Did You Know That the IRS May File a "Substitute for Return" from FATCA Report Account Holder Information?

Did you know that, under Internal Revenue Code, Section 6620, if a taxpayer does not timely file a U.S. tax return, the IRS is authorized to prepare and file a U.S. tax return for that taxpayer based on the knowledge that it has on hand? The return prepared by the IRS is called a Substitute for Return (SFR).

On the SFR, IRS will list the income, calculate the tax due, add interest and a penalty for failing to file, and send the non-compliant taxpayer a bill based on its efforts. This bill will come at a high price. IRS will assess taxpayer's tax liability based on information that it has received from the taxpayer's employers, banks, and OTHER third parties. The IRS will not include itemized deductions or credits, and allows only a filing status of single or married filing separately, only one personal exemption, and the standard deduction. Due to this, the taxpayer may owe I.R.S. an inflated amount.

Most taxpayers learn that the IRS has prepared an SFR when they receive a letter in the mail. The first correspondence (assessment letter) from the IRS is Notice CP2566. This notice will direct the taxpayer to:

•Immediately file the delinquent tax return or

•Accept IRS' proposed assessment by signing and returning the Response form, or

•Call IRS if the taxpayer thinks that she is not obligated to file a tax return for the period being assessed.

IRS Notice CP2566 states: "Keep in mind that this amount may be higher than what you would owe if you filed your own return".

If the taxpayer does not respond to the assessment letter within 30 days, a second letter, or Statutory Note of Deficiency is sent out by registered mail. This is known as Letter 3219-B. The IRS will mail the letter of deficiency when it is prepared to act as if its proposed tax assessment is correct. Thus, IRS is prepared to begin collecting any unpaid tax, penalties and interest.

IRS then allows the taxpayer 90 days to take one of the following actions:

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•File an original tax return,

•File a Consent to Assessment and Collection (agreeing to the IRS calculations), or

•Explain why the taxpayer does not have an obligation to file a tax return for year being assessed.

There are technical details involved in a SFR situation that most taxpayers are not aware of, and owing IRS can be complicated. It may even result in the loss of the taxpayer's passport.

On December 3, 2015, the FAST Act (Fixing America's Surface Transportation) was signed into law. The FAST Act approved Internal Revenue Code Section 7345 also known as "Revocation or Denial of Passport in Case of Certain Tax Delinquencies". It includes tax provisions that most taxpayers are not aware of:

1. The U.S. Secretary of State is authorized by law to deny or renew a passport, and empowered to revoke a passport, of any taxpayer that is identified by IRS as seriously delinquent. The definition of seriously delinquent includes a taxpayer that has outstanding debt for payment of federal taxes in excess of $50,000.00 including interest and penalties. The list of affected taxpayers will be compiled by IRS and submitted to the State Department.

2. There is added increased authorization for private IRS collectors. The law now requires private debt collectors. Many people are worried that private taxpayer financial information will fall into "unscrupulous" hands.

3. The State Department is also authorized to deny an application for a passport if the applicant fails to provide a valid social security number or provides an incorrect social security number or invalid social security number. If an incorrect or invalid number is provided willfully, recklessly or negligently, the passport can be denied or revoked.

For a U.S. Citizen taxpayer, Section 7345 can be more alarming than FATCA because it could affect the taxpayer's freedom of movement. A U.S. citizen is not permitted to enter or leave the U.S. on anything other than a valid U.S. passport, even if the taxpayer has other nationalities. Many taxpayers have recently received (or will soon receive) a FATCA Letter. This means that the taxpayer has already been identified as a U.S. taxpayer by a Foreign Financial Institution, and his or hers name and financial account information, will be disclosed to the IRS. Chances are, if the account holder's account is in certain countries, that this information has already been released to the I.R.S., as the first FATCA exchange of information took place in September of 2015.

What does all this mean and why is it important? Take a U.S. taxpayer that does not reside in the U.S., does not report offshore accounts or file tax returns. The foreign financial institutions will report the taxpayer's account balances and income earned on the accounts as they are obligated to do under FATCA. The IRS will receive the information, and cross-reference. IRS will begin to send notifications. IRS could prepare a SFR and send a notice to the taxpayer. If the taxpayer cannot pay, and the amount due is over $50,000.00 and becomes delinquent; well then, the taxpayer may lose his or her passport.

IRS and its reach is now full circle. Taxpayers should not be victims of their own making, and should consult their tax specialist if they are out of compliance.