

Offshore Asset Reporting: Rules, Enforcement, and Options for Compliance

Thompson & Knight  Impact[®]

Andrew Wootton

Overview: Reporting Regimes for Offshore Assets

- **Department of the Treasury: Report of Foreign Bank and Financial Accounts (FBAR)**
 - FinCen Form 114 (Formerly Form TD F 90-22.1)
- **Tax Return Reporting Forms**
 - Form 8938, Statement of Specified Foreign Financial Assets
 - 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
 - Others – Form 8621 (information return for PFIC shareholders), Form 8865 (information return for partners of foreign partnerships), 8891 (reporting by beneficiaries of certain Canadian Retirement Plans)

Department of the Treasury: Report of Foreign Bank and Financial Accounts (FBAR)

- **Overview:** A United States person must file an FBAR if that person has a financial interest in or signature authority over any financial account(s) outside of the United States and the aggregate maximum value of the account(s) exceeds \$10,000 at any time during the calendar year.
- **Three Requirements:**
 - Person is a United States Person
 - Asset is a “financial account”
 - Person has a financial interest or signature authority in a financial account outside the U.S.

Department of the Treasury: Report of Foreign Bank and Financial Accounts (FBAR) (cont).

● **United States Person:**

- A citizen or resident of the United States
 - References definition of a U.S. resident in Section 7701(b)
- An entity created or organized in the United States or under the laws of the United States
 - The term “entity” includes corporations, partnerships, and LLCs
 - Tax filing status is not determinative (a DRE may be required to file an FBAR)
- A trust or estate formed under the laws of the United States

● **Financial Accounts:**

- Bank accounts, securities accounts, options or commodities accounts, mutual funds, other accounts at foreign financial institutions

Department of the Treasury: Report of Foreign Bank and Financial Accounts (FBAR) (cont).

● Financial Interest Subject to Reporting

- The United States person is the owner of record or holder of legal title of the account
- “Real” owner of an account if the owner of record is a person acting as an agent, nominee, attorney, or a person acting on behalf of the person with real beneficial ownership
- Account owned by a corporation in which a U.S. person owns directly or indirectly more than 50 percent of the total of the vote or value of the corporation’s stock
- Account owned by a partnership in which a U.S. person owns directly or indirectly more than 50 percent of the partnership’s profits or capital.
- The owner of record or holder of legal title is a trust of which the United States person: (i) is the trust grantor; and (ii) has an ownership interest in the trust for United States federal tax purposes.
- The owner of record or holder of legal title is a trust in which the United States person has a greater than 50 percent present beneficial interest in the assets or income of the trust for the calendar year.
- The owner of record or holder of legal title is any other entity in which the United States person owns directly or indirectly more than 50 percent of the voting power, total value of interest in equity or profits
- FBAR regulations are silent on attribution

● Signature authority is the authority of an individual (alone or in conjunction with another individual) to control the disposition of assets held in a foreign financial account

Department of the Treasury: Report of Foreign Bank and Financial Accounts (FBAR) (cont).

- **Exceptions:**

- Consolidated FBAR – a U.S. person that is an entity and is named in a consolidated FBAR filed by a greater than 50 percent owner
- IRA Owners and Beneficiaries in a retirement plan described in Sections 401(a), 403(a), or 403(b) are not required to report accounts held by or on behalf of the plan.
- Certain individuals with signature authority but no financial interest in an account
- Certain beneficiaries of trusts holding foreign accounts

- **Excluded Accounts:**

- Certain Accounts Jointly Owned by Spouses if the FBAR is filed by the other spouse.
- Correspondent/Nostro Account. Correspondent or nostro accounts (maintained by banks and used solely for bank-to-bank settlements).
- Accounts of governmental entities
- International Financial Institution. A foreign financial account of any international financial institution (if the United States government is a member) (e.g., the World Bank and the International Monetary Fund (IMF))
- Accounts held by a United States Military Banking Facility

Department of the Treasury: Report of Foreign Bank and Financial Accounts (FBAR) (cont).

