A Brave New World for U.S. Taxpayers with Foreign Assets: The New and Enhanced FBAR and FATCA Requirements

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Matthew D. Lee is a former U.S. Department of Justice trial attorney who concentrates his practice on all aspects of white collar criminal defense and federal tax controversies. He has extensive experience in advising clients on issues regarding foreign bank account reporting (FBAR) obligations, the Foreign Account Tax Compliance Act (FATCA), the Internal Revenue Service’s 2009 Offshore Voluntary Disclosure Program, 2011 Offshore Voluntary Disclosure Initiative, and 2012 Offshore Voluntary Disclosure Program. He has represented hundreds of U.S. taxpayers with undisclosed foreign bank accounts. Mr. Lee has published numerous articles regarding the IRS voluntary disclosure programs and FBAR and FATCA reporting obligations and speaks frequently on these topics.

Mr. Lee has also represented clients in all stages of proceedings before the Internal Revenue Service, including audits, appeals, and collections, and Tax Court and district court litigation. He has advised corporate clients on matters involving anti-money laundering laws and regulations and advising clients as to corporate compliance issues involving the Bank Secrecy Act, the USA Patriot Act, FATCA, and anti-money laundering laws and regulations.

Mr. Lee has represented both corporations and individuals in criminal investigations involving tax, money laundering, health care, securities, public corruption, and fraud offenses, and has significant experience in handling all stages of federal litigation including trials and appeals.

Mr. Lee publishes a blog devoted to addressing the latest developments in the tax controversy field at www.taxcontroversywatch.com.
The U.S. Government’s Crackdown on Offshore Tax Evasion

IRS Commissioner Douglas H. Shulman:

- “Combating international tax evasion is a top priority for the IRS. We have additional cases and banks under review. The situation will just get worse in the months ahead for those hiding assets and income offshore.” (February 8, 2011)
- “Tax secrecy continues to erode . . . . We are not letting up on international tax issues, and more is in the works. For those hiding cash or assets offshore, the time to come in is now. The risk of being caught will only increase.” (February 8, 2011)
- “Our focus on offshore tax evasion continues to produce strong, substantial results for the nation’s taxpayers . . . . As we’ve said all along, people need to come in and get right with us before we find you . . . . We are following more leads and the risk for people who do not come in continues to increase.” (January 9, 2012)

Justice Department Offshore Compliance Initiative

“The Tax Division’s top litigation priority is the concerted civil and criminal effort to combat the serious problem of non-compliance with our tax laws by U.S. taxpayers using secret offshore bank accounts – a problem that a 2008 Senate report concluded costs the U.S. Treasury at least $100 billion annually.”

– U.S. Department of Justice website

Enforcement Efforts to Date

- UBS Deferred Prosecution Agreement (Feb. 2009)
- Approximately 150 investigations of offshore account holders are underway since 2009
  – 49 account holders have been criminally charged;
  – 41 guilty pleas have been entered;
- A number of facilitators who helped clients hide assets offshore at UBS and other banks have been indicted, including 19 bankers and 2 attorneys
- 8 independent financial advisors have been charged, one of whom was convicted, and the rest are awaiting trial
Enforcement Efforts To Date (continued)

- Indictment, guilty plea, and sentencing of Wegelin & Co. (Switzerland’s oldest bank)
  - DOJ Press Release: “This case represents the first time that a foreign bank has been indicted for facilitating tax evasion by U.S. taxpayers and the first guilty plea and sentencing of such a bank.”
- Other banks under criminal investigation in Switzerland, Israel, and India

FBAR Reporting Requirements

- Required as part of Bank Secrecy Act since 1970s
- U.S. taxpayers with foreign accounts have two obligations
  - Answer question “yes” on Form 1040, Schedule B, Part III (due April 15 or due date of extended return) or other applicable tax return
Foreign Bank Account Reporting
Form 706

- New form and instructions issued January 2012
- Required to be filed annually by June 30
- All forms to be filed with Detroit Service Center
- No extensions of deadline are available
- Mailbox rule does NOT apply

Foreign Bank Account Reporting
Form 990

Form TD F 90-22.1 (FBAR)

- New form and instructions issued January 2012
- Required to be filed annually by June 30
- All forms to be filed with Detroit Service Center
- No extensions of deadline are available
- Mailbox rule does NOT apply
Who is required to file an FBAR?

