

# Updated IRS streamlined filing program: snowbirds beware

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On October 8, 2014, the IRS issued FAQs clarifying its amnesty programs for non-compliant taxpayers who want to catch-up on their U.S. tax filing obligations.<sup>1</sup> These FAQs address the recently amended streamlined filing compliance procedures, offshore voluntary disclosure program (OVDP), and delinquent information return and FBAR submission procedures.<sup>2</sup> The FAQs are not relatively enlightening, except for the [FAQ on the nonresident streamlined procedures](#) (dubbed the “Streamlined Foreign Offshore Procedures” by the IRS). After briefly summarizing some relevant general rules regarding streamlined, this blog will address the consequences of that FAQ for snowbirds who are US citizens or green card holders and have not filed during the three-year period for which tax returns must be submitted under streamlined and, according to the IRS, spend too much time in the United States. Ultimately, these snowbirds are ineligible for streamlined and must find an alternative way to catch-up with their U.S. tax filing obligations.

## I. Summary of the streamlined program

Effective July 1, 2014, there are two versions of the streamlined filing program: one for non-U.S. residents, the other for U.S. residents. Which version applies depends on the taxpayer’s residency under the peculiar rules in the streamlined procedures. Residency is defined in the negative in the eligibility requirements of the nonresident streamlined procedures (the IRS coined it the “non-residency requirement”). Notably, residency under the streamlined program is independent of the general residency rules in the *Internal Revenue Code*.

Consequently, although taxpayers with a green card are U.S. residents under the general rules of the Code,<sup>3</sup> they may be nonresidents under streamlined. Adding insult to injury, the IRS has two different non-residency requirements: one for U.S. citizens or green card holders, and the other for non-U.S. citizens, non-green card holders. The non-residency requirement applicable to U.S. citizens or green card holders is relevant to the streamlined procedures for snowbirds, while the non-residency requirement for non-U.S. citizens, non-green card holders is much more humane and does not exacerbate the dilemma created by the other version of the non-residency requirement.<sup>4</sup>

Under the general streamlined procedures, taxpayers must submit all required tax returns for each of the most recent three years for which the U.S. tax return due date (including extensions) has passed and six years of late FBARs. There is no criminal penalty protection under streamlined, while civil penalty protection is available unless (1) the original tax noncompliance (for nonresidents) or return (for residents) was fraudulent or (2) the FBAR violation (if applicable) was willful.<sup>5</sup> A summary of the specific streamlined procedures is below.

### 1. **Non-resident streamlined** (or “Streamlined Foreign Offshore Procedures”).

To qualify for nonresident streamlined, taxpayers must:

- 1.1. meet the applicable non-residency requirement (if married taxpayers want to file joint tax returns, both spouses must meet the applicable non-residency requirement);
- 1.2. have failed to report income from a foreign financial asset and pay U.S. tax, and may have failed to file an FBAR or international information return regarding the foreign financial asset; and
- 1.3. the failure to file resulted from non-willful conduct.<sup>6</sup>

U.S. citizens and green card holders meet the non-residency requirement if—in at least one year during the three-year period that tax returns must be submitted under streamlined—they both (A) had a non-U.S. “abode” and (B) were physically outside the United States for at least 330 full days.<sup>7</sup> The 330-day prong means that taxpayers can spend up to 35 days (36 days in a leap year!) in the United States and still qualify for nonresident streamlined.

The non-residency requirement explicitly originates from the rules in § 911, commonly known as the “foreign earned income exclusion,” and, accordingly, raises the question whether the 35-day rule can be supplemented by the disjunctive clause in § 911(d)(1)(A) for “bona fide” foreign (i.e., non-U.S.) residents who are U.S. citizens or are otherwise residents of certain countries with U.S. income tax treaties.<sup>8</sup> That is, one requirement for the foreign earned income exclusion in § 911 is that taxpayers must either be (A) bona fide foreign residents for at least one entire taxable year or (B) meet the 35-day rule (the latter is essentially a safe harbor).<sup>9</sup>

Before the new IRS FAQ, the streamlined procedures did not explicitly discuss the applicability of the bona fide foreign residence test, but deferred to (and continues to defer to) the rules in § 911 “for purposes of these procedures.”<sup>10</sup> For example, “abode” has the same meaning for streamlined’s non-residency requirement as it does in § 911(d)(3), where an abode is generally a dwelling.<sup>11</sup> The new FAQ, however, clarifies that § 911 only applies for purposes of determining a taxpayer’s abode—and that the 35-day rule cannot be supplemented by the bona-fide foreign residence test.