- **Consequences of Noncompliance:**
 - Civil Financial Penalties: No minimum; but maximum penalties range from \$10,000 for each negligent violation to the greater of \$100,000 or 50 percent of an account's value at the time of the violation for willingly failing to file an FBAR report
 - Criminal Penalties: fines of up to \$250,000 and/or prison term of up to five years
 - **Rules are clear that it is possible to assert penalties in amounts that exceed the balance in an account**

Form 8938, Statement of Specified Foreign Financial Assets

- **U.S. citizens or resident individuals that have interests in certain “foreign financial assets” exceeding \$50,000 in value on the last day of the year or \$75,000 at any point during the year must file Form 8938 as part of their annual tax return**
 - Thresholds to file \$100,000 and \$150,000 for married taxpayers filing jointly; higher limits for U.S. taxpayers residing abroad
- **Obligation to file is independent of FBAR filing requirements (may need to file both reports)**
- **Differences from FBAR reporting requirements:**
 - Only individuals must file for now; IRS has issued proposed regulations requiring partnerships, closely-held corporations and trusts to file
 - Definition of a “U.S. Resident” includes U.S. residents that elect to file as nonresidents under the provisions of U.S. income tax treaties
 - Expanded class of assets covered by reporting requirements

Form 8938, Statement of Specified Foreign Financial Assets (cont.)

- **Foreign financial assets subject to reporting:**
 - **Financial accounts held at foreign financial institutions**
 - **Foreign financial assets held for investment (*i.e.*, not used in an active trade or business) that are not held in an account at a financial institution:**
 - Stock or securities issued by a non-U.S. person (stocks or bonds issued by foreign corporations)
 - Any interest in a foreign entity, including capital or profits interests in a foreign partnership or an interest in a foreign estate or trust
 - Any financial instrument or contract that has an issuer or counterparty that is not a U.S. person
 - Foreign pension accounts

Form 8938, Statement of Specified Foreign Financial Assets (cont.)

- **Consequence of Non-Compliance:**
 - Initial penalty of \$10,000
 - Additional penalties of up to \$50,000 for failure to file after receiving notice from IRS that filing is required
 - 40 Percent accuracy penalty for understatement of tax attributable to assets not properly reported
 - Statute of limitations for tax returns does not run if Form 8938 is not properly completed
 - Reasonable cause exceptions apply

Enforcement Efforts

● Prosecution of Foreign Banks

- May 2014: Credit Suisse AG pleaded guilty to conspiracy to assist U.S. taxpayers in filing of false tax returns and other documents, and agreed to pay \$2.6 billion to the federal government and New York State
 - Facts cited in the guilty plea included the failure by accountholders to report income or comply with FBAR reporting requirements
- February 2009 – deferred prosecution agreement between U.S. Dept. of Justice and UBS based on charges that UBS conspired with account holders to defraud U.S. government
 - Settlement: \$780 million in fines; UBS ordered by Swiss government to release to the DOJ information on U.S. account holders

Enforcement Efforts (cont.)

- **Civil and Criminal Prosecution of Individuals**
 - Account holders – based on information acquired from UBS and other sources
 - Account holders have been prosecuted for filing false income tax returns and failure to file FBAR reports
 - Penalties include monetary penalties, probation and jail sentences
 - Bankers/financial advisors – individuals employed by foreign banks or financial institutions that participated in setting up structures intended to avoid U.S. tax have been charged with conspiracy to defraud the IRS
- **Implementation of FATCA expected to accelerate enforcement efforts**

Enforcement Efforts (cont.)

● Non-Prosecution/Non-Target Agreements

- Program initiated August 29, 2013 between U.S. Dept. of Justice and the Swiss Federal Department of Finance
- Non-Prosecution Program targets Swiss banks that were not subject to a criminal investigation but which have reason to believe they may have committed tax-related offenses
- Terms : DOJ agrees not to prosecute a participating bank under the following conditions:
 - Bank provides description of how U.S. accounts were structured, operated and supervised during period beginning August 1, 2008
 - Bank provides details regarding U.S. accounts – number of accounts, value of each account, general information regarding U.S. persons associated with the accounts, information on deposits and withdrawals, names of relationship managers, client advisors, asset managers, etc.
 - Bank assists DOJ with the submission of a request under U.S.-Swiss tax treaty for specific identity of account holders

Enforcement Efforts (cont.)