- An FBAR must be filed if all of the following requirements are satisfied:
  - The filer is a U.S. Person;
  - The U.S. Person has a financial account;
  - The financial account is in a foreign country;
  - The U.S. Person has a financial interest in, or signature or other authority over, the financial account; and
  - The aggregate account balance of all such foreign accounts exceed $10,000 (in U.S. dollars) at any time during the calendar year.

Who is a “U.S. Person”?

- A U.S. Person includes:
  - A citizen of the U.S.,
  - A resident alien of the U.S., and
  - A U.S. corporation, partnership, trust, limited liability company, or other type of business entity.
- Generally includes: expatriates, U.S. citizens and residents residing abroad, certain foreign citizens who are working and paying taxes in the U.S., and individuals that are required to file FBARs annually even if they maintain joint accounts with a non-U.S. spouse.
What is a reportable financial account?

- “Account” is broadly defined to include any foreign “bank, securities, or other financial accounts”
- “Bank accounts” include savings deposits, demand deposits, checking accounts, and any other accounts maintained with a person engaged in the business of banking
- “Securities accounts” include accounts maintained with a person in the business of buying, selling, holding, or trading stock or other securities
- “Other financial accounts” include:
  - An account with a person that is in the business of accepting deposits as a financial agency;
  - An account that is an insurance policy with a cash value or an annuity policy;
  - An account with a person that acts as a broker or dealer for futures or options transactions in any commodity or on or subject to the rules of a commodity exchange or association; or
  - An account with a mutual fund or similar pooled fund which issues shares available to the general public that have a regular net asset value determination and regular redemptions (does NOT include hedge funds)

What is a “financial interest”?

- An individual has a “financial interest” in a foreign account if he or she is the owner of record of, or has legal title to, the account, regardless of whether the account is maintained for his or her own benefit or for the benefit of others.
- A U.S. person also has a reportable financial interest in a foreign bank account if the account is held by:
  - An agent, nominee, or attorney on behalf of the U.S. Person;
  - A corporation in which the U.S. Person owns more than 50% of the voting power or the total value of the shares;
  - A partnership in which the U.S. Person owns directly or indirectly more than 50% of the interest in profits or capital;
  - Any other entity in which the U.S. Person owns directly or indirectly more than 50% of the voting power, total value of the equity interests or assets, or interest in profits;
  - A trust, if the U.S. Person is the trust grantor and has an ownership interest in the trust for U.S. tax purposes; and
  - A trust in which the U.S. Person either has a present beneficial interest in more than 50% of the assets or from which such person receives more than 50% of the current income.
What is “signature authority”?  

- Broadly defined as the authority of an individual (alone or in conjunction with another) to control the disposition of money, funds or other assets held in a financial account by direct communication to the person with whom the financial account is maintained.
- The test for determining whether an individual has signature or other authority over an account is whether the foreign financial institution will act upon a direct communication from that individual regarding the disposition of assets in that account.
- The final regulations also exempt certain individuals with signature or other authority over, but no financial interest in, foreign accounts.

FBAR Filing Exemptions

- Certain accounts jointly owned by spouses (only one FBAR required)
- Consolidated FBAR for certain entities
- Correspondent/nostro accounts owned by banks
- U.S. government accounts
- IRA owners and beneficiaries
- Participants/beneficiaries of tax-qualified retirement plans

FBAR Filing Exemptions (continued)

- Individuals with signature authority only in the following situations:
  - Officer/employee of a federally-regulated bank
  - Officer/employee of a financial institution regulated by SEC or CFTC
  - Officer/employee of Authorized Service Provider with respect to registered investment company
  - Officer/employee of publicly-traded company (or its subsidiary)
- Certain trust beneficiaries
- Accounts maintained at U.S. military banking facilities
FBAR Penalties for Non-Compliance

- Criminal penalties for willful violations:
  - Up to 5 years imprisonment and $250,000 fine
- Civil penalties
  - Non-willful violation: Up to $10,000 for each violation
  - Willful violation: Greater of $100,000 or 50 percent of the balance in the account at the time of the violation
- Both civil and criminal penalties can be imposed together.

