Tax Filing Obligations for U.S. Shareholders of a Foreign Corporation

"u.s. shareholders" of a CFC are required to file Form 5471 with their personal tax return, even if the CFC has no subpart F income. Form 926 is used to report transfers ofproperty (including cash) to a foreign corporation. Since a foreign corporation will have some kind of foreign bank or financial account, the U.S. shareholders who have control, signatory authority or a financial interest, over the account must file Form TD F 90-22.1 by June 30th of the year after the calendar year. If the foreign corporation's shareholders have made an election to have the corporation treated as a disregarded (non-corporate)entity for U.S. tax purposes, then the shareholders must file a Form 8865 for a foreign partnership and a Form 8858 for a foreign disregarded entity. In order to make an election to be treated as a disregarded entity, a Form 8832 must be filed. If the foreign corporation has made an investment in any passive foreign investment companies, or if the foreign corporation is a PFIC, then the U.S. shareholders may be required to file a Form 8621 to report their share of the income of the PFIC or the gain on any dispositions of PFIC shares. If the Foreign Corporation has any U.S.-source income, it will need to file a Form 1120-F. If it is a Foreign Sales Corporation, it will need to file a Form 1120-FSC. In the event of the purchase or sale of a foreign corporation, the buyer and seller will need to file a Form 8883, which is an Asset Allocation Statement. If the shareholders or the corporation rely on a treaty that overrides a provision of the IRC, a Form 8833 must be filed to reflect a Treaty Based Return Position. Depending on the nature of thebusiness of the corporation, other forms may be required.

The following is a very brief description of the forms mentioned here.

Form 5471 for U.S. Shareholders of Foreign Corporations This is an "Information Return of U.S. Persons With Respect to Certain Foreign Corporations." It is required to be filed at the time that you file your corporate or personal tax return, including any extended filing date. A second copy must be sent to the Philadelphia office of the IRS.

If you are: (1) a shareholder, director or officer in a foreign corporation; (2) the grantor ofa trust that has formed a foreign corporation (aka IBC); or (3) an individual whose U.S. corporation or partnership owns shares in a foreign corporation, then you must determine whether you are required to file IRS Form 5471.

There are five categories of persons required to file this form:

(1) A U.S. citizen or resident who is an officer, director or a 10% shareholder of a FPHC (Le. an investment company).

(2) A U.S. citizen or resident who is an officer or director of a foreign corporation in which a U.S. person has acquired stock that meets the 10% ownership requirement.

(3) A U.S. person (defined below) who acquires stock in a foreign corporation,which when added to any stock owned meets the 10% ownership requirement.

(4) A U.S. person who had control of a foreign corporation for an uninterrupted period of at least 30 days during the accounting year of the corporation.

(5) A U.S. shareholder who owns stock in a foreign corporation that is a CFC for an uninterrupted period of 30 days or more during any tax year and whoowned that stock on the last day of the year.

For the purposes described above, a "U.S. Person" includes a citizen, permanent resident, domestic partnership, domestic corporation, a domestic trust or a domestic estate. Depending on which of the five categories apply to a particular taxpayer, differentschedules must be completed. An officer of director of a CFC who is not an owner of the CFC will be required to file under category 2 where certain U.S. persons have acquired additional stock in the corporation. A category 2 filer is only required to complete page one and schedule G. Where a U.S. corporation is the 100% owner of a foreign corporation that is not a FPHC, the corporation could be classified as a category 3, 4 and 5 filer. In this case, all of the schedules except Schedule A, Part II and Schedule 0, Part 1 may be required.

In the instructions to the 2006 Form 5471, the IRS estimates that the average time required for record keeping to prepare this form is 82.5 hours, that the average time required for learning about the form is 16 hours and that the average time required to prepare the form is 24 hours. (That does not include the separate time estimates for schedules J, M, Nand 0.) Clearly, these time estimates are for fairly substantial business activity rather than for a foreign corporation with only a few transactions. However, we believe the time required to learn how to prepare this form is much greater than the IRS estimate, even for a tax professional who familiar with domestic tax law.

A nasty surprise that your pre parer discovers when reading the instructions is that Schedules C, F and H must be prepared on the basis of U.S. based GAAP (generally accepted accounting principles). This precludes the use of the cash or hybrid method of accounting. The return itself is just four pages, but there are also four pages of worksheets included in the 15 pages of instructions.

