

November 2012

U.S. Citizens Living in Canada – New Streamlined Procedures for Getting Caught Up With the IRS

In what has become a recurring topic over the last two years, the U.S. Internal Revenue Service (IRS) announced new streamlined filing compliance procedures to allow U.S. taxpayers living outside of the U.S. to come into compliance with their U.S. income tax and related filing obligations. The announcement was made by the IRS on June 26, 2012, and details surrounding the procedures were finalized, and became effective on, September 1, 2012.

Background

This subject may sound very familiar, particularly for those that have been following the issue over the past two years. In our [Spring 2011 Tax Alert](#) we wrote about the “2011 IRS Offshore Voluntary Disclosure Program” and in our [Winter 2012 Tax Alert](#) we wrote about the “2012 Offshore Voluntary Disclosure Program” as well as an IRS “fact sheet” that provided an alternative for certain U.S. citizens residing outside of the U.S. for coming into compliance with the IRS. With this in mind, one can be forgiven for growing tired of this subject. However, it is estimated that there are over one million U.S. citizens living in Canada and a relatively low portion of this population is actually fully compliant with their U.S. income tax and related filing obligations. Many Canadian resident U.S. citizens would like to get caught up with the IRS, but they have been waiting for a more reasonable approach to doing so. Most of these people have viewed previous programs as having significant short-comings, such as being too costly to comply with, too punitive in terms of penalties and/or too vague in terms of the criteria used to provide forgiveness of penalties. While the new procedures are in no way perfect, they do address many of the deficiencies of other IRS programs, particularly in the case of U.S. citizens who have a relatively simple tax profile. Furthermore, these procedures provide retroactive relief for failure to timely elect for the deferral of recognition of income in the U.S. on Canadian retirement savings plans (RRSPs and RRIFFs), an issue that was not well addressed in previous programs.

Overview of Basic U.S. Tax Filing Obligations

U.S. citizens living outside of the U.S. are still required to file U.S. tax returns annually with the IRS. This is due to the fact that in addition to taxing its residents, the U.S. also continues to tax its citizens, irrespective of where they live in the world. In most cases, the average U.S. citizen living in Canada has little or no U.S. source income and ultimately there is little or no U.S. income tax on the U.S. tax return. In this case the annual U.S. tax filing obligation becomes more of an administrative requirement that comes with being a U.S. citizen. While it is beyond the scope of this article to provide a complete listing of all of the U.S. filing requirements of a U.S. citizen in Canada, a few of the more common items, in addition to a personal tax return, are listed below.

- 1. TD F 90-22.1 – Report of Foreign Bank and Financial Accounts (FBAR):** U.S. citizens, residents and certain other U.S. persons must annually report their direct or indirect financial interest in, or signature authority over, a financial account that is maintained with a financial institution located in a foreign country (ie: outside of the U.S.) if, for any calendar year, the aggregate value of all foreign accounts exceeded USD \$10,000 at any time during the year.
- 2. 3520 – Annual Return to Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts:** Taxpayers must report various transactions involving foreign trusts, including creation of a foreign trust by a U.S. person, transfers of property from a U.S. person to a foreign trust and receipt of distributions from foreign trusts.
- 3. 3520A – Information Return of Foreign Trust with a U.S. Owner:** Taxpayers must also report ownership interests in foreign trusts by U.S. persons with various interests

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- 4. 5471 – Information Return of U.S. Persons with Respect to Certain Foreign Corporations:** Certain U.S. persons who are officers, directors or shareholders in certain foreign corporations are required to report specific information related to the corporation.

Description of Streamlined Procedures

The streamlined procedures do not replace other IRS programs such as the 2012 Offshore Voluntary Disclosure Program. Rather, the streamlined procedures are meant to provide an alternative to taxpayers that present a “low compliance risk”. Although the IRS has stated that it will review all submissions made under the procedures, the level of scrutiny will be adjusted according to the level of compliance risk presented by the submission. Where a taxpayer is considered to be “low risk”, the IRS will streamline (ie: expedite) its review and it will not assert penalties or pursue follow-up actions. Conversely, submissions that present a higher compliance risk will not be eligible for the streamlined processing and will be subject to a more thorough review that could include, among other things, a full IRS examination and a request for additional tax returns. The procedures are generally available for individuals who have not resided in the U.S. since January 1, 2009 and have not filed a U.S. tax return during the same period.

Compliance Risk Determination

The IRS states that it will determine the level of compliance risk based on the information provided in the submission, including information contained in the U.S. tax returns and the responses to questions set out in an IRS Questionnaire required as part of the package. A submission will be considered low risk if the tax returns are relatively simple with little or no U.S. tax owing. Absent any specific risk factors, a submission will be considered low risk if the tax returns show less than \$1,500 in U.S. tax owing in each of the three years submitted. The risk level may rise if any of the following factors are present:

- If the taxpayer is under audit or investigation by the IRS
- If the taxpayer has received an FBAR warning letter

- If the taxpayer had significant economic activity in the U.S. in the years in question
- If the taxpayer has financial accounts outside of their country of residence
- If the tax returns seek to claim a refund of U.S. tax

The presence of any one of these factors may not automatically cause a taxpayer to be considered high risk, however, if any of these risk factors exist, careful consideration is needed before making a submission under the procedures. The IRS lists other risk factors that should also be taken into consideration.