Increasing Rates of Foreign Bank Account Reporting

Circular 230 and FBAR Reporting
Circular 230 Obligations and FBAR

- OPR has published "Professional Responsibility and the Report of Foreign Bank and Financial Accounts" on IRS website
- Key points:
  - "Practitioners who prepare an individual's Form 1040 have a duty under Circular 230 to inquire of their clients with sufficient detail to prepare proper and correct responses to the foreign bank account questions on Schedule B." See Circular 230 sec. 10.22
  - "[G]ood faith reliance contemplates that a practitioner will make reasonable inquiries when a client provides information that implies possible participation in overseas transactions/accounts subject to FBAR requirements."
  - Preparer has no obligation to prepare FBAR for taxpayer, but "does have an affirmative obligation to advise the client of the need to file the FBAR form and the consequences of failing to do so."

Circular 230 Obligations and FBAR

- "A practitioner whose client declines to make full disclosure of the existence of, or any taxable income from, a foreign financial account during a taxable year, may not prepare the client's income tax return for that year without being in violation of Circular 230." (IRS OVDP FAQ 47)
- Best practices for return preparers:
  - Engagement letters should advise of FBAR filing obligation and address whether the preparer will prepare FBARs
  - Questionnaire/organizer should request information about foreign bank accounts and assets, and preparer should follow up to ensure client responds in writing
  - Document any oral conversations with taxpayer in writing

The Foreign Account Tax Compliance Act: Background and Goals
What is FATCA?

• "The Foreign Account Tax Compliance Act (FATCA) is an important development in U.S. efforts to improve tax compliance involving foreign financial assets and offshore accounts." (www.irs.gov)
• "FATCA was enacted in 2010 by Congress to target non-compliance by U.S. taxpayers using foreign accounts. FATCA requires foreign financial institutions (FFIs) to report to the IRS information about financial accounts held by U.S. taxpayers, or by foreign entities in which U.S. taxpayers hold a substantial ownership interest." (www.treasury.gov)

Two Primary FATCA Requirements

• Foreign financial institutions are annually required to report directly to the U.S. government information about financial accounts held by U.S. taxpayers, or held by foreign entities in which U.S. taxpayers hold a substantial ownership interest.
• U.S. taxpayers with specified foreign financial assets that exceed certain thresholds must report those assets to the IRS annually on an information return.

FATCA History

• Enacted by Congress in 2010 as part of the Hiring Incentives to Restore Employment (HIRE) Act; added Chapter 4 of Subtitle A of Internal Revenue Code, and new IRC sections 1471 through 1474
• Preliminary guidance issued: Notice 2010-60; Notice 2011-34; and Notice 2011-53
• Proposed regulations issued February 15, 2012
• Numerous comments received; public hearing held on May 15, 2012
• Announcement 2012-42 issued October 24, 2012
• Final regulations issued January 17, 2013
Final Regulations Issued January 17, 2013

- “These regulations give the Administration a powerful set of tools to combat offshore tax evasion effectively and efficiently. The final rules mark a critical milestone in international cooperation on these issues, and they provide important clarity for foreign and U.S. financial institutions.”
  – Treasury Department press release

FATCA Part One: Obligations of Foreign Financial Institutions (FFIs)

FATCA Policy in Context of U.S. Tax Laws

- U.S. taxpayers’ investments have become increasingly global in scope
- Recognition that foreign financial institutions (FFIs) are in best position to identify and report with respect to their U.S. account holders
- Absent reporting by FFIs, some U.S. taxpayers may attempt to evade U.S. tax by hiding money in offshore accounts
- “To prevent this abuse of the U.S. voluntary tax compliance system and address the use of offshore accounts to facilitate tax evasion, it is essential in today’s global investment climate that reporting be available with respect to both the onshore and offshore accounts of U.S. taxpayers.” (Preamble to Final Regulations)
What Does FATCA Require of FFIs?

- FATCA requires Foreign Financial Institutions (FFIs) to report to the IRS information about financial accounts held by U.S. taxpayers, or by foreign entities in which U.S. taxpayers hold a substantial ownership interest. In order to avoid withholding under FATCA, a participating FFI will have to enter into an agreement with the IRS to:
  - Identify U.S. accounts,
  - Report certain information to the IRS regarding U.S. accounts, and
  - Withhold a 30 percent tax on certain U.S.-connected payments to non-participating FFIs and account holders who are unwilling to provide the required information.
- Registration will take place through an online system. FFIs that do not register and enter into an agreement with the IRS will be subject to withholding on certain types of payments relating to U.S. investments.

