and grow tax-deferred within the plan. Withdrawals are tax-free when used for qualified higher education expenses. Although there is no Federal income tax deduction for a contribution to a 529 plan, many states including Maryland, the District of Columbia, Missouri, and Virginia allow a state income tax deduction. Please note that it is important to check the specific state rules and annual deduction limitations.

Other alternatives to reduce the income tax on a child's investment income include tax exempt bonds and US Savings bonds (Series EE & I) that allow deferral of the recognition of the accrued interest income until the year of final maturity, redemption or other disposition. This is presumably allowing flexibility to time the recognition in a lower tax rate year, such as after the child turns 18 when his or her income likely will qualify for lower rates.

Roth IRA Conversions

TIPRA also includes a provision allowing the conversion of an IRA (individual retirement account) to Roth IRA status without regard to an income limitation. This provision is about the timing of tax revenue for the government and is considered a tax revenue raiser provision. It is an opportunity for taxpayers who anticipate future tax savings sufficient to offset the tax paid on conversion. The change is effective for tax years after 2009. If the conversion election is made in 2010, the tax due on conversion is payable over two years- half in 2011 and half in 2012.

How do you estimate the savings and make the decision? The tipping point in the analysis might be the flexibility allowed for a Roth IRA that is not available for a Traditional IRA. For instance, Roth IRAs have no mandatory withdrawal requirements, as do traditional IRAs. Therefore, the fund can remain invested tax-free, and although subject to estate tax, the beneficiary will be getting tax-free income unlike those who inherit traditional IRAs.

Many of us would choose to lock in the future tax-free withdrawal benefit of a Roth IRA by paying tax on a limited amount of pre-conversion income. Anyone, regardless of income level, can make nondeductible contributions to an IRA.

For 2006 and 2007, the annual contribution limits are $4,000 and $5,000 if you are 50 or older. For 2008 and 2009, the contribution limits are $5,000 and $6,000. Only the earnings prior to conversion in 2010 will be subject to tax, and all future earnings will be tax free regardless of when withdrawn.

Please contact your ATA representative for more information.

TAX TIP

ENERGY EFFICIENCY DEDUCTION

On June 2, 2006 the Internal Revenue Service (IRS) issued an advance copy of Notice 2006-52 on how commercial building owners or leaseholders can qualify for the tax deduction for making their building energy efficient. The notice establishes a process to certify the required energy savings in order to claim the deduction.

The commercial building deduction, which was enacted in the Energy Policy Act of 2005, allows taxpayers to deduct the cost of energy-efficient property installed in commercial buildings.

The amount of the deductible may be as much as $1.80 per square foot of building floor area for buildings that achieve a 50-percent energy savings target. The notice provides that buildings below the 50-percent threshold may, nevertheless, qualify for a deduction of up to 60 cents per square foot of building floor area if they meet a 16⅔-percent energy savings target.

Before claiming the deduction, the taxpayer must obtain a certification that the required energy savings will be achieved. The notice describes the content of that certification and the qualifications that must be met by the person providing the certification.

Contact your ATA accountant to determine what you have to do to qualify for this credit.