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IRS expands amnesty program once reserved for expatriates

By Kathleen Pender

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The Internal Revenue Service has expanded a streamlined amnesty program to include people living in the United States who unintentionally failed to report interest, dividends and other income from foreign financial accounts on their U.S. tax returns.

The program previously was available only to U.S. citizens and green-card holders living abroad who inadvertently failed to report income on their U.S. tax returns. But the eligibility requirements were so strict they eliminated most potential applicants.

San Francisco tax attorney Robert W. Wood says only two or three of the hundreds of people who contacted him about the program qualified.

The IRS announced on June 18 that it was dropping most of those requirements and extending the streamlined offer to people living in the United States. On July 1, thousands of foreign financial institutions began handing over information on U.S. account holders to the IRS under the Foreign Account Tax Compliance Act.

"It's not a good idea to sit and wait. If the (IRS) finds the account holder before the account holder comes forward, they are not eligible" for amnesty, says Palo Alto tax lawyer Paul DiSangro.

To qualify for the streamlined program, taxpayers must certify that their failure to disclose offshore assets or income was non-willful. But unlike a separate amnesty offer called the Offshore Voluntary Disclosure Program, it does not grant the taxpayer immunity from criminal prosecution.

Penalties are much steeper under the voluntary disclosure program than under the streamlined program, which is designed for people who didn't understand Uncle Sam's unique worldwide tax grab.

Almost everyone living in the United States must report income earned in any country - including income on foreign financial accounts - on Form 1040, assuming they meet U.S. filing requirements. This applies to U.S. citizens, permanent residents (green-card holders) and most people on work visas.

U.S. citizens and green-card holders living abroad also must report income earned anywhere in the world - including investment income - on their 1040, again assuming they meet U.S. filing requirements.

Even if a person living abroad has a green card that has expired for immigration purposes, the person is subject to U.S. tax filing unless he or she has "actively abandoned" the green card, says Roland Sabates, director of H&R Block's Expat Tax Services.

People generally get a credit on their U.S. tax return for income tax paid to a foreign country. For expats, this reduces or eliminates their U.S. tax liability, but they are still supposed to report their worldwide income on a 1040 if they meet filing requirements.

Separately, U.S. citizens and residents must file FinCEN Form 114 (better know as the FBAR) if they have a total of more than $10,000 in foreign banks or financial accounts at any point during the calendar year.

In 2009, the IRS first offered the Offshore Voluntary Disclosure Program to taxpayers with unreported foreign accounts and income. This was around the time Swiss bank UBS agreed to begin turning over information on U.S. account holders to the IRS.

After several amendments, this program requires people to file an original or amended tax return and FBARs for up to eight years in which they had unreported foreign income or assets. They must pay any taxes due and a 20 percent penalty on unpaid tax, plus interest on the tax and penalty.

They also must pay a one-time penalty equal to 27.5 percent of the highest aggregate balance in their previously undisclosed foreign accounts over the past eight years.

Once the deal is completed, the IRS will not refer the taxpayer for criminal prosecution.

The streamlined program was introduced in 2012. Under the relaxed rules announced last month, taxpayers must file or amend tax returns for up to three years in which they had unreported foreign income and pay any additional tax, plus interest, but no tax penalty.

They also must file missing FBARs for up to six years.

There is a one-time penalty equal to 5 percent of the highest aggregate year-end balance in previously undisclosed foreign accounts during this three- or six-year period.

People are exempt from the 5 percent penalty if they lived outside the United States for at least 330 days in at least one of the three prior years and did not maintain a primary U.S. residence during that year, Sabates said.

They also must certify that their conduct was non-willful, which the IRS defines as "due to negligence, inadvertence, or mistake or conduct that is the result of a good faith misunderstanding of the requirements of the law."

The streamlined program "is awfully attractive," Wood says. "The danger is where you have conduct that looks suspicious." That could include "moving money around from country to country or from one bank to another."

People whose behavior might look willful should consult a tax lawyer to see if the Offshore Voluntary Disclosure Program is a better option. People who have already applied for that program but not completed it can switch to the new program.

"If you have already closed out of the old program, there is no way to get any money back, and that's a shame," says tax lawyer DiSangro. "There were people who were non-willful who came forward under the old program" and paid the much harsher penalties.

That's what they get for jumping on the amnesty bandwagon too soon.