

SMITH CARMICHAEL ASSOCIÉS

Re: Reporting Funds in Foreign Bank Accounts

The Internet and instant global communications have made international banking very easy. You can sit comfortably in your home and deal online with a bank anywhere in the world. Some unscrupulous promoters even advertised the "tax-free" benefits of using foreign banks. That is wrong and criminal. Recently, Congress and the IRS have taken steps to end abuses. The IRS is actively reminding taxpayers of their filing responsibilities under the Bank Secrecy Act and the Foreign Account Tax Compliance Act. The IRS has also reopened its voluntary offshore disclosure program.

Bank Secrecy Act

The Bank Secrecy Act requires taxpayers to file Form TD F 90-22.1, Report of Foreign Bank and Financial Accounts (known as the "FBAR") if they have:

1. A financial interest in, signature authority or other authority over one or more accounts in a foreign country, and
2. The value of the account exceeds \$10,000 at any time during the calendar year.

The Bank Secrecy Act does not prohibit taxpayers from owning a foreign bank account. It just requires reporting and disclosure. The rules apply to all citizens and residents of the U.S. as well as domestic corporations, estates, partnerships, and trusts.

A financial account for purposes of the FBAR is defined very broadly and includes any bank, securities, securities derivatives or other financial instruments accounts. The IRS has explained that the term includes any savings, demand, checking, deposit or any other account maintained with a financial institution or other person engaged in the business of a financial institution.

The FBAR must be received by the Treasury Department on or before June 30 of the year following the calendar year being reported. The FBAR is not filed with your federal income tax return. Instead, it is mailed to the Treasury Department or filed electronically with the Treasury Department. Failure to file an FBAR may potentially result in civil penalties, criminal penalties or both.

There are exceptions to reporting under the Bank Secrecy Act. One of the most important covers accounts in U.S. military banking facilities operated by U.S. financial institutions overseas. These accounts, which serve military personnel, are not treated as foreign bank accounts for reporting purposes.

Foreign Account Tax Compliance Act

In 2010, Congress passed the Foreign Account Tax Compliance Act (FATCA). FATCA imposes additional reporting requirements on taxpayers separate and distinct from the Bank Secrecy Act and FBAR reporting. Since passage of FATCA, the IRS has been issuing guidance. Because FATCA is so complex, the guidance has been issued piece-meal and additional guidance is in the pipeline.

Under FATCA, certain U.S. taxpayers holding "specified foreign financial assets" outside the U.S. must report those assets to the IRS. Generally, reporting applies to specified individuals holding specified foreign financial assets with an aggregate value exceeding certain thresholds. The threshold amounts

vary if the taxpayer is single, married filing jointly, married filing separately, or the taxpayer is living abroad.

The IRS has explained that specified foreign financial assets include (not an exhaustive list) foreign financial accounts, and foreign non-account assets held for investment (as opposed to held for use in a trade or business), such as foreign stock and securities, foreign financial instruments, contracts with non-US persons, and interests in foreign entities. More details about specified foreign financial assets are expected to be available when the IRS issues additional guidance.

Individuals subject to the new disclosure rules will file new Form 8938, Statement of Specified Foreign Financial Assets. Form 8938 reporting applies for specified foreign financial assets in which the taxpayer has an interest in tax years starting after March 18, 2010. For most individual taxpayers, the IRS has explained that this means they will start filing Form 8938 with their 2011 income tax return. At this time, the IRS is only requiring "specified individuals" to file Form 8938. The IRS has indicated that it may require reporting by "specified domestic entities" when more regulations are issued.

As with FBAR reporting, there are some exceptions to FATCA reporting. Please contact our office for more details about these exceptions.

Offshore voluntary disclosure programs

In early 2012, the IRS announced it was reopening its offshore voluntary disclosure program. Previously, the IRS had launched two temporary programs (in 2009 and 2011) to encourage taxpayers to disclose unreported foreign accounts. In exchange for their voluntary disclosures, the IRS offered taxpayers a reduced penalty framework.

The reopened, third offshore voluntary disclosure program is similar to the 2009 and 2011 programs. However, there are some important differences. The highest penalty in the reopened program is 27.5 percent compared to 25 percent in the 2011 program. In certain cases, taxpayers may qualify for reduced penalties of 12.5 percent or five percent. The reopened program has no set closing date. However, the IRS reserved the right to end the program at any time. The IRS also indicated that the terms of the program could change at any time.

International agreements

Recently, the IRS has met with success in negotiating agreements with many "bank secrecy" countries to disclose tax evasion. The IRS is also working closing with international organizations, such as the Organisation for Economic Co-operation and Development (OECD) to curb tax evasion. The IRS has warned that if it finds out about a taxpayer's offshore account through any of these agreements (or elsewhere) rather than through voluntary disclosure initiative, it intends to assess every penalty at its disposal under the law.