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OFFICE OF
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[REDACTED]

Dear [REDACTED]:

This is in reply to your letter dated June 19, 2002, in which you requested assistance and advice regarding your ability to claim a foreign tax credit for Canadian income tax paid on a gift transfer of a Canadian summer cottage to your son.

Your letter contains a number of specific questions regarding whether the Canadian tax paid is creditable on your U.S. income tax return. The National Office of the Internal Revenue Service may issue rulings to individuals as to the tax effects on their acts or transactions in circumstances described in Revenue Procedure 2002-1, 2002-1 I.R.B. 1. The revenue procedure, which also sets forth the procedural requirements for obtaining a ruling, is available on the Internet at http://www.irs.gov/ind_info/bullet.html. While your letter did not comply with the requirements for obtaining a letter ruling, we offer the following general information.

Section 901(a) of the Internal Revenue Code permits a taxpayer to elect to credit income taxes paid or accrued to a foreign country against the taxpayer's U.S. income tax liability, subject to the foreign tax credit limitations of section 904. Section 904(a) and (d) generally limit the allowable foreign tax credit to the amount of pre-credit U.S. tax on the taxpayer's foreign source taxable income. Section 862(a)(5) of the Code provides that gains, profits, and income from the sale or exchange of real property located without the United States shall be treated as foreign source gross income. However, in general, a gift transfer of property by a taxpayer to another individual is not, for U.S. income tax purposes, a taxable event to the donor. Instead, the donee is assigned the donor's basis in the property under section 1015 of the Code, and the donee, rather than the donor, will be liable for U.S. income tax on the appreciation in the property upon a subsequent sale or exchange. Under section 904(c), creditable foreign taxes in excess of the pre-credit U.S. tax liability on a taxpayer's foreign source taxable income may be carried back two years and forward five years, but in each year the allowable credit is limited to the U.S. tax on the taxpayer's foreign source income.

Article XXIV(1) of the United States-Canada Income Tax Convention, available on the IRS web site at <http://www.irs.gov>, provides that residents of the United States are

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permitted a credit against U.S. income tax for the appropriate amount of income tax paid or accrued to Canada. Paragraph (3)(a) states that for purposes of Article XXIV, income or gain shall be deemed to arise in Canada (i.e., treated as foreign source income) to the extent that Canada may tax it. Article XIII(1) of the Convention provides that gains derived by a U.S. resident from the transfer of real property situated in Canada may be taxed by Canada.

Article XIII(7) of the Convention provides an election that may prevent double taxation in situations where an individual is subject to tax on the transfer of real property in both Canada and the U.S., but where only Canada deems that a taxable transfer of property has occurred at a particular time. The election under Article XIII(7) of the Convention permits an individual to be liable to tax in the U.S. for the year in which the property transfer is deemed to have occurred in Canada as if the individual had sold and repurchased the property for an amount equal to its fair market value at a time immediately prior to the deemed transfer. The effect of the election is that the individual will have a U.S. tax liability against which to take a credit for the Canadian tax. The U.S. Treasury Department Technical Explanation to the Convention specifically indicates that Article XIII(7) would apply in the situation of a gift by a U.S. resident which Canada deems to be an income-producing event for its tax purposes but with respect to which the U.S. defers taxation while assigning the donor's basis to the donee.

To make the election provided in Article XIII(7) of the Convention for purposes of claiming a foreign tax credit for Canadian tax paid a taxpayer must file, in addition to Form 1116 (Foreign Tax Credit for Individuals), a Form 8833 (Treaty-Based Return Position Disclosure Under Sections 6114 and 7701(b)) with the U.S. income tax return for the year of the transfer. Forms 1116 and 8833 are both available on the IRS web site at http://www.irs.treas.gov/forms_pubs/forms.html.

The foregoing is general information provided for your assistance and does not constitute a ruling. We hope the information will be helpful to you.

Sincerely,
Barbara A. Felker (Badge # 50-02271)
Chief, Branch 3
Office of the Associate Chief Counsel
(International)