Taxation of Canadians in America

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Contents

Tables

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Acknowledgments

Robert (Bob) Keats, was the first person to see a need for US-Canada financial planning, and has been serving Canadians and Americans with US-Canada cross border issues for more than 30 years. In 1990, he founded Keats, Connelly and Associates, which is now called KeatsConnelly. It is because of Bob's foresight and hard work that we are now able to write the first and only book dedicated solely to the taxation of Canadians in the US.

We also want to acknowledge all of the KeatsConnelly employees, past and present, on their contribution to this book. We have tried to capture their cumulative knowledge in the following pages. Though we wrote the book, it is the cumulative effort of decades of employees learning this subject matter by working directly with clients day-after-day, year-after-year, that we have been able to accumulate the knowledge we are putting into this book.

Ultimately, if it were not for the support and understanding of our spouses we would not have been able to accomplish a large undertaking such as this. Because the time we spent researching, writing, and editing took away time from our families, their patience and encouragement to finish the book was essential.

Lastly, we want to thank all of the clients we have worked with over the years. It is our clients that have put us in a position to be able to write a book on this important topic, and without them this book would not have been possible. It is for our current and future clients that we wrote this book.

Introduction

We estimate that more than 1 million Canadians file tax returns in the US and another 1 million should be filing, but don't. Based on our experience, many of those that do file have a number of mistakes that could be very costly if the Internal Revenue Service (IRS) were to discover those mistakes. Of those who don't file, but should, we find the main reason is that they do not fully understand the US residency requirements and therefore the requirement to file US tax returns.

As Canadians, you can hardly be blamed for the fact that, as a group, your US tax returns are most likely being done incorrectly. Taxation in general is complex enough, add to that rules that are seldom used by most tax preparers, then toss in the Treaty that can modify the Canadian *Income Tax Act* and the US Internal Revenue Code and you have a very complex set of rules. If that were not bad enough, in a number of cases, there are no clear rules or regulations addressing the issues you are facing, which makes it very difficult to file correctly even if you are trying to do the right thing.

This book will attempt to address most of the US tax- and estate-planning issues you will face as a Canadian living in the US. We will be primarily addressing individual taxation because it is the area most people need help. Besides, to discuss the cross-border implications of corporations, partnerships, trusts, etc., would require at least one whole book dedicated to nothing but the tax issues cross-border businesses face. While we will discuss these various entities from time-to-time, we will only cover the issues from the perspective of how they affect you as the individual.

KeatsConnelly is the largest and most experienced cross-border wealth management firm in North America that specializes in helping Canadians and Americans realize their dreams of a cross-border lifestyle. KeatsConnelly was started in 1990 and has more than 35 employees, with offices in Phoenix, Arizona; Boynton Beach, Florida; and Calgary, Alberta.

Cross Border Tax & Accounting is a wholly owned subsidiary of KeatsConnelly that specializes in tax planning and preparation for Canadian and US citizens, who live, work, or conduct business across the US-Canada border. A team of Canadian Chartered Accountants and US Certified Public Accountants prepare all types of US and Canadian tax returns. It is the cumulative expertise and experience of the professionals at KeatsConnelly and Cross Border Tax & Accounting that we draw upon in writing this book.

From our vantage point, the need for cross-border specialists is apparent, but we understand that you do not have our vantage point, so we will try to explain why it is so important to hire professionals that are experts in US-Canada tax planning and preparation.

Here are some reasons that a professional who specializes in US-Canada tax should be used:

- **Prevent risk:** There are risks that are unique to preparation of returns with international issues, such as forms that need to be filed and elections that need to be made. Failure to file a required form can be devastating, literally costing you tens of thousands or hundreds of thousands of dollars. That may not be the worst of it; you could be deported or even imprisoned.
- **It is complex:** Some of the complexities that arise on a regular basis are immigration, deemed disposition of property, residency issues, income, estate and gift taxes, how to title and own assets, the myriad of foreign reporting forms and the related issues and penalties involved, currency exchange, qualifying for Social Security benefits, special elections that need to be made, etc. We contend that it is impossible for

someone who dabbles in this area to know all of the complexities involved. We have specialized in US-Canada taxes for more than 20 years and find it difficult at times to keep up with all of the changes going on in this area; there is no way that anyone who is new to this subject should be attempting to prepare these returns.

