Offshore Tax Evasion:

IRS Tax Compliance
FATCA/FBAR

by

Gary S. Wolfe, Esq.

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On March 18, 2010, President Obama signed the Hiring Incentives to Restore Employment (HIRE) Act, which included the Foreign Account Tax Compliance Act (FATCA).

Under the Act, new reporting and disclosure requirements for foreign assets will be phased in between 2010 – 2014.

International investors are subject to annual U.S. income tax compliance filings, if they have a Green Card, are U.S. taxpayers, or are in the U.S. for 183 days in any one tax year or for 122 days per year, over three tax years.

FBAR

A FBAR filing is a Report of Foreign Bank and Financial Account (Form TD F 90-22.1). If you fail to file a FBAR (due June 30th of each year), you may be subject to penalties of up to 50% of the account balance (annually) and a felony (up to 10 years in jail).

U.S. Taxpayers should answer the following three questions:

1. Did you disclose the foreign bank account on your Form 1040?
2. Did you report income from a foreign bank account?
3. Did you file an FBAR for the foreign bank account?

U.S. Taxable Residents with offshore structures ordinarily must file the following annual U.S. tax compliance:

- Annual Form 1040: report worldwide income (including hedge fund income);
- Foreign Financial accounts over $10,000 file form TDF 90-22.1, Report of Foreign Bank and Financial Accounts, "FBAR Filing," due June 30th following tax year (separate tax filing);
- Foreign Financial Assets valued in excess of $50,000 file form 8938, "Specified Foreign Financial Assets" attached to form 1040 (Foreign Account Tax Compliance Act: "FACTA Filing.")

Note that filing form 8938 (with form 1040) does not relieve U.S. taxable residents of the requirement to file "FBAR," Form TDF 90-22.1 if FBAR filing is otherwise due.

FATCA

Chapter 1
Summary of HIRE and Foreign Account Tax Compliance Act

On March 18, 2010, President Obama signed the Hiring Incentives to Restore Employment ("HIRE") Act (P.L. 111-147) (The "Act"), which included the Foreign Account Tax Compliance Act containing new foreign account tax compliance rules.

Under the Act, new reporting and disclosure requirements for foreign assets will be phased in between 2010 – 2014:

1. Foreign Institutional Reporting: Foreign Institutions have new reporting and withholding obligations for accounts held by U.S. Persons (generally effective after 12/31/12, commencing 1/1/13).

2. Foreign Financial Assets ($50,000): Individuals with an interest in a "Foreign Financial Asset" have new disclosure requirements. If foreign financial assets are valued in excess of $50,000, the U.S. Taxpayer must attach certain information to their income tax returns for tax years beginning after March 18, 2010. (U.S. Taxpayers are not required to disclose interests that are held in a custodial account with a U.S. financial institution).

The penalty is substantial ($10,000, plus additional amounts for continued failures, up to a maximum of $50,000 for each applicable tax period). The penalty may be waived if the individual can establish that the failure was due to reasonable cause and not willful neglect.

3. 40% Penalty: A 40% accuracy-related penalty is imposed for underpayment of tax that is attributable to an undisclosed foreign financial asset understatement. Applicable assets are those subject to mandatory information reporting when the disclosure requirements were not met. The penalties are effective for tax years beginning after March 18, 2010.

4. 6 Year Statute of Limitations: Statute of limitations re: omission of income in connection with foreign assets: The statute of limitations for assessments of tax is extended to six (6) years if there is an omission of gross income in excess of $5,000 attributable to the foreign financial asset. The six-year statute of limitations is effective for tax returns filed after March 18, 2010, as well as for any other tax return for which the assessment period has not yet expired as of March 18, 2010.

5. Passive Foreign Investment Companies: The Act imposes an information disclosure requirement on U.S. Persons who are PFIC shareholders. A PFIC is any foreign corporation if:

a. 75% or more of the gross income of the corporation for the taxable year is passive income; or

b. The average percentage of assets held by such corporation during a taxable year which produce passive income or which are held for the production of passive income are at least 50%.

6. Foreign Trusts with U.S. Beneficiaries: The Act clarifies if a foreign trust is treated as having a U.S. Beneficiary, an amount accumulated is treated as accumulated for the U.S. Person's benefit even if that Person's trust interest is contingent.

The Act clarifies that the discretion to identify beneficiaries may cause the trust to be treated as having a U.S. Beneficiary. This provision is effective after March 18, 2010.

7. Rebuttable Presumption/Foreign Trust – U.S. Beneficiary: The Act creates a rebuttable presumption that a foreign trust has a U.S. Beneficiary if a U.S. Person directly or indirectly transfers property to a foreign trust (unless the transferor provides satisfactory information to the contrary to the IRS). This provision is effective for property transfers after March 18, 2010.

8. Uncompensated Use of the Foreign Trust Property: The Act provides that the uncompensated use of the foreign trust property by a U.S. Grantor, a U.S. Beneficiary (or a U.S. Person, related to either of them), is treated as a distribution by the trust. The use of the trust property is treated as a distribution to the extent of the fair market value of the property's use to the U.S. Grantor/U.S. Beneficiary, unless the fair market value of that use is paid to the trust.

The loan of cash or marketable securities by a foreign trust, or the use of any other property of the trust, to or by any U.S. Person is also treated as paid or accumulated for the benefit of the U.S. Person. This provision applies to loans made and uses of property after March 18, 2010.

9. Reporting Requirements, U.S. Owners of Foreign Trusts: This provision requires any U.S. Person treated as the owner of any portion of a foreign trust to submit IRS-required information and insure that the trust files a return on its activities and provides such information to its owners and distributees.

This new requirement imposed on U.S. Persons treated as owners is in addition to the current requirement that such U.S. Persons are responsible for insuring that the foreign trust complies with its own reporting obligations. This provision is effective for taxable years beginning after March 18, 2010.

10. Minimum Penalty re: Failure to Report Certain Foreign Trusts: This provision increases the minimum penalty for failure to provide timely and complete disclosure on foreign trusts to the greater of $10,000 or 35% of the amount that should have been reported.

In the case of failure to properly disclose by the U.S. Owner of a foreign trust of the year-end value, the minimum penalty would be the greater of $10,000 or 5% of the

amount that should have been reported. This provision is effective for notices and returns required to be filed after December 31, 2009.

Chapter 2
Foreign Financial Assets

U.S. Taxpayers who hold any interests in specified foreign financial assets during the tax year must attach their tax returns for the year certain information with respect to each asset if the aggregate value of all assets exceeds $50,000. An individual who fails to furnish the required information is subject to a penalty of $10,000. An additional penalty may apply if the failure continues for more than 90 days after a notification by the IRS to a maximum of $50,000. The penalty may be avoided if the Taxpayer shows a reasonable cause for the failure to comply.

The Joint Committee on Taxation, Technical Explanation of the Hiring Incentives to Restore Employment Act (JCX-4-10) clarifies that although the nature of the information required to be disclosed is similar to the information disclosed on an FBAR, it is not identical.

For example, a beneficiary of a foreign trust who is not within the scope of the FBAR reporting requirements because his interest in the trust is less than 50%, may still be required to disclose the interest with his tax return if the $50,000 value threshold is met. In addition, this provision is not intended as a substitute for compliance with the FBAR reporting requirements, which remain unchanged.

For purposes of IRC Code §6038(D) as added by the HIRE Act, a specified foreign financial asset includes:

1. Any depository, custodial, or other financial account maintained by a foreign financial institution, and

2. Any of the following assets that are not held in an account maintained by a financial institution:

a. Any stock or security issued by a person other than a U.S. Person

b. Any financial instrument or contract held for investment that has an issuer or counterparty other than a U.S. Person, and

c. Any interest in a foreign entity (IRC §6038(D)(b) as added by the 2010 HIRE Act).

The information required to be disclosed with respect to any asset must include the maximum value of the asset during the tax year (IRC §6038(D)(c) as added by the 2010 HIRE Act).

For a financial account, the Taxpayer must disclose the name and address of the financial institution in which the account is maintained and the number of the account.

In the case of any stock or security, the disclosed information must include the name and address of the issuer and such other information as is necessary to identify the class or issue of which the stock or security is a part.

In the case of any instrument, contract, or interest, a Taxpayer must provide any information necessary to identify the instrument, contract, or interest along with the names and addresses of all issuers and counterparties with respect to the instrument, contract, or interest.

Under these rules, a U.S. Taxpayer is not required to disclose interests held in a custodial account with a U.S. financial institution. In addition, the U.S. Taxpayer is not required to identify separately any stock, security instrument, contract, or interest in a disclosed foreign financial account.

An individual who fails to furnish the required information with respect to any tax year at the prescribed time and in the prescribed manner is subject to a penalty of $10,000 (IRC §6038(D)(d) as added by the 2010 HIRE Act). If the failure to disclose the required information continues for more than 90 days after the day on which the notice was mailed (from the Secretary of Treasury), the individual is subject to an additional penalty of $10,000 for each 30-day period (or a fraction thereof) with the maximum penalty not to exceed $50,000.

In addition to the $10,000 penalty (up to $50,000) under IRC §6038(D) a 40% accuracy-related penalty is imposed on any understatement of tax attributable to a transaction involving an undisclosed foreign financial asset.

The statute of limitations for omission of gross income attributable to foreign financial assets (omission of gross income in excess of $5,000 attributable to a foreign financial asset), is extended to six years.

The IRC §6038(D) penalties are not imposed on any individual who can show that the failure is due to reasonable cause and not willful neglect. (IRC §6038D(g), as added by the 2010 HIRE Act.)

The information disclosure with respect to foreign financial assets supplements the FBAR reporting regime. The HIRE Act broadens reporting requirements and extends the rules to ownership of foreign assets such as foreign stocks, securities, interests in foreign companies not covered by the FBAR reporting. The threshold reporting requirement amount for FBARs ($10,000) is increased to $50,000. While the FBAR reporting covers those having signatory or other authority, the new reporting regime focuses on ownership.

Chapter 3
IRS Form 8938: Statement of Specified Foreign Financial Assets

"FATCA" Tax Reporting

Under the Foreign Account Tax Compliance Act ("FATCA") for tax years beginning after March, 18, 2010, specified persons (i.e. U.S. Citizens, resident aliens), who have an ownership interest in specified foreign financial assets (i.e. foreign financial accounts, foreign stock, any interest in a foreign entity) must file Form 8938 (attached to their form 1040 tax return) if the value of the foreign financial assets exceeds applicable "reporting threshold".

The value of a specified foreign financial asset, for Form 8938 reporting purposes is the asset's fair market value.

For Individuals: more than $50,000 on the last day of the tax year, more than $75,000 at any time during the tax year. If living abroad; $200,000 on the last day of the tax year or more than $300,000 at any time during the tax year.

For Married Taxpayers: more than $100,000 on the last day of the tax year, more than $150,000 at any time during the tax year, if living abroad: $400,000 on the last day of the tax year, or more than $600,000 at any time during the tax year.

The IRS anticipates issuing regulations that will require domestic entity to file Form 8938, if it holds specified foreign financial assets whose value exceeds the applicable reporting threshold. Until the IRS issues such regulation, only individuals must file Form 8938.

