

# 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.

## THE US INTERNAL REVENUE SERVICE IS ON THE WARPATH

Canadian taxpayers are generally defined as people who reside here. Quite simple actually! Residence in turn is based on several factors including the location of your permanent home, your medical coverage, your driver's license, your club memberships, your bank accounts and where you 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. Most countries apply the same tests to determine if you are a taxpayer.

But things are different under the laws of the United States. Living there makes you a US taxpayer as it would in Canada. However, unlike most countries, the United States taxes individuals both on the basis of residence as well as citizenship. If one or both of your parents are US citizens you too might just be a US citizen (*derivative citizen*) even if you were born outside the United States. This is not the complete story on being a US taxpayer (as the chart below shows) but it's a good start.

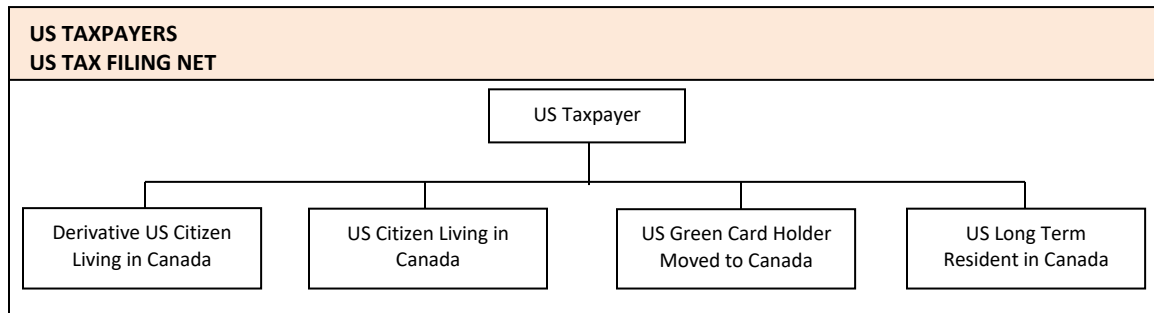
US taxpayers living in Canada usually fall into one of three categories as far as compliance is concerned.

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

Given the current US push to identify non filers, there is little doubt that they will eventually be found out. Perhaps sooner than they think. The penalties for being delinquent can be enormous but can be avoided by getting US filings up to date.

## US Tax Filing Net

All US taxpayers living in Canada usually need to file several types of US returns that will be discussed later. Here are the most common situations that will cause Canadian residents to be US tax filers.



A US *long term resident* is someone who may be living in Canada but 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. Incidentally, they may have children who were born in the US while they were there and they will be US citizens and taxpayers.

## US Citizenship

In most countries, citizenship depends on where you were born or on a successful application for citizenship. The United States has a broader definition of citizenship than most countries. Consequently, people living in Canada could be a US citizen (hence a US taxpayer) and not even know it.

Under the 14th Amendment to the US Constitution, any person born in the United States or US territories is a US citizen. But here's the harder part. Individuals born outside of the US with at least one US citizen parent could also be US citizens. Children who are US citizens because of their parent's citizenship are referred to as derivative citizens. There are many rules that will determine if you are a US citizen so you should get legal advice if you are uncertain.

## US Tax Surveillance

US persons 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 haven't filed so they start to take this more seriously.

- ◆ Checking your place of birth shown on your Canadian passport when you enter the United States.
- ◆ Applying draconian penalties for non compliance.
- ◆ Sharing information between the IRS and Canada Revenue Agency.
- ◆ Requiring Canadian financial institutions (starting in 2013) to report details of bank transactions of US citizens to the IRS under the *Foreign Account Tax Compliance Act*.
- ◆ Checking your record of US tax compliance when you decide to move back to the United States

The US borders are well armed. You will find US customs, US immigration and Homeland Security all there, at the ready, and working with extensive databases.

## Voluntary Disclosure

The bottom line is that US tax authorities will most likely find you eventually if you haven't been filing your US returns. It is far better to voluntarily disclose now to avoid or minimize fines and penalties.

The United States has had several amnesty programs available recently but at present they have all expired. Although they don't say so, they are primarily designed to detect individuals who are intentionally committing tax evasion. On the other hand, individuals who have not been complying with US tax laws simply because of ignorance or neglect are usually able to file a voluntary (quiet) disclosure and get themselves up to date without incurring penalties. Six years of returns is the standard disclosure period for those who can show they were not liable for any taxes in the United States.

## US Tax Forms You Need to Know About

There can be many US forms to be completed to get US tax filings up to date. Most come with significant penalties for not filing or not filing on time. Some of the forms need to be filed every year even if a US tax return is not required so they need to be in your disclosure package.

US RETURNS AND COMPLIANCE FORMS	
Return	Name
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 Person with Respect to Certain Foreign Corporations
Form 8891	US Information Return for Beneficiaries of RRSPs
Form TDF 90-22.1	Report of Foreign Bank and Financial Accounts (FBAR)

## FBAR Returns

Foreign Bank Account returns (FBAR) are not income tax returns but they must be filed by US citizens 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 return is normally required to be *received* by the US Department of the Treasury in Detroit Michigan by June 30 each year.

Financial accounts to be reported include accounts owned by the individual or accounts where the individual has signature authority – which might include accounts of a private company, accounts for a charity for which you have signing authority or a trust or estate accounts if you are a trustee. This is perhaps the most seriously overlooked return not filed by US persons other than the tax return itself.

## Conclusion

By now it should be obvious that not filing US tax returns is a pretty serious matter. We have helped file a number of voluntary disclosures and none of our clients has ever been fined or penalized or even had to pay any income tax.

It is important to make sure that you give the IRS a full explanation of the reasons for not filing that is truthful, complete and contains a detailed covering letter outlining your otherwise good filing practices here in Canada. If you do that, chances of a happy outcome are high. If not, things could go terribly wrong. Because of the number of universities and high tech companies located locally, there tends to be a higher than normal number of Americans in the area. *This US Tax Alert first appeared in the Exchange Magazine.*

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