



US TAX ALERT

US TAX ALERT is a commentary on topics of current interest – usually topics relating to recent changes in tax law, new IRS administrative practices or current interpretations arising from tax cases. *Professional advice should be obtained before acting on any of this information.* ed.9/11

US TAX FILING OBLIGATIONS – THE STAKES JUST GOT MUCH HIGHER

The standard test of being a taxpayer of a country is based on such things as where you live day to day, have your medical coverage, own a car, have bank accounts and carry on the normal trappings of daily living. It's a subjective test and not defined in the Income Tax Act. Sometimes it is referred to as your centre of vital economic interests.

But things are different under the laws of the United States. In the US, being a resident there counts you in as a taxpayer as it does in Canada. *However, if you are a US citizen you are still a full fledged US taxpayer.* Unlike most other countries, the US taxes individuals both on the basis of citizenship and residence. If you or your parents have ever lived in the US you might also be a US taxpayer if you meet certain conditions. From this point on we will refer to all individuals who must file US tax returns as *US taxpayers*.

US Tax Compliance

US taxpayers living in Canada usually fall into three main categories as far as tax compliance is concerned.

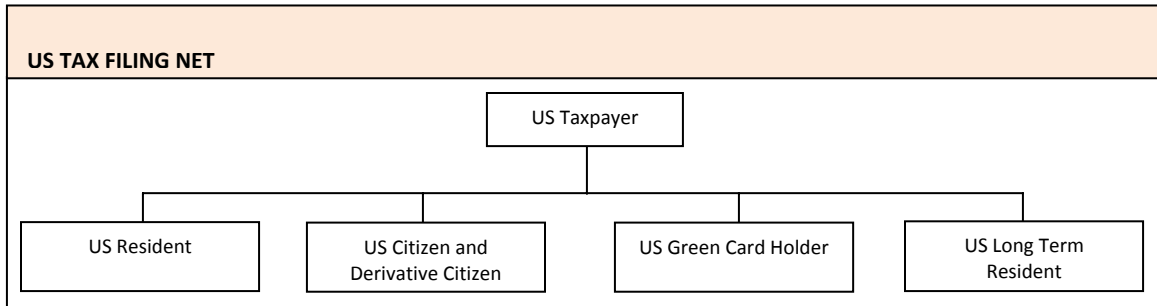
- ◆ Those who know they are US taxpayers and file their US tax returns and other compliance forms every year.
- ◆ Those who don't know they are US taxpayers and therefore don't file any US returns.
- ◆ Those who know they are US taxpayers and choose not to file because 1) they don't want to be bothered, 2) they don't think they owe any taxes or 3) they just refuse.

Obviously those who file are on side but those in the second and third categories are not. There is little doubt that they will eventually be found out and perhaps soon due to increased US surveillance.

If you are a US taxpayer you may have to file a US tax return even if you have no US tax to pay. If your gross income is over a certain threshold depending on your filing status (between \$3,500 and \$20,000) you must file even if your US tax is eliminated by foreign tax credits or income exclusions.

US Tax Filing Net

Obviously, the US has a wide tax net and there are many people living in Canada who should be filing US 1040 tax returns as US taxpayers or 1040NR returns as non-resident aliens. This article will deal primarily with US income tax compliance for US taxpayers living in Canada. Taxpayers who must file as US taxpayers no matter where they live are as follows:



A *US long term resident* described above is someone who has lived in the US for more than seven of the last fifteen years – usually under a green card. Typically they are Canadians who have gone to the United States to work but have now returned to Canada with a US tax history. They may have children who were born there who will therefore be US citizens for life.

US Citizenship

Citizenship usually depends on where you were born and in some cases will be based on a successful application for citizenship. Notwithstanding, the United States has a broader definition of citizenship than most countries and therefore many people living in Canada are US citizens (hence US taxpayers) and do not even know it.

Under the 14th Amendment to the US Constitution, any taxpayer born in the US and US territories is a US citizen, regardless of whether or not they have since moved out of the United States. But here's the rub. Individuals born outside of the US with at least one US citizen parent may be US citizens. For example, if both parents are US citizens, their children will be citizens if either parent *resided* in the United States for any period of time before the child was born. If only one parent is a US citizen and the child was born after November 14, 1986, the child will be a citizen if the parent resided in the US for five years and at least two of those years were after age 14. In both cases the test will be met even if the child never resides in the United States. Children who are US citizens because of their parent's citizenship are sometimes referred to as derivative citizens. A chart is attached outlining the broad principles of citizenship.

