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Automatic reporting from European governments required in FATCA

It is not illegal to have foreign financial accounts. However, clients associated with foreign financial accounts are cautioned to remain vigilant in following foreign compliance reporting requirements. Program clients may be subject to onerous penalties from the IRS and possible criminal prosecution.

On April 10, 2012, the U.S. government entered into a reciprocal agreement with France, Spain, Italy, Germany and the United Kingdom authorizing the voluntary and automatic exchange of foreign financial information. Beginning next year, the agreement allows each government to automatically receive information about their citizens who have bank accounts in any of the other five countries.

This agreement expands existing foreign account reporting requirements in one significant respect: The foreign governments, rather than the financial institutions, will be the ones voluntarily reporting this information. Similar agreements were also signed by the United States with Denmark, Mexico, Japan and Switzerland.

In November 2012, the U.S. Treasury announced that it is engaged in discussions with more than 50 countries and jurisdictions across the globe to improve international tax compliance. Albert L. Grasso, a founding principal of Chuhak & Tecson P.C., commented, "Additional agreements are currently being negotiated. A side effect of these agreements is that foreigners with U.S. accounts will also be subjected to disclosure in their home countries."

The foundation of these new requirements stems from the Foreign Account Tax Compliance Act (FATCA), Section 6038D of the Internal Revenue Code, which was enacted in 2010 as an effort to curb tax evasion by individuals with bank accounts overseas.

The new automatic reporting by the European governments is set to take effect on Jan. 1, 2014, for returns filed in 2015. Each government will voluntarily disclose the name of any individual or entity with a foreign financial account open on Jan. 1, 2014. Accounts closed prior to this date will not be identified under the agreement.

Currently, the IRS requires individuals who have a foreign bank account, brokerage account, mutual fund, trust or other type of financial account to fill out Form TD F 90-22.1, Report of Foreign Bank and Financial Accounts (FBAR). The IRS imposed this requirement on U.S. citizens because foreign financial institutions are often not subject to the same reporting requirements as U.S. banks are.

Generally, individuals and entities are subject to the FBAR filing requirement if: 1) They had a financial interest or signatory authority over at least one foreign financial account outside the U.S. and 2) the aggregate amount of all foreign financial accounts exceeded $10,000 at any point during the calendar year reported. However, the FBAR instructions also list a number of exceptions to those who must file.

FBAR is not filed with an income tax return, but rather must be received by the Treasury on or before June 30 of the year following the tax year being reported. There are no extensions granted for filing an FBAR, even if an individual or entity has received an extension for the income tax return.

While the FBAR form has been around since the early 1990s, many taxpayers often do not file them even when they are required to do so. In order to encourage compliance of foreign reporting in light of this new agreement, the IRS plans to match the names of individuals who file FBARs against a list of names provided by the foreign governments. If a name appears on the government list without a corresponding FBAR, the IRS will target that individual for an audit or possible criminal prosecution.

The penalties for a nonwillful failure to file will not exceed $10,000. However, where the failure to file is deemed willful, the penalty may be the greater of $100,000 or 50 percent of the amount in the account(s) at the time of the violation. See 31 U.S.C. Section 5321(a)(5). In addition to the civil costs, under 31 U.S.C. Section 5322, willful violation may also result in a criminal penalty of a fine up to $250,000, imprisonment for up to five years, or both.

THE BUZZ

Lindsey Paige Markus

Lindsey Paige Markus, a principal at Chuhak & Tecson P.C., draws on her early career in business, finance and clinically applied neuroscience to communicate with clients and develop creative solutions to fit their estate planning and asset protection needs. In 2012, Lindsey was recognized as one of the 40 Illinois Attorneys Under Forty to Watch and was named an Illinois Super Lawyer Rising Star 2010-2013. She is a collaborative law fellow and is licensed in Illinois and Florida.

Clients who have not previously filed are encouraged to take advantage of the IRS' Voluntary Disclosure Program before FATCA takes effect. Where a taxpayer fully discloses his foreign accounts and complies with the program, the IRS will not recommend criminal prosecution to the Department of Justice. The program enables noncompliant taxpayers to minimize their chance of criminal prosecution and resolve their tax liabilities.

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Unlike similar programs in 2009 and 2011, the current program does not have a set deadline for taxpayers to apply. However, the IRS may change the terms of the program at any time and the IRS may also increase penalties or limit eligibility or completely terminate the program. While the IRS generally has three years from the filing of a return in which to audit a taxpayer and assess additional tax, FATCA amended Section 6501(e) to extend the statute of limitations to six years where a taxpayer omits levels of income attributable to one or more assets required to be reported. Additionally, participants in the IRS Offshore Voluntary Disclosure Program may be required to file eight years of amended returns.

Grasso cautioned, "Individuals who believed that their accounts were unlikely to be discovered because they dealt with financial institutions with no U.S. presence, especially in countries other than Switzerland, should reconsider continued nondisclosure. Expanded intergovernmental cooperation and enhanced computer cross-checking are real game-changers. After 2013, the issue will not be whether the accounts will be discovered, but when."

Compliance with FATCA and voluntarily disclosing information on an FBAR is now more critical than ever in order to ensure that a client will not face civil or criminal penalties for failing to report foreign financial information. The fact that these disclosures will stem directly from the governments, rather than from the foreign institutions, marks a significant step toward a global effort to curb tax evasion.

A special thanks to Chuhak & Tecson law clerk Jennifer Krah for her contribution to this month's column.

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