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U.S. Banking and Tax Laws Behoove International U.S. Taxpayers

Dear Ladies and Gentlemen,

Dieser Newsletter ist nur auf Englisch verfügbar. Eine deutsche Zusammenfassung finden Sie [hier](#).

As the Swiss banks move decisively toward a resolution of their U.S. tax trouble, we have seen increasing interest from clients with U.S. connections who have asked us what to do to come clear with their own U.S. tax issues. In the following guest newsletter our Morison International partners from New York will give you an overview on your obligations as a U.S. taxpayer and different options to come clear with your past if you have failed to comply. If you need further advice, please feel free to contact either the authors directly or artax and we can get you in touch.

The United States' Foreign Account Tax Compliance Act ("FATCA") has manifested itself outside of U.S. in recent months, as shown by the agreement announced on August 29, 2013 between the U.S. Department of Justice and Swiss Federal Department of Finance. As a result, numerous Swiss banks have been notifying U.S. account-holders to either provide evidence that their accounts have been properly disclosed to the Internal Revenue Service ("IRS") or confirm participation in the Offshore Voluntary Disclosure Program ("OVDP"). Failure to comply with the forgoing will likely result in the bank releasing information about the account and account-holder to the U.S. Department of Justice, which will then determine whether to pursue a criminal investigation and prosecution.

In addition to prompting international agreements, FATCA seeks to enforce U.S. tax and banking laws by requiring U.S. banks to withhold 30% of international fund transfers and by requesting foreign financial institutions to disclose account-holders who may have failed to comply with U.S. tax obligations.

Under U.S. tax law (Internal Revenue Code) and banking laws (Bank Secrecy Act), U.S. residents and citizens (including those living outside of U.S.) have two primary reporting obligations to the Treasury Department. First, U.S. taxpayers must report all of their worldwide income (including income from wages and investments) and their interests in certain entities. Generally, such entities include corporations, partnerships, and trusts that are organized outside of U.S. and are not publicly traded. Second, pursuant to the U.S. Bank Secrecy Act, all U.S. taxpayers must file Forms 114 ("FBARs") reporting their financial interest in a financial account outside of U.S. when the aggregate value of such accounts exceeds $10,000. Under U.S. law, non-compliant taxpayers face criminal prosecution and penalties that could exceed the undisclosed account's balance.

U.S. taxpayers who have not complied with their reporting obligations may become compliant and avoid criminal prosecution by entering agreements with IRS through the OVDP, or related procedures known as "Opting Out" or the "Streamlined Compliance Program."

Offshore Voluntary Disclosure Program

Under the OVDP, a U.S. taxpayer discloses foreign bank accounts and amends returns for an eight year "voluntary disclosure period." Taxpayers must then pay taxes on all previously unreported income along with a 20% accuracy related penalty on such taxes. In addition, the taxpayer pays one of three non-negotiable penalties based on the highest annual aggregate account balance that the taxpayer has previously failed to disclose. These OVDP penalties are applied, in lieu, of the FBAR penalty under the banking law, penalties under the tax code, and potential liabilities for years prior to the voluntary disclosure period.

1) <u>27.5% OVDP Penalty</u>: The standard penalty equals 27.5% of the highest annual aggregate account balance during the voluntary disclosure period. This penalty applies in the majority of OVDP cases, and while substantial, it provides amnesty from criminal prosecution for non-compliance.

2) <u>12.5% OVDP Penalty</u>: A taxpayer will qualify for a 12.5% penalty if the taxpayer's highest aggregate account balance in each of the years within the voluntary disclosure period is less than $75,000.

3) <u>5% OVDP Penalty</u>: A taxpayer will qualify for a 5% penalty if the taxpayer falls within one of three categories, two of which apply to U.S. taxpayers living outside of U.S. ("foreign resident").

    a. <u>De Minimis</u>: To qualify the taxpayer (1) must not have opened or caused the account to be opened; (2) exercised minimal, infrequent contact with the account; (3) must not have withdrawn more than $1,000 from the account in any year the taxpayer was non-compliant; and (4) must establish that all applicable U.S. taxes were paid on funds initially deposited to the account.

    b. <u>Unaware Foreign Resident</u>: The taxpayer must be a foreign resident who was unaware that he/she was a U.S. citizen.

    c. <u>Compliant Foreign Resident</u>: The taxpayer must (1) reside in a foreign country; (2) have made a good faith showing that he or she timely complied with all tax reporting and payment requirements in the country of residence; and have less than $10,000 of U.S. source income each year.

Opting Out

Before or after entering the OVDP, a taxpayer may irrevocably elect to "opt out" of the OVDP's rigid penalty structure described above. In such case, the IRS will examine the taxpayer's former non-compliance under the Internal Revenue Code, the Bank Secrecy Act, and their accompanying regulations. Generally, a six year statute of limitations applies as opposed to the OVDP's eight year disclosure period. Protection from criminal prosecution is generally provided to the taxpayer if the "opt out" occurs after entering the OVDP.

Generally, under the Bank Secrecy Act there are three levels of penalties for the failure to file FBARs:

1) Willful Penalty: The penalty equals the greater of 50% of the highest account balance or $100,000 per account annually. The burden is on the IRS to prove that the taxpayer was willful, i.e., knew of or was willfully blind towards the FBAR filing requirement. Evidence of willfulness includes letters from the IRS (or other entities) to the taxpayer informing of the FBAR filing responsibility or the taxpayer's previous FBAR filings.

2) Non-Willful: Where the IRS cannot prove that the taxpayer was willful in failing to file, the penalty is $10,000 per account annually.

3) Non-Willful with Reasonable Cause: Where the taxpayer had reasonable cause for failure to file, the IRS will not impose penalties. The taxpayer must show proof of reasonable cause, which includes reliance on a tax-professional.

In all three penalty levels the taxpayer can negotiate based on facts and circumstances in his/her particular case. The Willful and Non-Willful penalties could be mitigated or lowered a based upon criteria, including the size of the undisclosed account.

Streamlined Compliance Procedure

The "Streamlined Filing Compliance Procedure" ("Streamlined Procedure") is designed for U.S. citizens living abroad and requires tax returns for a 3 year period as well as filing delinquent FBARs for a 6 year period. Eligible taxpayers are only responsible for any U.S. back-taxes and do not pay any FBAR penalties.

To be eligible for the Streamlined Procedure, a taxpayer must (1) have resided outside the U.S. since January 1, 2009, (2) have not filed a U.S. tax return during the same period, and (3) present a low compliance risk. A variety of factors apply in determining the existence of low compliance risk, including whether the taxpayer:

- Owes less than $1,500 in taxes for each year being disclosed;
- Has declared all their income in their country of residence; and
- Has a financial interest in an account located outside of his/her resident country.

While seemingly "streamlined," this option is limited in scope and there exists minimal IRS guidance for its use.

Conclusion

As FATCA and the U.S. Department of Justice are breaking down international legal barriers, it is important for non-compliant U.S. taxpayers living in U.S. or abroad to consider the above-discussed options.

There are many complexities associated in becoming compliant with U.S. tax laws and banking laws. Each taxpayer's situation is different and requires a thorough individual analysis. For this reason, non-compliant individuals are urged to seek legal advice from U.S. counsel knowledgeable regarding the relevant U.S. laws and IRS procedures.

Authors

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