

Living Abroad, Paying Taxes In The USA

By Robert W. Wood

Over 8 million Americans live abroad. Most have bank accounts where they live. Of course, there are also many millions of foreign bank accounts held by stateside American individuals, American companies, and foreign companies owned by Americans. Most are receiving letters from their banks asking for their U.S. tax ID numbers.

Some banks even want you to certify you are compliant with the Internal Revenue Service. American citizens, residents — even people with a U.S. address or phone number — should be prepared for such requests. Possible American status can mean proving that you are compliant with the IRS or proving that you are not American after all. The bank may close your account if you don't respond favorably.

Having your account in the name of a company does not necessary shield you, and can make filings more complex. When a U.S. shareholder owns part of a foreign corporation, it can trigger reporting, including filing an IRS Form 5471. It is an understatement to say this form is important. Failing to file it means penalties, generally \$10,000 per form.

A separate penalty can apply to each Form 5471 filed late, or that is incomplete or inaccurate. This penalty can apply even if no tax is due on the return. Moreover, if you fail to file a required Form 5471, *your entire tax return remains open for audit indefinitely*. Normally, the statute of limitations on IRS audits expires after three or six years, depending on the issue and its magnitude.

This override of the normal IRS statute of limitations is sweeping. The IRS not only has an indefinite period to examine and assess taxes on items relating to the missing Form 5471. In fact, the IRS can make any adjustments to the *entire* tax return with no expiration until the required Form 5471 is filed. Individuals have problems too.

FATCA, the Foreign Account Tax Compliance Act, penalizes foreign banks that don't hand over Americans. American citizens and green card holders must report worldwide income on U.S. tax returns. If you have a foreign bank account you must check "yes" on Schedule B.

You may also need to file an IRS Form 8938 with your Form 1040 to report foreign accounts and assets. And then there are FBARs, reports of foreign bank accounts that in the aggregate exceed \$10,000 at any time during the year. Violators are dealt with harshly.

Tax evasion can mean five years in prison and a \$250,000 fine. Filing a false return can mean three years and a \$250,000 fine. Failing to file FBARs can be criminal, too. Fines can be up to \$500,000 and prison can be up to ten years. Even *non-willful* FBAR violations draw a \$10,000 fine.

The penalty for willful FBAR violations is the greater of \$100,000 or 50 percent of the amount in the account for each violation. Each year you didn't file is a separate violation. In one recent case, the IRS imposed civil FBAR penalties totaling 150 percent in an offshore account. The man contested the penalty, but the court upheld the FBAR penalties even though they exceeded his account balance. See *United States v. Zwerner*, 13-22082 (S.D. Fla.).

With all of these variables, receiving correspondence from your foreign bank can seem quite threatening. Fearing to make the situation worse, some people react like a deer in the headlights. But the bank's letter or call is unlikely to evaporate. Failing to respond in any way is likely to mean the bank will close your account, if it isn't closed already.

Banks routinely turn over the names of closed accounts, and may even be more likely to disclose closed accounts than active ones. Another possible response may be to tell the bank that you are compliant, even if you're not. However, this is dangerous. The bank or the IRS will find out, maybe not right away, but eventually.

Joining one of two IRS amnesty programs and telling your bank you have done so is clearly the safest choice. The primary program is the Offshore Voluntary Disclosure Program, or OVDP.

In the OVDP, you pay back taxes and penalties but you will not be prosecuted. You pay taxes on previously unreported income, interest, and a 20 percent penalty. Plus, you pay a penalty equal to 27.5 percent of the highest account balance over eight years.

The other main alternative is the IRS's Streamlined program. It is far less expensive if you qualify. But unlike the OVDP, the Streamlined program does not end in a closing agreement that conclusively resolves the issues. In the Streamlined program, there is always the risk of audit, which technically can occur up to six years later.

Rather than enter either the OVDP or Streamlined programs, some people consider filing amended tax returns and FBARs outside these IRS programs. They might tell the bank they have complied with IRS laws and wait. However, this is considered a "quiet" disclosure — a correction of past tax returns and FBARs without drawing attention to what you are doing. The IRS warns against it.

Ironically, the IRS policy may encourage some people to just start filing complete tax returns and FBARs prospectively, without trying to fix the past. But that too can carry big risks. It might enable you to tell your bank you are now complying with IRS rules. Yet just starting to file FBARs and report foreign income and accounts can look conspicuous. There is a risk your past non-compliance will be noticed.

In all of these alternatives, consider your numbers, and review your facts realistically. If you have moved banks multiple times to avoid having to disclose, it is hard to see this as non-willful. So don't kid yourself when you assess your fact pattern and conduct.

Although the chance of a terrible result might be fairly small, "terrible" in this case can mean pretty terrible with either criminal prosecution or large civil penalties. A certain 27.5 percent penalty (in the OVDP) is far more attractive than the risk of much higher penalties. Many taxpayers seem to assume that the feds can't and won't prosecute everyone.

That may be true, yet it is still a serious gauntlet to run. Most people in this situation should get some professional advice. The focus should be on getting the situation resolved in a way that makes sense for the client's facts, risk profile, and pocketbook.



Robert W. Wood is a tax lawyer with www.WoodLLP.com, and the author of "Taxation of Damage Awards & Settlement Payments" (www.TaxInstitute.com). This is not legal advice.