Revised Streamlined Procedure

Delinquent U.S. individual tax filers

U.S. persons including U.S. citizens or green card holders residing in Canada who are not up to date with their U.S. filing obligations should consider the available programs in an effort to become tax-compliant.

The updated streamlined procedures announced on June 18, 2014 modified changes to the 2012 streamlined program, now known as the Streamlined Foreign Offshore Program ("SFOP") requiring the filing of 3 years of past-due returns (with required disclosures and international information returns) plus 6 years of FBARs.

There were also modifications to the 2012 Offshore Voluntary Disclosure Program ("OVDP") and a new streamlined procedure called Streamlined Domestic Offshore Program for U.S. persons residing in the United States.

The advantage of utilizing SFOF is that civil penalties including tax related penalties or information return penalties will be waived unless examination results in a determination that the original non-compliance was fraudulent and/or the FBAR violation was willful. Only tax payable, if any, and interest is due with the SFOP submission including all required international reporting forms. Upon filing under the SFOP, if there is a tax deficiency, tax related penalties could apply to the tax deficiency.

You may refer to *www.irs.gov/Individuals/International-Taxpayers/Streamlined-Filing-Compliance-Procedures* for detailed information.

Your exposure if you do not become tax-compliant

With FACTA between Canada and the U.S., the sharing of financial account information becomes effective July 1, 2015 as Canadian financial institutions began their due diligence procedures in 2014. The financial information is provided to CRA who then may provide such information to the IRS in accordance with the Exchange of Information provision of the Canada/U.S. tax treaty ("treaty"). The sharing of financial information could cause an IRS examination. You may refer to www.fin.gc.ca/n14/14-018-eng.asp for information on FACTA.

If the IRS has initiated a civil examination of a taxpayer's returns for any year regardless if the examination relates to undisclosed foreign financial assets, the taxpayer will not be eligible to use any of the available programs.

Civil penalties including those that are tax related (failure to file/pay/accuracy related), information return or FBAR related and potential criminal penalties could be significant if the normal assessment procedures applied.

Expatriation?

Going forward, those who wish to wish to explore expatriation by giving up U.S. citizenship or their green card will have to timely file IRS Form 8854 and compute if applicable, an exit type tax if they are considered a "Covered Expatriate" ("CE") under Section 877A of the IRS Code.

The exit tax is composed of a market to market tax on certain unrealized gains in excess of $668,000 (2013) and a 30% tax on future receipt of certain deferred items. The market to market tax may be deferred if you meet certain conditions.

Covered expatriate status which is otherwise dependent on an average federal income tax liability greater than $135,000 (2013) for the 5 years ending before the date of expatriation or having a net worth of at least $2M at the expatriation date will be automatic if you have not complied with 5 years of tax returns prior to expatriation. There are certain exceptions to CE status for certain dual citizens and minors.

Tax payable

For most U.S. persons residing in Canada, there may be no tax payable if substantially all of your income is from Canadian sources because of the foreign tax credit mechanism. The annual foreign earned income exclusion ($97,600-2013) which is a deduction in arriving at adjusted gross income on the U.S. 1040 tax return, may exclude your T4 or self-employment income from taxation. However leakage may result if income determination for U.S. tax purposes under the IRS Code and Regulations is different from Canada.

Where applicable, relief may be available from the treaty but that position may require filing IRS Form 8833 to disclose a Treaty-based Return Position Disclosure. There may be an opportunity to reduce your Canadian tax previously paid if there is U.S. tax payable on U.S. source income. If you provided personal services in the U.S., regardless of who paid the remuneration, that income may be resourced to Canada if you qualify for an exemption under the treaty.

Outside of the program, the omission of an international information return generally attracts a minimum $10K penalty for non-compliance unless in certain circumstances, a reasonable cause defense is available and accepted.

Compliance hurdles

For the most part, the preparation of the basic U.S. return may not be overly complicated. However information gathering including the completion of required IRS international information returns increases time on the file and the professional cost of compliance for any taxation year where they may apply.

For example:

1. For RRSPs and RRIFs, the reporting is generally simple on IRS Form 8891 and on the FBARs. Basically, the 8891 indicated to the IRS that you were claiming benefits of Article XVIII, par. 7 of the treaty to defer tax on accumulating income in your RRSP/RRIF until a distribution is made. For pension or other retirement plans that are under the scope of Article XVIII, similar plain-paper disclosure was required under previously issued Revenue Procedures or possibly could be made by filing a protective 8833 although the latter was not required for Article XVIII per Regulation 301.6614.

2. On October 27, 2014, the IRS eliminated the requirements to disclose the foregoing and the requirement to file the 8891 for "eligible individuals" by issuing Rev. Proc. 2014-55 applicable to retirement plans that fall under the scope of Article XVIII. It appears that an "eligible individual" will not include a taxpayer who has not filed a tax return. Hence the foregoing disclosures and 8891 should still be made for taxation years filed under the SFOP. As the 8891 is repealed for 2014, it appears that for taxation years subsequent to 2014 that may be part of a SFOP filing, the IRS will announce what they require for the retirement plan. Likely, a simple Treaty disclosure will suffice.

