Global IRW Newsbrief

Information reporting and withholding (IRW)

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IRS simplifies process for certain US citizens residing overseas to comply with filing obligations

The IRS has announced new procedures that should provide welcome relief for US citizens, including dual citizens, who have missed US tax filing obligations. The new procedure, which goes into effect September 1, 2012, allows certain low compliance risk US taxpayers living abroad who have failed to timely file US tax returns and Reports of Foreign Bank Accounts (FBARs) to get current by filing income tax returns going back three years and FBARs going back six years.

This announcement is a change from the requirements of the two prior and current Offshore Voluntary Disclosure Initiatives (OVDIs) which required the most recent eight years of returns and FBARs to be filed. Participants in the current OVDI, as in the last one, must generally file amended tax returns (disclosing the accounts) for the eight previous years; pay any taxes and interest they owe for those years; and pay a 20% penalty on back taxes owed. They must also pay an "FBAR" penalty equal to 27.5% of the account's highest balance during the eight years, up from 25% in the 2011 program. In some cases they may qualify for a reduced 5% or 12.5% penalty. The current OVDI program has no fixed end date. The provisions of IR-2012-65 will appeal to a different group of taxpayers than those who owe substantial back taxes as described below.

Targeted taxpayers

The category of taxpayers who will qualify for this new compliance plan appears to be long-term expats and /or dual citizens who have never lived in the US or left when very young. This initiative is in line with the procedures the IRS Tax Attaches adhered to prior to the 2009 OVDI, when long-term expats or dual citizens

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discovered they had US filing requirements and came to the US embassy for assistance. It seems to be back to the former "common sense" approach for those taxpayers who owe little to no tax and present no risk of fraud. Although the Internal Revenue Manual requires six years of returns to be filed to become compliant, the three years suggested in IR-2012-65 is an administrative grace to reduce taxpayer burden and costs and save IRS processing time.[1]

The group of taxpayers targeted by this announcement likely live in high tax countries and owe little to no tax due to the US foreign tax credit mechanism, or have limited compensation whereby little or no tax is due after application of the foreign earned income and housing exclusions of Internal Revenue Code (IRC) section 911. As expected, IR-2012-65 includes a caveat that people who do not owe significant back tax are the focus; others who are seen as a higher risk will get a tougher review and audits could go back more than three years.

The announcement also mentions that the IRS will determine the level of compliance risk presented by the submission based on certain information provided on the returns filed, and based on certain additional information that will be required as part of the submission. Low risk will be assumed to exist on "simple returns" with little or no US tax due. Absent high risk factors, if the submitted returns and application show less than $1,500 in tax due in each of the years, they will be treated as low risk. The IRS will include additional information as to the specific factors the IRS will use to assess the level of compliance risk, and how information regarding those factors should be presented in the submission.

> ***PwC Observation:*** *The comment about "simple returns" creates more questions that the IRS will need to address in their next information release. The majority of the US taxpayers who owe little tax are presumably either able to exclude all compensation from US gross income, or are tax compliant in a high tax country, and thus are able to offset their foreign source income with the US foreign tax credit. The exclusions under IRC section 911 and the limitations on foreign tax credits under IRC section 904 can be technically complex and thus may not necessarily be considered "simple." Hopefully this will be one of the clarifications when further instructions are issued.*

Proposed new procedure and timing

Many details of this new procedure, including where to send submissions, are still being considered by the IRS and will be made public in the next few months. While all details have not been worked out by the IRS, taxpayers wishing to use the new procedure will be required to submit: (1) delinquent tax returns, with appropriate related information returns, for the past three years, (2) delinquent FBARs for the past six years, and (3) any additional information regarding compliance risk factors required by future instructions. Payment of any federal tax and interest due must accompany the submission. If a taxpayer believes failure to file and pay and/or accuracy penalties should not be applied, a reasonable cause letter, signed under penalties of perjury, will need to be submitted. The reasonable cause letter should follow the guidelines set forth in IRS Fact Sheet FS-2011-13.

> ***PwC Observation:*** *Many US citizens (including dual citizens), green card holders or other expatriates who have lived outside the US for long periods of time have already participated in one of the prior OVDIs, and paid penalties on the late filed returns and on the highest balance of the highest*

[1] I.R.M. 1.2.14.1.18

year of their foreign bank accounts. The IRS has not issued any guidance as to whether those taxpayers will still have to go through the onerous "opt out" procedure, while taxpayers who waited and have similar facts and circumstances may be treated more favourably under IR-2012-65.

New approach and relief on Canadian pension plans

Throughout all of the prior compliance initiatives, Canadians with US filing obligations have been concerned by the reporting requirements of Canadian eligible plans (including registered retirement pension plans known as "RRSPs" and registered retirement income funds known as "RRIFs").[2] These pension plans can be similar to US IRAs, but are often FBAR reportable. This reporting has sometimes led to a skewed balance for the determination of the highest balance in the highest year to determine the penalty. If the taxpayer timely filed their US tax return, then income from those plans was deferred in the US as long as the taxpayer timely filed a tax return and attached Form 8891, *US Information Return for Beneficiaries of Certain Canadian Registered Retirement Plans*, to report the account. However, because so many taxpayers were unaware of their filing requirements, timely elections were often not made on Forms 8891, as required under Revenue Procedure 2002-23. This new compliance plan offers retroactive relief for failure to timely elect income deferral on Canadian plans for which deferral is permitted by treaty, without having to submit a ruling request to allow Rev. Proc. 2002-23 treatment. Taxpayers seeking to defer income on those types of accounts would need to file a request for more time to elect the deferral and provide a statement describing the events that led to the failure to make an election, the events that led to discovery of the failure, and the nature of any professional adviser's engagement and responsibilities if the taxpayer relied upon one.

PwC Observation: *IR-2012-65 will require a statement as to why the deadline was missed, but presumably will be less burdensome than the current requirement to submit a request for a private letter ruling under Treasury Regulation section 301.9100-3 ("9100 Relief") to extend the time for making the election under Rev. Proc. 2002-23.*

Conclusion

The decision as to whether to enter the new OVDI under IR-2012-5 or the compliance program described above in IR-2012-65 is highly dependent on individual facts and circumstances. Taxpayers who believe they qualify for the provisions of IR-2012-65 may want to begin collecting their records and contacting their advisors now rather than wait until after September 1, 2012. Each taxpayer should consider their specific situation and the options available before making a decision about how best to become compliant regarding their previously unreported offshore accounts and income.

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[2] See Revenue Procedure 2002-23 for additional details of covered Canadian plans. Rev. Proc. 89-45, 1989-2 CB 596 was superseded by Rev. Proc. 2002-23, 2002-1 CB 744. This IRS pronouncement was designed to accommodate the expansion of the Treaty by way of assorted protocols to cover not only RRSPs, but also RRIFs and other Canadian pension, retirement and employee-benefit plans.

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