



Private Clients Alert[®]

Legal and financial developments
affecting individuals and their families

A publication of Nixon Peabody LLP

June 2009

Report of Foreign Bank and Financial Accounts (“FBAR”) due on June 30; voluntary disclosure program regarding unreported offshore accounts ends September 23, 2009

Executive Summary

The annual report of Foreign Bank and Financial Accounts (“FBAR”), filed on form TD F 90-22.1, is **due on June 30, 2009. Steep civil penalties and criminal sanctions apply for non-compliers.** A voluntary disclosure program related to previously unreported foreign account income is effective through September 23, 2009.

Discussion

The annual report of Foreign Bank and Financial Accounts (“FBAR”) is due every June 30. The FBAR for calendar year 2008 is due on June 30, 2009. Unfortunately, filing extensions are not permitted. The report is filed separately from any required income tax returns.

The report must be filed by any U.S. person who has a financial interest in, or signature authority over any financial account (e.g., bank or security account) in a foreign country, if the aggregate value of the account or accounts exceeds \$10,000 at any time during the year.

A “U.S. person” includes a citizen or resident of the U.S., as well as domestic business entities, trusts, and estates. In October of 2008, the IRS changed the FBAR instructions, and added to the list of required filers certain nonresidents “doing business in the U.S.” However, the Service recently indicated that the expanded definition relating to nonresident aliens would not apply to 2008 reports due June 30, 2009. To reiterate, for the 2008 FBAR, the term “United States person” means (1) a citizen or resident of the U.S., (2) a domestic partnership, (3) a domestic corporation, or (4) a domestic estate or trust. Clarification of the reporting requirements for nonresident aliens doing business in the U.S. must await additional guidance, presumably involving 2009 reports due June 30, 2010.

An individual has a “financial interest” in a foreign account to the extent the individual has legal title or is the owner of record. It is possible that multiple persons may have filing responsibilities for the same account. For example, the owner of an account and another person who holds a power of attorney on the account each has a separate filing responsibility over the same account. In the same vein, multiple trustees of a trust that holds a foreign account are each required to report.

A more than 50% shareholder (held directly or indirectly) of a corporation that owns a foreign account is deemed to hold a financial interest in the corporation’s account, and has a reporting responsibility. A similar rule applies to partnerships; a more than 50% partner in a partnership that holds a foreign account also has a reporting responsibility. A beneficiary of a trust (holding a present interest in more than 50% of the trust assets, or is entitled to more than 50% of trust income) also has a filing requirement. In these situations, both the entity and the individual shareholder, partner, or beneficiary has a separate filing requirement for the same account.

A nominee, attorney, or agent of an individual holding a foreign account also has a filing responsibility.

A “financial account” includes any bank, securities, securities derivatives, debit card, prepaid credit card account, or any other financial instruments account. The term includes any savings, demand, checking, deposit, or any other account maintained at a foreign financial institution. A report is required whether or not the financial account generates any income.

The “maximum value” of the account that must be reported (*new for 2008 reports*) is the largest amount of currency and non-monetary assets that appears on any quarter or more frequent account statements for a year (or if statements are not issued, the largest amount in the account at any time during the year). Foreign currency is converted using the official exchange rate at the end of the year. If an asset is withdrawn from the account, the value is the fair market value at the time of the withdrawal.

Failure to file an FBAR on a timely basis can result in civil penalties, criminal sanctions, or both. Pursuant to the American Jobs Creation Act of 2004, the maximum civil penalty for a non-willful failure to file is \$10,000. A reasonable cause exception is part of the law, presumably applicable if the account is disclosed on the taxpayers’ U.S. income tax return (Form 1040 Schedule B) and the income generated by the account included in the taxpayer’s income. For willful non-compliance, the maximum penalty is the greater of \$100,000 or 50% of the amount of the foreign accounts.

Criminal penalties include a \$250,000 fine and up to 5 years of imprisonment. If non-compliance is in tandem with other U.S. law violations (other criminal activity), the maximum penalty is a \$500,000 fine and 10 years imprisonment.

The FBAR reporting requirement has its genesis in the Bank Secrecy Act. This law was enacted based on a concern that U.S. persons were using financial institutions in tax havens to hide illegal activities or to evade tax. The law required the Treasury to draft forms that can be used to track cash movements and track non-filers. Originally, enforcement of FBAR reporting was handled by the Federal Crimes Enforcement Network (“Network”). The primary responsibility of the Network is to detect terrorist funding and money laundering. In 2003, the Network transferred enforcement responsibly to the IRS, in order to improve compliance.

The FBAR is filed with the IRS in the Detroit Service Center or hand delivering it to any local IRS office. Data from the filed forms is input into a database used by the IRS and the Network to track the flow of money.

Recently, the Service has stepped up its offshore account enforcement actions. Most of the emphasis has been on Swiss financial accounts and Liechtenstein trust accounts. In order to provide non-compliers with an incentive to disclose offshore accounts and previously unreported income, the IRS offered an offshore voluntary disclosure program, effective from March 23 to September 23, 2009. The program allows taxpayers to avoid some or all civil penalties, effectively eliminating the risk of criminal sanctions, and to calculate the total cost of resolving offshore issues while becoming compliant. The program has specific procedures that must be followed, and is commenced by informing IRS Criminal Investigation personnel. Generally, unreported income and all required forms must be prepared and filed for the years 2003–2008 (6 years) in order to become compliant under the program.

Participating taxpayers must pay back-taxes and interest for six years and either an accuracy related or delinquency penalty. But, in lieu of all other penalties that may apply, including FBAR and information return penalties, the IRS will assess a penalty equal to 20% of the amount in foreign accounts with the highest aggregate asset value.

The primary purpose for the program is to allow taxpayers to pay tax on foreign unreported income. Individuals who reported and paid tax on their taxable income but did not file FBARs, should not use the voluntary disclosure program and should instead simply file the delinquent FBAR reports, attaching a statement explaining why the reports are not timely. Copies of the late FBARs should be forwarded by September 23, 2009, to the Philadelphia Offshore Identification Unit. Under the program, the IRS won't impose a penalty for the failure to file the FBARs on a timely basis.

Questions? The Nixon Peabody Private Clients Group will be pleased to answer any questions you may have. Please do not hesitate to contact us.

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To ensure compliance with IRS requirements, we inform you that any tax advice contained in this communication is not intended or written to be used, and cannot be used, for the purpose of (i) avoiding penalties under the Internal Revenue Code or (ii) promoting, marketing or recommending to another party any transaction or matter addressed herein.



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