Foreign Trusts

The value of an interest in a foreign trust, during the tax year, (if taxpayer doesn't know its fair market value is the Maximum Value of the interest in the foreign trust calculated as the sum of the following amounts:

1) The value of all of the cash (or other property) distributed during the tax year from the trust to the beneficiary, plus

2) The value (using the IRC§7520 Valuation Tables) to receive mandatory distributions as of the last day of the tax year;

Foreign Grantor Trusts

A U.S. Taxpayer, who is the owner of a foreign grantor trust, does not have to report specified financial assets, held by the trust if:

1) The US Taxpayer reports the trust on a timely filed form 3520 for the same tax year;

2) The trust timely files Form 3520-A (Annual Information Return of Foreign Trust with a U.S. owner) for the same tax year;

3) Taxpayer identified on form 8938 how many of these forms they filed.

Specified Foreign Financial Assets

Foreign financial accounts include any depository (or custodial) account maintained by a foreign financial institution, any equity or debt interest in a foreign financial institution including any financial account maintained by a financial institution organized under the laws of a U.S. possession (America Samoa, Guam, The Northern Mariana Islands, Puerto Rico or the U.S. Virgin Islands)

A foreign financial institution is any financial institution that is not a U.S. entity, and satisfies one of the following conditions:

1) It accepts deposits;

2) It holds financial assets for the account of others;

3) It is engaged in the business of investing or trading in securities, partnership interests, or commodities;

4) It includes investment vehicles such as foreign mutual funds, hedge fund and private equity funds.

Interests in Specified Foreign Financial Assets

A U.S. Taxpayer:

1) Has an interest in a specified financial asset if any income, gains, losses, deductions, credits, gross proceeds, or distribution from asset dispositions is required to be reported on U.S. income tax returns;

2) Who is the owner of a disregarded entity, has an interest in any specified foreign financial assets owned by the disregarded entity;

3) Who has an interest in a financial account that holds specified foreign financial assets, do not have to report the assets held in the account;

4) Does not own an interest in any specified foreign financial asset held by a partnership, corporation or estate, as a result of their status as a partner, shareholder or beneficiary;

5) Who is the owner, under the grantor trust rules of any part of a trust, has an interest in any specified foreign financial asset held by that part of the trust;

6) Does not have an interest in a foreign trust or a foreign estate specified foreign financial asset, unless they know (or have reason to know) of the interest. If they receive a distribution from the foreign trust or foreign estate, they are considered to know of the interest.

Exceptions to Tax Reporting (Form 8938)

U.S. Taxpayers do not have to report a specified foreign financial asset on Form 8938:

1) If the financial account is maintained by a U.S. payer which includes: a U.S. financial institution, a domestic branch of a foreign bank or insurance company, a foreign branch or subsidiary of a U.S. financial institution;

2) If the U.S. Taxpayer reports the specified foreign financial asset on timely filed IRS forms:

a) Form 3520: Annual Return to Report Transactions with Foreign Trusts and Receipt of certain foreign Gifts

b) Form 5471: Information Return of U.S. Persons with Respect to Certain Foreign Corporations

c) Form 8865: Return of U.S. Persons with Respect to Certain Foreign Partnerships

Civil Penalties (Form 8938)

1) Failure to File Penalty: A penalty of $10,000 for each 30 day period not filed, (within 90 days after the IRS notifies of the failure to file) after the 90 day period has expired, up to $50,000 maximum penalty.

2) Accuracy-Related Penalty: A 40% penalty on a tax underpayment as a result of an undisclosed specified foreign financial asset.

3) Fraud: A 75% penalty on a tax underpayment, due to fraud.

Criminal Penalties (Form 8938)

Criminal penalties may be imposed for:

1) Failure to file Form 8938;

2) Underpayment of tax;

3) Failure to report asset.

Statute of Limitations

1) For failure to file Form 8938, failure to report a specified foreign financial asset, the statute of limitations remains open until 3 year after the date Form 8938 is filed.

2) For failure to include in gross income, an amount relating to one or more specified foreign financial assets, and the amount omitted in more than $5,000, any tax owed for the tax year, can be assessed at any time within 6 years after the tax return is filed.

Chapter 4
Foreign Financial Institutions

U.S. Source Income (U.S. Accounts)

Under the new law with respect to each U.S. account (any financial account held by one or more specified U.S. persons or U.S. owned foreign entities (IRC §1471(d)(1)(A)), the foreign financial institution must provide information about account gross receipts and withdrawals.

U.S.-Source investment income is subject to U.S. information reporting and tax withholding.

Every person engaged in a trade or business in the United States must file with the IRS a Form 1099 information return for payments totaling at least $600 that it makes to a U.S. Person in the course of its trade or business (IRC §6041).

To avoid 28% back-up tax withholding (IRC §3406), a U.S. Person must furnish the payor with Form W-9 establishing that the payee is a U.S. Person (T.R. §32.3406(d)-1 and T.R. §32.3406(h)-3).

The combination of Form 1099 tax reporting and 28% back-up tax withholding is intended to ensure that U.S. Persons pay tax on investment income.

U.S. source income amounts, paid to foreign persons, are exempt from Form 1099 information reporting because they are subject to non-resident withholding rules.

A non-resident investor who seeks withholding tax relief for U.S. source investment income must provide certification on the appropriate IRS Form W-8 to the withholding agent to establish foreign status and eligibility for an exemption or reduced tax rate.

A withholding agent making payments of U.S. source amounts to a foreign person is required to report the payments, including any U.S. tax withheld, to the IRS on Forms 1042 and 1042-S by March 15th of the year following the year that the payment is made (T.R. §1.1461-1(b) and (c)). If the withholding agent withholds more than is required, the payee may file a claim for refund.

A non-financial foreign entity that is a beneficial owner of a withholdable payment must certify that it has no substantial U.S. owners or provide identifying information for each substantial U.S. owner.

Chapter 5
Withholding Agents

The Foreign Account Tax Compliance Act (The "Act") expands withholding rules and additional reporting requirements for foreign financial institutions and non-financial foreign entities.

Under U.S. tax law, a withholding agent must deduct or withhold a tax equal to 30% on any withholdable payment (e.g., interest, dividends, rents, salaries, wages, premiums, annuities, compensations, and other fixed or determinable annual or periodical gains, profits and income from sources within the United States) made to a foreign financial institution or to a non-financial foreign entity (unless specific reporting requirements are met).

For each U.S. account maintained by the foreign financial institution, the institution must provide identifying information for each account holder that is a specified U.S. Person or substantial U.S. owner, the account number, the account balance, and gross receipts and withdrawals from the account.

A non-financial foreign entity that is a beneficial owner of a withholdable payment must certify that it has no substantial U.S. owners or provide identifying information for each substantial U.S. owner.

Every person required to deduct or withhold any tax to enforce reporting on certain foreign accounts is liable for the tax and is indemnified against claims and demands of anyone for the amount of the payments. (IRC §1474(a), as added by the 2010 HIRE Act.)

Chapter 6
Six-Year Statute of Limitations

Under the new law, the statute of limitations is extended to six years if there is an omission of gross income in excess of $5,000 and the omitted gross income is attributable to a foreign financial asset.

Taxes are generally required to be assessed within three years after a Taxpayer's return was filed, whether or not it was timely filed. A special rule extends the three-year limitation period in the case where there is a substantial omission of income.

If a Taxpayer omits substantial income on a return, any tax with respect to that return may be assessed and collected within six years of the date on which the return was filed.

In the case of income taxes, there is a substantial omission of income if the Taxpayer omits from gross income an amount that was properly includible in gross income and that is in excess of 25% of the amount stated on the return.

The state of limitations period will be suspended if the Taxpayer failed to timely provide information with respect to foreign financial assets required to be reported. The limitation period will not begin to run until the information required has been furnished to the IRS.

The new six-year statute of limitations applies not only to returns filed after March 18, 2010 on which the Taxpayer fails to report income in excess of $5,000 attributable to foreign financial assets, but also to returns filed on or before the date for which the statute of limitations is still open on March 18, 2010 (Act §513(d) of the HIRE Act [PL 111-147]).

For example, a 2006 tax return (filed in 2007), on which the Taxpayer failed to report more than $5,000 of income attributable to a foreign financial asset and which is otherwise subject to the three-year limitations period, will be subject to the new six-year statute of limitations.

Chapter 7
Foreign Financial Institutions – Qualified Intermediary

Under the 2010 HIRE Act (IRC §1471(c)(1)), a foreign financial institution that is a party to a qualified intermediary agreement with the IRS must report the following information regarding each U.S. account maintained by the institution:

1) The name, address, and TIN of each account holder that is a specified U.S. Person;

2) The name, address and TIN of each substantial U.S. owner of any account holder that is a U.S. owned foreign entity;

3) The account number;

4) The account balance or value as determined at such time and in such manner as the IRS prescribes;

5) The gross receipts and gross withdrawals or payments from the account as determined for such period and in such manner as the IRS prescribes.

A Qualified Intermediary ("QI") is a foreign financial institution that has entered into a withholding and reporting agreement (QI Agreement) with the IRS (T.R. §1.1441-1(e)(5)(ii)).

For U.S. Taxpayers, the QI must provide the U.S. payor with Form W-9 for each U.S. recipient account holder (the QI is not required to back-up withhold or file Form 1099).

For non-resident withholdings, a QI is a withholding agent subject to reporting rules, and payor for purposes of back-up withholding and Form 1099 information reporting rules.

Under a QI Agreement, a QI may choose not to assume primary responsibility for non-resident withholding. The QI must provide a U.S. withholding agent with Form W-8IMY certifying the status of its unnamed U.S. account holders and is not required to withhold or report the payments on Form 1042-S.

A foreign financial institution that becomes a QI and elects primary withholding responsibility is not required to forward beneficial ownership information regarding its customers to a U.S. financial institution or other withholding agent of U.S. source investment income to establish the customer's eligibility for an exemption from or reduced rate of, U.S. withholding tax.

Instead, the QI is permitted to establish for itself the eligibility of its customers for an exemption or reduced rate, based on a Form W-8, and information as to residence obtained under the know-your-customer rules to which the QI is subject in its home jurisdiction, as approved by the IRS or as specified in the QI Agreement (Rev. Proc. 2000-12, 2000-1 CB 387).

A QI may treat an account holder as a foreign beneficial owner of an account if the account holder provides a valid Form W-8 or other valid documentary evidence supporting foreign status. The QI cannot reduce the withholding rate if the QI knows the account holder is not the beneficial owner of a payment to the account.

If the foreign account holder is the beneficial owner of a payment, the QI can shield the account holder's identity from U.S. custodians and the IRS.

If a foreign account holder is a nominee and not the beneficial owner of a payment, the account holder must provide the QI with Form W-IMY for interest and specific information about each beneficial owner to which the payment related.

A QI that receives this information may shield the account holder's identity from a U.S. custodian, but not from the IRS.

If an account holder is a U.S. Person, the account holder must provide the QI with Form W-9 supporting U.S. status. Absent receipt of Form W-9, the QI must follow the presumption rules in the QI agreement to determine whether non-resident 30% withholding, or 28% back-up withholding, is required. A reduced rate of non-resident withholding may not be applied based on the presumption rules.

Pursuant to the QI agreement presumption rules, U.S. source investment income paid to an offshore account is presumed paid to an undocumented foreign account holder and is subject to 30% withholding.

Foreign source income and broker proceeds paid to an offshore account are presumed paid to a U.S. exempt recipient and are exempt form both non-resident and back up withholding.

A QI must file Form 1042 by March 15th of the year following any calendar year in which the QI acts as a QI.

A QI is not required to file Form 1042-S for amount paid to each separate account holder, but must file a separate Form 1042-S for each type of reporting paid (income that falls within a particular withholding rate or within a particular income, exemption or recipient code).

