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Vern Krishna: U.S. steps up tax enforcement beyond its borders

VERN KRISHNA | March 26, 2014 | Last Updated: Mar 25 9:40 AM ET

As of July 1, the United States will tighten the tax noose around the necks of Canadian citizens living in Canada and anyone else whom it considers to be “U.S. persons” for tax purposes, writes Vern Krishna Getty Creative

As of July 1, the United States will tighten the tax noose around the necks of Canadian citizens living in Canada and anyone else whom it considers to be “U.S. persons” for tax purposes. The Canada Revenue Agency will assist the U.S. by kicking away the stool on which they stand. All of this intrusion into our sovereignty is in the name of curtailing so-called “aggressive tax avoidance.”

Tax avoidance is as old as taxes. Our courts tell us that tax minimization is quite legitimate, but governments say that “aggressive” tax avoidance is not, and they are stepping up efforts to collect information from international sources, financial institutions, whistle blowers, and even criminals who have stolen information. Canada now has in force 18 Tax Information Exchange Agreements (TIEAs) with other jurisdictions. It has signed four other TIEAs that are not yet in force, and is negotiating a further eight with other jurisdictions.

On Feb. 5, we signed a new form of inter-governmental agreement (IGA) to improve international tax compliance and collection of information, but this time specifically targeted at U.S. persons living in Canada. The Foreign Account Tax Compliance Act was enacted in March 2010, but after much kicking, screaming, and political posturing in Washington, Canada eventually capitulated and signed on to its reporting requirements. In the end, the economic power of the U.S. was just too much to withstand, and the retaliatory threat of a 30% withholding tax on U.S. investments was the final straw.

On the face of it, FATCA appears benign: it requires U.S. persons to report their foreign assets to the Internal Revenue Service. Since the U.S. taxes its citizens regardless of where they live, the IRS is stepping up tax enforcement on their foreign banks accounts and assets. In fact, FATCA will be quite intrusive for many individuals who are dual citizens by accident — for example, those born in America and who left at an early age, or who have not had significant ties with the U.S. for decades.

The Act requires U.S. citizens and Canadian financial institutions to report on the accounts of U.S. taxpayers or foreign entities in which U.S. taxpayers have a substantial interest. U.S. citizens and individual residents must report annually (Form 8938) if they have more than $50,000 of "foreign financial assets" or if the total value of such assets was more than $75,000 at any time in the year. Foreign financial assets include bank and brokerage accounts, and a long list of other securities issued by foreign persons.

Individuals must even report any inherited foreign securities. Assets do not include personal residences and rental properties. Retirement Savings Plans, Retirement Income Funds, Education Savings Plans, Disability Savings Plans, and Tax-Free Savings Accounts are, for now, exempt. Smaller deposit-taking institutions, such as credit unions with less than $75-million in assets, are also exempt.

The financial penalties for failing to report can be formidable. Unintentional non-reporting attracts a penalty of $10,000. However, intentional non-reporting ups the ante. An individual with a bank account of $1-million who has intentionally failed to report for four years would owe $2-million in penalties.

Some U.S. citizens will respond by relinquishing their citizenship. In 2013, according to the U.S. Treasury Department, 3,000 Americans gave up their citizenship, more than three times the number in 2012.

Governments write the laws to which taxpayers respond and must assume responsibility for their laws if they produce perverse results. All taxes are ultimately behavioural, a fact that the international leaders of the G8 countries gloss over when labeling tax planning as "aggressive." Now U.S. tax enforcement and sanctions for non-reporting are becoming equally aggressive, and the authorities are crossing national boundaries in hot pursuit.