International Coordination and Model Intergovernmental Agreements

- Treasury is collaborating with foreign governments to develop two alternative model intergovernmental agreements that facilitate the effective and efficient implementation of FATCA.
- Model 1 IGA: FFIs in jurisdictions that have signed Model 1 IGAs report the information about U.S. accounts required by FACTA to their respective governments who then exchange this information with the IRS.
- Model 2 IGA: A partner jurisdiction signing an agreement based on the Model 2 IGA agrees to direct its FFIs to register with the IRS and report the information about U.S. accounts required by FATCA directly to the IRS.

International Coordination (continued)

- To date, United Kingdom, Mexico, Denmark, Ireland, Switzerland, Spain, and Norway have signed or initialed model agreements.
- Treasury is engaged with more than 50 countries and jurisdictions to curtail offshore tax evasion, and more signed agreements are expected to follow in the near future.
FATCA Part Two:
Obligations of U.S. Taxpayers
to Report Foreign Assets

FATCA Also Requires Reporting of Foreign
Assets by U.S. Taxpayers

- U.S. taxpayers with "specified foreign financial assets" that exceed certain thresholds must now report those assets to the IRS.
- A specified foreign financial asset includes (1) financial accounts maintained by foreign financial institutions and (2) other foreign financial assets held for investment such as foreign stocks or securities, interests in a foreign entity, any financial instrument or contract that has as an issuer or counterparty that is other than a U.S. person, foreign pensions and deferred compensation plans, and certain foreign trusts and estates.
- Form 8938, "Statement of Foreign Financial Assets," must be filed with the tax return.

Overview of Section 6038D

- New Internal Revenue Code provision enacted as part of 2010 HIRE Act
- Requires reporting of specified foreign financial assets if aggregate value exceeds certain thresholds
- Applies to tax years beginning after March 18, 2010
- Requires that new information return be attached to a taxpayer's U.S. income tax return
Section 6038D Is Effective Now

- Form 8938 "Statement of Foreign Financial Assets" with instructions has been finalized
- Temporary Regulations issued on December 14, 2011 and effective December 19, 2011
- This means that individual taxpayers must file Form 8938 beginning with their 2011 Form 1040s
- Filing by domestic entities has been deferred temporarily
- www.irs.gov/form8938 for updates

Who Is Required to File Form 8938?

You must file Form 8938 if:

1. You are a "specified individual."
   AND
2. You have an interest in "specified foreign financial assets" required to be reported.
   AND
3. The aggregate value of your specified foreign financial assets is more than the reporting threshold that applies to you.

Who is a “Specified Individual”?

A specified individual is:
- A U.S. citizen
- A resident alien of the United States for any part of the tax year (see Pub. 519 for more information)
- A nonresident alien who makes an election to be treated as resident alien for purposes of filing a joint income tax return
- A nonresident alien who is a bona fide resident of American Samoa or Puerto Rico (see Pub. 570 for definition of a bona fide resident)
What is a “Specified Foreign Financial Asset”?

A specified foreign financial asset (SFFA) is:

- Any financial account maintained by a foreign financial institution
  - Foreign bank accounts
  - Foreign mutual funds
  - Foreign hedge funds
  - Foreign private equity funds
  - Certain foreign insurance products
What is a SFFA? (continued)

- Other foreign financial assets held for investment that are not in an account maintained by a U.S. or foreign financial institution, namely:
  - Stock or securities issued by someone other than a U.S. person
  - Any interest in a foreign entity
  - Any financial instrument or contract that has as an issuer or counterparty that is other than a U.S. person
  - Foreign pensions and deferred compensation plans
  - Foreign trusts and estates (if "specified individual" is aware of its existence)

Form 8938 – Part II

Form 8938 – Part II (continued)
Determining Whether a "Specified Individual" Has An "Interest" in a SFFA

- "Specified Individual" generally has an interest if any income, gains, losses, deductions, credits, gross proceeds, or distributions attributable to the holding or disposition of the SFFA would be reportable on the individual's tax return
- Individual owner of a disregarded entity is treated as having an interest in any SFFA owned by the entity
- "Specified Individual" who is treated as owner of a foreign trust is treated as having an interest in any SFFA held by the trust
- "Specified Individual" NOT treated as having an interest in any SFFA held by partnership, corporation, trust, or estate solely as a result of the individual's status as partner, shareholder, or beneficiary

What are the reporting thresholds for domestic taxpayers?