Chapter 8
HIRE Foreign Account Tax Compliance: 40% Penalty

The HIRE Act gives the IRS assessment and collection remedies unavailable with respect to the FBAR penalty.

A 40% accuracy-related penalty is imposed for underpayment of tax attributable to transactions involving undisclosed foreign financial assets. Undisclosed foreign financial assets include foreign financial assets that are subject to information reporting but the required information was not provided by the Taxpayer.

The 40% accuracy-related penalty is imposed for underpayment of tax that is attributable to an undisclosed foreign financial asset understatement (IRC §6662(b)(7) and (j) as added by the HIRE Act 2010). An undisclosed foreign financial asset understatement for any tax year is the portion of the understatement for the year that is attributable to any transaction involving an undisclosed foreign financial asset.

In contrast to the FBAR penalty, which is limited to collection through the U.S. Financial Management System (which collects non-tax debts for the government), the HIRE Act penalties give the IRS the ability to assess and collect these new penalties through its administrative powers (including tax levy and tax lien).

The new penalties under the HIRE Act are for the understatement of tax and impose a lesser burden of proof and threshold for imposition of the penalty than the willful FBAR penalty.

Chapter 9
Penalty for Failure to Report

The minimum amount of penalty for failure to report information or file returns for foreign trusts is increased to $10,000.

If any notice or return required to be filed under IRC §6048 is not filed on or before the due date, or does not include all the information that is required, or includes incorrect information, then the person required to file such notice or return must pay a penalty equal to the greater of:

1) $10,000, or

2) 35% of the gross reportable amount (5% for U.S. Persons treated as owners of the trust) (IRC §6677(a), as amended by the 2010 HIRE Act).

Prior to these revisions, the penalty for failure to provide the required information or file a return with respect to certain foreign trusts was 35% of the gross reportable amount (5% for U.S. Persons treated as owners of the trust).

With the new minimum amount, the IRS will be able to impose a $10,000 penalty even when there is not enough information to determine the gross reportable amount.

The maximum amount of the penalty has changed. The penalty for failure to report information or file a return with respect to certain foreign trusts cannot exceed the gross reportable amount (IRC §6677(a)).

To the extent that the aggregate amount of penalties exceeds the gross reportable amount, the IRS must refund the excess to the Taxpayer (IRC §6677(a), as amended by the 2010 HIRE Act).

Chapter 10
Uncompensated Use of Foreign Trust Property

The uncompensated use of foreign trust property by a U.S. Grantor, a U.S. Beneficiary, or a U.S. Person related to either of them is treated as a distribution by the trust for non-grantor trust income tax purposes (which also includes the loan of cash or marketable securities by a foreign trust or the use of any other property of the trust).

The distribution treatment of foreign trust transaction has been expanded to include the uncompensated use of property by certain U.S. Persons. The treatment of foreign trusts as having U.S. beneficiaries for grantor trust purposes has been expanded to include loans of cash or marketable securities or the use of any other trust property to or by a U.S. Person.

If a foreign trust permits the use of any trust property by a U.S. Grantor, a U.S. Beneficiary, or any U.S. Person related to either of them, the fair market value of the use of such property is treated as a distribution by the trust to the Grantor or Beneficiary (IRC §643(i)(1), as amended by the 2010 HIRE Act).

This treatment does not apply to the extent that the trust is paid the fair market value of such use within a reasonable time (IRC §643(i)(2)(E), as added the 2010 HIRE Act). If distribution treatment does apply to the use of trust property, the subsequent return of such property is disregarded for federal tax purposes (IRC §643(i)(3), as amended by the 2010 HIRE Act).

Chapter 11
Foreign Trusts Treated as Having U.S. Beneficiaries

For purposes of treating a foreign trust as a grantor trust, there is a rebuttable presumption that the trust has a U.S. beneficiary if a U.S. Person transfers property to the trust. An amount is treated as accumulated for a U.S. Person even if that person has a contingent interest in the trust.

A foreign trust is treated as having a U.S. beneficiary if any person has discretion to make trust distributions, (unless none of the recipients are U.S. Persons). An amount will be treated as accumulated for the benefit of a U.S. Person even if that person's interest in the trust is contingent on a future event (IRC §679(c)(1) as amended by the 2010 HIRE Act).

If any person has the discretion (by authority given in the trust agreement, by a power of appointment or otherwise, of making a distribution from the trust to or for the benefit of any person), the trust will be treated as having a beneficiary who is a U.S. Person, unless the trust terms specifically identify the class of person to whom such distribution may be made and none of those persons are U.S. Persons during the tax year (IRC §679(c)(4) as added by the 2010 HIRE Act).

If any U.S. Person who directly or indirectly transfers property to the trust is directly or indirectly involved in any agreement or understanding that may result in trust income or corpus being paid or accumulated to or for the benefit of a U.S. Person, that agreement or understanding will be treated as a term of the trust (IRC §679(c)(5) as added by the 2010 HIRE Act). The agreement or understanding may be written, oral or otherwise.

The provision creating a rebuttable presumption allowing the IRS to treat a foreign trust as having a U.S. beneficiary if a U.S. person directly or indirectly transfers property to the trust applies to transfers of property after March 18, 2010. (Act Section 532(b) 2010 HIRE Act.)

Chapter 12
Reporting Requirements for U.S. Persons Treated as Owners of a Foreign Trust

A U.S. Person who is treated as the owner of any portion of a foreign trust under the grantor trust rules, must submit any information required by the IRS with respect to the foreign trust (in addition to the current requirement that such U.S. Persons are responsible for insuring that a foreign trust complies with his own reporting obligations) (see IRC§6048(b)(1), as amended by the 2010 HIRE Act). This requirement to supply information about the trust applies to tax years beginning after March 18, 2010 (Act §534(b) of the 2010 HIRE Act).

The current reporting obligations of the foreign trust include making a return for the year and providing certain information to each U.S. Person who is treated as the owner of any portion of the trust, or who receives a direct or indirect distribution from the trust (IRC §6048(b)(1)(A) and (B)).

Chapter 13
Information Reporting for Passive Foreign Investment Companies

U.S. shareholders of passive foreign investment companies (PFICs) must file an annual information return containing information required by the IRS.

A U.S. Person who is a PFIC shareholder must file IRS Form 8621, Return by a Shareholder of a Passive Foreign Investment Company or Qualifying Electing Fund, for each tax year in which that person:

1. Recognizes gain on a direct or indirect disposition of PFIC stock.

2. Receives certain direct or indirect distributions from a PFIC.

3. Makes a reportable election.

Under IRC §1298, a U.S. Person who is a PFIC shareholder must file an annual report containing information required by the IRS. Since a PFIC shareholder only reports information required by the IRS, Code §1298(f) does not require any reporting until the IRS issues guidance (this provision is contingent upon IRS instructions).

In addition to the Code §1298(f) an individual who is a PFIC shareholder can also be required to disclose annual information under new Code §6038(D) (i.e., accounts in excess of $50,000).

IRC §1298(f) applies to all U.S. Persons. In contrast, only individuals are subject to IRC §6038(D) (unless the IRS issues guidance requiring annual information disclosure for domestic entities).

Chapter 14
Pre-Immigration Planning

Under the Foreign Account Tax Compliance Act ("FATCA"), effective 1/1/14, Foreign Financial Institutions ("FFI") must withhold 30% tax on U.S. source "withholdable payments" (and "pass-through payments') including:

1. U.S. Source FDAP Income: including portfolio interest;

2. Gross proceeds from U.S. securities. To avoid the withholding tax the foreign financial institution either has an agreement with the IRS or if no agreement, certify no substantial U.S. owners, or disclose all substantial U.S. owners.

Under FFI agreements, foreign banks must:

1. Determine which accounts are U.S. taxpayers;

2. Report to IRS regarding U.S. accounts;

3. Deduct 30% of withholdable payments to recalcitrant account holders.

Pre-Immigration Planning (Tax Strategies)

1. Accelerate income prior to entry into U.S.;

2. Defer income until resume non-residency (for investment portfolios by use of international life insurance and deferred annuities);

3. For investment portfolio earnings (e.g. "short-term" capital gains, "ordinary income" interest), defer or entirely eliminate tax by international life insurance. See my article, "U.S. Tax Planning for Passive Investments".

4. Prior to U.S. entry, "Step-up" basis transactions if tax basis substantially less than FMV. For publicly traded property can sell and repurchase, transfer to corporation in "taxable transaction" and still maintain ownership (through corporation).

5. To avoid anti-deferral regimes, sell stock of foreign mutual fund (PFIC) and purchase interest in U.S. fund.

Chapter 15
FATCA Update 2013

On November 8, 2012, the U.S. Treasury Department announced that it is engaged with more than fifty countries to improve international tax compliance and implement the information reporting and withholding tax provisions under the Foreign Account Tax Compliance Act ("FATCA").

The U.S. Treasury is seeking bilateral agreements in which they reciprocally exchange tax information with foreign governments who will give the IRS information on U.S. taxpayers (U.S. citizens, U.S. tax residents and U.S. Green Card Holders) who have accounts in their respective country, and they will receive financial information on their country's taxpayers who have U.S. bank and brokerage accounts, disclosed by the IRS.

The U.S. Treasury Department has concluded a bilateral agreement with the United Kingdom and is currently finalizing inter-governmentals with the following countries:

1. France

2. Germany

3. Italy

4. Spain

5. Japan

6. Switzerland

7. Canada

8. Denmark

9. Finland

10. Guernsey

11. Iceland

12. Isle of Man

13. Jersey

14. Mexico

15. The Netherlands

16. Norway

The task of gathering the information will be borne by the banks and financial institutions who are seeking to pass the cost of FATCA compliance on to their customers. The U.S. and the respective countries will focus on tax transparency and seek to find out where these taxpayers are hiding their unreported money.

FATCA/Foreign Financial Institutions

FATCA contains two principal operative provisions, one applying to "Foreign Financial Institutions" ("FFIs") and the other to all other foreign entities receiving payments from U.S. sources, either on their own behalf or acting as an intermediary. FFIs and other foreign entities that receive payments from U.S. sources under the provisions of FATCA (signed into law March 2010, under the "HIRE Act") are being compelled to promote compliance with U.S. law requiring the U.S. persons to report income from non-U.S. accounts.

"Foreign Financial Institutions" are defined to include any entity not resident in a U.S. state or possession that:

1. Accepts deposits in the ordinary course of a banking or similar business;

2. Engages in the business of holding financial assets for the account of others; or

3. Engages primarily in the business of investing, re-investing or trading in securities, partnership interests, commodities or any interests in securities, partnerships or commodities.

Foreign Financial Institutions – U.S. Tax Withholding

Any "withholdable payment" by a U.S. withholding agent to any FFI would be subject to 30% tax withholding unless the FFI enters into a reporting agreement with the IRS.

"Withholdable payments" include:

1. U.S. source investment income;

2. U.S. source proceeds from the sale of any property "of a type which can produce interest or dividends";

3. While gains from the sale of property are generally not includable in U.S. income, for non-residents FATCA subjects sale proceeds to withholding.

FFIs may avoid U.S. tax withholding if they execute an IRS agreement, under which they would be required to:

1. Obtain information regarding each holder of each account maintained by the FFI to determine which accounts are U.S. accounts and comply with IRS' verification and due diligence procedures;

2. Annually report information with respect to any U.S. account held at the FFI;

3. Deduct and withhold 30% of any "pass thru payment" to a 'recalcitrant account holder' or FFI not subject to an agreement (or elect to be withheld upon);

4. Comply with IRS information requests;

5. If under FFI's domestic law, the FFI would be prohibited from reporting the required interaction, the FFI must obtain a waiver of such prohibition or lose the account.

