

IRS Announces New FBAR Relief for U.S. Citizens Residing Outside the United States and U.S. Expatriates Holding Foreign Retirement Accounts

Legal Alert
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Garvey Schubert Barer Legal Update, June 2012

On June 26, 2012, the Internal Revenue Service (IRS) announced a plan to help U.S. citizens living abroad, including persons holding dual citizenship who have failed to file U.S. tax returns or Form TDF 90-22.1, Report of Foreign Bank and Financial Accounts (FBAR) to become compliant with their U.S. tax filings without facing onerous penalties or additional enforcement action¹. The new guidelines are for “low compliance risk” taxpayers, generally people who have simple tax returns and owe \$1,500 or less in tax for any years covered under the new procedure. The new procedure will go into effect on September 1, 2012.

Low Compliance Risk Taxpayers

The IRS reprieve is for certain U.S. citizens and others residing abroad who haven’t been filing U.S. tax returns and provides the opportunity to catch-up with their U.S. tax filing obligations, *if they owe little or no back taxes*. Qualifying taxpayers will owe US\$1,500 or less in U.S. tax for any of the years covered by the new procedure. The new procedure, details of which have not yet been finalized, requires affected taxpayers to file delinquent tax returns along with the appropriate related information returns for the past three years and to file delinquent FBARs for the past six years. Payment of tax and interest will have to accompany the submission². Tax, interest and penalties, if appropriate, will be imposed in accordance with federal tax law. If the taxpayer claims reasonable cause for failure to file tax returns, information returns, or FBARs, a statement must be submitted explaining the reasonable cause. While the IRS announcement looks to provide Low Compliance Risk Taxpayers with a favorable approach to resolve delinquent U.S. tax filings, action under the new procedure must wait for final IRS procedures.

FBAR Filing Requirements With Respect to Foreign Retirement Accounts

The IRS also announced that for Low Compliance Risk Taxpayers, the new procedure will resolve certain issues related to certain foreign retirement plans. For example, U.S. expatriates living in Canada are not taxed by the United States on income earned by Canadian Registered Retirement Savings Plans (RRSP) so long as the taxpayer timely files their U.S. tax return and attaches Form 8891, “U.S. Information Return for Beneficiaries of Certain Canadian Registered Retirement Plans.” Many U.S. expatriates had no knowledge of the requirement to make an

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election for the deferral of U.S. tax on RRSPs. The IRS announced that the new procedure will offer retroactive relief for the failure to timely elect income deferral on specific retirement and education savings plans in which deferral is permitted by an income tax treaty with the United States. Taxpayers seeking to defer income on those types of retirement or education savings accounts would need to file a submission and provide: (a) a statement requesting an extension of time to make an election to defer income tax and identifying the pertinent treaty position; (b) for relevant Canadian plans, a Form 8891 for each tax year and description of the type of plan covered by the submission; and (c) a statement describing (i) the events that led to the failure to make a timely election, (ii) the events that led to discovery of the failure, and (iii) if the taxpayer relied on a professional advisor, the nature of the advisor's engagement and responsibilities.

Other FAQ's under the OVDP

The Offshore Voluntary Disclosure Program (OVDP) was announced on January 9, 2012 after the closure of the voluntary disclosure initiatives of 2011 and 2009³. OVDP allows delinquent U.S. taxpayers to become current with their U.S. tax returns, informational returns and FBARs with predetermined penalties. The OVDP requires accurate and complete disclosure of both offshore and domestic income/accounts. The OVDP does not have a stated expiration date but can be terminated by the IRS at any time as to specific classes of taxpayers or as to all taxpayers. On June 26, 2012, the IRS released a long-awaited update to frequently asked questions for the OVDP.

Under FAQ #21, the IRS warned that it will exclude U.S. taxpayers from the OVDP if such U.S. taxpayer (a) appeals a foreign tax administrator's decision to disclose or fails to disclose such taxpayer's foreign account information⁴; or (b) such U.S. taxpayers have or had foreign accounts at specific foreign financial institutions that have faced sanctions from the U.S. government. In addition, taxpayers under IRS criminal investigation are not eligible to participate in the OVDP and if the IRS has initiated a civil examination, regardless of whether it relates to undisclosed foreign accounts, the taxpayer will not be eligible to participate in the OVDP.

Due to the unknown expiration date of the OVDP, taxpayers may request a preliminary acceptance into the OVDP. The IRS will review the request within 45 days and send the taxpayer a preliminary acceptance letter. Thereafter, taxpayers have 90 days from the date of the preliminary acceptance letter for submitting the completed voluntary disclosure. A taxpayer may also apply for a 90-day extension. Thus, once preliminarily accepted into the OVDP, if the IRS were to terminate the program, presumably, the taxpayer will still have the opportunity to participate in the program if the documents are submitted timely.

FBAR Filings for U.S. Persons that Owe No U.S. Taxes

For U.S. taxpayers who reported and paid tax on all their taxable income for prior years but did not file FBARs, the taxpayer should file the delinquent FBAR forms and attach a statement explaining why the reports are filed late⁵. The IRS will not impose a penalty for the failure to file the delinquent FBARs if there were no underreported tax liabilities and the taxpayer has not previously been contacted regarding an income tax examination or a request for delinquent U.S. tax returns. There is no need for these taxpayers to use the OVDP.

¹IR-2012-64 and IR-2012-65, June 26, 2012.

²Note that “higher compliance risk” taxpayers are subject to a more thorough review from the IRS and, potentially, an audit.

³See, IRS-2012-5 released on January 9, 2012.

⁴Section 3506 requires U.S. taxpayers challenging a foreign government’s disclosure of tax information by that government, to notify the U.S. Justice Department of such challenge. U.S. taxpayers failing to comply with such notification will now no longer be eligible for the OVDP.

⁵FAQ #17.