

SMITH CARMICHAEL ASSOCIÉS

Re: FBAR and Foreign Financial Assets Filing Requirements

The Foreign Account Tax Compliance Act (FATCA), enacted in 2010 as part of the Hiring Incentives to Restore Employment (HIRE) Act, is an important development in U.S. efforts to combat tax evasion by U.S. persons holding investments in offshore accounts.

Under FATCA, certain U.S. taxpayers holding financial assets outside the United States must report those assets to the IRS. In addition, FATCA requires foreign financial institutions to report directly to the IRS certain information about financial accounts held by U.S. taxpayers, or by foreign entities in which U.S. taxpayers hold a substantial ownership interest.

Reporting by U.S. Taxpayers Holding Foreign Financial Assets

U.S. taxpayers holding foreign financial assets may be required to report certain information about those assets on a new form (Form 8938) to be attached to the taxpayer's annual tax return. Reporting applies for assets held in tax years beginning after March 18, 2010. With the issuance of additional regulations, FATCA may require reporting by specified domestic business entities. For now, only specified individuals are required to file Form 8938. For most individual taxpayers, Form 8938 should be filed with the 2011 tax return they file during the 2012 tax filing season.

Form 8938 is required when the total value of specified foreign assets exceeds certain thresholds. For example, a married couple living in the United States and filing a joint tax return would not file Form 8938 unless their total specified foreign assets exceed \$100,000 on the last day of the tax year or more than \$150,000 at any time during the tax year.

The thresholds for taxpayers who reside abroad are higher. For example, a married couple residing abroad and filing a joint return would not file Form 8938 unless the value of specified foreign assets exceeds \$400,000 on the last day of the tax year or more than \$600,000 at any time during the year.

A specified foreign financial asset is:

1. Any financial account maintained by a foreign financial institution. This does not include a U.S. payer (such as a U.S. domestic financial institution), the foreign branch of a U.S. financial institution, or the U.S. branch of a foreign financial institution.
2. Other foreign financial assets held for investment that are not in an account maintained by a US or foreign financial institution, namely:
 1. Stock or securities issued by someone other than a U.S. person,
 2. Any interest in a foreign entity, and
 3. Any financial instrument or contract that has as an issuer or counterparty that is other than a U.S. person.

Individuals who may have to file Form 8938 are U.S. citizens and residents, nonresidents who elect to file a joint income tax return and certain nonresidents who live in a U.S. territory. However, Form 8938 is not required of individuals who do not have an income tax return filing requirement.

U.S. taxpayers who own a foreign bank account, brokerage account, mutual fund, unit trust, or other financial account may also be required to file a Form TD F 90-22.1, Report of Foreign Bank and Financial Authority (FBAR), if:

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

The new Form 8938 filing requirement does not replace or otherwise affect a taxpayer's obligation to file an FBAR.

Failure to report foreign financial assets on Form 8938 will result in a penalty of \$10,000 (and a penalty up to \$50,000 for continued failure after IRS notification). Further, underpayments of tax attributable to non-disclosed foreign financial assets are subject to an additional substantial understatement penalty of 40 percent.

Reporting by Foreign Financial Institutions

FATCA also requires foreign financial institutions ("FFIs") to report information directly to the IRS about financial accounts held by U.S. taxpayers, or by foreign entities in which U.S. taxpayers hold a substantial ownership interest. To properly comply with these new reporting requirements, an FFI will have to enter into a special agreement with the IRS by June 30, 2013. Under this agreement a "participating" FFI will be obligated to:

1. undertake certain identification and due diligence procedures with respect to its accountholders;
2. report annually to the IRS on its accountholders who are U.S. persons or foreign entities with substantial U.S. ownership; and
3. withhold and pay over to the IRS 30-percent of any payments of U.S. source income, as well as gross proceeds from the sale of securities that generate U.S. source income, made to (a) non-participating FFIs, (b) individual accountholders failing to provide sufficient information to determine whether or not they are a U.S. person, or (c) foreign entity accountholders failing to provide sufficient information about the identity of its substantial U.S. owners.