3. U.S. persons with TFSAs or who are contributors to their children's RESPs will create additional reporting issues if those investment vehicles are classified as a foreign grantor trusts, requiring IRS Forms 3520-A/3520 for each TFSA and RESP. If the TFSA is not regarded as a retirement plan, income credited annually including the CESG and gains (losses) on the sale of securities is included in income. The receipt of foreign gifts in excess of $100K have a 3520 reporting requirement. Canadian family trusts created as part of an estate freeze with U.S. persons as contributors or beneficiaries will also present issues.

4. If you hold at least 10% interest in a Canadian corporation or partnership, you may have to file IRS Form 5471 or 8865 respectively, or possibly IRS Form 8621 if the corporation is a PFIC ("passive foreign investment company"). The latter may hold true for investments in Canadian mutual funds that may be classified under U.S. rules as a corporation and taxed under the punitive excess distribution regime unless certain elections are made. Form 5471 becomes more complicated if the corporation is a CFC (controlled foreign corporation) requiring balance sheet/income statement information and the computation of an accrual on the U.S. 1040 of Subpart F income (generally passive income) for your share of that income if certain minimum thresholds are exceeded. Under a 10% interest in a foreign partnership may require 8865 reporting for contributions to the partnership that are in excess of $100k.

5. Also IRS Form 926 for asset transfers to a foreign corporation such as the incorporation of your proprietorship or simply for just cash transfers in excess of $100K.

6. Commencing in 2011, IRS Form 8938- Statement of Foreign Financial Assets may also have to be filed. And of course we have the FBARs (FINCEN114) required by FINCEN.

Basically any foreign entity you have an interest in may require additional disclosure, an information return or a different manner in computing income for U.S. tax purposes. Each of these forms and instructions are available on the IRS website.

Overview of SFOP

The primary criteria for acceptance into the SFOP is that the reason for the non-compliance was due to non-willful conduct and that you meet a non-residency test.

Non-willful conduct requires you to certify on IRS Form 14653. Non-willful conduct is conduct that is due to negligence, inadvertence, or mistake or conduct that is the result of a good faith misunderstanding of the requirements of the law.

The non-residency requirement is generally met if in any one of the 3 past due years, you were present outside of the U.S. for at least 330 days. The presence test will not be met if you have more than 35 (business or vacation days) in the U.S. in each of the 3 years. In that case you would not qualify for SFOP and may consider filing under the normal assessment procedures with no waiver of civil penalties unless in certain circumstances, a reasonable cause defense is available. Here, you may have to file more than 3 years of returns and applicable international information returns.

The SFOP is extended to amended returns for the 3 year period. The amended return feature is important as filing omissions such as the failure to include items in income or file various international information returns can come now under SFOP without having to demonstrate a reasonable cause defense. The 2012 program did not have the amended return(s) feature. It is also extended to those who previously filed as a "quiet disclosure" outside of any program.

Only FBARs/international information returns

There is a specific procedure for the need for solely filing delinquent FBARS or other international information returns without the SFOP. For FBARs, there must be no change in tax payable previously reported. For the international information returns, it appears one is not precluded from using this filing procedure if there may be additional tax payable, however this procedure requires a reasonable cause defense for the international information return. If the latter is not accepted, penalties will apply.

What if you don't qualify for SFOP?

Alternative to the SFOP is filing under normal assessment procedures or applying under the 2014 OVDP ("Offshore Voluntary Disclosure Program").

The OVDP is generally reserved for taxpayers who may possess higher risk such as those who may have difficulty in determining or be concerned that their conduct may not be non-willful. If one's conduct was willful then all bets are off causing civil and potential criminal penalties to apply.

If non-willful conduct is not an issue but you don't meet the non-residency requirement, then assessment under the normal assessment procedures may be acceptable.

The OVDP applies to those who have been non-tax compliant with regards to one's offshore assets. Non-compliance may include having not reported an element of gross income or filing international information returns. The procedures for filing an OVDP application are more detailed. The disclosure period for the OVDP is 8 years of past due filings. There is now a 50% miscellaneous offshore or OVDP penalty (previously 27.5%) on the highest value of undisclosed foreign assets during the 8-year disclosure period. The OVDP penalty is in lieu of levying the otherwise civil penalties noted above (excluding the accuracy related penalty) and criminal penalties.

The asset base may exclude assets that were purchased with after-tax funds or from funds that were not subject to U.S. taxation if the assets have not yet produced any gross income or there has been no U.S. taxable event or reporting obligation to disclose. RRSPs/RRIFs and pension/retirement plans whose accumulated income is exempt under the treaty or where there is no other reporting requirement may be excluded from the asset base.

Recommendation

Based on your fact pattern, you need to discuss each filing alternative with your accountant or experienced tax attorney. In most cases, the decision will be based on the creditability of the willful conduct certification. The IRS has provided limited guidance on their interpretation of willful conduct.

Presently there is no expiration date for an application under the SFOP or OVDP, however with FACTA in place, there may not be the need for these programs much longer as it will be easier to find delinquent taxpayers to assess unpaid tax, civil and criminal penalties.

Contact your professional advisor prior to implementing any of the outlined strategies

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