- **Complexities need to be coordinated:** Immigration should not be undertaken until the income and estate consequences have been considered and proper planning has been taken. You need to consider what actions need to be taken to show the authorities that you are a resident of one country or the other. You need to consider what actions need to be taken before you exit Canada and what actions should be taken after you are a resident of the US. Many of these actions need to be done in a particular order, so you have to know what comes first, second, third, etc.

Here is an analogy for you to consider. If you were building a house, would you go out and hire an architect, a carpenter, a mason, electrician, and painter and not coordinate them? What would happen if the framer did his or her work before the architect developed the plans? What would happen if the carpet was installed before the drywall was hung? We can all agree that the job would be a complete disaster, yet this is exactly what people typically do when looking to move across the border; very first thing they do is hire an immigration attorney to get them a visa. Guess what, you are now subject to a bunch of US tax laws and you have done no planning; it is already a mess and you have barely gotten started.

- **The difference between knowledge and experience:** It is one thing to know that A, B, and C need to be done, it is another thing to know the specifics of how to get A, B, and C done. The perfect analogy here is that of graduating university students. Even if they are in fields such as law, accounting, and medicine, we all know that they have no idea what they are doing when they get out of school, yet they have "learned" how to do their jobs in school. The knowledge that is needed is as deep as it is broad, and it takes experience to learn it. Keep in mind that 20 years as a brain surgeon does not qualify you as a heart surgeon, and vice versa. Similarly, 20 years as an accountant does not qualify that accountant as a cross-border tax specialist.

- **Two experts on each side of the border do not equal a cross-border specialist.** On a regular basis we have clients that come to us who have hired the best advisor in Canada and the best advisor in the US only to find out after spending hundreds of thousands of dollars that the professionals' lack of understanding of the other country's laws created a hurdle they could not overcome. Similarly, those specialists do not typically coordinate with other specialists.

The problem from your perspective (the taxpayer), is that you cannot tell the difference between a correctly filed and incorrectly filed tax return. Understandably, you do not know what forms need to be filed, what elections need to be made, or in some cases do not even know what is taxable income and what is not. If you knew those things, you would prepare your own returns.

The solution is a cross-border tax specialist; someone who focuses on US-Canada tax. That person should have access to cross-border planning professionals who can look at all the aspects of a cross-border lifestyle and coordinates those aspects together, just as a general contractor would coordinate all of the aspects of building a house.

We realize that some of you are skeptical and think that we are simply trying to scare you into hiring our firm to prepare your taxes. Well, you are partially correct; we are trying to scare you, but not necessarily into using our services. There are a handful of US tax specialists who will do a fine job in preparing your returns. Though there may be more, we know of about a half-dozen firms in the US that we would trust to prepare your returns properly.

When seeking a competent cross-border tax specialist, we believe it is fair to be curious about the cost of preparing a US tax return with cross-border issues. Of course, we cannot speak for all of our peers, but based on our experience, you can expect to pay approximately $1,000 at the low end, up to $5,000 at the high end, depending on the complexity of your situation. These estimates do not include Canadian returns or business returns. For your first US return, you can expect to pay double, due to the calculations, elections, etc. that need to be made in the first year.

In the more than 20 years KeatsConnelly has been specializing in cross-border issues, we believe that we have seen every situation and have heard every question. We are using that experience as the basis for writing this book. We are writing this book to address most of the tax issues that Canadians need to know while living in the US.

To the best of our knowledge, this is the first and only book dedicated to the topic of taxation of Canadians living in the US and we hope it will become an indispensable guide for Canadians living in the US.

Other books written by the professionals at KeatsConnelly that are part of the Cross-Border Series include, *The Border Guide: A Guide to Living, Working, and Investing across the Border*, *A Canadian's Best Tax Haven: The US*, and *Buying Real Estate in the US: The Concise Guide for Canadians*. You can find these books at www.self-counsel.com/default/personal-finance.html, www.crossborderseries.com, www.crossborderseries.ca, or crossborderseries.net, or www.crossborderbooks.ca.

We are writing another book that will cover the *Taxation of Americans in Canada*. This book should be released in 2013 and will also be on the Self-Counsel Press, crossborderseries.net, and crossborderbooks.ca websites when ready.