Apparently, § 911 does not really apply “for purposes of these procedures,” as the streamlined rules state.<sup>12</sup> The purpose for the IRS’s hard stance in the non-residency requirement is (presumably) that individuals who spend more than 35 days in the United States for the three-year period under streamlined should know their U.S. tax obligations better.<sup>13</sup>

## **2. Resident streamlined** (or “Streamlined Domestic Offshore Procedures”).

To qualify for resident streamlined, taxpayers must:

- 2.1. fail to meet the non-residency requirement (at least one spouse must fail the non-residency requirement for joint filers);
- 2.2. have previously filed a U.S. tax return (if required) for each year during the three-year period that tax returns must be submitted under streamlined;
- 2.3. have failed to report income from a foreign financial asset and pay U.S. tax, and may have failed to file an FBAR or international information return regarding the foreign financial asset; and
- 2.4. the failure to file resulted from non-willful conduct.<sup>14</sup>

The third requirement is particularly noteworthy for snowbirds who have not filed a U.S. tax return for the three-year period under streamlined, because it essentially disqualifies them from resident streamlined. The resident streamlined procedures are abundantly clear on this: taxpayers “may not file delinquent income tax returns (including Form 1040, U.S. Individual Income Tax Return)” under resident streamlined.<sup>15</sup>

## **II. No streamlined for snowbirds who need to file late forms 1040**

The IRS’s new FAQs clarify that snowbirds who do not meet the 35-day rule and need to file late Forms 1040 do not qualify for streamlined (under both the resident and non-resident versions of the program). The IRS FAQ on nonresident streamlined provides that non-residency under the nonresident streamlined procedures is defined in the procedures, not in § 911 and its regulations, except for purposes of determining a taxpayer’s abode.<sup>16</sup> These snowbirds must explore the new 2014 OVDP or alternative (and less-certain) means of becoming compliant with their U.S. tax filing obligations.

To qualify for nonresident streamlined, noncompliant taxpayers must meet the non-residency requirement; that is, they must have spent 35 days at most in the United States for at least one tax year during the relevant three-year streamlined period and meet the non-U.S. abode requirement to qualify for the amnesty program. To make matters worse, noncompliant taxpayers who do not meet the non-residency requirement cannot file late income tax returns (e.g., Form 1040) under resident streamlined. Consequently, many non-filer snowbirds who migrate to the United States for what most would consider an insignificant amount of time—e.g., 36 days every year—will not qualify for streamlined.

### **II.1. Example: Mr. Snowbird’s yearly migrations to the United States**

For example, take the typical Canadian snowbird, Mr. Snowbird, who is physically present in Canada for 10 months and in the United States for 2 months at his vacation home every year during the relevant three-year streamlined period. Mr. Snowbird is a dual citizen of Canada and the United States, conducts all of his business in Canada, has no significant U.S. investments other than the vacation home, and has never filed U.S. tax returns (although he was required to do so).

Unfortunately, Mr. Snowbird does not qualify for nonresident streamlined because he spent over 35 days every year during the relevant three-year streamlined period and therefore, fails the non-residency requirement. Mr. Snowbird also does not qualify for resident streamlined because he has never filed a U.S. tax return. Notably, under the old streamlined rules, it was generally understood that a taxpayer like Mr. Snowbird would be permitted to submit returns under streamlined since he did not meet the substantial presence test and would qualify as a Canadian resident under the U.S.-Canada tax treaty.<sup>17</sup> According to the IRS, Mr. Snowbird’s only recourse for voluntary disclosure, and the applicable amnesty that accompanies it, is under the new 2014 OVDP, where he must pay at least a 27.5% penalty on his foreign assets.

Alternatively, Mr. Snowbird could file his late U.S. tax returns and attach reasonable cause arguments as appropriate; however, it is unclear how far back in time he must go when filing his late U.S. tax returns. Under streamlined and OVDP, Mr. Snowbird generally must file for three years and eight years, respectively. If he does not use one of these amnesty programs, there is no guidance limiting his filings to a specified number of years. Let us assume that Mr. Snowbird was born in Canada and obtained his U.S. citizenship derivatively through a U.S.-citizen parent, and did not know he was a citizen until 2014.<sup>18</sup> He has never had a U.S. passport and does not have a U.S. Consular Report of Birth Abroad.

Thus, if Mr. Snowbird does not use OVDP, there is no telling how far back he must file late U.S. tax

returns to become compliant with his filing obligations. If only nonresident streamlined's non-residency requirement or resident streamlined's U.S. tax return requirement were more accommodating to snowbirds like him.

Also note that nonresident taxpayers must certify under penalties of perjury that they meet the eligibility requirements for nonresident streamlined—which include the non-residency requirement—on their streamlined certification form. Consequently, Mr. Snowbird would be ill-advised if he chooses to misrepresent his residency on his certification form because he could face criminal prosecution for doing so.<sup>19</sup>

### III. Conclusion

As the example above illustrates, the IRS's position on a snowbird's eligibility for streamlined is rather ominous. Does physical presence exceeding 35 days every year justify the disqualification of noncompliant taxpayers who have spent relatively small amounts of time in the United States every year from streamlined—both the resident and nonresident flavors of the program—and the imposition of a 27.5% (or 50%) penalty under OVDP? That seems to be a draconian result, especially for taxpayers who spend two months or less in the United States every year.

