private client services update

July 20, 2011

THE FBAR AND OVDI ARE NOT HEALTH FOODS . . . BUT YOU SHOULD KNOW WHAT THEY ARE AND WHY THE AUGUST 31, 2011 EXPIRATION DATE MATTERS

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An FBAR is a Report of Foreign Bank and Financial Accounts (Form TD F 90-22.1). Any United States person who has signature authority over, or a financial interest in, a financial account located in foreign country is required to file an FBAR if the balance in the account was more than $10,000 at any time during the calendar year. Interestingly, a “foreign country” includes the commonwealth of Puerto Rico, the commonwealth of the Northern Mariana Islands, and the territories and possessions of the United States (Guam, American Samoa, and the United States Virgin Islands), along with all other geographical areas outside the United States. A “United States person” includes a citizen or resident of the United States, a domestic partnership, a domestic corporation, and a domestic estate or trust. If the person can control the disposition of money or other property in the foreign account by delivery of a document containing his or her signature (or his or her signature and that of one or more others) to the bank or other person with whom the account is maintained, the person has signature authority over the account. Additionally, authority exists in a person who can exercise power that is comparable to signature authority over the account by direct communication to the bank or other person with whom the account is maintained, either orally or by some other means. Whether or not such authority is ever exercised is irrelevant to the FBAR filing requirement.

For example, a U.S. resident with power of attorney for his elderly parents’ accounts in Canada must file an FBAR if the power of attorney gives him signature (or comparable) authority over the financial accounts. An FBAR will be due by June 30 of the year following the year that the balance of one or more of the accounts reaches the $10,000 threshold. The granting by the Internal Revenue Service (“IRS”) of an extension to file Federal income tax returns does not extend the FBAR filing due date, and an extension of the FBAR due date cannot be requested or granted. If the filer does not have the information necessary to file the return by June 30, a return should be completed with the best available information, then amended when additional or more accurate information becomes available.

Because the FBAR is not subject to the mailbox rule, which generally applies to income tax return filings, it must be received by the U.S. Treasury Department by the deadline. Timely filing will be easier following Treasury’s Financial Crimes Enforcement Network (FinCEN) announcement on July 18, 2011 that the forms can now be electronically filed, as long as only one signature is necessary for completion of FBAR. Spouses who want to file a joint FBAR for accounts held jointly will still be required to file on paper; however, spouses who wish to e-file can each file separately for their joint accounts.

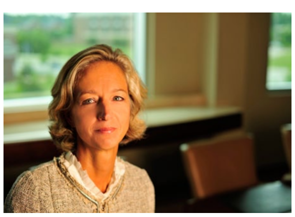
Penalties resulting from the failure to file FBARs can easily exceed the balance of the foreign account. The criminal and civil penalties for willful failure to file are onerous: On the criminal side, the willful failure to file is a felony punishable by a fine of $250,000, or five years in jail, or both. Willful failure to file carries a civil penalty, which can be applied annually, of the greater of $100,000 or 50% of the account balance, while negligent failure to file an FBAR is subject to a civil penalty of $10,000 per violation. No penalty is imposed if the taxpayer can show reasonable cause for the failure to file, and delinquent FBARs should be filed with a statement explaining why the reports are filed late.

In addition to the obligation to report foreign accounts to the IRS, any income generated by the foreign accounts must be reported on the appropriate tax returns. The willful failure to report this income may be treated as tax evasion—a felony punishable by a fine of $100,000, or five years in jail, or both, which may also constitute tax fraud, carrying civil penalties up to 75% of the tax evaded. Additional penalties may be assessed for the failure to report transactions with foreign trusts and receipt of certain foreign gifts (Form 3520), ownership interests in foreign trusts (Form 3520-A), interests and positions of responsibility in certain foreign corporations (Form 5471), transactions between a 25% foreign owned domestic corporation or foreign corporation engaged in a trade or business in the United States and a related party (Form 5472), and certain interests in foreign partnerships (Form 8865).

On February 8, 2011, the IRS announced the Offshore Voluntary Disclosure Initiative ("OVDI"), a special voluntary disclosure initiative designed to bring offshore money back into the U.S. tax system and help people with undisclosed income from offshore accounts get current with their taxes. Voluntary disclosure is a longstanding practice under which the IRS Criminal Investigations division takes timely, accurate and complete voluntary disclosures into account in deciding whether to recommend to the U.S. Department of Justice that a taxpayer be criminally prosecuted. The new voluntary disclosure initiative follows a previous special voluntary disclosure program (the "OVDP") which ended on October 15, 2009, with 15,000 voluntary disclosures covering banks in more than 60 countries. The penalty structure under the OVDI is higher than under the OVDP, so that people who did not participate in the 2009 voluntary disclosure program are not rewarded for waiting, with a penalty of 25% of the amount in the foreign bank accounts in the year with the highest aggregate account balance covering the 2003 to 2010 time period. Participants whose offshore accounts or assets did not surpass $75,000 in any calendar year covered by the OVDI will qualify for a lower penalty rate of 12.5%. All participants must pay back-taxes and interest for up to eight years, as well as accuracy-related and/or delinquency penalties.

The OVDI offers clear benefits designed to encourage voluntary disclosure now rather than risk detection. IRS efforts in the international arena will only increase as time goes on, and taxpayers hiding assets offshore who do not come forward will face far higher penalty scenarios as well as the possibility of criminal prosecution. The high cost, both financial and psychological, of the IRS discovering an undisclosed foreign account make the benefits of disclosure of foreign accounts, and participation in the OVDI if there is unreported income, well worth considering. Time is rapidly running out: all original and amended tax returns, along with payment for taxes, interest and accuracy-related penalties must be filed by August 31, 2011.

about the author



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