You must find out if you or your company is required to file this form. If you have any ownership interest in a foreign corporation or if you are an officer or director of a foreign corporation, you must file. If you are the grantor of a foreign trust and if the trust owns shares in a foreign corporation, you may have to file this form. The following is a partial list of who has to file. If you own 50% or more of a domestic corporation or partnership that owns 10% or more of a foreign corporation, you might be required to file this form.

The penalties for a failure to file the return are severe - and it is not necessary that thecorporation have any profits for the penalties to apply. A return must be filed even if there is no taxable income to report. Complete details of the applicable penalties are provided in the instructions to Form 5471, but in general, the penalty is $10,000 per year for failing to file the form. In addition, if the form is not filed, your personal income tax return is deemed to be incomplete and the statute of limitations does not begin to run until the information required by Form 5471 has been submitted. .

This form is required to be filed by April 15th or the extended due date of your personal or corporate tax return.

Form 926 for Transfers to Foreign Corporations

Previously, Form 926 was required to report the transfer of certain property to foreign corporations, partnerships, estates or trusts. It was primarily used to report transfers of appreciated property that were potentially subject to the 35% excise tax under IRC Section 1491. However, that IRC section was repealed by the *Taxpayer Relief Act of* 1997 and the continued purpose of Form 926 was unclear, until it was revised in October, 1998.

This return now requires the disclosure of transfers of tangible or intangible property (even if it is not appreciated property) to a foreign corporation. Transfers to a foreign partnership are to be reported on Form 8865. Transfers to a foreign trust are to be reported on Form 3520.

Form 926 is a brief one and % page form with only two pages of instructions. However, it requires an attachment describing the property transferred that can sometimes involve more than a few pages of explanation.

The report is required to be included with the taxpayer's income tax return. Failure to file this form may subject the transferor of the property to a penalty of 10% of the fair market value of the property, but not more than $100,000, unless the IRS can show that the failure to file was intentional. In addition, the statute of limitations for examining an income tax return where the form should have been filed is extended to three years after

Form 926 is filed.

On February 4, 1999, the IRS and the Treasury Department released final Treas. Regs. that modify, clarify and, in some cases, simplify information reporting requirements contained in proposed Treas. Regs. issued on September 8, 1998, relating to transfers by U.S. persons to foreign corporations. The final Treas. Regs., which implement amendments made by the *Taxpayer Relief Act of* 1997 and require certain cash transfers to foreign corporations to be reported, also provide guidance needed to comply with the reporting requirements related to such cash transfers and transfers of property to foreign partnerships.

Form 8832-Check the Box Entity Classification

This form can be used to avoid having to file a Form 5471 if it is filed on a timely basis after the formation of a CFC. For a single owner CFC in a country that is not on the "per se" list described in Treas. Reg. Section 301.7701-2(b)(8), the corporation can elect to be a "disregarded entity." Generally, the "per se" list does not include any International Business Companies or any foreign limited liability companies. An IBC and a foreign LLC will be treated as a foreign corporation unless it makes an election to be a disregarded entity.

A summary of the income, expenses, assets and debts of the foreign entity will have to be reported on a Form 8858 (see below). The net income of the entity would then be included in the Form 1120 of a domestic corporation that is the sole owner of the CFC or on the Form 1040 of an individual who is the sole owner of a CFC. If there are multiple owners of the foreign entity, it will have to file a Form 8865 (see below) for a foreign partnership.

With a disregarded entity election, the Form 5471 is not required. However, that is not clearly the case with the Form 926 and we advise clients to file this form even if they have elected to have their CFC be taxed as disregarded entities.

The disregarded entity election does not help to avoid the complications and cost of the Form 5471 for a foreign corporation or LLC with multiple owners because the owners will be required to file a Form 8865, which is more complicated than the Form 5471. But it does permit flow through tax treatment and avoids a number of tax disadvantages of the CFC.

Form 8858-Information Return of U.S. Persons with Respect to Foreign Disregarded Entities This form was first required for the 2004 tax year. It consists of three pages and is designed to provide the IRS with a way to connect foreign disregarded entities with their U.S. owners. It requires identifying information, a summary of the income and deductions, a very brief balance sheet, a number of questions and a brief summary of the earnings and profits of the foreign entity. The third page of the form is a matrix of transactions between the entity and various related parties, including the owners of the entity. This page substantially duplicates the information required by Form 926 but there is no reference to the Form 926 on this form or to this form from the Form 926.