- Unmarried taxpayers living in the U.S.: The total value of specified foreign financial assets is more than $50,000 on the last day of the tax year or more than $75,000 at any time during the tax year.
- Married taxpayers filing a joint income tax return and living in the U.S.: The total value of specified foreign financial assets is more than $100,000 on the last day of the tax year or more than $150,000 at any time during the tax year.
- Married taxpayers filing separate income tax returns and living in the U.S.: The total value of specified foreign financial assets is more than $50,000 on the last day of the tax year or more than $75,000 at any time during the tax year.

What are the reporting thresholds for taxpayers living abroad?

- Taxpayers living abroad. You are a taxpayer living abroad if:
  - You are a U.S. citizen whose tax home is in a foreign country and you are either a bona fide resident of a foreign country or countries for an uninterrupted period that includes the entire tax year, or
  - You are a U.S. citizen or resident, who during a period of 12 consecutive months ending in the tax year is physically present in a foreign country or countries at least 330 days.
- A taxpayer living abroad must file if:
  - You are filing a return other than a joint return and the total value of your specified foreign assets is more than $200,000 on the last day of the tax year or more than $300,000 at any time during the year; or
  - You are filing a joint return and the value of your specified foreign asset is more than $400,000 on the last day of the tax year or more than $400,000 at any time during the year.
Form 8938 Requires Disclosure of Tax Items Attributable to SFFAs

- Part III of Form 8938 requires that filers must summarize tax items attributable to SFFAs
- Individuals must identify specific tax items (interest, dividends, gains/losses, deductions, credits, etc.) that correspond to SFFAs
- Individuals must also list the form, schedule, and line upon which these tax items are reported

Form 8938 – Part III

Other Rules for Form 8938

- If you do not have to file an income tax return for the tax year, you do not need to file Form 8938, even if the value of your specified foreign assets is more than the appropriate reporting threshold.
- If you are required to file Form 8938, you do not have to report financial accounts maintained by:
  - a U.S. payor (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.
No Duplicative Reporting Required

• If you are required to file a Form 8938 and you have a specified foreign financial asset reported on Form 3520, Form 3520-A, Form 5471, Form 8621, Form 8865, or Form 8891, you do not need to report the asset on Form 8938. However, you must identify on Part IV of your Form 8938 which and how many of these form(s) report the specified foreign financial assets.

• Even if a specified foreign financial asset is reported on a form listed above, you must still include the value of the asset in determining whether the aggregate value of your specified foreign financial assets is more than the reporting threshold that applies to you.

• NOTE: FBAR must still be filed

No Duplicative Reporting Required (continued)

• Form 3520 – Annual Return To Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts
• Form 3520-A – Annual Information Return of Foreign Trust With a U.S. Owner
• Form 5471 – Information Return of U.S. Persons With Respect to Certain Foreign Corporations
• Form 8621 – Information Return by a Shareholder of a PFIC or Qualified Electing Fund
• Form 8865 – Return of U.S. Persons With Respect to Certain Foreign Partnerships

Form 8938 – Part IV
Guidance for Valuing SFFAs

- The regulations provide that the appropriate value of specified foreign financial assets for purposes of Form 8938 reporting is each such asset's highest fair market value during the year, and must be reported in U.S. dollars. If the asset is denominated in foreign currency, the maximum value is first determined in the foreign currency and is then converted to U.S. dollars at the taxable year-end spot rate for converting that currency. Specific guidelines are provided for which exchange rate should be used.
- For financial accounts, a reasonable estimate of the maximum value is allowed. Periodic account statements provided at least annually may be relied on to determine the maximum value, provided that the taxpayer does not have reason to know that the statement does not reflect the maximum value. For other financial assets, the fair market value on the last day of the taxable year can be used, unless the taxpayer knows that this is not a reasonable estimate (for example, if the taxpayer knows that the asset value declined during the year).
- Joint owners of a SFFA generally each include the full value of the asset for determining whether threshold is met (except for married taxpayers filing jointly).

Special Rules for Trusts and Estates

- Domestic trusts are not reporting taxpayers – only individuals need to report.
- Beneficiary is not treated as owning the assets of a trust or estate. However, owners of an interest in a grantor trust will report the SFFAs of the trust attributed to them, subject to some exceptions.
- An interest of a beneficiary in a foreign trust or a foreign estate is itself an SFFA. However, the beneficiary needs to know or have reason to know about the foreign trust or estate based on readily accessible information before it will be considered an SFFA. A receipt of a distribution from the estate or trust constitutes knowledge for this purpose.