FFIs that are subject to an agreement and are required to report the name, address and TIN of account holders include:

1. Any specified U.S. person included in the account (i.e. any U.S. resident with the exception of publicly-traded corporations, banks, R.E.I.T.s and RICs).

2. A "substantial U.S. owner" (i.e. any person owning more than a 10% interest in any entity) or in case of payees primarily in the business of trading, anyone who owns any interest in the entity, including a profits-only interest.

Non-FFIs

A payee of U.S. source income who is a non-FFI is not permitted to enter into an IRS non-withholding agreement.

A withholding agent is required to withhold 30% of any withholdable payment to a non-FFI, regardless of whether the payee is the beneficial owner of the payment.

To avoid withholding, the payee would either have to:

1. Certify that the beneficial owner of any payment have no "substantial U.S. owners", or

2. Provide the name, address and TIN of each beneficial owner.

3. Report to the IRS all payee information received.

Exceptions to withholding:

1. Beneficial owners that are publicly traded;

2. Certain members of affiliated groups;

3. Residents of U.S. possessions.

The withholding agent would have to withhold if the agent has any reason to know any payee certifications or representations are false.

FATCA Effective Dates

Most FATCA requirements would apply to payments made after 12/31/12.

On 4/8/11, the IRS issued FATCA guidance instructing FFIs on the steps required for them to identify U.S. accounts among their existing account holders.

The 4/8/11 notice includes:

1. "A private banking test" for private bankers to attempt to find U.S. connections among account holders.

2. Details on the definition of pass-through payments.

3. Provides for a certification process for "deemed compliant" FFIs.

4. Provides that FFIs have to report only year-end balances to the IRS, and does not have to report basis on investment transactions.

In IRS Notice 2011-76, the IRS provided a new timeline whereby FFIs have until 6/30/13 to enter into a FATCA agreement with the IRS, and they will not be required to report on U.S. account holders until 2014.

On 2/8/12 the IRS issued additional FATCA guidance, including an agreement among the U.S., France, Germany, Italy, Spain, Switzerland and the UK to cooperate on implementing FATCA and arranging an automatic bilateral information exchange with the U.S. through the existing treaty structure.

The information sharing arrangement takes one of two forms:

1. FFI to U.S. government direct, or

2. FFI to foreign government and then to U.S. government.

FATCA Information Disclosure

U.S. taxpayers (individuals, not corporations, partnerships, or limited liability companies) are required to attach Form 8938: Statement of Specified Foreign Financial Assets to their Form 1040 tax returns if the aggregate value of such assets is greater than $50,000.

Specified Foreign Financial Assets include: depository or custodial accounts at FFIs, stocks or securities issued by foreign persons, a financial instrument or contract held for investment issued by a foreign country or party and any interest in a foreign entity.

The civil penalty for failure to supply this information is $10,000 with an additional $10,000 penalty up to a maximum of $50,000, after notice from the IRS (IRC Sec. 6038D(g).

Any understatement of tax attributable to an undisclosed foreign asset is subject to a 40% penalty (IRC Sec. 6662(j)).

<u>Statute of Limitations</u>

FATCA (IRC Sec. 6501(c)(8)(e) extends from three years to six years the period of assessment for understatements attributable to failure to report foreign accounts on the date such information is actually provided to the IRS.

When a taxpayer fails to report certain foreign asset information, the statute is tolled for a period including the taxpayer's non-compliance plus three years; the extended statute applies to the taxpayer's entire tax return, not just to foreign assets. This provision is effective for any year open on the date of enactment (March 2010) and to returns filed after enactment.

FATCA Foreign Trusts

FATCA clarifies foreign trust reporting as follows:

1. An amount is treated as accumulated for the benefit of a U.S. beneficiary of a foreign grantor trust even if the U.S. beneficiary's interests are contingent on a future event (IRC Sec. 679(c)(10).

2. If any person, such as a trustee or protector, has the power to add beneficiaries, the trust shall be considered to have U.S. beneficiaries unless a specific list is provided and no beneficiary is a U.S. person (IRC Sec. 679(c)(4).

. Any agreement or understanding, such as a letter of wishes, may result in a U.S. person benefiting from the trust, and will be considered a trust term (IRC Sec. 679(c)(5).

4. It imposes new reporting requirements on any U.S. person treated as an owner of any portion of a foreign trust and creates a presumption that a foreign trust has a U.S. beneficiary, unless the beneficiary submits information that no part of the income or corpus of the trust may be paid or accumulated for the benefit of a U.S. person, and if the trust were terminated during the taxable year, no part of the income or corpus could be paid for the benefit of a U.S. person (IRC Sec. 679(d)).

5. Cash and securities, if provided or loaned to a beneficiary, are considered distributions, the fair market value of any use of property owned by the trust, such as real estate, is treated as a trust distribution (IRC Sec. 643(i)).

Chapter 16
IRS Extended Deadline (7/1/14)
Special Contribution by Ryan L. Losi, CPA

U.S. Treasury extended until July 1, 2014 the enforcement of the new law, Foreign Account Tax Compliance Act ("FATCA") to give foreign banks more time to comply.

FATCA requires foreign banks, insurance companies and investment funds to send the IRS information about American's offshore accounts worth more than $50,000.

Robert Stack, U.S. Treasury deputy assistant for international tax affairs said, "We are providing an additional 6 months to complete agreements with countries and jurisdictions around the globe."

According to 7/12/13 Reuter's article, U.S. Treasury delays offshore tax-dodge law by 6 months

"Foreign banks that do not that do not comply with the law can be effectively frozen out of U.S. capital markets because of a 30-percent withholding tax on U.S. source income."

The U.S. has finalized Inter-Governmental Agreements (IGA's) with 8 countries (dozens more are in negotiations): Germany, Spain, Norway, Switzerland, Ireland, Mexico, Denmark, and United Kingdom.

The IGA's do not need U.S. congress approval but many foreign governments must approve them.

According to the 7/12/13 Treasury notice: IRS issued Notice 2013-43

1) A new registration website for banks to sign up with the IRS opens 9/19/13

2) Businesses must register by 4/25/14 to avoid FATCA penalties starting 7/1/14.

FBAR

Chapter 17
Ownership of Accounts and Signature Authority

Ownership of Accounts

Under the instructions to Form TD F 90-22.1, a U.S. person has a financial interest in a bank, securities, or other financial account in a foreign country under either of the following circumstances:

1) A U.S. person is the owner of record or has legal title, whether the account is maintained for his or her own benefit or for the benefit of others including non-U.S. persons. If an account is maintained in the name of two persons jointly, or if several persons own a partial interest in an account, each of those U.S. persons has a financial interest in that account.

2) U.S. person has a financial interest in each bank, securities, or other financial account in a foreign country for which the owner of record or holder of legal title is:

a) A person acting as an agent, nominee, attorney, or in some other capacity on behalf of the U.S. person;

b) A corporation in which the U.S. person owns directly or indirectly more than 50 percent of the total value of shares of stock;

c) A partnership in which the U.S. person owns an interest in more than 50 percent of the profits (distributive share of income); or

d) A trust in which the U.S. person either has a present beneficial interest in more than 50 percent of the assets or from which such person receives more than 50 percent of the current income.

Signature Authority

For purposes of Form TD F 90.22-1, a U.S. person is considered to have signature authority over a foreign financial account if such person can control the disposition of money or other property in the account by delivering his or her signature (or his or her signature and that of one or more other persons) to the bank or other person maintaining the account.

In addition, a U.S. person has “other authority” subject to FBAR reporting if such person can exercise comparable power over an account by direct communication to the bank or other person maintaining the account, either orally or by some other means.

Chapter 18
Exceptions & Mechanics of Filing

Exceptions

Notwithstanding the general rules, Form TD F 90.22-1 is not required to be filed under the following circumstances:

1) An officer or employee of a bank which is subject to the supervision of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Office of Thrift Supervision, or the Federal Deposit Insurance Corporation need not report that he has signature or other authority over a foreign bank, securities or other financial account maintained by the bank, if the officer of employee has NO personal financial interest in the account.

2) An officer or employee of a domestic corporation whose equity securities are listed upon national securities exchanges or which has assets exceeding $10 million and 500 or more shareholders of record need not file such a report concerning the other signature authority over a foreign financial account of the corporation, if he has NO personal financial interest in the account and he has been advised in writing by the chief financial officer of the corporation that the corporation has filed a current report, which includes that account.

3) As noted above, a U.S. person is not required to report any account maintained with a branch, agency, of other office of a foreign bank or other institution that is located in the United States, Guam, Puerto Rico, and the Virgin Islands.

Mechanics of Filing

Reporting on Form TD F 90-22.1 is required for each calendar year that a U.S. person maintains such interest or authority over foreign financial accounts. Persons having a financial interest in 25 or more foreign financial accounts are required only to note that fact on the form, i.e. a general statement indicating that information on all such accounts will be available upon request. (31 CFR § 103.24 Such persons will be required to provide detailed information concerning each account when so requested by the Secretary or his delegate.)

The Form TD F 90-22.1 is filed with the U.S. Department of the Treasury, P.O. Box 32621, Detroit, MI 48232-0621, or it may be hand carried to any local office of the Internal Revenue Service for forwarding to the Department of the Treasury in Detroit, MI. The Form TD F 90¬-22.1 must be filed on or before June 30 each calendar year. An extension for filing one's U.S. income tax return does not extend the deadline for making a TD F 90-22.1 filing.

Additional Issues

Each U.S. person subject to this reporting requirement must also maintain records showing, (1) the name in which each such account is maintained, (2) the number or

other designation of such account, (3) the name and address of the foreign bank or other person with whom such account is maintained, and (4) the type of such account, and the maximum value of each such account during the reporting period (31 CFR §103.32). These records must be retained for a period of 5 years and must be kept at all times available for inspection as authorized by law.

Chapter 19
Artwork and Foreign Land

*On 6/24/09, the IRS updated their Voluntary Disclosure FAQ clarifying the FBAR reporting requirements for foreign land and artwork owned in the taxpayer's own name.

In FAQ #37, the IRS confirmed that the FBAR filing for foreign land and artwork owned in the taxpayer's own name, is due once the asset becomes income-producing (i.e., yields current income, or gain from the sale).

If the foreign land/artwork is held in an entity, the taxpayer is required to file tax information returns (Trust: Form 3520) (Corporation: Form 5471).

Re: FAQ 20 A taxpayer owns valuable land and artwork located in a foreign jurisdiction. This property produces no income and there were no reporting requirements regarding this property. Must the taxpayer report the land and artwork and pay a 20 percent penalty?

FAQ 20 relates to income producing property for which no income was reported. Under those circumstances, no distinction is made between assets held directly and assets held through an entity in computing the 20 percent offshore penalty. However, if the taxpayer owns non-income producing property in the taxpayer's own name, there has been no U.S. taxable event and no reporting obligation to disclose. The taxpayer will be required to report any current income from the property or gain from its sale or other disposition at such time in the future as the income is realized. Because there has as yet been no tax noncompliance, the 20 percent offshore penalty would not apply to those assets. If the foreign assets were held in the name of an entity such as a trust or corporation, there would have been an information return filing obligation that may need to be disclosed.

*The IRS updated Offshore Voluntary Disclosure Program Frequently Asked Questions and Answers again on 6/26/12.