1

The Basics of US Taxation

The US Internal Revenue Code (IRC) is synonymous with the Canadian *Income Tax Act* and is among, if not the most, complex system of taxation in the world. This book will cover a very small segment of the IRC, and even for the IRC sections we do discuss, we will not be going into great detail.

There are two basic points we want to make sure are clear and said up front; the US taxes its citizens and residents on their worldwide income, and that the US tax burden is about one-third less than that of Canada. In this chapter, we will discuss the Internal Revenue Service (IRS), IRS audits, filing requirements, and the basic layout of a US tax return.

1. History of the Internal Revenue Service (IRS)

In 1862, during the US Civil War, President Lincoln and Congress created the position of Commissioner of Internal Revenue and enacted an income tax to pay war expenses. The income tax was repealed ten years later. Congress revived the income tax in 1894, but the Supreme Court ruled it unconstitutional the following year.

In 1913, the 16th Amendment gave Congress the authority to enact an income tax. That same year, the first Form 1040 appeared after

Congress levied a 1 percent tax on net personal incomes of more than $3,000, with 6 percent surtax on incomes of more than $500,000.

In 1918, during World War I, the top rate of the income tax rose to 77 percent to help finance the war effort. It dropped sharply in the postwar years, down to 24 percent in 1929, and rose again during the Depression. During World War II, Congress introduced payroll withholding and quarterly tax payments.

In the 1950s, the agency was reorganized to replace a patronage system with career, professional employees. The Bureau of Internal Revenue's name was changed to the Internal Revenue Service (IRS). The IRS Commissioner and Chief Counsel are selected by the president and confirmed by the Senate.

The IRS *Restructuring and Reform Act* of 1998 prompted the most comprehensive reorganization and modernization of the IRS in nearly half a century. The objective of the act was for the IRS to reorganize itself in a way that would resemble the private sector model of organizing around customers. Few outside of the IRS would say that objective was met.

The IRS is a bureau of the Department of the Treasury and in fiscal year 2010, the IRS collected more than $2.3 trillion in revenue and processed more than 230 million tax returns.

The following mission statement describes the roles of the taxpayers and the IRS:

- In the United States, the Congress passes tax laws and requires taxpayers to comply.
- The taxpayer's role is to understand and meet his or her tax obligations.
- The role of the IRS is to help the large majority of compliant taxpayers with the tax law, while ensuring that the minority who are unwilling to comply pay their fair share.

The IRS is organized to carry out the responsibilities of the Secretary of the Treasury. The Secretary has full authority to administer and enforce the internal revenue laws and has the power to create an agency to enforce these laws. The IRS was created based on this legislative grant.

The Internal Revenue Code provides for the appointment of a Commissioner of Internal Revenue Service to administer and supervise the execution and application of the internal revenue laws.

2. The Basics

Income taxes are based on income and are imposed at the federal level, most state levels, and some local city levels within the US. Each state or city may define taxable income differently; however, most states refer to the federal law for determining taxable income. Common examples of income that may be taxed differently by a state than by the federal government are Social Security income, interest income from US treasury obligations, and pension benefits from that state's governmental workers. Cities typically tax income earned within that city. Cities that impose a separate tax are generally limited to the states of Ohio, Pennsylvania, and New York. In the US, you must file separate returns to the federal, state, and city governments, similar to filing separate Canadian federal and Quebec provincial returns.

In the US, individuals, estates, trusts, and certain corporations are subject to income tax. Partnerships and corporations that make an election to be treated as a small business (known as making an "S election") are not taxed. Partnerships and S corporations are what are called "flow through" entities. This means that the income, expenses, and ultimately the income tax flows through to the individual partners or shareholders. Nonresidents of the US are not allowed to be shareholders of an S Corporation.

Regular corporations (sometimes referred to as "C corporations") are subject to double taxation because the corporation pays tax on the income and when a dividend is paid, the individual pays tax on the dividend. The corporation does not receive a deduction for the dividend and the individual does not receive a credit for tax paid by the corporation.

Federal and many state income tax rates are graduated, meaning that at higher levels of income you pay progressively higher levels of tax. The tax rate that corresponds to your highest level of income is known as your marginal tax rate. For individuals, the income level at which the various tax rates apply, varies by your filing status.