There is a penalty of $10,000 for a failure to file this form "within the time prescribed." The time prescribed is the due date of the tax return of the owner(s) of the disregarded entity including any extensions of time to file.

Form 886S-Return of U.S. Persons with Respect to Certain Foreign PartnershipsWhere there are multiple owners of a foreign limited liability entity or foreign partnership, certain U.S. owners of the entity must file a Form 8865. This form is a combination of the Form 1065 for domestic partnerships and the Form 5471 for CFCs. Because of the complexity of partnership tax law, the foreign partnership return is more complex than the foreign corporation return but the instructions to the Form 8865 are just 10 pages as compared to 15 pages for the foreign corporation return.

The filing requirements are somewhat similar to those for the U.S. owners of a CFC and also serve to identify which of the various schedules must be submitted by different kinds of filers.

A category 1 filer is a U.S. person who owns 50% or more of the partnership. Because of the rules for constructive ownership and attribution of ownership, there can be more than one 50% owner of a foreign partnership.

A category 2 filer is a U.S. person who owns a10% or greater interest in the partnership.However, if the partnership had a category 1 filer, no other partner would be required to file as a category 2 filer.

A category 3 filer is a U.S. person who has contributed property to the partnership during the tax year and who owns a 10% or greater interest after making that contribution or whose contribution had a value (on the date of the transfer) in excess of $100,000.

A category 4 filer is a U.S. partner who had an acquisition, disposition or change in his proportionate partnership interest during the tax year.

A schedule K-1 is required to be prepared for each U.S. partner to report the partner's share of the income, deductions and credits of the partnership.

The Form 8865 must be filed with the income tax return of the U.S. partners who are required to file the form. In some cases, this could include all of the partners or in other cases, it might only include a 50% or greater partner.

There is a $10,000 penalty for a failure to file a timely return. A reduction in foreign tax credits will be imposed for an incomplete return filed on time.

Form 8621-Passive Foreign Investment Company

Form 8621 is used to report the income of or gains from a PFIC, which is a foreign corporation where 75% or more of the gross income is from passive investments or where 50% or more of the assets are held for the production of investment income or gains.

If a foreign corporation owned by U.S. persons is a CFC and is also a PFIC, the CFC reporting rules take precedence for the shareholders who own at least 10% of the stock of the corporation. Thus, income received from the CFC/PFIC or gains from thedisposition of shares of the PFIC will be treated as subpart F income and will be classified as ordinary income in the hands of the shareholders of the CFC/PFIC.

However, those shareholders of the CFC/PFIC who own an interest of less than 10% will be subject to the PFIC reporting rules. This means that they must either elect to pay tax on the

Glossary

A Plain English Guide to Tax Jargon in this Book

The following explanations represent a plain English translation of the applicable tax and financial terms. The emphasis in the Glossary is on tax and financial terms that are common in connection with international transactions.

2003 Tax Law: The Jobs and Growth Tax Relief Reconciliation Act of 2003.

2004 Tax Law: The American Jobs Creation Act of 2004

***10/50* Corporations:** A non-CFC with at least a 10% but not more than a 50% ownership by U.S. taxpayers

Above-the-line Deduction: A deduction that reduces adjusted gross income such as IRA contributions, alimony and others that are listed at the bottom of page one of the individual Form 1040.

Accrual Method of Accounting: An accounting method is which revenue is recognized as income when it is earned, even though not received and expenses are recognized when incurred even though not yet paid. (See Cash Method.)

Adjusted Basis: The cost of property after adjustment for certain deductions or additions as permitted or prescribed by the U.S. tax laws. In some instances, the basis of property is derived from the basis of other parties, such as a donor or an estate.

Adjusted Gross Income: Total individual income before itemized or standard deductions and personal exemptions.

Affiliated Group of Corporations: Corporations with the same parent or subsidiary corporations or corporations owned by the same non-corporate individuals or entities, which elect to file a consolidated return.

Alien: A person who is not a citizen of the U.S.

Alternative Minimum Tax (AMT): A method of determining taxable income and the amount of tax due for high income taxpayers and corporations that uses rules significantly different from the rules used in the "normal" method of taxation. The initial purpose of this alternative tax scheme was to reduce the opportunities for total tax avoidance with various tax deductions and credits.

Annuity: Generally, any series of payments. In the context of a private annuity, it's a series of payments for the life of the annuitant or annuitants, which is also known as a life income annuity.