Special Rules for Trusts and Estates (continued)

- In determining the "maximum value" of a beneficial interest in a foreign trust, the maximum value is the sum of (a) the fair market value on the last day of the year of all cash and property distributed to the beneficiary, and (b) the actuarial value on the last day of the year of the beneficiary's rights to receive mandatory distributions. If the beneficiary cannot obtain information to calculate (b), they can use only the value under (a).
- In determining the value of a beneficial interest in an estate, the taxpayer can limit the computation to that described in (a) above, if it cannot obtain the information needed to value the beneficial interest.
Penalties for Non-Filing of Form 8938

- Failure to file Form 8938 may result in a $10,000 civil penalty as well as an additional $10,000 continuation penalty for each 30 day period after the taxpayer is notified by the IRS of the failure to file (not to exceed $50,000)
- Exception if failure to file is due to reasonable cause and not due to willful neglect
- The fact that a foreign jurisdiction would impose a civil or criminal penalty for disclosing the required information is NOT reasonable cause
- Criminal penalties may also apply
- Failure to file Form 8938 or certain assets on Form 8938 may keep the statute of limitations open for ALL items on a return until 3 years after Form 8938 is filed.

Section 6038D filing by domestic entities

- Proposed Regulations issued on December 14, 2011
- 3 requirements:
  - U.S. entity must have an interest in a specified foreign financial asset with an aggregate value exceeding $50,000 on the last day of the tax year or more than $75,000 at any time during the tax year;
  - U.S. entity is “closely held” by one U.S. individual taxpayer; and
    - “Closely held” means 80% of the vote or value of the stock, capital interests or profits interests is held by one U.S. individual taxpayer.
  - Either:
    - At least 50% of the U.S. entity’s gross income for the tax year is passive income or 50% of the U.S. entity’s assets at any time during the tax year produce or are held for the production of passive income; or
    - 10% passive income or assets plus the U.S. entity is formed or availed of by a prohibited individual with a principal purpose to avoid reporting under Section 6038D.
- Notice 2013-10: Filing by domestic entities deferred until 2013

Options for U.S. Taxpayers with Undisclosed Foreign Bank Accounts
IRS Offshore Voluntary Disclosure Program

- Through December 2012, 39,000 taxpayers have come forward, and Treasury has collected $5.5 billion
- IRS reopened program on January 9, 2012
- Similar to the 2011 program, but with a few significant differences:
  - Open for an indefinite period of time until otherwise announced – terms of OVDP could change at any time;
  - Requires individuals to pay an FBAR penalty of 27.5% (compared to 25% in the 2011 program), may be reduced to 12.5% or 5% in certain circumstances; and
  - 8 year “rolling” look-back period with exclusion of compliant years

OVDP (continued)

- More stringent eligibility requirements:
  - U.S. government receipt of taxpayer information from “John Doe” summons, treaty request, or similar action is disqualifying event
  - Taxpayers who appeal foreign tax administrator’s decision to release account information must notify U.S. Attorney General or be disqualified
  - IRS may in its discretion designate certain classes of taxpayers ineligible
- Continuation of penalty relief under FAQs 17/18 for taxpayers who have reported all foreign-source income
OVDP Offshore Penalty: 27.5 percent

- Values of foreign accounts and other foreign assets are aggregated for each year and the penalty is calculated based upon highest year's aggregate value during the OVDP period.
- Composition of penalty base:
  - Applies to all of the taxpayer's offshore holdings that are related in any way to tax non-compliance, including bank accounts, tangible assets such as real estate or art, and intangible assets such as patents or stock or other interests in a U.S. or foreign business
  - Tax noncompliance includes failure to report income from the assets, as well as failure to pay U.S. tax that was due with respect to the funds used to acquire the asset.

OVDP Offshore Penalty: 5 percent

FAQ 52

- Taxpayer who (a) did not open or cause the account to be opened; (b) has exercised minimal, infrequent contact with the account; (c) has, except for a withdrawal closing the account and transferring the funds to an account in the United States, not withdrawn more than $1,000 from the account in any year for which the taxpayer was non-compliant; and (d) can establish that all applicable U.S. taxes have been paid on funds deposited to the account (only account earnings have escaped U.S. taxation).
- Taxpayer who is a foreign resident and was unaware he or she was a U.S. citizen.
- Taxpayer who (a) resides in a foreign country; (b) has made a good faith showing that he or she has timely complied with all tax reporting and payment requirements in the country of residency; and (c) has $10,000 or less of U.S. source income each year.