- **Non-Prosecution Agreements (cont.)**
 - **Penalties: 20-50% of maximum value of U.S. Related Accounts, based on date accounts were opened**
 - **Penalties reduced by the following:**
 - **Value of accounts that were not undeclared (*i.e.*, U.S. account holder complied with reporting and tax requirements)**
 - **Value of accounts that were disclosed by the bank to the IRS**
 - **Value of accounts that were disclosed to the IRS by the account holder through an Offshore Voluntary Disclosure Program following notification by the Swiss bank of such a program, and prior to execution of the Non-Prosecution Agreement**

Compliance Alternatives

- **Options for noncompliant taxpayers to become compliant without criminal prosecution:**
 - **Offshore Voluntary Disclosure Program (OVDP)**
 - **Streamlined Filing Compliance Procedures (SFCP)**
 - **Delinquent FBAR Submission Procedures**
 - **Delinquent International Return Procedures**
 - **Opt-Out/Quiet Disclosure**
- **Note that the programs described above are intended to encourage compliance with all tax compliance requirements, not just those related to FBAR and 8938 reporting**

Compliance Alternatives (cont.)

- **For IRS compliance programs, two relevant questions:**
 - **Have all taxes been paid?**
 - **If not, was the failure to pay taxes willful?**
- **Willfulness – the “voluntary, intentional violation of a known legal duty.” *U.S. v. Sturman*, 951 F.2d 1466 (6th Cir. 1991).**
 - Whether a violation is willful can be inferred from a person’s course of conduct
 - Under a theory of “willful blindness,” an individual’s refusal to learn about the FBAR reporting requirements was sufficient to constitute willfulness. *U.S. v. Williams*, 489 Fed. Appx. 655 (4th Cir. 2012).

Compliance Alternatives (cont.)

- **Have all taxes been paid?**
 - **If yes, and**
 - **(i) the person is not under a civil or criminal investigation by the IRS;**
 - **(ii) the person has reasonable cause for the failure to file the required FBAR or tax information reports (e.g., Form 8938); and**
 - **(iii) the person has not been contacted by the IRS about the delinquent reports; then**
 - **IRS recommends that the noncompliant individual file any past due FBAR reports and/or information reports, along with an explanation of reasonable cause as to why the reports were not filed timely**
 - **Assuming reasonable cause exists, no penalties should apply**

Compliance Alternatives (cont.)

- If all taxes have not been paid . . .
- Was the failure to pay taxes willful?
 - If not, taxpayer may qualify for the **Streamlined Domestic Compliance Procedures (SCDP)**. Requirements to qualify for this program:
 - Applies to individuals and estates whose failure to report income from foreign financial assets, pay tax and file FBARs and/or information returns (e.g., Form 8938) was non-willful
 - Not available if IRS has initiated a civil examination of the taxpayer’s return
 - Person has filed tax returns for the three most recent periods for which the due date has passed
 - **Terms of Participation:**
 - Taxpayer must file amended tax returns for three previous years for which due date has passed and amended FBAR reports for six years for which the due date has passed,
 - Returns must include a signed statement declaring that taxpayer qualifies for this program, all FBAR reports and amended tax returns have been filed and that prior failures to file required reports and pay taxes when due was not willful, and that penalty payment amount is accurate
 - Taxpayer must include payment of all unpaid taxes, interest and a “miscellaneous Title 26 penalty” equal to 5% of the highest aggregate value of the unreported foreign financial assets

Compliance Alternatives (cont.)