Annuitant: The person who receives an annuity, usually as payment for cash or other property, also known as the settlor or transferor

Appreciated Property: Property with a fair market value greater than its initial cost without regard to its tax basis.

At-Risk: These rules impose restrictions on deductions or credits to the value of indebted property that is subject to loss by the taxpayer. These rules primarily deny deductions or credits arising from debts for which the taxpayer is not personally liable.

Avoidance of Tax: Legal methods of tax minimization or reduction.

Basis: The cost of property for the purpose of computing gain or loss on the disposition of the property. In most cases, basis equals the purchase price. See adjusted basis.

Basis Limitations: Various parts of the tax law limit deductions and credits for property to the amount of adjusted basis for the taxpayer.

Bearer Shares: Shares of the stock of a corporation that are not registered. Whoever has possession of the bearer shares owns that portion of the net assets and net profits of the corporation. Bearer shares are often used to hide or disguise the ownership of the corporation.

Buyer: See obligor and transferee.

CCH: Commerce Clearing House, a major publisher of tax and legal information.

Capital Assets: Any assets that are not: (1) inventory in a trade or business; (2)depreciable personal or real property; (3) certain works created through the personal effort of the taxpayer; (4) business accounts and notes receivable; and (5) certain U.S. publications. Depreciable personal property and real property are subject to special rules for measuring the amount of any gain or loss but they are similar to those of other kinds of capital assets.

Capital Gains: For tax purposes, this is a gain on a capital asset.

Capital Loss: For tax purposes, this is a loss arising from the disposition of a capital asset wherein the property is sold for less than its adjusted basis.

Cash Method of Accounting: A method of accounting in which income is not recognized until it is received and expenses are not recognized until they are paid. (See Accrual Method of Accounting.)

Certificate of Deposit (C.D.): An obligation of a financial institution to hold a deposit and to return it and to pay interest at a future maturity date.

CFC: See Controlled Foreign Corporation.

Check-the-box: A method of selecting the form of taxation of an entity whereby a partnership, LLC or foreign corporation can elect to be taxed as a corporation or as a partnership (where there are multiple owners) or as a 'disregarded entity' where there is only one owner.

Commercial Annuity: Generally an annuity issued by an insurance company; an annuity that is not a private annuity.

Controlled Foreign Corporation (CFC): A foreign corporation in which over 50% of the stock is held by five or fewer U. S. persons who each own 10% or more of the stock.

Constructive Ownership: Taxpayers are deemed to have a common interest in the ontrol of an entity by virtue of their relationship. Generally. this relationship includes a spouse, lineal

descendants. parents and grandparents. siblings and co-owners of
corporations or partnerships. In some cases, constructive ownership applies to the beneficiary of an estate or trust. However, the specifics vary from one situation to another and rely on different definitions in the tax law.

Cost: The amount paid for an investment for tax purposes. See Adjusted Basis.

DASTM: See Dollar Approximate Separate Transactions Method of Accounting.

Deemed Royalties: Income that is imputed to a U.S. owner of an intangible asset that is transferred to a foreign corporation where the imputed income is based on an assumed royalty that is derived from the income generated by the intangible asset. Further details are included in our *Controlled Foreign Corporation Tax Guide* and IRC Section 367(d).

Deferred Payment Annuity: An annuity in which the first payment to the annuitant by the obligor does not begin until more than a year after the annuity payment was made by the annuitant.

Depreciable: Property that declines in value over time and for which the tax law permits annual deductions to approximate the annual loss of value of the property.

Depreciation: The amount of a deduction from the initial value (cost basis) of property to reflect the decline in value over time.

Direct Investments: An investment held in the name of the individual taxpayer.

Disregarded Entity: A foreign legal entity that elects to be treated for tax purposes as a disregarded entity or proprietorship (one owner). The election is made on Form 8832.

Dollar Approximate Separate Transactions Method of Accounting (DASTM): A method of accounting in a currency that is subject to hyper-inflation.

Domestic Entity: For federal tax purposes, an entity organized under the laws of one of the fifty states of the U.S. For the purpose of state law, this would apply to any entity organized in and subject to the laws of that state. Entities include corporations. Limited liability companies. partnerships. estates and trusts

Earnings and Profits: This is a difficult concept to describe briefly, but it basically represents the accounting income of a business as contrasted with the taxable income of the business. E & P is computed without use of certain accelerated deductions for depreciation and with some other adjustments.