There are many rules that will determine if you are a US citizen. You should get legal advice on this if you are uncertain.

US Tax Surveillance

US taxpayers living in Canada who are in denial about their US tax filing obligations should get ready for a shock – a big shock. The US Internal Revenue Service is taking increasingly tough measures to locate you - both non filers and tax evaders. Here are a few ways the US Internal Revenue Service (IRS) may detect non filers or scare the bejeebers out of those who don't file and know they should.

- ◆ Checking your place of birth shown on your Canadian passport when you enter the United States.
- ◆ Applying draconian penalties for non compliance that can run into thousands of dollars and even criminal prosecution for willful non compliance.
- ◆ Sharing information between the IRS and Canada Revenue Agency under the authority of the Canada - US tax treaty.
- ◆ Requiring Canadian financial institutions (starting in 2013) to report details of bank transactions of US citizens to the IRS or withhold 30% tax. (*Foreign Account Tax Compliance Act*)

The US borders are well armed. You will find US customs, US immigration and Homeland Security all there, at the ready and working together with databases on their computer terminals. A few of my clients without proper identification have suffered interviews with the US constabulary and it was not a pleasant experience. If your US status is unclear US border officers can, at their whim, bar you from entering the US for several years and there is no appeal.

Foreign Account Tax Compliance (FATCA)

In March 2010, the Foreign Account Tax Compliance Act (FATCA) became a new US tool to combat offshore tax evasion and will require increased reporting to the IRS. Starting in 2013, Canadian financial institutions must report details of a US taxpayer's Canadian financial accounts to the IRS including their social security numbers. Should US taxpayers refuse to comply, the US will require a 30% withholding tax on Canadian bank payments to such individuals.

Canadian financial institutions are not happy about this and concerns have already been raised about privacy law issues. Notwithstanding, do not allow yourself to think that US compliance measures are going to let up any time soon.

Voluntary Disclosure

The bottom line is that US tax authorities will eventually find you out if you have not been filing US tax returns. It is far better to voluntarily disclose now and avoid or minimize fines and penalties. The closer we get to 2013, the higher the stakes get so put your house in order now.

The United States has had a few US amnesty programs available recently – the most recent expiring August 31, 2011. They are primarily designed for individuals intentionally committing tax evasion. On the other hand, individuals who have not been complying with US tax laws because of ignorance or even neglect have usually been able to file a (quiet) voluntary disclosure which generally results in no penalties if the disclosure is truthful, timely and complete. Six years of returns is the standard disclosure period.

US Tax Forms You Need to Know About

Here are some of the US forms that may have to be completed to get US tax filings up to date. Many come with severe penalties (like \$10,000 and up) for non filing or not filing on time. Some forms need to be filed even if a US tax return is not required.

US RETURNS AND COMPLIANCE FORMS	
Return	Name
1040	US Resident tax return
Form 3520	Annual Return to Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts
Form 3520A	Annual Information Return of a Foreign Trust with a US Owner
Form 8833	Treaty Based Return Position Disclosure
Form 5471	Information Return of US Taxpayer with Respect to Certain Foreign Corporations
Form 8891	US Information Return for Beneficiaries of Certain Canadian Registered Retirement Plans
Form 8938	Statement of Foreign Financial Assets (Effective 2013)
Form TDF 90-22.1	Report of Foreign Bank and Financial Accounts
Form 8621	Return by Shareholder of a Passive Foreign Investment Company

FBAR Returns

Foreign Bank Account returns are not income tax returns but must be filed by US taxpayers who own or have signature authority over financial accounts (bank accounts, investment accounts, RRSPs, RESPs, TFSAs etc.) outside the United States if the aggregate balance of these accounts exceeds \$10,000 at any time in the year. The form is TDF 90-22.1. The return must be received by the US Department of the Treasury in Detroit Michigan by June 30 and there are significant penalties (starting at \$10,000) for not filing or even filing late.

Canadian financial accounts that must be reported include accounts owned by the individual and accounts where the individual has signature authority only, joint accounts, accounts of a private company you may own, accounts for a charity on which you have signing authority or a trust or estate if you are a trustee. This is perhaps the most seriously overlooked return not filed by US taxpayers other than a tax return.