Chapter 20
Domestic Corporations and Foreign Accounts

In the IRS Workbook on the Report of Foreign Bank and Financial Accounts, the IRS advised that a domestic (e.g., NY) corporation that has foreign accounts:

1. The corporation must file a FBAR for the corporations' accounts.

2. A majority shareholder (over 50% of the value of the stock), must also file a FBAR.

For a domestic corporation with foreign accounts, both the corporation and the majority shareholder must each file a FBAR to report the foreign account (owned by the domestic corporation).

Chapter 21
Reporting Foreign Life Insurance Policy

In response to my inquiry, the IRS clarified (by FAQ) that a foreign life insurance policy is a foreign financial account if it includes a cash surrender value. The IRS 7/31/09 response:

1. Is a foreign life insurance policy with cash surrender value a financial account for FBAR reporting purpose?

A financial account, as defined in the FBAR General Instructions, includes "savings, demand, checking, deposit, time deposit, or any other account maintained with a financial institution or Other Person engaged in the business of a financial institution." An insurance policy with cash surrender value can "store" cash, available for withdrawal at a later time, and for this reason is treated as a financial account with a financial institution for FBAR purposes. If the insurance policy is located in a foreign country and has cash surrender value, the policyholder may have to report the policy on a FBAR. For FBAR reporting purposes, the cash surrender value of the policy is the value of the account. Insurance policies that are issued by a foreign-owned company but that are acquired through an insurance agent located in the United States is not a foreign financial account and is not required to be reported on an FBAR.

For Tax Year 2008, if the foreign life insurance policy is owned by either an individual, or a trust with one beneficiary, the FBAR filing is due by September 23, 2009.

If the foreign life insurance policy is owned by a trust with two or more beneficiaries, a beneficiary of more than 50% of trust assets must file the FBAR (on account of the trust).

Chapter 22
Filing Requirements for Gold or other Non-Cash Assets

Under IRS FAQ's regarding Report of Foreign Bank and Financial Accounts (FBAR), the IRS confirmed:

1. A FBAR must be filed whether or not the foreign account generates any income;

2. A FBAR is required for account maintained with financial institutions located in a foreign country if the account holds gold (or other non-cash assets).

Chapter 23
Hedge Funds

After the landmark agreement between the U.S. and Swiss government over secret (UBS) Swiss bank accounts, held by U.S. Citizens, the IRS is now focusing on hedge funds in the Cayman Islands. Recently, IRS officials advised that certain U.S. investors in offshore hedge funds must file a FBAR.

On June 12, 2009, an IRS official stated that the term "financial interest" (which requires a FBAR filing) includes hedge funds that "function as mutual funds".

It appears the IRS and Justice Department will identify U.S. Taxpayers who evade U.S. taxes, by investing with offshore hedge funds. The IRS and Justice Department are pressing foreign financial institutions to provide them with information about Americans with "foreign, secret bank accounts."

Chapter 24
Offshore Hedge Funds
*By Gary S. Wolfe, Published in The California Tax Lawyer (Summer 2009 Edition).

FBARs and Offshore Hedge Funds

After the landmark agreement between the U.S. and Swiss government over secret UBS Swiss bank accounts held by U.S. citizens, the IRS is now focusing on hedge funds in the Cayman Islands. Recently, IRS officials advised that certain U.S. investors in offshore hedge funds must file a FBAR.

On June 12, 2009, an IRS official stated that the term "financial interest" (which requires a FBAR filing) includes hedge funds that "function as mutual funds." It appears the IRS and Justice Department will identify U.S. taxpayers who evade U.S. taxes by investing with offshore hedge funds. The IRS and Justice Department are pressing foreign financial institutions to provide them with information about Americans with "foreign, secret bank accounts."

Senate Finance Committee Chairman Max Baucus (D., Mont.) has introduced legislation that would require an FBAR to be filed with a tax return. It would also require U.S. financial institutions to report to the IRS transfers of money into any foreign financial account. This would make it possible for the IRS to have information about the creation of a foreign account at the beginning.

Chapter 25
Trusts

Each US Trustee of a trust account must file a FBAR (even if the beneficiary of the trust is not a US Person). If the owner of an account gave someone the power of attorney over the account, both the owner and the attorney-in-fact must file a FBAR (if both are US Taxpayers).

If a trust that holds a foreign financial account provides for a Protector, whose powers include directing distributions if the Protector is a US Person, the Protector must file a FBAR.

If several members of the same family have accounts, the FBAR rules apply to each account holder individually. The IRC §318 attribution rules do not apply to filing the FBAR.

Under the grantor trust rules (IRC §679) any US Person who establishes a foreign trust (which holds the foreign financial account), established by a US Person for any US beneficiary, the US Settlor is responsible for filing a FBAR for the trust accounts (even if the US Settlor of the trust is not a beneficiary, has no authority over the trust or any of the trust accounts). Under US tax rules, he is treated as the owner of the trust (for US income tax purposes) because the trust is deemed a grantor trust which makes him responsible to file the FBAR form.

Financial interest may be present even if there is no signatory authority. If a trust holds an account and the US Taxpayer has a present beneficiary interest in more than 50% of the trust assets, receives more than 50% of the trust assets, or receives more than 50% of the current trust income, he must file a FBAR.

If a trust has 2 or more beneficiaries and none of the beneficiaries has more than a 50% interest in the income of principal, then none of them needs to file a FBAR (although each US Trustee who is a US Taxpayer must file the FBAR). Regarding the rules for a discretionary trust, if a US Taxpayer receives distributions of more than 50% of trust income or principal in any given year, it requires filing the FBAR.

Chapter 26
Foreign Bank Accounts: Definitions

Each U.S. person having a financial interest in, or signature or other authority over, any foreign financial accounts with an aggregate value exceeding $10,000 at any time during the calendar year must report such relationship by filing Form TD F 90-22.1, Report of Foreign Bank and Financial Accounts ("FBAR").

In addition, they have to disclose the foreign account filing requirement on Schedule B of Form 1040 and including the income from these accounts on the United States person's U.S. federal income tax return.

Who Must File

Form TD F 90.22-1 is required to be filed by every U.S. person for each calendar year in which such person has a financial interest in, or signature or other authority over, any foreign financial accounts with an aggregate value exceeding $10,000 at any time during the calendar year. The test is based in the alternative – financial interest in or signature authority over the account.

Definitions

For purposes of FBAR, the term "United States person" means (1) a citizen or a resident of the United States, (2) a domestic partnership, (3) a domestic corporation, or (4) a domestic estate or trust.

The term "financial account" generally includes any bank, securities, securities derivatives or other financial instrument accounts, (including any accounts in which the assets are held in a commingled fund, and the account owner holds an equity interest in the fund), savings, demand, checking, deposit, time deposit, or any other account maintained with a financial institution (or other person engaged in the business of a financial institution).

Any of the financial accounts described above is considered to be a foreign financial account for purposes of FBAR, if it is located outside the United States, Guam, Puerto Rico, and the Virgin Islands. The situs of a financial account is determined by the location where the branch is, not the location of the institution's home office.

Chapter 27
The Element of Control

Under the FBAR instructions, signatory authority may be present and a FBAR may be required when there is an indirect element of control. The FBAR instructions state: "Authority exists in a person who can exercise comparable power over an account by direct communication to the bank or other person with whom the account is maintained, either orally or by some other means."

If a foreign corporation holds a foreign account and a US Person owns more than 50% of the shares, a FBAR must be filed. US Persons who are officers or directors of foreign corporations and have signatory authority over foreign corporate accounts must also individually file a FBAR whether or not they own shares of the corporation (certain publicly traded corporations and banks under US control are exceptions to this rule).

For partnerships owning foreign accounts, if the US Taxpayer holds more than a 50% interest in the partnership profits, they are required to file a FBAR.

If the US Person is the owner of a foreign life insurance policy or a foreign annuity contract with cash surrender value in excess of $10,000, he must file a FBAR. The owner of the contract has no direct authority over the accounts in which the premiums are deposited or invested. However, the owner has the authority to withdraw cash from the policy or contract.

The owner has a financial interest in the policy or contract and has an indirect financial interest in the underlying accounts.

Chapter 28
Financial Interest Signatory Authority

The FBAR is not a tax return. The FBAR is a financial disclosure (i.e., a report of the Taxpayer's foreign financial accounts). The FBAR must be filed even if the reported accounts generate no interest or other taxable income. All income earned on the foreign account must be reported on the tax return of the beneficial owner which is an entirely separate reporting from the FBAR. However, once a Taxpayer discloses a foreign account on their Form 1040 Schedule B, the FBAR must be filed.

The FBAR form is designed to disclose the US Taxpayer's connection to a foreign financial account. The form details the US Taxpayer (e.g., name, address, identification number and balance held in the account over $10,000). The form asks for the name of the financial institution, the country and the account number for each account, if more than one. If there are joint owners, their names and identification numbers are requested and if the person who is reporting claims to have no financial interest in the account (such as a person holding a power of attorney or a corporate officer who has no shares in the corporation), then the name and the identification number of the beneficial owner must be disclosed.

Any US Person who has a financial interest in, or signatory authority over, any financial accounts in a foreign country if the total value of such accounts exceeds $10,000 at any time during the calendar year must file a FBAR. The accounts in Puerto Rico, Guam, and the Northern Mariana Islands, American Samoa, and the US Virgin Islands are exceptions to this rule (see Workbook on the Report of Foreign Bank and Financial Accounts (FBAR)

US Taxpayers include resident aliens and other foreign individuals who are considered US Persons under the Substantial Presence Test (i.e., because of the time spent in the US in a given year [IRC §§7701(b)(1)(A)(ii) and 7701(b)(3)]). (FBAR rules also apply to a domestic trust, estate, partnership or corporation.)

A US Taxpayer has a required financial interest in an account if they:

1. Are the owner of the account.

2. Have legal title to the account (even if it is for someone else's benefit).

Both financial interest and the signatory authority generate the requirement to file the FBAR. When the account is in joint names, all joint owners must file their own FBAR (even though the funds may belong to only one of them). An exception to the joint account rule applies only if the joint owners are husband and wife (if they live together).

Chapter 29
U.S. Taxpayer Tax Compliance Issues

FBAR rules are not found in the Code. Rather, they are set forth in the Bank Secrecy Act, first enacted by Congress in 1970. Since 2003, however, the IRS bears responsibility for enforcing these rules.

The FBAR rules require that every U.S. Person report (i) any financial interest or authority over a (ii) financial account in a foreign country with (iii) an aggregate value over $ 10,000 at any time during the taxable year. The report must be filed on a Form TD F 90-22.1, Report of Foreign Bank and Financial Accounts (hence the acronym "FBAR"). U.S. Persons must also disclose the existence of the account on their Form 1040, Schedule B, Part III. This is commonly referred to as "checking the 'B' box."

Taxpayers who fail to disclose the account on their Form 1040 could be subject to criminal sanctions for filing a false tax return.

The FBAR report is due on June 30th. This due date is not subject to extensions. The FBAR report must be filed separately from the U.S. Person's tax return.

Financial Interest Or Authority

A U.S. Person has a financial interest in a foreign account if he or she is the legal or beneficial owner. Attribution rules apply in making this determination. A person serving as a shareholder, partner, and trustee may also be deemed to hold a financial interest if the owner of the account is (i) a person acting as an agent on behalf of the U.S. Person, (ii) a corporation where the U.S. Person owns, directly or indirectly, more than 50 percent of the outstanding stock, (iii) a partnership in which the U.S. Person owns more than 50 percent of the profits, or (iv) a trust in which a U.S. Person has either a present interest in more than 50 percent of the assets or from which the U.S. Person receives more than 50 percent of the income. If these thresholds are met, the U.S. Person has an FBAR reporting obligation, regardless of whether he or she has any authority over the account.