Entity: An "entity" is an organization other than a natural person. It includes but is not limited to corporations, partnerships, trusts or estates.

Estate Tax: A tax based on the value of property transferred at death. The tax is based on a graduated set of rates ranging from 18% to 49% and is not applicable until the taxable estate exceeds the unified credit amount.

Evasion of Tax: Illegal methods of tax minimization or reduction, which usually involves some element of secrecy or deception.

Expatriation: The act or process of relinquishing citizenship or of changing the country of permanent residence. The term expatriate is also used to describe someone who is living and working outside of the U.S. even though that person has no intention of losing their citizenship or permanent residence status. But for tax purposes, expatriate refers to those who relinquish their citizenship.

ETl/ExtraterritorialIncome Exclusion: A tax deduction created to provide an incentive for export sales by U.S. taxpayers. It was repealed by the Jobs Act of 2004.

Fair Market Value: An amount that would be paid by a willing seller and accepted by a willing buyer, both of whom are under no compulsion to buy or sell and both of whom have full knowledge of the significant facts about the property.

Family Limited Partnership: A limited partnership that is owned entirely by members of the same family.

Fee Simple: The unrestricted ownership of property by an individual.

Fiscal Year: An accounting year that begins on a date other than January 1st and ends on a date other than December 31. The choice of a fiscal year is generally available only to corporations.

FIRPTA: Foreign Investment in Real Property Tax Act of 1980.

Flat Tax: This is a term used by advocates of an income tax system with a single tax rate. Some tax reform proponents advocate a flat or single rate tax based on the sales price of goods or services, which is the same as a sales tax.

Foreign Corporation: A corporation domiciled (located) in a different country or state.

Foreign Investment Company: A regulated investment company (mutual fund) that elects to distribute at least 90% of its income each year as provided in IRe Sections 1246 and 1247. These provisions have been repealed by the Jobs Act of 2004 for tax years after 2004.

Foreign Grantor Trust: A trust (formed by a U.S. person) that is created under and governed by the law of a jurisdiction outside the U.S. The U.S. person who funds the trust is generally treated as the owner of the assets of the trust for tax purposes, in accordance with IRC Sections 671 through 679. IRC Section 7701 (a)(30) classifies a trust for tax purposes as domestic if two tests are met. A trust is treated as a domestic trust if: (1) a court within the U.S. can exercise primary supervision over the administration of the trust;, and (2) one or more U.S. persons have the authority to control all substantial decisions of the trust. If either of the foregoing conditions is not satisfied, the trust is treated as a foreign trust.

Foreign Mutual Fund: See Passive Foreign Investment Company.

Foreign Partnership: A partnership that is formed under the laws of a foreign country.

Foreign Persons: Foreign means a non-resident of the U.S. who is a citizen of another country or an entity organized under the laws of another country. In the context of state law, the term refers to any entity not organized under the laws of that state. Also, see non-resident alien.

Foreign Personal Holding Company: A personal holding company that is a foreign corporation. The definition of a FPHC is included in IRe Section 954(c) but it generally includes passive investment income of a foreign corporation such as interest, dividends, capital gains and investment type rents or royalties. It also includes income for personal services performed by owners of the corporation.

Foreign Sales Corporation: A special category of a foreign corporation owned by U.S. persons that was given U.S. tax incentives for export sales. This tax provision was repealed by the *FSC Repeal and Extraterritorial Income Exclusion Act* of *2000.*

Foreign-Source Income: Income derived from sources outside the U.S., such as employment in a foreign country, income from a business or real estate located within a foreign country, dividends from some foreign corporations and other investment income from foreign-sources.

Foreign Tax Credit: A credit from U.S. income taxes for the amount of income taxes paid to a foreign country on the same income.

Form 926: Statement of transfers to or from a CFC.

Form 1116: Foreign tax credit for individuals.

Form 1118: Foreign tax credit for corporations.

Forms 3520 and 3520-A: See Foreign Grantor Trust.

Form 5471: See Controlled Foreign Corporation and Foreign Corporation.

Form 8621: See Passive Foreign Investment Company.

Form 8832: See Disregarded Entity.

Form 8865: See Foreign Partnership.

Form TD F 90-22.1: A return to disclose the existence and authority over a foreign bank account or other foreign financial account.

FPHC: A foreign personal holding company (see Personal Holding Company and Foreign Corporation).