Documentation Requirements of the Streamlined Procedures

The following items are required to make a complete submission under the procedures:

- Three years of delinquent U.S. federal tax returns (including related information returns)
- Six years of delinquent FBARs
- Payment of any tax and interest (if applicable)
- IRS streamlined procedures Questionnaire
- For any taxpayer seeking relief for failure to timely elect for the deferral of U.S. income recognition for Canadian RRSP and RRIF plans under the Canada-U.S. treaty, they must include:
 - A statement requesting an extension of time to make the election
 - Form 8891 for each tax year and each plan
 - A statement signed by the taxpayer under penalties of perjury describing
 - The events that led to the failure to make the election
 - The events that led to the discovery of the failure
 - If the taxpayer relied on a professional advisor, the nature of the advisor’s engagement and responsibilities

The IRS has also stated that the package of documents must be sent as a single submission to a specific “Streamlined” processing centre, located in Austin, TX.

Other Considerations

The streamlined procedures are new, and as practitioners work through the procedures with their clients and with the IRS, additional guidance

is likely to emerge. However, there are several key considerations that must be taken into account today, when determining if the procedures are right for an individual taxpayer, some of which include:

- **Social Security Number:** In order to make a submission under the procedures, the taxpayer must have a U.S. social security number (SSN). The application for a SSN must be initiated by the taxpayer with a US Social Security Administration office and does not form part of the streamlined submission. The SSN must be obtained before making a submission under the streamlined procedures.
- **Expiry Date:** The IRS has not set a deadline for the procedures; however, it has the ability to terminate them at any time. Given that many Canadian resident U.S. citizens would likely meet the “low risk” profile, it would be prudent to take advantage of the relief provided in these procedures sooner rather than later.
- **Amended tax returns:** The IRS has clearly stated that amended tax returns will not be accepted under the streamlined procedures, with the exception of returns that are being amended exclusively to submit late-filed elections to seek relief for failure to timely elect the deferral of income recognition in the U.S. on Canadian RRSPs and RRIFs. Amended returns for any other reason will automatically be classified as high risk.
- **Criminal prosecution:** The IRS has clearly stated that the procedures do not provide protection from criminal prosecution if the IRS and Department of Justice determine that the taxpayer’s particular circumstances warrant such a prosecution. In addition to consulting a legal advisor, taxpayers concerned about this issue, and wishing to come forward to the IRS, should consider one of the IRS’s other disclosure programs.

Summary

As we have stated in previous articles on this subject, the IRS has been clear in its communications with the public that it has devoted, and will continue to devote, significant resources towards identifying taxpayers abroad that have failed to meet their U.S. tax filing obligations. Fortunately, the streamlined procedures are one example of how the IRS has

attempted to make it easier for previously non-compliant U.S. citizens to get caught up with the IRS, particularly when their situation is low risk and does not fit into other IRS disclosure programs that are more suitable for more complex situations. With that said, the introduction of this new program is yet another reminder of the importance of using a qualified U.S. tax practitioner to assist in properly addressing one’s U.S. filing obligations.

Contact your Collins Barrow advisor for more information on your U.S. filing obligations as well as any other US tax matters. §

Process Change - US Individual Taxpayer Identification Number (ITIN)

On June 22, 2012, the IRS announced interim changes to the Individual Taxpayer Identification Number (ITIN) application process.

What is an ITIN?

An ITIN is a tax processing number issued by the IRS to individuals who are required to have a US taxpayer identification number but who do not have, and are not eligible to obtain, a US Social Security Number (SSN). Individuals with US citizenship or who possess a US green card or a valid US work permit are generally eligible for a US SSN and are not eligible for an ITIN. Individuals who do not fall into the preceding categories would be required to obtain an ITIN.

What is an ITIN used for?

The most common use of an ITIN is for foreign (non-US) nationals who have US federal tax reporting or filing requirements. As an example, a nonresident alien of the US, who earns US rental income, is generally required to file a US tax return. In order for such a tax return to be processed by the IRS, it must include an ITIN (or an application for an ITIN if the individual is filing for the first time).

How is an ITIN obtained?

In order to obtain an ITIN, individuals must complete IRS Form W-7 – Application for IRS Individual Taxpayer Identification Number. Form W-7 provides basic information about the taxpayer (ie: name, address, date of birth, nationality, etc.) and it must be accompanied by documents that prove the individual's identity and foreign status. While some exceptions do exist, in most cases the ITIN application and supporting documentation must be attached to a US federal tax return. The ITIN is issued to the individual by the IRS as part of the tax return assessment procedures.

What has changed?

Form W-7 has not changed, however, the procedures surrounding the documents required to prove the individual's identity and foreign status have changed.

Under the "old" rules, an applicant could prove their identity and foreign status by providing a copy of their foreign passport, as long as it was certified by a US notary or a US acceptance agent. Effective June 22, 2012, the IRS has stated that it will no longer accept the certification of the passport copy by a US notary or US acceptance agent and it will only accept a passport copy if it is certified by the issuing agency (ie: Passport Canada in the case of a Canadian passport).

As an alternative, ITIN applicants can send their original documentation, such as their Canadian passport, to the IRS with their ITIN application. For obvious reasons, few people choose to do this.

It should be noted that this new process is an interim measure and the IRS has stated that final rules will be issued before the start of the 2013 tax return filing season. Furthermore, there are certain exceptions to the interim measures that will allow individuals to follow the "old" procedures.

Contact your Collins Barrow advisor for more information on the procedures required to obtain a US ITIN as well as any other US tax matters. §

Collins Barrow publishes a regular *US Tax Alert* for its clients and associates. It is designed to highlight and summarize the continually changing tax and business scene across Canada with respect to US issues. While *US Tax Alert* suggests general planning ideas, we recommend professional advice always be sought before taking specific planning steps.

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