Non-owners with authority over a foreign account are also subject to the FBAR reporting rules. Authority means the U.S. Person has the ability to order a distribution or disbursement of funds or other property held in the account. This is not limited to signature authority, but includes the ability to order distributions by verbal commands or other communication. Authority does not include persons who have the right to invest, but not distribute, the foreign account funds.

There is no limitation for taxpayers who have authority over a foreign account, but only in an official capacity. (For example, the president of a corporation, the general partner of a partnership, or the manager of an LLC may be subject to these rules.)

Both the entity, as beneficial owner, and the representative, who has control over the account, may be required to file an FBAR report. Similarly, when more than one

U.S. Person has authority over an account, i.e., president and vice president, both persons may have an FBAR reporting obligation.

Even when the account is subject to joint control, and the signature of someone other than the taxpayer is required to cause a distribution, the taxpayer is still considered to have authority over the account for FBAR reporting purposes.

Financial Account In A Foreign Country

The term financial account is broadly defined as any asset account and encompasses simple bank accounts (checking or savings), as well as securities or custodial accounts. It also includes a life insurance policy or other type of policy with an investment value (i.e., surrender value).

Foreign country naturally refers to any country other than the United States. Puerto Rico, U.S. possessions and territories are included as part of the United States (as they should) for these purposes. Accounts held by U.S. Persons in these areas are not foreign accounts subject to FBAR reporting.

The IRS has indicated that a traditional credit card with a foreign bank is not a foreign account. However, use of a credit card as a debit or check card could trigger foreign account status and thus an FBAR reporting obligation.

$10,000 Threshold

To be reportable, the account must have assets the value of which during the year, exceeds $10,000.

The Instructions to the FBAR report state that if the aggregate value of all financial accounts exceeds $10,000 at any time during the year, the U.S. Person must file an FBAR report. A U.S. Person who possesses multiple foreign accounts, all of which have less than $10,000, but which collectively exceed $10,000, may have an FBAR reporting obligation.

Taxpayers may transfer an appreciating asset to a foreign account, such as stock or securities. As these assets increase in value, they may trigger an FBAR reporting requirement.

Whether the account generates any income is not relevant.

Penalties

In an attempt to improve compliance, Congress enhanced the FBAR penalties in 2004. Under pre-2004 law, civil penalties applied only to willful violations. In 2009, civil penalties up to $10,000 may be imposed on non-willful violations. This penalty may be avoided if there was reasonable cause and the U.S. Person reported the income earned on the account. 31 U.S. C. §5321(a)(5).

Although reasonable cause is not defined, the IRS will likely apply the reasonable cause standard for late-payment/late-filing penalties.

The penalty for willful violations is far more severe. It is equal to the greater of $100,000 or 50 per-cent of the balance of the account at the time of the FBAR violation. No reasonable cause exception exists for a willful violation. 31 U. S. C. §5321(a)(5)(c).

The IRS has six years to assess a civil penalty against a taxpayer that violates the FBAR reporting rules.

Chapter 30
Form TD F 90-22.1

*In FBAR FAQ #26 (posted on 6/24/09), the IRS confirmed that the revised version of Form TD F 90-22.1 (revised October 2008) should be used to report foreign accounts (including prior delinquent years):

If I had an FBAR reporting obligation for years covered by the voluntary disclosure, what version of the Form TD F 90-22.1 should I use to report my interests in foreign accounts?

Taxpayers should use the current version of Form TD F 90-22.1, (revised in October 2008), to file delinquent FBARs to report foreign accounts maintained in prior years. The taxpayer may, however, rely on the instructions for the prior version of the form (revised in July 2000) for purposes of determining who must file to report foreign accounts maintained in 2008 and prior calendar years.

Although the FBAR was revised in October 2008, IRS News Release IR-2009-58 (June 5, 2009) and IRS Announcement 2009-51, both available at the IRS website, permit the use of the definition of "United States person" in the prior version of the FBAR in determining who must file FBARs that are due on June 30, 2009. Accordingly, for all FBARs that are due in the current and prior years, the term "United States person" means (1) a citizen or resident of the United States; (2) a domestic partnership; (3) a domestic corporation; or (4) a domestic estate or trust.

With regard to interest charged (on penalties) under FAQ #36, the IRS confirmed:

1. For accuracy-related and delinquency penalties, interest runs from the due date of the Form 1040 (tax return) at issue.

2. For all other penalties, interest runs from the date of the assessment of the penalty.

*The IRS updated the FAQs Regarding Report of Foreign Bank and Financial Accounts (FBAR) – Filing Requirements on July 26, 2013.

Chapter 31
Revised Form TD F 90-22.1

In October 2008, the IRS issued a revised version of TD F 90-22.1 "Report of Foreign Bank and Financial Accounts ("FBAR").

The revised FBAR form states: "Do not use previous editions of this form after December 31, 2008". All FBAR's due for Tax Years 2008 (forward) and back year FBAR's (unfiled) are to be reported on the new form.

The revised FBAR form includes new provisions designed to facilitate IRS off-shore enforcement. Specific new provisions are included for:

1. Foreign Trusts (Trust Protector)

If a U.S. person appoints a Trust protector, for a foreign account held by a Foreign Trust, the U.S. person has a financial interest in the account and must file a FBAR.

2. Foreign Trusts (Trust Beneficiaries)

Trust beneficiaries do not have a FBAR filing requirement unless they are a U.S. person who is the beneficiary of more than 50% of a Trust holding a foreign account.

3. Debit Card (Prepaid Credit Cards)

Reportable financial accounts include debit cards and prepaid credit card accounts.

4. Foreign Persons

Foreign persons in and doing business in the U.S. are required to provide identifying information (i.e., "foreign identification number", such as foreign passport number) and file FBAR's.

5. Account Value

Instead of an account value range, U.S. taxpayers must fill in the exact value of the account during the calendar year.

6. Foreign Account Owners

U.S. persons, with signature authority over the account (who file the FBAR) must identify the account's foreign owner.

7. Joint Filing for Married Taxpayers

Previously, married taxpayers had to file separate FBAR's for a jointly owned account. The new FBAR allows joint filing. The new FBAR requires the filer to provide the identifying information for the "principal joint owners".

8. Record Retention

The new FBAR explicitly states the records must be kept for a period of 5 years and must be kept at all times available for inspection.

Chapter 32
Currency Transaction Report (CTR) & Suspicious Activity Report (SAR)

U.S. financial institutions file Currency Transaction Reports (CTR) and Suspicious Activity Reports (SAR) with the IRS Detroit Computing Center (uploaded into the IRS/DCC Currency Banking and Retrieval System database at the IRS/DCC).

The combined CTR/SAS currency transaction reports provides a paper trail (or roadmap) for investigations of financial crimes and illegal activities including: tax evasion, embezzlement and money laundering. Between 1994 – 1997, the IRS Criminal Investigation Division initiated 1030 investigations as a result of CTR/SAR (Currency Transaction Reports).

Report/Requirements

Currency Transaction Report (CTR) – Filed by financial institutions that engage in a currency transaction in excess of $10,000.

Currency Transaction Report Casino (CTRC) – Filed by a casino to report currency transactions in excess of $10,000.

Report of Foreign Bank and Financial Accounts (FBAR)

Filed by individuals to report a financial interest in or signatory authority over one or more accounts in foreign countries, if the aggregate value of these accounts exceeds $10,000 at any time during the calendar year.

IRS Form 8300, Report of Cash Payments Over $10,000 Received in a Trade or Business – Filed by persons engaged in a trade or business who, in the course of that trade or business, receives more than $10,000 in cash in one transaction or two or more related transactions within a twelve month period.

Suspicious Activity Report (SAR) – Filed on transactions or attempted transactions involving at least $5,000 that the financial institution knows, suspects, or has reason to suspect the money was derived from illegal activities. Also filed when transactions are part of a plan to violate federal laws and financial reporting requirements (structuring).

Chapter 33
Family Ownership Attribution Rules

IRC §318 constructive ownership of stock rules attribute ownership to family members who maintain common ownership in an entity (e.g., trust). If 2 or more family members are Trust beneficiaries (or any one act as Trustee), the issue is whether IRC §318 Family Attribution Rules (i.e., greater than 50% ownership interests) require any Trust beneficiary to file a FBAR to disclose foreign bank accounts owned by the Trust.

Under IRS §318(a)(1)(A)(i)(ii), an individual shall be considered as owning the stock owned, directly (or indirectly), by or for:

1. His spouse.

2. His children, grandchildren and parents.

The IRS has advised:

A US Taxpayer, who is a Trustee, is required to file a FBAR for the Trust if the US Trustee has either:

a. A financial interest, or

b. Signature authority over a foreign account.

On 8/21/09 the IRS confirmed to my law offices: A beneficiary of more than 50% of trust assets must file the FBAR on account of the trust.

As the IRS clarified (8/21/09) U.S. Taxpayer Family Trusts may hold Foreign Bank (and Financial) accounts, and unless one of the Trust beneficiaries has a more than a 50% interest in income or principal, none of the Trust beneficiaries are required to file a FBAR (to disclose the foreign bank [financial] account).

On 8/21/09, the IRS confirmed:

1. If the trust has a discretionary class of two or more beneficiaries, and none of the beneficiaries has a more than a 50% interest in income or principal, none of the beneficiaries need to file a FBAR to report foreign bank accounts.

2. The "ownership" attribution rules of Title 26 (IRC §318) are not applicable to a FBAR (filing) (which includes a discretionary class of beneficiaries [i.e., family trusts]).

Chapter 34
Foreign Accounts with Multiple Signatories

*On 6/24/09, the IRS updated their Voluntary Disclosure FAQ clarifying the FBAR reporting requirements for foreign accounts with multiple signatories:

If parents have a jointly owned foreign account on which they have made their children signatories, the children have an FBAR filing requirement but no income. Should the children just file delinquent FBARs as described by FAQ 9 and have the parents submit a voluntary disclosure? Will both parents be penalized 20 percent each? Will each have a 20 percent penalty on 50 percent of the balance?

Only one 20 percent offshore penalty will be applied with respect to voluntary disclosures relating to the same account. In the example, the parents will be jointly required to pay a single 20 percent penalty on the account. This can be through one parent paying the total penalty or through each paying a portion, at the taxpayers' option. For those signatories with no ownership interest in the account, such as the children in these facts, they may file delinquent FBARs with no penalty as described in FAQs 9 and 41. However, any joint account owner who does not make a voluntary disclosure may be examined and subject to all appropriate penalties.

If there are multiple individuals with signature authority over a trust account, does everyone involved need to file delinquent FBARs? If so, could everyone be subject to a 20 percent offshore penalty?

Only one 20 percent offshore penalty will be applied with respect to voluntary disclosures relating to the same account. The penalty may be allocated among the taxpayers making the disclosures in any way they choose. The reporting requirements for filing an FBAR, however, do not change. Therefore, every individual who is required to file an FBAR must file one.

*The IRS updated Offshore Voluntary Disclosure Program Frequently Asked Questions and Answers on 6/26/12

Chapter 35
Non-Resident Aliens

Non-resident aliens file Form 1040 NR to report U.S. taxable income. Form 1040 NR does not require a Schedule B (to report foreign accounts by completing boxes 7(a) and 7(b) on Form 1040 Schedule B).

If the person filing Form 1040 NR has foreign accounts, he is not required to attach Schedule B to his tax return (to report the foreign accounts).