For the 2011 tax year, individuals are subject to federal graduated tax rates from 10 to 35 percent; the 35 percent tax rate applies to taxable income of more than $379,150 for couples filing jointly and single individuals. Also for 2011, corporations are subject to federal graduated rates of tax from 15 to 35 percent; the 35 percent tax rate applies to corporate taxable income of more than $18,333,333. State income tax rates vary from 0 to 11 percent. State and local taxes are generally deductible in computing federal taxable income.

The Federation of Tax Administrators website www.taxadmin.org/fta/rate/ has information on the latest tax rates, surveys, and rankings.

3. Dealing with the IRS

While the IRS is not the demonic organization it is frequently made out to be, it's an organization you do not want to get on the bad side of. Fortunately, staying in the IRS's good graces is relatively easy to do; file your taxes on time and pay the taxes you are legally required to pay.

In the US you are typically not contacted by the IRS unless it wants something such as additional information. Neither ignore nor panic when you receive a letter or notice; instead, we suggest that you contact a professional and have them assist you with the process. Just because the IRS asserts something, does not mean that it is correct.

Do not pay additional amounts of tax without making sure you owe it. Over the years, we have seen many taxpayers pay additional amounts without checking with us or otherwise confirming that the amount being asked for was legitimate. We guess that based on our experience, greater than 50 percent of the notices sent by the IRS asking for additional money are incorrect in part or in whole.

This is what the IRS says about a notice. "If you receive a letter or notice from the IRS, it will explain the reason for the correspondence and provide instructions. Many of these letters and notices can be dealt with simply without having to call or visit an IRS office. The notice you receive covers a very specific issue about your account or tax return. Generally, the IRS will send a notice if it believes you owe additional tax, are due a larger refund, if there is a question about your tax return, or it needs additional information."

Here is a copy of IRS Summertime Tax Tip 2011-22, August 24, 2011.

Every year the Internal Revenue Service sends millions of letters and notices to taxpayers, but that doesn't mean you need to worry. Here are eight things every taxpayer should know about IRS notices — just in case one shows up in your mailbox:

1. *Don't panic. Many of these letters can be dealt with simply and painlessly.*

2. *There are number of reasons the IRS sends notices to taxpayers. The notice may request payment of taxes, notify you of a change to your account, or request additional information. The notice you receive normally covers a very specific issue about your account or tax return.*

3. *Each letter and notice offers specific instructions on what you need to do to satisfy the inquiry.*

4. *If you receive a correction notice, you should review the correspondence and compare it with the information on your return.*

5. *If you agree with the correction to your account, usually no reply is necessary unless a payment is due.*

6. *If you do not agree with the correction the IRS made, it is important that you respond as requested. Write to explain why you disagree. Include any documents and information you wish the IRS to consider, along with the bottom tear-off portion of the notice. Mail the information to the IRS address shown in the lower left part of the notice. Allow at least 30 days for a response.*

7. *Most correspondence can be handled without calling or visiting an IRS office. However, if you have questions, call the telephone number in the upper right corner of the notice. Have a copy of your tax return and the correspondence available when you call.*

8. *It's important that you keep copies of any correspondence with your records.*

For more information about IRS notices and bills, see Publication 594, "The IRS Collection Process." Information about penalties and interest charges are available in Publication 17, "Your Federal Income Tax for Individuals." Both publications are available at www.IRS.gov.

Caution: One thing to point out is that Canadians seem to be much more likely to call Canada Revenue Agency (CRA) or the IRS to ask questions about the law, than Americans. We suggest that you do not call the IRS for advice for a number of reasons. First and most importantly is that the IRS is not bound by the advice the employees provide on the phone. In the best of cases, you are flipping a coin as to whether you will get an answer that is correct. Given that you will have a number of cross-border issues, this will increase the complexity and therefore decreases the likelihood of receiving an answer you can rely on. We hope the following analogy makes the problem clear:

We provide you a hat full of possible answers, 40 percent of them will be correct answers and 60 percent will be incorrect answers. You are to blindly pull one answer from the hat, then bet thousands of dollars on the fact you have one of the correct answers — that is not a bet we would want to take. Also, when talking to the IRS agent, you may either not accurately convey the issue or you may not understand the answer due to the fact that you do not understand the law or the tax lexicon. Lastly, you may inadvertently tell the IRS agent something you should not be telling him or her.