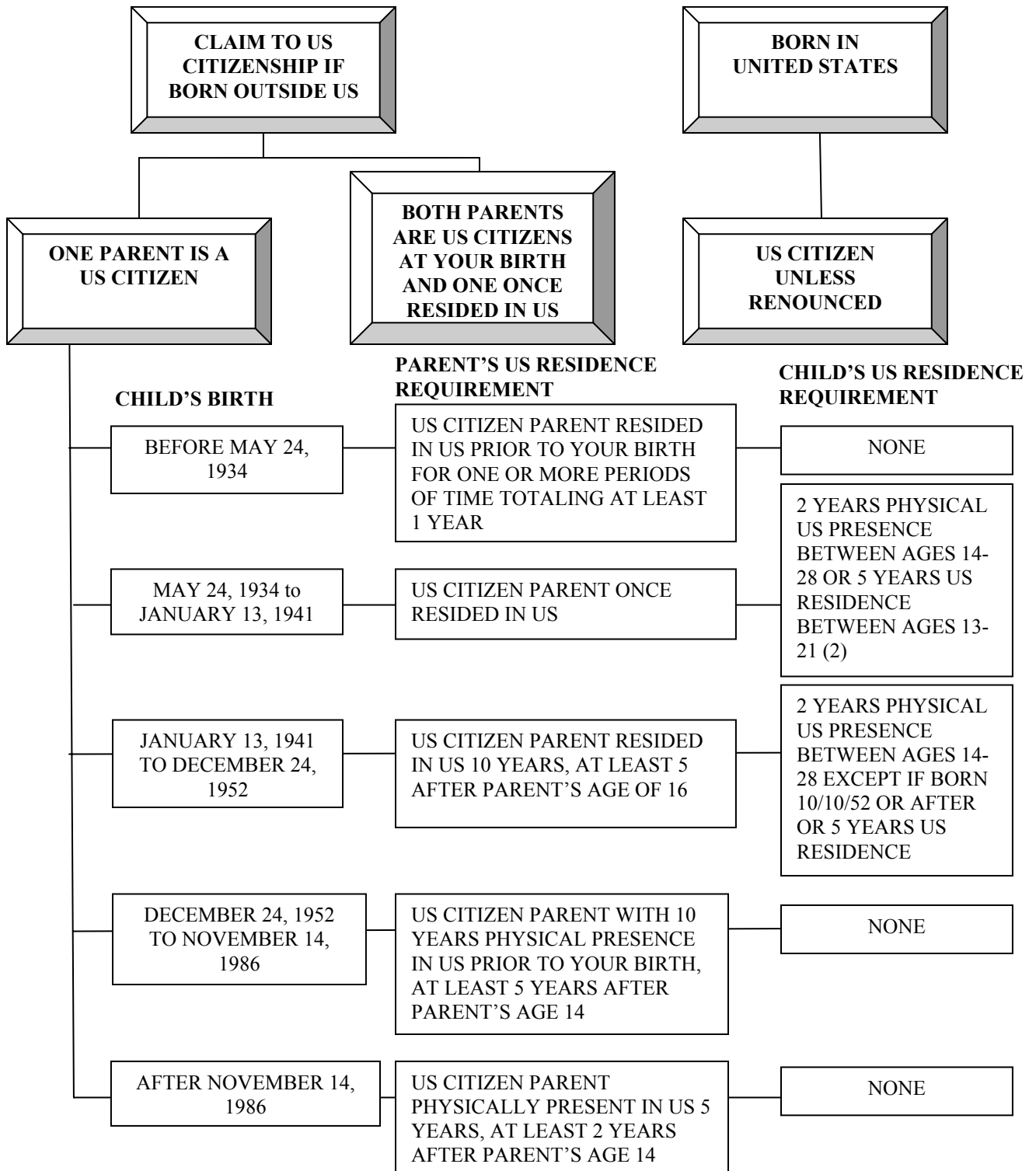
Conclusion

By now it should be obvious that not filing US tax returns is a pretty serious matter. We have filed a number of voluntary disclosures and none of our clients has ever been fined or penalized. We make sure our clients give the IRS a full explanation of the reasons for not filing that is truthful, and complete as well as a history of their residency changes. If you do that, chances of a happy result are quite high. If not, things could go terribly bad.

*J. E. Arbuckle Financial Services Inc.
30 Dupont St. E., Suite 205, Waterloo, Ontario N2J 2G9
Phone: 519-884-7087 Fax: 519-884-7087
Email: info@finplans.net*



US CITIZENSHIP AND DERIVATIVE CITIZENSHIP



- 1) The chart is a general representation of the definition of US citizenship or derivative citizenship but the rules are complex and professional advice should be obtained before making any final determination. Other methods also exist to acquire US citizenship such as by naturalization (E&OE).
- 2) Child's US residence is no longer required and US citizenship may be regained if lost under earlier rules.