Artists, athletes, and entertainers who are not citizens or residents of the U.S. do not have to file FBAR's (if they occasionally come to the U.S. to participate in exhibits, sporting events or performances).

Generally, a foreign person has to file FBAR's if they are considered to be doing business in the U.S. (i.e., conducting business in the U.S. on a regular and continuous basis).

Chapter 36
U.S. Permanent Residents

*On 6/24/09, in FAQ #46, the IRS addressed the FBAR filings for U.S. permanent residents (either a “green card”, or a permanent resident [under the "substantial presence" test]):

A taxpayer moved to the U.S. in 2007 and is now a permanent resident of the U.S. The taxpayer had a requirement to file an FBAR for one year but failed to do so. Is the taxpayer subject to a penalty equal to 20 percent of the account?

First, the taxpayer should confirm that the taxpayer had an FBAR filing requirement. Assuming that the taxpayer was required to report the interest earned on the account during the year the taxpayer was in the U.S. and failed to do so, the taxpayer is subject to a penalty based on the high account balance during the year. The penalty may be limited to five percent if the taxpayer did not avoid U.S. tax with respect to the deposits and if the account was passively held during the year the taxpayer was in the U.S. If there was no unreported taxable income related to the unreported foreign accounts that would have been reported on the FBAR, the taxpayer will not be subject to the 20 percent offshore penalty. In that case, the taxpayer should file delinquent FBARs attaching a statement explaining why the FBAR was not timely filed.

Chapter 37
U.S. Trustee Foreign Non-Grantor Trust

A U.S. trustee of a foreign non-grantor trust must file Form TD F 90-22.1 if the Trustee has a financial interest in or signature authority or other authority over any financial accounts, including bank, securities, or other types of financial accounts in a foreign country if the value of such accounts exceeds $10,000. A person has a financial interest in any such account if she has legal title to it.

Trustees generally have legal title to accounts in which trust funds are invested. In addition, if legal title to an account is held by a corporation or partnership and the trustee owns more than 50% of the corporation or partnership, the trustee will be treated as having a financial interest in such account.

A person has signature authority over an account if she can control the disposition of account property by the delivery of a document signed by her and one or more other persons. A person has other authority over an account if she can control such disposition by direct communication to the person with whom the account is maintained.

Form TD F 90-22.1 must be filed by June 30th of the year following the year in which the U.S. person had such financial interest or signature or other authority.

Chapter 38
Amended Tax Returns (Voluntary Disclosure)

U.S. Taxpayers who fail to report offshore accounts by filing FBAR (TD F 90.22-1) face criminal and civil penalties:

1. Failure to Report Income

(3 Felonies and 1 Misdemeanor) up to 14 years in jail, plus 75% Civil Tax Fraud Penalty, 25% Failure to Pay Tax Penalty.

2. Failure to File FBAR's

(a maximum annual penalty of 50% of the account balance, up to 10 years in jail a $500,000 fine).

3. Perjury

Taxpayers Form 1040/Schedule B must declare whether Taxpayers have any authority over, or interest in foreign accounts with a total of more than $10,000.

In the IRS 6/24/09 FAQ update the IRS stated:

What is the distinction between filing amended returns to correct errors and filing a voluntary disclosure?

An amended return is the proper vehicle to correct an error on a filed return, whether a taxpayer receives a refund or owes additional tax. A voluntary disclosure is a truthful, timely and complete communication to the IRS in which a taxpayer shows a willingness to cooperate (and does in fact cooperate) with the IRS in determining the taxpayer's correct tax liability and makes arrangements in good faith to fully pay that liability. Filing correct amended returns is normally a part of the process of making a voluntary disclosure under IRM 9.5.11.9. Taxpayers and practitioners trying to decide whether to simply file an amended return with a Service Center or to make a formal voluntary disclosure under the process described in IRM 9.5.11.9 and the March 23, 2009 memoranda should consider the nature of the error they are trying to correct.

Taxpayers with undisclosed foreign accounts or entities should consider making a voluntary disclosure because it enables them to become compliant, avoid substantial civil penalties and generally eliminate the risk of criminal prosecution. Making a voluntary disclosure also provides the opportunity to calculate, with a reasonable degree of certainty, the total cost of resolving all offshore tax issues. It is anticipated that the voluntary disclosure process is appropriate for most taxpayers who have underreported their income with respect to offshore accounts and assets. However, there will be some cases, such as where a taxpayer has reported all income but failed to file the FBAR (FAQ 9), or only failed to file information returns (FAQ 42), where it remains appropriate for the taxpayer to simply file amended

returns with the applicable Service Center (with copies to the Philadelphia office listed in FAQ 9).

The IRS stated position is that a Taxpayer's voluntary disclosure entitles the Taxpayer to become compliant, avoid substantial civil penalties and generally eliminate the risk of criminal prosecution.

In reality, a taxpayer who makes a voluntary disclosure may:

1. Spotlight their "tax crimes"

2. If the voluntary disclosure is not accepted, jeopardize them and subject them to criminal prosecution

The IRS SBSE 3/23/09 memorandum, Subject: Routing of Voluntary Disclosure Cases, which addresses a change in the processing of voluntary disclosure requests containing offshore issues.

1. Such requests will continue to be initially screened by Criminal Investigation to determine eligibility for voluntary disclosure, and, if involving only domestic issues will be forwarded to Area Planning and Special Programs for Civil Processing;

2. Voluntary disclosure eligibility for offshore issues will be initially screened by Criminal Investigation and forwarded to the Philadelphia Offshore Identification Unit (POIU) for processing.

Voluntary Disclosure risks include:

1. Heightened risk of criminal prosecution (since initial screening is by the IRS Criminal Investigation Division);

2. A voluntary disclosure may be used as an evidentiary admission of Taxpayer's unreported income;

3. A voluntary disclosure may waive Taxpayer's 5th Amendment right against self-incrimination;

4. While a voluntary disclosure is pending the IRS may request more information, commence an audit or initiate criminal prosecution.

As an alternative strategy to a voluntary disclosure, the "quiet filing" (for the Tax Years at issue) of an amended tax return (or original tax return) may instead:

1. Pre-empt criminal charges for the failure to file FBAR returns, Form 1040 tax returns and failure to pay tax;

2. Pre-empt a 75% civil tax fraud penalty, for failure to file or pay tax and a 25% failure to pay tax penalty;

3. If the income is properly reported (i.e., no substantial understatements which are subject to a 6 year statute of limitations), the tax filing will commence the 3-year statute of limitations (for each year) for IRS audit.

Chapter 39
Statute of Limitations

*On 6/24/09, in FAQ #31, the IRS confirmed they would be able to assess taxes under a 6 year statute of limitations if the IRS can prove a substantial omission of gross income:

How can the IRS propose adjustments to tax for a six-year period without either an agreement from the taxpayer or a statutory exception to the normal three-year statute of limitations for making those adjustments?

Going back six years is part of the resolution offered by the IRS for resolving offshore voluntary disclosures. The taxpayer must agree to assessment of the liabilities for those years in order to get the benefit of the reduced penalty framework. If the taxpayer does not agree to the tax, interest and penalty proposed by the voluntary disclosure examiner, the case would be referred to the field for a complete examination. In that examination, normal statute of limitations rules will apply. If no exception to the normal three-year statute applies, the IRS will only be able to assess tax, penalty and interest for three years. However, if the period of limitations was open because, for example, the IRS can prove a substantial omission of gross income, six years of liability may be assessed. Similarly, if there was a failure to file certain information returns, such as Form 3520 or Form 5471, the statute of limitations will not have begun to run. If the IRS can prove fraud, there is no statute of limitations for assessing tax.

*The IRS updated the FAQs Regarding Report of Foreign Bank and Financial Accounts (FBAR) – Filing Requirements on July 26, 2013.

Chapter 40
Penalty Regime for Foreign Bank Account Filing
*By Gary S. Wolfe, Published in The California Tax Lawyer (Summer 2009 Edition)

Penalty Regime for Foreign Bank Account Filing (FBAR)

Each U.S. person who has a financial interest in, or signature or other authority over, one or more foreign financial accounts (valued over $10,000, at any time during a calendar year) is required to report the account on Schedule B/Form 1040, and TD F 90-22.1 (Report of Foreign Bank and Financial Accounts (FBAR)), due by June 30 of the succeeding year (I.R.M. 5.21.6.1. (2/17/09)). The IRS has six years to assess a civil penalty against a taxpayer who violates the FBAR reporting rules.

Failure to file the required report or maintain adequate records (for 5 years) is a violation of Title 31, with civil and criminal penalties (or both). For each violation a separate penalty may be asserted.

(I) Non Willful Violation: Civil Penalty – Up to $10,000 for each violation.

(II) Negligent Violation: Civil Penalty – Up to the greater of $100,000, or 35 percent of the greatest amount in the account.

(III) Intentional Violations -

(1) Willful Failure to File FBAR or retain records of account: (a) Civil Penalty – Up to the greater of $100,000, or 50 percent of the greatest amount in the account; (b) Criminal Penalty – Up to $250,000 or 5 years or both.

(2) Knowingly and Willfully Filing False FBAR: (a) Civil Penalty – Up to the greater of $100,000, or 50 percent of the greatest amount in the account; (b) Criminal Penalty – $10,000 or 5 years or both.

(3) Willful Failure to File FBAR or retain records of account while violating certain other laws: (a) Civil Penalty – Up to the greater of $100,000, or 50 percent of the greatest amount in the account; (b) Criminal Penalty – Up to $500,000 or 10 years or both.

Chapter 41
Failure to File Penalties

A willful violation of the Form TD F 90.22-1 requirements (i.e., failure to file Form TD F 90.22--1, failure to supply information on the report, or filing a false or fraudulent report) could result in the imposition of civil and/or criminal penalties. (The instructions for Form TD F 90.22-1 specifically provide that criminal penalties for failing to comply with FBAR are provided in 31 U.S.C. § 5322(a) and (b), and 18 U.S.C. § 1001. In addition, civil penalties for failure to comply are generally provided in 31 U.S.C. § 5321.)

Civil Penalties

If any U.S. person willfully violates the Form TD F 90.22-1 filing requirement, such person may be liable to the U.S. government for a civil penalty of not more than $25,000 (31 U.S.C. § 5321. Section 5321 generally provides that if a U.S. person willfully violates a regulation, such person may be liable for a civil penalty of not more than the greater of the amount (not to exceed $ 100,000) involved in the transaction (if any) or $25,000.

With respect to reporting on Form TD F 90.22-1, a U.S. person is not reporting a transaction but, rather, reporting his interest or signature authority over a foreign financial account. Thus, the maximum amount of potential civil penalty is $25,000.):

Criminal Penalties

If a U.S. person willfully violates the reporting requirement, such person may be subject to a fine of not more than $250,000, or imprisoned for not more than 5 years, or both (31 U.S.C. § 5322(a)); and

If a U.S. person willfully violates the reporting requirement while violating another law of the United States, or as part of a pattern of any illegal activity involving more than $100,000 in a 12-month period, such U.S. person may be subject to a monetary fine of not more than $500,000, or imprisoned for not more than 10 years, or both (31 U.S.C. § 5322(b)).

If a U.S. person, with respect to Form TD F 90.22-1, (1) falsifies, conceals, or covers up by any trick, scheme, or device a material fact, (2) makes any materially false, fictitious, or fraudulent statement or representation, or (3) makes or uses any false writing or document knowing the same to contain any materially false, fictitious, or fraudulent statement or entry, such person may be fined, or imprisoned for not more than 5 years, or both (18 U.S.C. § 1001).