4. The IRS Examination (Audit) Process

The IRS examines (audits) tax returns to verify that the tax reported is correct. Selecting a return for examination does not always suggest that the taxpayer has either made an error or been dishonest. In fact, some examinations result in a refund to the taxpayer or acceptance of the return without change.

The IRS selects returns for examination using a variety of methods, including:

- **Potential participants in abusive tax-avoidance transactions:** Some returns are selected based on information obtained by the IRS through efforts to identify promoters and participants of abusive tax-avoidance transactions. Examples include information received from "John Doe" summonses issued to credit card companies and businesses and participant lists from promoters ordered by the courts to be turned over to the IRS.

- **Computer scoring:** Some returns are selected for examination on the basis of computer scoring, which means computer programs give each return numeric "scores." The Discriminant Function System (DIF) score rates the potential for change, based on past IRS experience with similar returns.

The Unreported Income (UI) DIF score rates the return for the potential of unreported income. IRS personnel screen the highest-scoring returns, selecting some for audit and identifying the items on these returns that are most likely to need review.

- **Information matching:** Some returns are examined because payer reports (i.e., tax slips), such as Forms W-2 from employers or Miscellaneous Income (Form 1099) statements from banks and brokerage firms, do not match the income reported on the tax return.

- **Related examinations:** Returns may be selected for audit when they involve issues or transactions with other taxpayers, such as business partners or investors, whose returns were selected for examination.

- **Other:** Area offices may identify returns for examination in connection with local compliance projects. These projects require higher level management approval and deal with areas such as local compliance initiatives, return preparers, or specific market segments.

An examination may be conducted by mail or through an in-person interview and review of the taxpayer's records. The interview may be at an IRS office (i.e., office audit) or at the taxpayer's home, place of business, or accountant's office (i.e., field audit). Taxpayers may make audio recordings of interviews, provided they give the IRS advance notice. If the time, place, or method that the IRS schedules is not convenient, the taxpayer may request a change, including a change to another IRS office if the taxpayer has moved or business records are there.

The audit notification letter tells which records will be needed. Taxpayers may act on their own behalf or have someone represent or accompany them. If the taxpayer is not present, the representative must have proper written authorization. The auditor will explain the reason for any proposed changes. Most taxpayers agree to the changes and the audits end at that level.

Taxpayers who do not agree with the proposed changes may appeal by having a supervisory conference with the examiner's manager or appeal their case administratively within the IRS, to the US Tax Court, US Claims Court, or local US District Court. If there is no agreement at the closing conference with the examiner or the examiner's manager, the taxpayers have 30 days to consider the proposed adjustments and their next course of action. If the taxpayer does not respond within 30 days, the IRS issues a statutory notice of deficiency, which gives the taxpayer 90 days to file a petition to the Tax Court. The Claims Court and District Court generally do not hear tax cases until after the tax is paid and administrative refund claims have been denied by the IRS. The tax does not have to be paid to appeal within the IRS or to the Tax Court. A case may be further appealed to the US Court of Appeals or to the Supreme Court, if those courts are willing to accept the case.

Note: Do not attempt to handle an IRS audit on your own; hire an experienced and competent tax professional to represent you.

5. Filing

All US citizens and noncitizens of the US that are residents (referred to as resident aliens) are required to file a US tax return if they meet certain income thresholds. To be clear, if you are considered a resident of the US, you are subject to the tax laws of the US, even if you are here illegally. You are a resident alien if you meet one of the following tests:

- Legal Permanent Resident (e.g., Green Card holder).
- You meet a 183-day substantial presence test. This is a two-part test and if you fail the first part of the test, you are generally a US resident, with limited exceptions. If you fail only the second part of the test, you can file Closer Connection Exception Statement for Aliens (Form 8840) to claim a closer connection to a foreign country (Canada) and will not be considered a US resident, assuming that in fact you do have a closer connection to Canada.
  - **Part 1 of the test:** You are physically present in the US at least 183 days during the calendar year. Note that each partial day counts as one day. The only exception is if you are traveling by plane and you simply pass through the US on your way to another foreign destination.
  - **Part 2 of the test:** You are physically present in the US for at least 183 days using the following three-year formula:
    - **Year 1:** Each day counts as one day.

- **Year X-1:** Each three days counts as one day.
- **Year X-2:** Each six days counts as one day.