FSC/ETI: See Foreign Sales Corporation and Extraterritorial Income Exclusion.

Functional Currency: A non-U.S. $ currency in which a business unit maintains its books and accounts.

G.A.A.P. (Generally Accepted Accounting Principles): A set of rules for the measurement or determination of income and net worth in the financial records of an enterprise. There are different methods of GAAP in different countries.

Gift: A gratuitous transfer of property or money for less than the fair market value of the property with the intent to make a gift.

Gift Tax: A tax based on the value of property transferred to others without consideration. The tax is based on the graduated set of rates used for the federal estate tax and is not applicable until the accumulated gifts by a taxpayer exceed the lifetime exclusion amount.

Grantor: The person who creates and funds a trust, usually for the benefit of another, where the person who funds the trust is treated as the owner of the trust assets under IRC Sections

671-679.

Hedging: This is an investment term that refers to the use of offsetting positions in various investments so that losses from one investment are offset by gains in another. Some businesses use hedging by purchasing an investment position that is expected to offset a gain or loss in a commodity due to price changes.

High-Yield Investment Programs: Alleged investments, usually from countries that do not have strict securities disclosure laws, which promise returns substantially higher than are available from traditional sources. The great majority (if not all) of these "investments" are Ponzi schemes in which the investments of new participants are paid to the earlier participants as a way to encourage them to spread the word about the investment.

HYIP: High Yield Investment Programs.

IBC: International business company or foreign corporation.

Imminent Risk of Dying: This means there is at least a 50% medical probability that the annuitant will survive for at least a year.

Income Tax: A system of taxation based on earnings from employment, profits from self-employment, income received from investments and capital gains from the sale of property. The U.S. income tax system permits numerous exemptions, exclusions and deductions and utilizes a graduated tax rate structure ranging from a bottom rate of 10% to a top rate of 35%.

Indirect Investments: An investment held by an intermediate legal entity such as a corporation or trust, rather than in the name of the individual taxpayer.

Installment Sale: The sale of property in exchange for a promise to pay for the property over a specified period of time, at a prescribed rate of interest. For tax purposes, the income is generally reported as it is received rather than when the transaction was made.

Internal Revenue Code (IRC): The Laws enacted by the U.S. Congress to define the tax obligations, tax compliance and reporting requirements, etc., of U.S. persons.

Investment in the Contract: For tax purposes, this is the amount that is paid by the buyer of an annuity for the annuity, plus or minus various adjustments. This is generally equal to the basis of the property being sold, plus any gain that may be recognized on the transaction.

Imputed Interest Rates: Interest rates that are assumed when there is no explicit rate in a specific transaction. For this purpose, the amount of an annuity payment includes an imputed interest factor similar to the interest rate on an installment sale. The applicable federal (interest) rate is prescribed by IRC Section 7520 and changes each month.

International Business Company: A corporation that is usually located in a low-tax country that is not allowed to conduct business in that country.

IRC: Internal Revenue Code.

IRS: Internal Revenue Service.

Inversion: The reincorporation of a company to a new country. This is sometimes referred to as corporate expatriation. The following definition is provided by the government: *"An inversion is* a *transaction through which the corporate structure of* a *U.S.-based multinational group is altered* so *that* a *new foreign corporation, typically located in* a *low- or no-tax country, replaces the existing U.* S. *parent corporation* as *the parent of the corporate group. "*

Investment in U.S. Property: Subpart F income of a CFC includes income that is invested in U.S. property, which includes a U.S. trade or business, U.S. real estate and stock or debt securities of a U.S. person. A complete definition is provided in IRC Section 956(c)

Joint Annuitant: A person who is one of two or more people who will receive annuity benefits in a joint and survivor annuity contract.

Joint and Survivor Annuity: An annuity in which the payments continue after the death of the first of two or more annuitants until after the death of all the annuitants who are parties to the contract.

Joint Ownership With Right of Survivorship: Property that is owned by two or more persons with an undivided interest in the property; also referred to as "tenancy in common" or "joint tenancy."

Life Expectancy Tables: The IRS has published tables of the average life expectancy of single annuitants and joint annuitants at various ages as set forth in the Treas. Reg. Section 20.2031-7A.

Life Income Annuity: An annuity that ceases at the death of the annuitant, with no further obligation to the estate or heirs of the annuitant.

