

Tax Filing and Financial Account Reporting Requirements For Dual US - Canadian Citizens in Canada

The requirement of all US citizens, including those who are also Canadian citizens, to file tax returns and disclose foreign bank accounts to the IRS has been law for many years, though it was rarely enforced. Following the enactment of the Patriot Act of 2001, Congress asked the US Treasury Department to improve methods to enforce FBAR (Foreign Bank and Financial Accounts Reporting Act) compliance.

Having a foreign bank account is not illegal as far as the US Treasury Department is concerned, however, those accounts, with some exemptions, must be disclosed and their balances reported to the IRS. The IRS has been given the authority to levy severe penalties for failure to comply.

Most US citizens in Canada would not owe taxes to the US on their earned income here. Canada and the US have a reciprocal tax treaty under which a foreign tax credit will generally be available to offset any double taxation that would otherwise exist. Unless an individual's taxable income is in excess of \$90,000, that individual will be credited for taxes paid to Canada Revenue. Though no taxes may be owed, the filing and reporting requirements still stand. Just to clarify the issue – penalties are not being assessed for nonpayment of tax; they are being assessed for failure to comply with disclosure requirements.

Tax Filing Requirements

The United States tax authority – IRS – is the only institution that requires U.S. citizens and deemed U.S. residents to file an annual tax return on which is reported income from all sources worldwide. Other countries apply this requirement to residents rather than citizenry.

Occasionally Americans living abroad are surprised by this requirement in those circumstances where they are already filing a tax return and paying taxes to a foreign country of residence. So refusing to file a U.S. tax return, they may also believe that filing tax returns on the same income to both countries means double taxation.

As the Internal Revenue Service has in place the power and wherewithal to assess rather stiff penalties against anyone who neglects his/her duty, noncompliance can ultimately be expensive. Where one has not filed a return stateside for many years, IRS requires filings for three prior years in addition to the current year. In 2011 this means filing tax returns for 2007, 2008, 2009 and 2010. While owing taxes to the United States Treasury is unusual due to filers being able to apply foreign tax credits and/or foreign earned income exclusions against any IRS assessments, the Service will require that six years be filed in the event that taxes are owed.

Filing requirements are actually based on a predetermined income level per filing status.

What are FBAR and FATCA?

If you are an American citizen or resident with financial accounts or assets outside the US, whose aggregate values exceed \$10,000 or \$50,000 respectively, you need to know the acronyms FBAR and

FATCA. In fact, if you have power-of-attorney over such accounts or assets, for an elderly parent for example, you also need to know these acronyms.

FBAR stands for the Report of Foreign Bank and Financial Accounts act and FATCA stands for the Foreign Account Tax Compliance Act.

Congress enacted these laws to address perceived tax abuse by US persons through the use of offshore accounts. The laws require individual taxpayers and foreign financial institutions (FFIs) to report to the IRS account information, including the name, address, taxpayer ID number, account number, and account balance (or value).

FBAR requires individuals to report accounts whose aggregate value exceeds \$10,000 at any time during the calendar year. FATCA requires individuals and FFIs to report similarly, but the value threshold is triggered when the aggregate value of a person's assets exceeds \$50,000.

While the reporting regimes for individuals under FBAR and FATCA are in place, the regime for FFIs will not be ready until January 1, 2013. Beginning then, the IRS will have data on file for large foreign asset holders to compare with information reported by taxpayers.

FBAR reporting is due June 30th of the year following the year the account holder meets the \$10,000 threshold. The information is reported via Form TD F 90-22.1. It is an information return filing, and not an income tax filing. Nonetheless, the penalties for failure to report are quite severe: Non-willful failure to file is \$10,000; willful failure to file is the greater of \$100,000 or 50% of the value of the foreign accounts. No penalty is assessed if the IRS determines a late filing was due to reasonable cause.

FATCA reporting by taxpayers begins in 2012 for assets held in taxable years beginning on or after January 1, 2011. Like FBAR, it is an information return filing. Taxpayers are required to file Form 8938, which must accompany their tax return. Failure to report will result in a penalty of \$10,000. A penalty of up to \$50,000 is assessed for continued failure to report after IRS notification. Further, underpayments of tax attributable to non-disclosed foreign financial assets will be subject to an additional substantial understatement penalty of forty (40%) percent.

FATCA reporting by FFIs begins in 2013. Accountholders who fail to provide sufficient information to determine their U.S. person status, non-participating FFIs, and foreign entity accountholders who fail to provide sufficient information about the identity of their substantial U.S. owners will confront draconian penalties. Participating FFIs will be obligated to withhold and pay over to the IRS thirty (30%) percent of any payments of U.S. source income that would have gone to the aforementioned group, as well as the gross proceeds from the sale of securities that generate U.S. source income that would have gone to the group.

The following table summarizes the main attributes of the two acts:

FBAR

What is a financial account? A "financial account" includes any bank, securities, derivatives or other financial instrument accounts.

Due date: June 30 of the year following the year that the account holder meets the \$10,000 threshold.

