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An estimated one million U.S. citizens living in Canada now have an extra reason to celebrate. The Internal Revenue Service announced new rules and procedures this week to help dual citizens with their U.S. filing obligations.

"We told the U.S. government that the vast majority of Canadians targeted were honest, hard-working and law-abiding individuals and they listened," said Finance Minister Jim Flaherty. "The only transgression of these dual citizens has been failing to file IRS paperwork that they were unaware they were required to file."

The softer IRS approach relaxes the filing requirements for taxpayers outside of the U.S. and provides additional relief for those who have contributed to Registered Retirement Savings Plans or Registered Retirement Income Funds in Canada.

"These are positive developments," Mr. Flaherty said in a news release.

Under U.S. law, its citizens are required to file a federal income tax return as well as Reports of Foreign Bank and Financial Accounts (FBARs) every year no matter where they reside. Most countries, including Canada, have a residency-based taxation system rather than a citizenship-based system.

In the majority of cases, U.S. citizens don't actually end up owing U.S. federal tax due to offsetting foreign tax credits.

For many, however, the fear of being assessed harsh penalties on late-filed FBARs (Form TD F 90-22.1), which could range from a "willful" failure to file penalty starting at \$100,000 to non-willful failure to file penalty of \$10,000 per violation, was enough to keep many dual citizens or U.S. citizens residing in other countries from coming forward.

But under new IRS rules, taxpayers will only be required to file delinquent tax and information returns for the past three years, instead of six, and to file delinquent FBARs for the past six years. And the IRS indicated that taxpayers presenting "low compliance risk" won't be hit with penalties. The IRS has defined "low risk" as those who generally file returns with less than \$1,500 in tax owing.

In general, the "risk" level rises as the income and assets of the taxpayer rise, if there are indications of sophisticated tax planning or avoidance, or if there is material economic activity in the United States. Additional risk factors include a history of noncompliance with United States tax law and the amount and type of United States income.

"For taxpayers in the grey zone – the small business owner, the high income earner, the wealthy grandmother with assets in a holding company – the news release may be less comforting," said Christine Perry, a cross border tax specialist with Keel Cottrelle LLP.

"Until we get some indication of who is a compliance risk and who isn't I think there will be a continued reluctance to come forward."

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