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Time Running Out to Disclose Foreign Accounts

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More and more financial institutions outside of the U.S. are going to disclose the names of their U.S. account holders to the IRS. This is an unavoidable result of the implementation of the 2010 Foreign Account Tax Compliance Act (FATCA). FATCA forces foreign financial institutions to disclose the names of their U.S. account holders, possibly beginning as early as mid-2014.

In addition, countries that previously protected the secrecy of bank accounts are not only supporting the implementation of FATCA, but are also cooperating with the U.S. to further encourage their banks to disclose U.S. account holders. On August 29, 2013, the U.S. Department of Justice announced a program designed to encourage Swiss banks to come forward and, among other things, provide detailed information regarding U.S. account holders. The Swiss Federal Department of Finance and the Department of Justice released a joint statement stating that Switzerland will encourage its banks to participate in the program.

U.S. taxpayers who have foreign accounts and have not informed the IRS of the existence of these accounts, even though they are required to do so, must now deal with some hard truths:

- Taxpayers Are Required to Disclose Foreign Accounts
- Penalties for Failure to Disclose Are Severe
- Taxpayers Should Act Quickly to Evaluate Participation in the Disclosure Program

It is critical that taxpayers with undisclosed foreign accounts focus now on these issues and actions – which could be the difference between avoiding penalties and costly punishments.

I. Taxpayers Are Required to Disclose Foreign Accounts

The Bank Secrecy Act has long required U.S. taxpayers to disclose amounts held in non-U.S. financial accounts in excess of $10,000 by filing Form TD F 90-22.1. The form, known as the FBAR form, must be received by the IRS by June 30 following any year in which the $10,000 threshold is met. The filing deadline cannot be extended, and the IRS can take up to six years from the original filing date to assess penalties for failure to file the FBAR form.

II. Penalties for Failure to Disclose Are Severe

The penalties for failing to file the FBAR form are severe, and can even include criminal sanctions. Non-willful violations expose the taxpayer to fines as high as $10,000 for each year the taxpayer fails to file a required FBAR form. The penalty for willful failure to file is generally the greater of $100,000 or 50 percent of the maximum amount held in all non-U.S. accounts during the year. For example, if a taxpayer has $250,000 in a foreign account for four years and does not file the FBAR form or report interest income earned by the account each year, the IRS could assess a $500,000 FBAR penalty if the failure was willful. There are some mitigation guidelines that may reduce the penalty, and the taxpayer may avoid the penalty altogether by showing that the failure to file was due to reasonable cause. Although the IRS claims that finding willfulness requires significant evidence of wrongdoing based on all the facts and circumstances, one Court intimated that the simple failure to correctly answer a question about foreign accounts on a taxpayer's return (by checking the wrong box) is sufficient to establish willfulness.

Criminal penalties are also possible, and can include fines of up to $500,000 and/or 10 years in prison. While rare, criminal prosecutions relating to FBAR violations do occur.

The Offshore Voluntary Disclosure Program

Beginning in 2009, the IRS established a series of "Offshore Voluntary Disclosure Programs" to encourage taxpayers to come forward and disclose their non-U.S. accounts, pay reduced penalties, and avoid criminal prosecution. The current program requires taxpayers to file delinquent FBAR forms and amended income tax returns disclosing undeclared income, and pay tax and penalties going back eight years. In order to be eligible for the program, taxpayers must submit a request for participation in the program before the IRS begins an audit or even receives the taxpayer's name from the foreign financial institution.

Taxpayers must also pay a single FBAR penalty equal to 27.5 percent of the highest aggregate balance held outside of the U.S. over the previous eight years. In addition, while the normal FBAR penalty applies only to non-U.S. *financial* accounts, the voluntary disclosure penalty applies to the value of *any* foreign assets that either produced undeclared income or were purchased with undeclared funds. For example, if the taxpayer has rental property overseas and did not declare the rental income, the value of the rental property will be included in the penalty calculation.

The penalty does not apply to any accounts or assets unrelated to tax noncompliance, i.e., assets that did not earn undeclared income and were not funded or purchased with untaxed funds. Also, the penalty under the voluntary disclosure program applies only once, rather than each year, which may significantly reduce the taxpayer's potential FBAR penalties. However, in certain cases it may be less expensive for taxpayers to simply file delinquent FBAR forms and pay the standard penalty rather than participating in the voluntary disclosure program, especially if the amounts held overseas are small and the taxpayer's actions were not willful.

III. Taxpayers Should Act Quickly to Evaluate Participation in the Disclosure Program

The 2010 Foreign Account Tax Compliance Act will force many non-U.S. financial institutions to disclose their U.S. account holders beginning in mid-2014. Moreover, the recent joint statement released by the United States and Switzerland and the Swiss bank disclosure program instituted by the United States are strong evidence of the United States' determination to uncover and prosecute those with undisclosed accounts who do not come forward.

These U.S. taxpayers, some of whom may not even be aware of their obligation to disclose the accounts, may be running out of time to take appropriate action before the IRS takes its own.

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