OVDP Offshore Penalty: 12.5 percent

- Taxpayer whose highest aggregate account balance (including the fair market value of assets in undisclosed offshore entities and the fair market value of any foreign assets that were either acquired with improperly untaxed funds or produced improperly untaxed income) in each of the years covered by the OVDP is less than $75,000.
OVDP: "Opt Out" Option

• An opt out is an election made by a taxpayer to have his or her case handled under the standard audit process.
• IRS recognizes that in certain cases, the opt out option may reflect a preferred approach. That is, there may be instances in which the results under the voluntary disclosure program appear too severe given the facts of the case.
• Full scope examinations will occur if opt out is initiated.
• If issues are found upon a full scope examination that were not disclosed by the taxpayer, those issues may be the subject of review by IRS Criminal Investigation.

OVDP: "Opt Out" Option (continued)

• Favorable scenarios for opting out:
  – Example 1 - Unreported Income But No Tax Deficiency
  – Example 2 - Unreported Income and Failure to File FBAR
  – Example 3 - Unreported Controlled Foreign Corporation
  – Examples 4/5 - Dual citizen residing abroad with no U.S. income and fully compliant with foreign tax laws
• Unfavorable scenarios for opting out:
  – Example 6 - Large Unreported Gain
  – Example 7 – Civil Fraud Penalty Warranted

Risks of “Quiet Disclosure”

• FAQ 15: "Taxpayers are strongly encouraged to come forward under the OVDP to make timely, accurate, and complete disclosures. Those taxpayers making 'quiet' disclosures should be aware of the risk of being examined and potentially criminally prosecuted for all applicable years."
• FAQ 16: "The IRS is reviewing amended returns and could select any amended return for examination. The IRS has identified, and will continue to identify, amended tax returns reporting increases in income. The IRS will closely review these returns to determine whether enforcement action is appropriate. If a return is selected for examination, the 27.5 percent offshore penalty would not be available. When criminal behavior is evident and the disclosure does not meet the requirements of a voluntary disclosure under IRM 9.5.11.9, the IRS may recommend criminal prosecution to the Department of Justice."
• Note: United States v. Michael A. Schiavo (D. Mass. 2011)
Streamlined Compliance Procedures for U.S. Taxpayers and Dual Citizens Residing Abroad

- Announced June 26, 2012; effective date September 1, 2012
- IRS Commissioner Shulman: "Today we are announcing a series of common-sense steps to help U.S. citizens abroad get current with their tax obligations and resolve pension issues"
- Must file 3 years of tax returns and 6 years of FBARs
- Scrutiny by IRS will depend upon assessment of "compliance risk"
- Penalty relief for "reasonable cause" is available
- Relief for certain foreign pensions and retirement plans (including Canadian RRSPs) is available
- But, no protection from criminal prosecution

Streamlined Compliance Procedures: Details Announced August 31, 2012

- Four eligibility criteria for streamlined procedure
  - Must have resided outside of U.S. since January 1, 2009
  - No U.S. returns filed for 2009, 2010, or 2011
  - Must not owe more than $1,500 in U.S. taxes per year
  - No amended returns (except for retroactive deferral of income)
- Otherwise considered high risk and subject to full examination
- Participants must also submit two-page questionnaire which includes questions about accountant
- No OVDP available once submission is made

Streamlined Compliance Procedures: Details Announced August 31, 2012

- High risk factors
  - Returns submitted through program claim a refund
  - Material economic activity in U.S.
  - Taxpayer has not declared all income in home country
  - Taxpayer is under audit or investigation by IRS
  - FBAR penalties previously assessed or FBAR warning letter
  - Bank accounts or entities in countries outside of home country
  - U.S.-source income
  - Indications of sophisticated tax planning or avoidance
IRS Guidance for U.S. Citizens Residing Abroad

- FS-2011-13 issued December 7, 2011
- IRS acknowledges that some U.S. citizens (or dual citizens) residing abroad only recently became aware of their U.S. tax and FBAR obligations
- Guidance suggests back-filing six years of tax returns and FBARs
- Failure-to-file and/or failure-to-pay penalties may be waived for reasonable cause
- FBAR penalties may be waived for reasonable cause

Questions?

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END

Thank you for participating in today’s program.
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