

Authored by G. Michelle Ferreira

May 5, 2008

Foreign Bank Account Reports are Due June 30, 2008 - Severe IRS Penalties Will Apply for Failing to File an FBAR

There is a common misconception that money invested offshore will somehow escape taxation in the United States. While funds kept in an offshore account may escape detection by the IRS, US taxpayers are required to report to the IRS income from world wide earnings. As long as the individual who has an interest in a foreign account is a US taxpayer, the income from such accounts must be reported for US income tax purposes. To curb the abuses often found with US taxpayers' ownership of offshore accounts, the IRS has stated that the agency is now actively pursuing taxpayers who fail to report their foreign bank accounts to the Service. Increased penalties now apply for failing to file a Foreign Bank Account Report (FBAR) annually with the Service. FBARs are required whether or not the foreign bank account earns any income.

The FBAR is the by-product of the Bank Secrecy Act, which was first enacted in 1970 because of the concern that tax haven jurisdictions were being used by US persons to hide the proceeds of illegal activities, evade tax, and for other criminal purposes. An FBAR must be filed annually by each person having an interest in, or a signature authority over, any financial account in a foreign country if the aggregate value of these accounts exceeds \$10,000 at any time during the calendar year. FBAR reports are due each year by June 30 of the year following the year which the account holder meets the \$10,000 threshold. The FBAR report is due this year on **June 30, 2008**.

Who is subject to the FBAR requirements?

The FBAR requirements apply to any "US person," which includes all US citizens and resident aliens. Non-resident aliens are not required to file an FBAR. The IRS defines a "US person" as (1) a citizen or resident of the United States, (2) a domestic partnership, (3) a domestic corporation, and (4) a domestic estate or trust. While the IRS does not define an LLC as a US person for purposes of the FBAR filing requirements, LLCs are specifically taxed as corporations, partnerships, or to the entity owner (i.e. a single-member LLC which is treated as a disregarded entity). Thus, it would appear that domestic LLCs meet the FBAR requirements.

What type of accounts have to be reported?

Generally, any type of account which holds liquid assets or marketable securities will be a "financial account" for purposes of the FBAR requirements. Everything from a cash account to a foreign mutual fund, such as an exchange traded fund, is classified as a "financial account." It is important to note that only financial accounts actually located in a foreign jurisdiction are subject to FBAR reporting. For example, if a US person has an investment account with Credit Suisse's New York office, this account would not require an FBAR, while an account with Credit Suisse's European offices would. Taxpayers are required to keep all records which are reported on the FBAR for five years.

What does an "interest" in a foreign account mean?

If a person can order the distribution, disbursement of funds, or other property from the financial account by signing a document providing such direction (either alone or as a co-signor with another person), then that individual has "signature authority" over the financial account. Likewise, if an individual can exercise similar control verbally or via another means of communication (such as e-mail), then the individual has authority over the foreign account. Many offshore accounts are structured in such a complicated fashion to have the appearance that the account is not connected to the US person in any way. In most instances, the FBAR reporting requirements will apply if, ultimately, a US person will financially benefit from funds held in such an account.

HRO CONTACT

G. Michelle Ferreira
Partner
michelle.ferreira@hro.com
415-268-1905



Holme Roberts & Owen LLP
Attorneys at Law

Experience Listens. Be Heard.™

Essentially, what constitutes a financial interest for purposes of the FBAR is based upon who owns the interest. An individual has a financial interest in every account for which he or she is the owner of record or has legal title, whether the account is for the owner's benefit or for the benefit of another. Individuals who serve as shareholders, partners, and trustees may also be deemed to hold a financial interest in an account if the account is owned by or the individual with legal title is any of the following: (1) a person acting as an agent, nominee, attorney, or in some other capacity on behalf of the US person, (2) a corporation in which the US person owns more than 50% of the total stock, either directly or indirectly, (3) a partnership in which the US person owns an interest in more than 50% of the profits, and (4) a trust in which the US person has either more than 50% interest in the assets or the US person receives more than 50% of the income.

Penalties:

The due date for filing an FBAR is on June 30 of the following year and every year in which the US person holds such an interest in a financial account. There are no extensions granted by the IRS to file the FBAR. Individuals who report their foreign earned income on their Form 1040 personal income tax return have not satisfied their FBAR filing obligations. A foreign account which satisfies the FBAR reporting requirements must be reported to the IRS even if the account does not generate taxable income to the US person. Thus, a taxpayer who fails to file an FBAR because the account did not generate income could still be liable for penalties for failing to file the FBAR.

The FBAR is the form TD-90-22.1 and it can be found on the IRS's website at <http://www.irs.gov>. The form is extremely detailed and requests information about the amount of funds in the account, the financial institution which manages the account, and the account number. The FBAR is, essentially, a road map for the IRS to locate funds which may have been unreported for US income tax purposes.

While the failure to report income for US income tax purposes has the potential for civil and criminal tax penalties, the failure to file an FBAR annually now has serious consequences. Congress has now increased the penalties for the non-willful failure to file the FBAR to a \$10,000 minimum. For a willful violation of the FBAR reporting requirements, the penalty is now a fine equal to the greater of \$100,000 or 50% of the amount of the transaction or of the balance of the account at the time of the offense. For a taxpayer who maintains an account balance of a million dollars, the penalty for willful failure to file the FBAR can be \$500,000. Once the IRS discovers an individual who maintains foreign accounts and who fails to file an FBAR, the IRS will likely explore whether civil fraud or criminal tax penalties can also be imposed. These penalties are over and above the penalties for failing to file an FBAR.

Conclusion:

The IRS's enforcement strategy for 2008 includes international tax compliance, including the Foreign Bank Account Reporting obligations of US taxpayers. The IRS has recognized that the globalization of the economy and the number of US persons having foreign financial accounts has increased dramatically in recent years. The IRS stated, "the FBAR is required because foreign financial institutions that do not conduct business in the United States may not be subject to the same reporting requirements that domestic financial institutions are subject to (such as the requirement to file a Form 1099 to report interest paid to an account holder). Although there are legitimate purposes for having a foreign account, the FBAR is a tool to help the US government identify persons who may be using foreign financial accounts to circumvent US law." While the FBAR will likely not generate revenue for the US, the failure to file an FBAR will generate revenue in the form of increased penalties which apply. US taxpayers who have investments abroad should be aware of these rules and the penalties which can apply for failing to report foreign bank accounts to the IRS.

This article is a periodic publication of Holme Roberts & Owen LLP and should not be construed as legal advice or legal opinion on any specific facts or circumstances, nor is it intended to address specific disclosure or compliance issues that may arise in particular circumstances or provide an exhaustive discussion of the topics discussed herein. The contents are intended for general informational purposes only, and you are urged to consult counsel concerning your own situation and any specific legal questions you may have. For further information regarding the topics described herein, please contact Michelle Ferreira listed on the right side of page one.