

What Every Lawyer Should Know About FATCA

By Robert W. Wood

Every lawyer should know that FATCA stands for the Foreign Account Tax Compliance Act. Enacted in 2010, it finally takes effect in 2014. If you represent domestic banks and other financial institutions, you already know they are key to Internal Revenue Service enforcement efforts. But if you represent overseas institutions, you might assume they have no reason to help the IRS. That's where FATCA comes in.

FATCA goes to the source, requiring offshore financial institutions to report Americans and make sure they pay the IRS. Institutions that don't rat out Americans face a series of stiff penalties. As a result, FATCA is causing a huge new wave of people to interact with their banks. Some have offshore accounts, interests in offshore trusts, or just signature power but no beneficial interest in an account. Some are dual citizens from birth who didn't even realize they were Americans!

Regardless of the how and why, if you are a U.S. citizen or resident and have a foreign bank account anywhere, it is no longer secret. There's no universal answer how to deal with bank queries. But how to deal with the IRS is relatively clear. Here's what you need to know about FATCA in 2014:

You must report worldwide income on your U.S. tax return. If you have an interest in a foreign bank account, check "yes" (on Schedule B). Worldwide income means everything, including interest, foreign earnings, wages, dividends and other income. If your income is taxed somewhere else, you might be entitled to a foreign tax credit. If you are living and working abroad, you might be entitled to an exclusion from U.S. tax for some or all income earned abroad. But you still must report it.

You also must file an FBAR annually if the aggregate of your foreign accounts exceeds \$10,000 at any time during the year. FBARs have been in the law since 1970, but have been actively enforced only recently. If you don't want to go to jail, pay attention to these forms — the government sure does.

The newest form under FATCA is part of your tax return. In general, it requires reporting where your foreign assets exceed \$50,000 in value. It covers many assets not covered by FBARs too.

If you fail to report your worldwide income or fail to check the foreign account box it can be considered tax evasion and fraud. The criminal statute of limitations is six years. Plus, the statute of limitations never expires on civil tax fraud, so the IRS can pursue you 10 or 20 years later for back taxes, interest and penalties.

If you failed to report income, your civil liability to the IRS can include a 20 percent accuracy-related penalty or a 75 percent civil fraud penalty. Failing to file an FBAR can carry a civil penalty of \$10,000 for each non-willful violation. If willful, the penalty is the greater of \$100,000 or 50 percent of the amount in the account for each year you didn't file.

Filing a false tax return is a felony that can mean up to five years and a fine of up to \$250,000. Failing to file FBARs can also be criminal, carrying fines up to \$500,000 and up to ten years in prison. Fortunately, the IRS has had three amnesty programs and the third is still underway.

If you participate, the result is formulaic. You submit up to eight amended tax returns and eight FBARs. You pay taxes, interest and a 20 percent penalty on your unreported income for the last eight years. Then, when all those are processed at the end of your case, you pay a penalty equal to 27.5 percent of the highest balance in your foreign accounts over the eight years. You aren't prosecuted and once you complete the paperwork and payments, you're done.

Some people don't want to pay those penalties and prefer a "quiet" disclosure. It involves amending tax returns and filing FBARs outside the IRS amnesty program and without drawing attention to what you are doing. The IRS frowns upon it and says it will treat you harshly if it catches you. But a few people are comfortable doing it and sometimes it's better than doing nothing.

In some cases, such filings might not be considered aggressive. For example, if you don't owe U.S. taxes (because of foreign tax credits, for example), filing past due FBARs is usually not grounds for any penalties. Even if you didn't report your offshore income on your tax return or disclose your account, you may be able to recompute your taxes to fit within this rule.

And while both tax returns and FBARs are important, FBARs today are arguably even more sensitive than tax returns. Civil and criminal penalties for failing to file FBARs are worse than tax penalties. That's one reason filing FBARs can make a huge difference even if minor errors on your tax returns are not corrected.

Even today, many people have never heard of FBARs. You can avoid penalties if you had "reasonable cause" for not filing FBARs, but the grounds for waiving penalties aren't terribly clear.

Depending on how serious your past problems are, some people just start filing accurate tax returns and FBARs prospectively. However, the risks are high. The IRS may ask about the lack of prior FBARs and of prior tax returns disclosing a foreign account. If they ask questions, you should respond through your attorney. And remember, never lie to the IRS.

Should you close all your foreign accounts and bring your money home? If you are considering not trying to clean up past tax returns and FBARs, you may be tempted to close your foreign account. In fact, many foreign banks will do it for you now that FATCA has complicated their compliance.

However, closing your foreign account doesn't relieve you of the obligation to file accurate tax returns and FBARs. Tying off the problem prospectively may make sense, but can make your lack of compliance even worse if your actions are viewed as efforts to conceal your previous offshore activities. For that reason, don't take any of these steps without professional advice.

There's widespread confusion and noncompliance involving foreign bank accounts, and the situation is unlikely to get better. Get some professional clarity and get your situation resolved.



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