Chapter 42
Tax Practitioners and Professional Responsibility

U.S. Taxpayers, who fail to file FBAR's to disclose foreign bank accounts, may seek a reasonable cause exception based on their "tax preparer's" failure to file the FBAR.

Tax Practitioners (Attorneys, CPA's) must comply with the FBAR rules as part of their due diligence (as to accuracy) obligation under IRS Circular 230 (Section 10.22).

The FBAR (TD F 90-22.1) is not a tax return. The FBAR is an information report required under the Bank Secrecy Act (BSA) 31 USC 5314 (and related regulations CFR 103.24, 103.27). Related records are required under 31 CFR 103.24 and 103.32.

The Practitioners' professional responsibility does not require that the Practitioner "audit" their client.

The Practitioner must:

1. Make reasonable inquiries in response to Taxpayer's information of overseas accounts/transactions.

2. A Practitioner may rely on information provided by a client in good faith.

3. The Practitioner must make reasonable inquiries if information appears incorrect, inconsistent or incomplete.

Chapter 43
Annual Filing Requirements and Reasonable Cause Exception

In April 2003, the Financial Crimes Enforcement Network delegated authority of the TD F 90-22.1 form (i.e., FBAR form) to the Internal Revenue Service (see IR 2003-48 (4/10/03); 31 CFR §103.5(6)(b)(8)). The IRS enforces all penalties associated with the FBAR with the same power it enforces tax reporting and payment compliance.

The IRS has been given the authority to enforce the filing rules and audit the reports as appropriate.

The FBAR filing is due by June 30th of the year following the year of the report with no provisions for extensions. The due date means the date it must be received by the US Treasury. Mailing it on the date it is due will result in a late filing. The FBAR form, filed separately from the income tax, must be mailed to US Department of Treasury, PO Box 32621, Detroit, Michigan 48232-0621.

If there is an emergency, the form can be hand-delivered to a local IRS office for forwarding to the Treasury Department in Detroit.

An amended FBAR may be filed by completing a revised FBAR with the correct information writing the words "Amended" at the top of the revised FBAR and stapling it to a copy of the original FBAR. For Taxpayers amending a late-filed FBAR, they should include a statement explaining their reasons for a late filing (i.e., request a reasonable cause exception from penalty).

A failure to file a FBAR has civil and criminal penalties (which are in addition to any income tax penalties if the income is not reported). The IRS must assess the civil penalties within 6 years of the FBAR violation (31 USC 5321(b)(1)).

For a willful failure to file, the civil penalty increases from $10,000 (non-willful failure to file) to the greater of $100,000 or 50% of the account balance in the foreign account for the tax year.

The civil penalties for non-willful failure to file may be waived by the IRS if the Taxpayer can show reasonable cause. If the Taxpayer has a reasonable cause exception, the FBAR should be filed with an explanation (i.e., the reasonable cause, with an express request for waiver of penalties).

The waiver of civil penalties for a reasonable cause exception may include among other factors:

1. All the income from the foreign account was included on the US Taxpayer's return.

2. The Taxpayer was unaware of the requirement to file (for example, lack of understanding of what constitutes a financial interest).

3. Once the Taxpayer became aware of the filing requirements, he filed all delinquent reports (up to 6 years).

Chapter 44
Civil and Criminal Penalties

Each U.S. Person who has a financial interest in, or signature or other authority over, one or more foreign financial accounts (value over $10,000, at any time during a calendar year) is required to report the account on Schedule B/Form 1040, and TD F 90-22.1 (Report of Foreign Bank and Financial Accounts (FBAR)), due by June 30 of the succeeding year (I.R.M. 5.21.6.1. (2/17/09)).

Failure to file the required report or maintain adequate records (for 5 years) is a violation of Title 31 with civil and criminal penalties (or both). For each violation a separate penalty may be asserted.

(I) Non-Willful Violation

Civil Penalty – Up to $10,000 for each violation. 31 U.S.C.§ 5321(a)(5)(A)

(II) Negligent Violation

Civil Penalty – Up to the greater of $100,000, or 35 percent of the greatest amount in the account. 31 U.S.C.

(III) Intentional Violations

1) Willful – Failure to File FBAR or retain records of account

Civil Penalty -Up to the greater of $100,000, or 50 percent of the greatest amount in the account.

Criminal Penalty -Up to $250,000 or 5 years or both

31 U.S.C. §5321(a)(5)(C), 31 U.S.C. § 5322(a) and 31 C.F.R. §103.59(b) for criminal

(2) Knowingly and Willfully Filing False FBAR

Civil Penalty – Up to the greater of $100,000, or 50 percent of the greatest amount in the account.

Criminal Penalty – $10,000 or 5 years or both

18 U.S.C. § 1001, 31 C.F.R. § 103.59(d) for criminal

(3) Willful – Failure to File FBAR or retain records of account while violating certain other laws

Civil Penalty – Up to the greater of $100,000, or 50 percent of the greatest amount in the account.

Criminal Penalty – Up to $500,000 or 10 years or both

31 U.S.C. § 5322(b) and 31 C.F.R. §103.59(c) for criminal

Chapter 45
Criminal Penalties: Willful Failure to File (Defenses)

Under IRS Form 1040, at the bottom of Schedule B, Part III, on Page 2, Question 7(a) states: "at any time during the previous year, did you have any interest in or signatory or other authority over a financial account in a foreign country, such as a bank account, a security account, or other financial account? The answer is either yes or no. If yes, Question 7(b) requires the name of the foreign country (with the account). Question 8 requires confirmation of receipt of distribution from the account, or if the Taxpayer was a grantor of, or transferor to a foreign trust (which requires filing Form 3520).

A willful failure to file a FBAR can lead to a felony of up to 10 years in jail and a $500,000 fine. The IRS must prove willfulness in order to assert the $500,000 monetary penalty and the imprisonment for up to 10 years (see 31 USC 5321(a)(5)(B); CCA 200603026; Eisenstein, 731 F.2d 1540 (CA – 11, 1984)).

Willfulness must be proven by the IRS under the standard of clear and convincing evidence. If the Taxpayer knew about the requirement to file, it would affect his defense. If the Taxpayer failed to report the foreign account interest or other income on his income tax return, it would affect his defense.

If a failure to file is deemed to be part of a criminal activity involving more than $100,000 in a 12-month period, the penalty limit increases to $500,000 with up to 10 years in jail. The issue of whether a failure to file is willful or non-willful is based on the facts of each case. Willfulness has been defined as the voluntary, intentional violation of a known legal duty, see Cheek 498 US 192, 67 AFTR 2d 91-344 (Supreme Court 1991).

A Taxpayer's good faith belief that he does not have to file (or even his negligent failure to file) can be a defense to the charge of willful failure to file (i.e., a defense to criminal charges).

A defense may include that the Taxpayer was advised by his advisor that no FBAR was required.

Failure to maintain adequate records of the foreign account for the years the FBAR filing is due may result in additional civil and criminal penalties.

Chapter 46
IRS FAQ: Explanation of FBAR Penalty

On 5/6/09, the IRS posted to its website FBAR FAQ #12, How does the penalty framework work? Can you give us an example? (Note: The FBAR FAQ has since been updated)

Under FAQ #12, the IRS projected a $1M deposit on account in a foreign bank, interest income ($50,000 per year) for 6 years, total income $300,000. Based on IRS projections, the $300,000 unreported income (undisclosed foreign bank account) may result in up to $2,306,000 due the IRS for:

1. Tax

2. Accuracy Related Penalty

3. FBAR Penalty

4. Compounded Interest

5. Plus Additional Penalties (e.g. failure to pay penalty) and Criminal Prosecution

12) How does the penalty framework work? Can you give us an example?

Assume the taxpayer has the following amounts in a foreign account over a period of six years. Although the amount on deposit may have been in the account for many years, it is assumed for purposes of the example that it is not unreported income in 2003.

Year Amount on Deposit Interest Income Account Balance

2003 $ 1,000,000 $ 50,000 $ 1,050,000

2004 $ 50,000 $ 1,100,000

2005 $ 50,000 $ 1,150,000

2006 $ 50,000 $ 1,200,000

2007 $ 50,000 $ 1,250,000

2008 $ 50,000 $ 1,300,000

(NOTE: This example does not provide for compounded interest, and assumes the taxpayer is in the 35-percent tax bracket, files a return but does not include the foreign account or the interest income on the return, and the maximum applicable penalties are imposed.)

If the taxpayer comes forward and has their voluntary disclosure accepted by the IRS, they face this potential scenario:

They would pay $386,000 plus interest. This includes:

- Tax of $105,000 (six years at $17,500) plus interest,

- An accuracy-related penalty of $21,000 (i.e., $105,000 x 20%), and

- An additional penalty, in lieu of the FBAR and other potential penalties that may apply, of $260,000 (i.e., $1,300,000 x 20%).

If the taxpayer didn't come forward and the IRS discovered their offshore activities, they face up to $2,306,000 in tax, accuracy-related penalty, and FBAR penalty. The taxpayer would also be liable for interest and possibly additional penalties, and an examination could lead to criminal prosecution.

The civil liabilities potentially include:

- The tax and accuracy-related penalty, plus interest, as described above,

- FBAR penalties totaling up to $2,175,000 for willful failures to file complete and correct FBARs (2003- $100,000, 2004 – $100,000, 2005 – $100,000, 2006 – $600,000, 2007 – $625,000 and 2008 – $650,000),

- The potential of having the fraud penalty (75 percent) apply, and

- The potential of substantial additional information return penalties if the foreign account or assets is held through a foreign entity such as a trust or corporation and required information returns were not filed.

Note that if the foreign activity started more than six years ago, the Service may also have the right to examine additional years.

About the Author

Gary S. Wolfe received his Juris Doctorate from Loyola Law School in 1982, where he was President of the Tax Law Society.

From 1982 through the present, Gary has been in private practice in Beverly Hills and Los Angeles.

Gary is an international tax attorney representing clients for IRS audits, international tax planning, and asset protection.

Previously, Gary was the managing partner of a tax and business law firm, which represented Fortune 500 companies (IBM, ITT) and financial institutions (Sterling Bank, First Charter Bank.) Gary now provides case management for international litigation.

In 1997, Gary completed the Team Beverly Hills civic leadership training.

From 1997-1999 Gary was Vice-President and Member of the Board of Trustees of The Greystone Foundation, Beverly Hills, California.

From 1995-2001, Gary was the Chief Financial Officer and a Member of the Board of Directors of the Le Faubourg Honore Homeowners Association, Beverly Hills, California.

Since 2004, Gary has been conducting private seminars throughout California on the IRS, International Tax and Asset Protection.

Gary is an international tax expert and a nationally published tax author. In 2013 he published articles in the ABA (ALI-CLE) publication: The Practical Tax Lawyer (Winter, 2013 Edition), "U.S. Tax Planning for Passive Investments," (Spring 2013

Edition), “Why U.S. Tax Evasion is a Bad Idea (UBS/Wegelin Bank),” and in the Summer 2013 Edition he published 2 articles:

1) “International Tax Planning for U.S. Exports (IC-DISC)” (with Ryan Losi, CPA)

2) “International Tax Evasion, Money Laundering, and Other Crimes”

In the Autumn 2013 Edition of the ABA/The Practical Tax Lawyer he will be publishing 2 articles:

1) “EB-5 Visas (Immigrant Investor Visas)” (with Mark Ivener, Esq.)

2) “Offshore Hedge Funds and Reinsurance” (with Allen Walburn, Esq.)