CROSS-BORDER TAXATION

IRS TAX AMNESTY FOR FAILURE TO REPORT FOREIGN ACCOUNTS ABOUT TO EXPIRE

Picture the following ..... A young man born in the United States, while vacationing in Canada, meets and falls in love with a Canadian woman. They get married and thereafter make their home in Vancouver, Canada, for the rest of their lives. The wife is highly successful in her career and accumulates significant wealth, nearly all of which is ultimately held in Canadian brokerage and bank accounts belonging solely to her and in her name. The wife dies suddenly in 2003, leaving her entire estate to her husband. He dies six years later, in 2009.

Following the husband's death, the Trustee of his estate comes across a document evidencing his U.S. Citizenship. He mentions this to his counsel, who, after seeking advice from her U.S. colleagues, discovers the following:

1. The fact that the husband was a U.S. citizen, never having renounced that, means that he was required to file a U.S. income tax return for each year of his life during which he earned income, including the years he spent living and working in Canada.

2. As a result of his late wife having left him her entire estate, their now combined estates are subject to U.S. Estate Tax. After certain limited available deductions, the estate will be taxed at approximately 35%. Had his Canadian wife not left him her estate, but rather passed some or all of it directly to their children, there would have been no U.S. tax liability on her estate, as she was a Canadian citizen who never resided in the U.S. or had U.S. citizenship.

3. The most serious of the husband's tax issues, however, was his failure, in each of the years 2003 to 2009, to file a Report of Foreign Bank and Financial Accounts (an "FBAR") with the U.S. Department of Treasury. Under U.S. law, any "U.S. person" who has a financial interest in, or even signing or other authority over, any financial account in a foreign country must file an FBAR every year, if the aggregate value of those accounts exceeded $10,000.00 at any time during a calendar year. A "U.S. person" includes a citizen or resident of the United States, as well as a U.S. partnership, corporation, estate or trust. An individual is also deemed to have a financial interest in an account under the following circumstances:

   • the account is owned by a domestic corporation, and the individual directly or indirectly owns more than 50% of the total value of that corporation's shares.

   • the account is owned by a partnership in which the U.S. person owns an interest in more than 50% of the profits.

   • The account is owned by a trust in which the U.S. person either has a present beneficial interest in more than 50% of the assets or receives more than 50% of the current income.

   With millions of dollars sitting in various Canadian financial accounts registered in the name of and belonging to the husband from 2003 through to his death in 2009, the husband's estate Trustee determines, to his shock, that the husband's failure to have filed an FBAR in each of those years could, potentially, resl:llt in liability to pay the greater of$100,000.00 or 50% (no, that is not a typo) of the highest aggregate balance for each year that an FBAR was not filed. Over the 7 year period, the possible liability to the IRS could actually be 3.5 times the amount in the various foreign bank and brokerage accounts, virtually wiping out the estate and leaving nothing for the heirs. Additionally, his estate would be liable for unpaid income taxes on any income earned in those Canadian accounts while he was the owner thereof, plus interest and penalties.

FBAR requirements are imposed on every U.S. person, as defined above, whether they live in or outside of the United States. The Trustee was faced with the dilemma of having to prove non-willfulness on the part of the now-deceased husband, over the objections and fears of the Canadian heirs, who realized they could be left with nothing if such non-willfulness could not be successfully proven.

In order to address perceived wide-spread non-compliance and to bring unreported foreign money back into the U.S. taxation system, the IRS announced the 2011 Offshore Voluntary Disclosure Initiative (the "Amnesty Program"). The Amnesty Program is designed to give U.S. taxpayers an incentive to file delinquent FBARs and satisfy outstanding tax obligations in return for reduced penalties. There are a number of conditions which a taxpayer must meet in order to take advantage of the Amnesty Program. In the event these can be met, there are two main benefits:

1. The taxpayer will avoid criminal prosecution; and

2. The taxpayer will be required to pay significantly lower penalties for failing to file the FBARs, being essentially a single penalty of 25% of the foreign accounts' highest aggregate balance for the tax years 2003 through 2010, instead of the possible 50% penalty referred to above which could be applied to each of the years in which an FBAR was not filed. The taxpayer would remain liable, however, for all taxes and interest on the foreign unreported income arising for any tax years 2003 to 2010, plus a 20% penalty on the aggregate underpayments for those years, and, if applicable, penalties for failure to file tax returns and for failure to pay appropriate taxes.

Entering into the Amnesty Program is only possible if a taxpayer reports the existence of the offshore accounts to the IRS before the IRS learns of those accounts.

The Amnesty Program ends on August 31, 2011. Any U.S. person, regardless of where he or she may be living, who has failed to comply with FBAR filing requirements may wish toconsider taking advantage of the Amnesty Program, rather than face the dire consequences of non-reporting. Our DW tax attorneys would be pleased to assist any client seeking advice regarding the Amnesty Program.

FOR MORE INFORMATION, PLEASE CONTACT:

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