

# 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.

## HAVE YOU FILED YOUR 1040?

Increasingly, US citizens ask us about their obligation to file US tax returns. US green card holders and US long term residents (also US citizens for tax purposes) have also contacted us because they were not sure of their US filing obligations. Without exception, US citizens should be filing US personal tax returns if their annual income exceeds the annual income filing thresholds which for 2008 were \$8,950 for singles, \$17,900 for joint returns and \$3,500 for married filing separately.

In Canada we file tax returns because we live here. US citizens must file a 1040 US tax return no matter where they live in the world or whether or not they have US source income.

In addition to the 1040 personal tax return, other forms may be required – most notably form TDF 90-22.1 to disclose details of financial accounts outside the United States. Penalties for non filing of the TDF 90-22.1 can be up to \$10,000 for a non wilful violation and a greater amount for a wilful violation. Then there are US forms to disclose transactions with foreign trusts, receipt of substantial gifts and bequests, reporting of RRSP balances, ownership of non US private companies, US estate and gift tax returns and so on. The penalties for non filing simply cannot be wished away.

One of my new clients still holding a green card had been living in Canada for over twenty years. He was recently hauled in at the border by US immigration officials, forced to file a declaration of his history in the United States (Record of Sworn Statement in Administrative Procedure) and stripped of his green card. He later got a letter from the IRS asking him to file a 1040 return.

Many US citizens in Canada will have little or no US tax to pay because there is a credit for Canadian taxes paid – so filing a US tax return usually is nothing more than an inconvenience. Not filing, however, can mean that the IRS, more than likely, will take away certain US tax credits and add penalties for non compliance.

Canadian income taxes are sometimes reduced by RRSP contributions, non taxable capital gains on the sale of a business and other deductions. These Canadian deductions do not necessarily reduce US reportable income so there could be US tax even when there is no Canadian tax. Oops! With good planning between the two countries, taxes can often be reduced but you must plan in advance – not after the horse is out of the barn.

## US Tax Amnesty

If a taxpayer comes forward voluntarily and files six years of US tax returns, the IRS will normally apply an amnesty by waiving penalties and only assess interest and taxes. But there's no guarantee that they will do that or won't go back to earlier years depending on the circumstances. Without a voluntary disclosure, there is no amnesty and a whole barrage of IRS weapons can be directed towards you. Why would anyone ever take that chance?

If you think you will never be detected by the IRS, don't be so sure. Since 9/11, the Department of Homeland Security has beefed up surveillance significantly. The Canada/US border is the equivalent of a war zone for persons who are a US security risk or a US tax evader or avoider. Canada and the United States regularly share information on taxpayers on either side of the border and each can use the other to collect unpaid taxes. The IRS has hired additional auditors and is matching citizenship and immigration records with tax filings. Renew your US passport and you may get a letter from the IRS asking why you haven't filed a 1040 tax return and please do so. Too late for amnesty at that point!

## Tax Evasion

This article speaks mainly about US citizens who have inadvertently not met their US tax filing obligations and owe little or no tax but have not sought to evade tax. The United States (and other countries) are also actively looking to catch tax cheats using Swiss bank accounts and other evasion devices. At the time of writing this article, a US tax evasion amnesty was in effect with a future deadline date. In the meantime, the IRS is proceeding full speed to find tax evaders who fraudulently try to pull a fast one on the IRS. For those who have done this, it would be best to get legal advice and get on side before the IRS finds you out. In a recent article on such US voluntary tax disclosures, it was recently said by a prominent US tax attorney, "All that is known is that if a US person with an undisclosed foreign account is discovered by the IRS that person will fare draconian penalties and the prospect of criminal prosecutions".

## US Citizenship

If you were born in the United States and have a US birth certificate, it's pretty obvious that you are a US citizen. But what about children of US citizens (one or both parents) who were not born in the US and may never have lived there? The rules are tricky for such individuals because they may have acquired what is called derivative citizenship which would make them US taxpayers. Maybe not! If you are in this situation, seek out professional assistance to determine whether or not you are a US citizen and if so then determine whether you have ever renounced it. This is something on which you should seek professional advice.

## Expatriation

In 2008, the US enacted new tax rules for US citizens wishing to renounce their citizenship – perhaps in part to end US tax filing responsibilities. Before this change in the law, US citizens had to file 1040 returns for another ten years before they were off the hook. For those expatriating after June 2008, the 10 year filing regime has ended and instead expatriates pay tax on any gain on a deemed disposition of their world wide assets (at fair market value) at the time of renunciation. This is similar in concept to Canada's departure tax. Tax obligations under the new rules will still keep tax

on gifts and bequests to US residents in the US tax net. Our November 2008 US Tax Alert deals with US expatriation and is on our website at [www.personalwealthstrategies.net](http://www.personalwealthstrategies.net).

## Conclusion

The article is a synopsis of the quagmire of rules and regulations that apply to non filers of US tax returns. Remember, surveillance is up and the IRS is a pit bull. While this article is about US tax compliance, the real issue is good management of your Canada / US tax matters now and in years to come. *This US Tax Alert was first written as an article for the MoneySaver magazine.*

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