Limited Liability Company (LLC): A legal entity that protects the members from personal liability arising from damages caused by the LLC or its employees. The LLC also helps to protect the assets owned by the LLC from the creditors of members (owners) of the LLC.

Limited Partnership: A partnership with two types of partners. General partners manage the partnership and are liable for any debts of the partnership in excess of the partnership assets. Limited partners have no personal liability for debts of the limited partnership beyond the amounts invested.

Long-Term Capital Gain or Loss: A gain or loss on a capital asset that may be subject to special tax treatment if the asset has been owned for more than a year by the seller. Generally, long-term capital gains are subject to a maximum tax rate of 20% for individuals and long-term losses are only deductible against any capital gains in the same year or to the amount of $3,000 of other income.

Medicare Tax: A tax of 2.9% of the wages of an employee, half of which is paid by the employer and half of which is paid by the employee through withholding. Self-employed persons pay the entire Medicare tax on their taxable profits.

Member: The term used to designate the owners of a LLC and to distinguish from partners or shareholders.

Mortality Risk: The risk of financial loss as a result of issuing an insurance contract on a person who survives for less for than the average life expectancy or as a result of issuing an annuity contract to a person who lives longer than the average life expectancy.

Non-Controlled Foreign Corporation: A foreign corporation that is not a CFC.

Non-Qualified Deferred Compensation: A deferred compensation arrangement for employees where no deduction is permitted by the employer until funds are distributed or otherwise available to the employee and subject to tax by the employee. For background on foreign deferred compensation plans see:

Non-Resident Alien: A person or entity that is not a citizen of the United States and is not a permanent resident of the United States.

NRA: See Non-Resident Alien.

Obligor: The person or company that is obliged to make the annuity payments, also known as the transferee or buyer (of the property).

Offshore: Usually refers to tax havens but it could apply to any country other than the country of residence or citizenship.

Ordinary Income: For tax purposes, this is a category of income that does not enjoy any special tax advantages. For purposes of an annuity contract, the imputed interest and the element of the payment that represents compensation for the termination of the obligation at death are taxed as ordinary income.

Original Issue Discount (010): A reduction in the issue price of a fixed income obligation (bond or note) below the redemption price. The difference represents interest that will be added to the redemption value of the obligation over time, instead of paying interest in regular intervals. (See IRC Sections 1272-1275.)

Passive Activity Loss: A loss resulting from an investment in a business enterprise in which the taxpayer is not an active participant.

Passive Foreign Investment Company: A foreign corporation in which 75% or more of the corporation's gross income consists of passive investment income (such as interest, dividends and capital gains), or a foreign corporation in which 50% or more of the assets of the corporation are used or held for the production of passive investment income.

Passive Income: Generally this means investment type income that is not compensation or profits from a trade or business in which the taxpayer is an active participant.

Payroll Taxes: A variety of taxes that are imposed on the amounts paid to employees. In the U.S. this usually includes the Social Security Tax, the Medicare Tax and the federal and state unemployment tax.

Personal Holding Company (PHC): A corporation in which over 60% of the income is earned from passive investments rather than from an active business, and that meets other conditions as set forth in IRC Sections 541-547.

Personal Services Income: This generally refers to income generated by a corporation from the personal services of an owner of the corporation

Personal Property: Generally consists of tangible property that is not real estate.

PFIC: See Passive Foreign Investment Company

Present Value: The immediate value of an amount or series of amounts that are not due until a future date. Generally, the present value of a future sum is the amount that would accumulate to equal that sum at a specified rate of interest (compounded) for a specified term of years.

Private Annuity: Generally an annuity contract that is not issued by an insurance company or is not a commercial annuity.

Qualified Appraisal: A formal valuation and appraisal analysis by a qualified appraiser who specializes in making appraisals of the subject property. The appraiser must be independent of the annuitant and the obligor.

Qualified Business Unit: This is a branch operation of a U.S. business or a subsidiary of a U.S. corporation that is operating in a foreign country and keeps its financial accounts in the currency of that country.

Qualified Electing Fund (QEF): A passive foreign investment company in which a U.S. shareholder has elected to report and pay taxes on the shareholder's portion of the annual income of the company.

Real Property: Land, buildings and improvements.

Recapture: A recovery by the IRS of deductions or credits claimed in one year that must be repaid in whole or in part due to a change in the qualifications of the taxpayer such as the disposition of property on which certain deductions or credits were claimed.