For example, if you spent 122 days each year, each of the last three years, this is what you would have:

- In 2011, you spent 122 days, times 1/1 = 122 days.
- In 2010, you spent 122 days, times 1/3 = 41 days.
- In 2009, you spent 122 days, times 1/6 = 20 days.

  Total number of days using the formula, equals 183 days and you fail Part 2 of the test and are considered a US resident unless you file Form 8840.

Note: If you arrive in the US on November 1 and leave on March 31, you would have been in the US a total of 121 days. If you did this year in and year out, you would pass the second part of the test most years. Every leap year, you would have stayed in the US 122 days and therefore failed the test and must therefore file Form 8840 to avoid being considered a US resident and subject to tax.

What makes this rule confusing are primarily two things: the fact that the test has two parts, and the fact that immigration has different rules. Remember that being in the US for less than 183 days is only one part of the test, if you are in the US every year for 122 days or more, you have failed part two of the test and must file Form 8840 to show the IRS that you are not a US resident. If you fail the second part of the test and do not file Form 8840, you are a US taxpayer and subject to US tax. In the Introduction, we mentioned that there is an estimated 1 million Canadians in the US that are residents who are not filing returns. It is this group of Canadians that spend four months or more each year in the US and do not file Form 8840 that we are mostly referring to.

There is another set of rules that you need to be concerned about: the immigration rules. These are the rules that the customs agents at the border are concerned with. These rules use a rolling 12-month period instead of the calendar year the IRS uses. For example, if you stay in the US from October 1 through April 1, you would have been in the US 183 consecutive days, yet only be in the US for 92 days in the first year and 91 days in the second year. If you assume no other days in the US in either year, you clearly passed both parts of the residency test for tax purposes, but failed the test for immigration purposes. To make matters worse, the Customs agents are not consistent in their application of the rules. Fortunately, you are typically looking at only being hassled by the Customs agents and nothing serious comes of it, but it does make it confusing for you when you are constantly getting conflicting answers.

If you are a resident or citizen, you still may not have to file a tax return if your income is less than certain thresholds. Table 1 shoes the income thresholds for two categories. (If these categories do not apply to you, you may fall into another category and corresponding threshold.)

Table 1
INCOME THRESHOLDS FOR FILING

Category	**You must file if gross income is at least**
Single:	
Younger than age 65	$9,500
Age 65 or older	$10,950
Married filing jointly and living together:	
Both spouses younger than age 65	$19,000
One spouse younger than age 65	$20,150
Both spouses age 65 or older	$21,300

Note: The US defines marriage as a man and a woman who are legally married. However, some states and many countries recognize common-law marriage, so the IRS will recognize common-law marriages if that marriage met, and continues to meet the requirements of that jurisdiction; allowing the couple to file jointly.

While some states and many countries recognize same-sex relationships, the IRS will not recognize them and those couples will not be allowed to file a joint return.

5.1 When to file your Individual Income Tax Return (Form 1040)

The normal due date for filing individual income tax returns (Form 1040) is April 15 of the year following the tax year. If this date falls on a weekend, the due date is the Monday following the weekend. You can get an automatic six-month extension of time to file your return by filing Application for Automatic Extension of Time to File

US Individual Income Tax Return (Form 4868) by the due date, typically April 15. By filing this form in a timely fashion, your time to file will be extended to October 15.

An extension provides only an extension of time to file, not pay your taxes. You must calculate and pay any taxes due by April 15 (or the adjusted date) to avoid penalties. If you are required to make estimated (installment) tax payments, you must make those payments even though your return is on extension.

Not all forms that you may need to file have the same due date. Those forms will in turn have their own forms to complete for an extension for that form, and that form only. Not only do some forms have different due dates, some forms do not allow for an extension of time to file. For example, the Annual Information Return of Foreign Trust with a US Owner (Form 3520-A) for reporting foreign trusts is due on March 15; and Application for Automatic Extension of Time To File Certain Business Income Tax, Information, and Other Returns (Form 7004) is required for the six-month extension, which means that the ultimate filing deadline is September 15, not October 15 like most of the rest of your return. Also, Report of Foreign Bank and Financial Accounts (Form TD F 90-22.1) is due June 30 and cannot be extended.

Filing an extension does not increase your chance of being audited. If fact, if you cannot get your tax information to the accountant early in the season, you may want the accountant to file an extension so that the accountant can prepare the return after April 15 when there is less pressure and he or she hasn't been working 12- to 16-hour days for the previous two months!