- **Streamlined Filing Compliance Procedures**

- **Advantages:**

- Lower penalties than OVDP – miscellaneous offshore penalty is equal to 5% of highest aggregate balance of taxpayer's unreported assets for the covered years
- Accuracy-related penalties for underreported income do not apply

- **Drawbacks:**

- Once a submission is made under the Streamlined procedures, the taxpayer may not participate in the OVDP
- If IRS examines returns and determines that failures to file FBAR/information returns and pay tax was due to willful conduct, ordinary civil and criminal penalty rules apply.
- Risk of criminal prosecution is not eliminated through this program.

Compliance Alternatives (cont.)

- **If all taxes have not been paid . . .**
- **Was the failure to pay taxes willful?**
 - **If yes, then taxpayer may still qualify to participate in the Offshore Voluntary Disclosure Program (OVDP)**
 - **Requirements for Eligibility:**
 - Individuals, corporations, partnerships, trusts and other entities are eligible to participate
 - Not available if IRS has initiated a civil or criminal examination of the taxpayer's return or received information from a third party regarding a taxpayer's noncompliance
 - Taxpayers may elect to participate even if they have already submitted amended returns or FBAR reports through a "quiet disclosure"

Compliance Alternatives (cont.)

● Terms of participation –

- Taxpayer must provide original and amended tax returns and FBAR reports for the eight most recent years for which the filing deadline has passed
- Payment of any unpaid tax and interest for the years covered by the disclosure
- Tax penalties – 20% accuracy-related penalties on the full amount of any offshore-related understatements, along with failure to pay and failure to file penalties as applicable
- Payment of 27.5% “miscellaneous Title 26 offshore penalty” based on highest aggregate value of unreported assets (in lieu of FBAR penalties).
 - Assets subject to the penalty include “all of the taxpayer’s offshore holdings that are related in any way to tax non-compliance, regardless of the form of the taxpayer’s ownership or the character of the asset”
 - Unlike streamlined compliance program, the penalty is not limited to financial assets
- The “miscellaneous” penalty increases to 50% if there is a public disclosure that any of the following has occurred:
 - An investigation of the financial institution where an asset is held
 - The financial institution is cooperating with the IRS or U.S. DOJ.
 - The foreign financial institution has been identified in a court approved issuance of a summons seeking information about U.S. taxpayers that may hold accounts (a “John Doe” summons)
- If the 50% penalty applies to any of a person’s assets, it will apply to all of such assets

Compliance Alternatives (cont.)

- **Terms of participation (cont.)**

- **Required Documentation:**

- Copies of statements for all financial accounts reflecting all account activity for each year covered by the disclosure
- Completed Offshore Voluntary Disclosure Letter, Foreign Account or Asset Statement for each unreported account and Taxpayer Account Summary
- Taxpayer must agree to extent the statute of limitations for the assessment of tax and FBAR penalties for all years included in the disclosure
- Other requirements may apply, depending on assets being disclosed
- Cooperate with the voluntary disclosure process
- Cooperate with IRS and DOJ enforcement efforts by providing requested information about institutions and other facilitators who helped the taxpayer establish the offshore arrangement

Compliance Alternatives (cont.)

● Opting out of OVDP

- If the OVDP penalty is unacceptable to a taxpayer, the taxpayer may irrevocably “opt-out” of the OVDP program and instead handle their disclosure under the ordinary audit process
- Reasons for opting out:
 - Taxpayer feels it has valid reasonable cause so OVDP FBAR and tax penalties would not apply under ordinary circumstances
 - Circumstances may provide that civil settlement would result in lower liability
- Once the taxpayer opts out, the case would be handled through the standard audit process – all applicable penalties and defenses would apply
- The standard statute of limitations would apply (the agreements made to extend the statute would not apply after the opt-out)
- OVDP guidance suggests that opting out may lead to complete examination of years at issue

Compliance Alternatives (cont.)

- **Quiet Disclosures**

- **Occurs when a taxpayer simply files amended tax returns and FBAR reports without notifying IRS in order to avoid 27.5% penalty**
- **IRS warns that quiet disclosures offer no protection from criminal prosecution of civil examination and imposition of all applicable penalties, even after amended returns and FBARs are filed**