Real estate Investment Trust: An investment trust that invests in real estate properties and/or in debt obligations secured by real estate.

Regulated Investment Company: A mutual fund.

Reinsurance: A transaction where a portion of an insurance contract is sold to another insurance company or group of companies to spread the risk of loss. A reinsurance company is in the business of insuring the contracts of retail insurance companies that sell insurance contracts to the public.

Related Persons: Generally this includes a spouse, children, parents or grandchildren and any entities such as partnerships, corporations or trusts in which the taxpayer and anyone related to the taxpayer has effective control over the entity.

Resident Alien: A person who lives in the U.S. for an extended period but who is not a citizen of the U.S. A resident alien is subject to the U.S. tax laws in the same manner as a U.S. citizen.

RIC: Regulated Investment Company.

Sales Tax: A tax based on the retail sales price of goods and services that is collected by the vendor of the goods or services.

S Corporation: A domestic corporation owned by U.S. taxpayers that elects to be taxed in a manner similar to a partnership, where the income, deductions and credits of the business are passed through to the shareholders and that avoid the corporate income tax.

Self-Employment Tax: A tax imposed on the taxable profits of a proprietor or partner based on 15.3% of the taxable profits up to $87,000 (in 2003). Half of the total selfemployment tax is allowed as a deduction in computing adjusted gross income.

Seller: See transferor and annuitant.

Settlor: The person who creates and provides the funds for a trust.

Shareholder: The owner of stock of a corporation, which normally entitles the holder of to vote on the selection of directors and certain other matters as set forth in the by-laws of the corporation.

Social Security Tax: A tax of 12.4% of the wages of an employee in the U.S. for wages up to $87,000 (for 2003). Half is paid by the employee through payroll withholding and half is paid by the employer.

Stock Options: A contractual right to purchase or to sell a specified number of shares of corporate stock, at a set price, for a specified period of time.

Subpart F Income: The group of IRC Sections 951-964 that define the income of a CFC that is subject to current taxation by certain shareholders of the CFC.

Tax Credit: A tax credit is treated like a payment of taxes. It reduces the tax due dollar for dollar, whereas a deduction reduces the taxable income upon which the income tax is computed. If the applicable income tax rate is 25% of taxable income, then a $1 tax credit would be worth as much as $4 of deductions.

Tax Shelter: An investment or financial transaction that is designed to generate substantial tax deductions or credits. An abusive tax shelter is one that the IRS regards as having no economic, business or financial purpose other than to avoid taxes.

Terminally Ill: See Imminent Risk of Dying.

Transferee: The person or organization that receives property in exchange for an annuity; also known as the buyer or obligor.

Transferor: The annuitant who transfers property for the annuity; also known as the seller of the property.

Trust: A contractual relationship between the owner of property (the grantor), a manager of the property (the trustee) and a beneficiary, whereby the trustee manages the property for the benefit of the beneficiary in accordance with the contractual terms set by the grantor.

Unified Credit: A credit against the estate tax or the tax on accumulated lifetime gifts. In 2004 and 2005, the credit is $555,800, which is equal to a deduction of $1 ,500,000. In 2006 through 2008 the credit is $2,000,000.

Unrelated: A natural person who is not related to the taxpayer by blood or by marriage, or a legal entity that is not subject to the control of the taxpayer.

Unsecured Contract: The general credit of the obligor/transferee is the only form of security available to the annuitant. No collateral or other methods of ensuring payment by the obligor may be utilized.

U.S. Person: A U.S. person is a citizen, a resident alien individual, a domestic trust, estate, partnership or corporation.

U.S.-Source Income: Income derived from sources in the U.S. such as from employment in the U.S., income from a U.S. based trade or business and most types of investment income from U.S. real estate, corporate dividends and interest on debt issued by U.S. persons.

U.S. Person: A U.S. person is a citizen, a resident alien individual, a domestic trust, estate, partnership or corporation.

U.S. Situs Property: Property situated (based) in the U.S.

Value Added Tax (VAT): A method of taxation based on the sales price of various goods or services wherein the amount of VAT paid by suppliers is deducted from the total due by the seller. The VAT is used in many countries other than the U.S.

Worldwide Taxation: The U.S. imposes income and estate and gift taxes on the worldwide income and assets of its citizens and permanent residents, without regard to where the income is earned, where the assets are located or where the citizen/resident is living at the time.

WTO: World Trade Organization.