5.2 Electronic filing

Paid preparers are now required to file all tax returns electronically, when possible. However, some returns have forms or situations that have not yet been approved for electronic filing. When electronically filing, your accountant will require you to sign the US Individual Income Tax Transmittal for IRS *e-file* Return (Form 8453).

5.3 Penalties and interest for underpayment, late filing, and late payment

If it is determined later (by you or the IRS) that the amount of tax owed is greater than the tax paid when the return was filed, there will be interest due on the underpayment of tax. The interest rate can change quarterly, but it is currently 3 percent for underpayments. The interest is compounded daily.

If you file your return late without a reasonable cause, the IRS will impose a penalty of 5 percent per month, with a maximum penalty of 25 percent. If your return is more than 60 days late, the IRS imposes a minimum penalty equal to the lesser of $135 or 100 percent of the tax due. If the failure to file is fraudulent, the monthly penalty is 15 percent, with a maximum penalty of 75 percent.

If you are late in paying your taxes, the penalty is .5 percent per month, with a maximum penalty of 25 percent. This penalty is in addition to the regular interest charge. This penalty may be doubled (to 1 percent) if after repeated requests to pay and a notice of levy, you do not pay.

As mentioned earlier, the IRS allows you to file for an automatic extension of time, giving you until to October 15 to file your return. However, you must still pay the tax by April 15. There is an exception to the late payment penalty if you paid at least 90 percent of the total tax owed by April 15.

If both the late payment and late filing penalties apply, the .5 percent penalty for late payment (but not the 1 percent penalty for continued nonpayment) will offset the penalty for late filing, during the period that the penalties run concurrently.

5.4 Filing status

There are five filing statuses in the US; single, married filing jointly, married filing separately, head of household, and qualifying widow or widower. In Canada, couples file their own separate returns, in the US married couples can, and typically do, file a joint return where both spouses report all of their income and deductions on a single return. Married couples may choose to file separately, but not as singles.

Note: As of this writing, six states recognized same-sex marriages. Marriage licenses are granted by these six states: Connecticut, Iowa, Massachusetts, New Hampshire, New York, and Vermont, plus Washington, DC and Oregon's Coquille and Washington's Suquamish Indian tribes. Common-law marriages are allowed in the following states plus the District of Columbia: Alabama, Colorado, Iowa, Kansas, Montana, New Hampshire, Oklahoma, Rhode Island, South Carolina, Texas, and Utah. As mentioned previously, the IRS will recognize common-law marriages, and will allow the couple to file as married filing jointly. In addition to the states listed, couples from other countries that recognize common-law marriages, such as Canada, will also be recognized by the IRS.

While it is usually beneficial for married couples to file jointly, there can be circumstances where filing separately might be beneficial. The most common situation in which a couple might consider filing separately is when one spouse has many more deductible expenses than the other spouse, such as medical expenses where the deduction is limited to the amount that exceeds 7.5 percent of income.

For example, assume in this very simplistic example that Jane has income of $100,000 and her husband Bob has income of $30,000. Bob also had $10,000 of medical expenses, whereas Jane had no medical expenses. If Jane and Bob were to file jointly, they would have $130,000 of income and their medical expenses would be limited to $250, the amount above 7.5 percent of $130,000 (130,000 x 7.5% = 9,750). In other words, the first $9,750 would not be deductible. On the other hand, if they filed separately, Bob would be allowed to deduct $7,750, as only $2,250 would not be allowed (30,000 x 7.5% = 2,250).

6. Notifying the IRS about Your Change of Address

The IRS will send all correspondence to your last known address; this includes any claims of refund or deficiency notices. Keeping the IRS up to date on how to contact you is important because your refund may be delayed otherwise. If you owe the IRS money, simply changing your address and not telling the IRS does not help; the IRS can enforce a deficiency even if you never received the notice, as long as the IRS sent it to your last known address.

To update your address, you can call the IRS at 1-800-829-1040 or by filing a Change of Address (Form 8822), or by correcting the address on an IRS correspondence and returning it with the correct information. We recommend filing the form rather than calling since the 800 number above is the general number and you will be on hold for a very long time. When filing Form 8822, we recommend that you send it by registered mail so that you have proof it was sent and received.