This result certainly will not encourage compliance and is inconsistent with IRS Commissioner Koskinen's rationale for expanding the streamlined program and the significant tightening of OVDP.<sup>20</sup> Hopefully, the IRS will reexamine its streamlined requirements to explicitly qualify noncompliant, non-filer taxpayers like Mr. Snowbird for streamlined. If the IRS truly wants to encourage voluntary disclosure, it could (at the least) allow taxpayers to file late income tax returns under its resident streamlined program. A 5% penalty under resident streamlined is certainly more palatable than a 27.5% (or 50%) penalty under OVDP, and is a fairer result for taxpayers who spend relatively trifling amounts of time in the United States every year.

<sup>1</sup>These FAQs can be accessed by navigating the links on this page: <https://www.irs.gov/Individuals/International-Taxpayers/Options-Available-For-U-S-Taxpayers-with-Undisclosed-Foreign-Financial-Assets>.

<sup>2</sup>For previous analysis, refer to Paul Barba, *Amended IRS Disclosure Programs Expand Eligible Taxpayers But Create the Canadian Snowbird Dilemma: Part 1* (July 7, 2014) available at <https://www.moodysgartner.com/amended-irs-voluntary-disclosure-programs-expand-eligible-taxpayers-but-create-the-canadian-snowbird-dilemma-part-1/>.

<sup>3</sup>I.R.C. § 7701(b)(1); Treas. Reg. § 301.7701(b)-1. *But see* Treas. Reg. § 301.7701(b)-7(a)(3).

<sup>4</sup>Accordingly, the rules applicable to non-U.S. citizen, non-green card holders will not be discussed here. For more, refer to Paul Barba, *supra* note 2.

<sup>5,6,7</sup>IRS, *Streamlined Filing Compliance Procedures* (Oct. 9, 2014), available at <https://www.irs.gov/Individuals/International-Taxpayers/Streamlined-Filing-Compliance-Procedures> [hereinafter General Streamlined]; IRS, *U.S. Taxpayers Residing Outside the United States* (Oct. 9, 2014), available at <https://www.irs.gov/Individuals/International-Taxpayers/U-S-Taxpayers-Residing-Outside-the-United-States> [hereinafter Nonresident Streamlined]; IRS, *U.S. Taxpayers Residing in the United States* (Oct. 9, 2014), available at <https://www.irs.gov/Individuals/International-Taxpayers/U-S-Taxpayers-Residing-in-the-United-States> [hereinafter Resident Streamlined].

<sup>8</sup>Nonresident Streamlined, *supra* note 5.

<sup>7</sup>Nonresident Streamlined, *supra* note 5; § 911(d)(3) (last sentence); Treas. Reg. § 1.911-2(b); IRS Publication 54 (Dec. 3, 2013), chapter 4, available at <https://www.irs.gov/pub/irs-pdf/p54.pdf>. See also § 911(d)(1).

<sup>8</sup>Rev. Rul. 91-58, 1991-2 C.B. 340 (the IRS ruled that U.S. residents are allowed to use the bona fide foreign residence test for purposes of § 911 under the nondiscrimination articles of certain U.S. income tax treaties, including the U.S.-Canada treaty).

<sup>9</sup>§ 911(a), (d)(1).

<sup>10</sup>Nonresident Streamlined, *supra* note 5.

<sup>11</sup>Treas. Reg. § 1.911-2(b).

<sup>12</sup>Resident Streamlined, *supra* note 5.

<sup>13</sup>See Amy S. Elliott, *IRS Answers Questions on Updated OVDP and Streamlined Filing*, 2014 Tax Analysts W.T.D. 120-3 (June 23, 2014) (statement by Jennifer Best, senior advisor, IRS Large Business and International Division, that “if you’re spending a substantial amount of time in the United States . . . you need to be responsible with respect to your tax obligations.”).

<sup>14</sup>Resident Streamlined, *supra* note 5.

<sup>15</sup>Resident Streamlined, *supra* note 5.

<sup>16</sup> IRS, *Streamlined Filing Compliance Procedures for U.S. Taxpayers Residing Outside the United States Frequently Asked Questions and Answers* (Oct. 8, 2014) available at <https://www.irs.gov/Individuals/International-Taxpayers/Streamlined-Filing-Compliance-Procedures-for-U-S-Taxpayers-Residing-Outside-the-United-States-Frequently-Asked-Questions-and-Answers>.

<sup>17</sup> § 7701(b)(3); Convention Between the United States of America and Canada with Respect to Taxes on Income and on Capital, U.S.-Can., Article IV(2), Sept. 26, 1980, T.I.A.S. 11087.

<sup>18</sup> U.S.C. § 1401(g).

<sup>19</sup> *E.g.*, § 7206(1); 18 U.S.C. § 1001.

<sup>20</sup> Statement of IRS Commissioner John Koskinen (June 18, 2014), at p.2, available at <https://www.irs.gov/uac/Newsroom/Statement-of-IRS-Commissioner-John-Koskinen>.