Fact sheet issued for Americans abroad

JESSICA WILTSE

By now, many Americans residing in Canada are aware of the U.S. crackdown on unreported foreign financial accounts (FBAR reporting) and related U.S. tax non-compliance.

In 2009 the Internal Revenue Service (IRS) implemented an offshore voluntary compliance initiative purporting to offer leniency to non-compliant U.S. taxpayers in exchange for returning to the U.S. system. Most Americans residing in Canada balked at this so-called leniency, which initially called for penalties of 20 per cent on the highest aggregate one-year foreign account balance over a look-back period of six years. (In 2011 it was changed to 25 per cent over a look-back of eight years.) Further, the initiative did not allow the IRS discretion in reducing penalties.

Recognizing that many U.S. citizens living in a foreign country may have failed to file U.S. tax returns and FBARs on a timely basis, the IRS issued a fact sheet (FS-2011-13) in December that describes relief if certain criteria are met. The fact sheet indicates that Americans living abroad who owe no U.S. tax for the prior six tax years may file U.S. tax returns for those years without penalties. For many Americans resident in Canada, this will be the case because of the availability of foreign tax credits for taxes paid in Canada.

For U.S. citizens who owe tax, the fact sheet indicates that the IRS will consider whether the failure to file or pay tax was a result of reasonable cause based on the facts and circumstances, several of which were outlined on the fact sheet. The fact sheet also provides guidance for taxpayers who failed to file an FBAR — in such cases, penalties may be imposed for willful and non-willful violations. Because the penalty is imposed per violation, which means per account per year, the FBAR penalty can be disproportionably harsh. The maximum penalty per non-willful violation is US$10,000; the penalty for willful violations is even higher.

However, the fact sheet indicates that penalties will not be imposed if the IRS finds reasonable cause for the failure to file FBARs. To establish reasonable cause, Americans living abroad should file delinquent FBARs for each of the prior six years with a statement indicating the reasons they are late.

Factors that could point to reasonable cause include reliance upon the advice of a professional tax advisor who was informed of the existence of a foreign financial account, a lack of any intentional effort to conceal income or assets related to an unreported foreign account that was established for a legitimate purpose and a lack of any material tax deficiency related to an unreported foreign account. Factors identified as potentially weighing against a finding of reasonable cause, on the other hand, are failure by the taxpayer to disclose a foreign financial account to his or her tax return preparer, the background and education of the taxpayer indicating that he or she should have known of the FBAR reporting requirements and a tax deficiency related to the unreported foreign account.

The IRS recently announced a third, open-ended voluntary compliance initiative (the 2012 VCI). Although there is no set deadline for the 2012 VCI, the IRS indicated its terms could change at any time.

The civil penalty scheme under the 2012 VCI is as follows:

- a one-time 27.5 per cent penalty on the highest aggregate annual balance in the unreported accounts during the eight-year look-back period, i.e. 2003-2010;
- a 20 per cent accuracy-related penalty or delinquency penalty on U.S. income tax that should have been paid during the look-back period on unreported income.

As under prior initiatives, a five per cent penalty may apply for long-term non-residents of the United States who have less than $10,000 of U.S.-source income annually and have been compliant with their tax obligations in their country of residence. A 12.5 per cent penalty is also available in limited circumstances.

To participate in the 2012 VCI, taxpayers must submit all original and amended tax and information returns (including FBARs) for the look-back period and must pay back taxes, interest, the applicable one-time civil penalty and the 20 per cent accuracy-related or delinquency penalty. As with the 2009 and 2011 initiatives, persons who feel the 2012 VCI penalty is disproportionate may undergo an examination to try to get the IRS to impose a lesser penalty.

In announcing the 2012 VCI, the IRS indicated it is developing procedures by which dual citizens and others who are delinquent in filing but owe no U.S. tax can come into compliance. Additional guidance will be welcome, as there are still many unanswered questions, particularly with respect to dual citizens and other non-residents who have been unaware of their U.S. tax and information reporting obligations, many of whom may have reasonable cause under the fact sheet approach. Americans living in Canada should carefully consider their options for coming forward, including whether to proceed with filing six years of returns. ■

Jessica Wiltse is an attorney at Hodgson Russ LLP in Buffalo, N.Y., specializing in cross-border and U.S. tax planning.