Who must File: Any US person with interest in, signature authority, or other authority over any financial account in a foreign country, if the aggregate value of these accounts exceeds \$10,000 at any time during the calendar year.

FATCA

What is a financial account? A "financial account" includes any bank, securities, derivatives or other financial instrument accounts.

Due date: Begins 2012 for taxpayers, and January 1, 2013 for foreign financial institutions.

Who must file: Taxpayers and foreign financial institutions that hold accounts for U.S. taxpayers or foreign entities in which U.S. taxpayers hold a substantial

US person: Includes citizen or resident of the USA, a domestic partnership, a domestic corporation, and a domestic estate or trust.

Filing report of accounts to IRS: Report foreign accounts by: 1) completing boxes 7a and 7b on Form 1040 Sch. B, box 3 on the Form 1041 "Other Information" section, box 10 on Form 1065 Sch. B, or boxes 6a and 6b on Form 1120 Sch. N; and 2) Form TD F 90-22.1

Is FBAR applicable to U.S. Residents? Yes, if the power of attorney gives the U.S. resident signature authority, or other authority comparable to signature authority, over the financial account. Whether or not such authority is ever exercised is irrelevant to the FBAR filing requirement.

Voluntary Disclosure Practice available: The original VDP program for taxpayers with unreported income from offshore accounts ended October 15, 2009. The IRS has announced a new 2011 Offshore Voluntary Disclosure Initiative that runs through Aug. 31, 2011.

Note that the Offshore Voluntary Disclosure deadline has been extended to September 9, 2011

Some individuals have innocently initiated offshore accounts that are not in compliance with FBAR or FATCA, while others have opened the very accounts the IRS is looking for. The IRS has initiated a program to allow all taxpayers to disclose previously unreported offshore accounts, and to amend their income tax returns to recognize previously unreported income. Taxpayers have until September 9, 2011 to meet all program requirements. For those who do, for the years 2003 through 2010, the program grants protection from significant civil penalties and criminal sanctions.

Tax forms and instructions for each year are available for downloading in pdf format from the IRS website. Search for forms and publications, then search for forms for prior years by the specific year, e.g. 1040A 2005. If you file delinquent tax returns and report FBARs to 2003, write a strong cover letter, explaining why you have not filed or disclosed your foreign accounts, to accompany both your tax returns and your TD F 90-22.1's.

ownership interest.

US person: Includes citizen or resident of the USA, a domestic partnership, a domestic corporation, and a domestic estate or trust.

Filing report of accounts to IRS:
Taxpayers file Form 8938.

Is FATCA applicable to U.S. Residents? Yes, as defined by U.S. person.

Voluntary Disclosure Practice available: The IRS has announced a new 2011 Offshore Voluntary Disclosure Initiative that runs through Aug. 31, 2011.

Contact Information

I urge you to write Jim Flaherty, Minister of Finance and John Baird, Minister of Foreign Affairs to express your concerns and demand action:

The Honourable James Flaherty P.C., M.P.
Minister of Finance
House of Commons
Ottawa, ON K1A 0A6 email: James.Flaherty@parl.gc.ca

The Honourable John Baird P.C., M.P.
Minister of Foreign Affairs
House of Commons
Ottawa, ON K1A 0A6 email: John.Baird@parl.gc.ca

I also encourage you to write the Privacy Commissioner of Canada to express your concerns about US legislation that could force Canadian financial institutions to provide your private financial information to the US tax authorities:

Office of the Privacy Commissioner of Canada
112 Kent Street
Place de Ville
Tower B, 3rd Floor
Ottawa, Ontario
K1A 1H3

Useful websites:

Expat tax specialists - free consultations, FAQs are helpful in identifying who must file
<http://www.taxbarron.com>

The official IRS website. Download forms and search for detailed information on filing.
www.irs.gov

Taxpayer Advocate Service, an independent body within the IRS that helps taxpayers who believe they are being treated unfairly.
www.irs.gov/advocate/

Americans Living Abroad, an organization that has been lobbying Washington on this issue.
www.aca.ch

An expatriate group with information on the current tax action:
<http://www.americansinparis.net>

American tax law firm with an interesting analysis of FATCA
<http://www.taxlitigator.com/articles/FBar>

Notes and Sources

1. Much of the US tax filing and FBAR information for US expats is courtesy of Barron Harper, Director of Barron's International Tax Service, and was found at the Americans in Paris website.
2. *The US Foreign Account Tax Compliance Act and its impact on dual citizens and Americans living in Canada*. This is a paper prepared anonymously by "Huck" and available by request through our office.
3. *FATCA and Foreign Bank Accounts: Has the U.S. Overreached?* Scott D. Michel and H. David Rosenbloom writing for VIEWPOINTS in Tax Analysts 2011.
4. *FBAR, Enforcement is Coming!* Steven Toscher, Esq. and Michel R. Stein, Esq. FBAR enforcement article download from <http://www.taxlitigator.com/articles/FBar>
5. The Globe and Mail, Barrie McKenna, June 13, 2011 and Roma Luciw, June 20, 2011.