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Don't Miss 2011 Foreign Account Report Deadlines and Your Last Chance for the Offshore Voluntary Disclosure Initiative

During the last several years, much attention has been given to the reporting requirements of U.S. persons with foreign financial accounts, in light of significant penalties and increased enforcement by the IRS. The required disclosure of such accounts began in 1972 under the Bank Secrecy Act, with an annual filing requirement on Form TD-F 90-22.1, now referred to as the FBAR. The report is required when a U.S. person (includes individuals, trusts, and domestic entities) had more than \$10,000 of value in a bank, securities, or other financial account(s) in a foreign country during the year. More specifically, the FBAR covers those accounts where the U.S. person has “financial interest in, or signature or other authority over” any such foreign accounts. It must be filed with the Department of the Treasury each June 30 following the calendar year in which any applicable accounts exceeded \$10,000. No extension is available. Failure to file an FBAR when due can result in a civil penalty of up to \$10,000, and willful failures may result in larger civil penalties, criminal penalties or both.

While the FBAR filing requirements have existed for almost forty years, the IRS first provided a voluntary disclosure program for unreported foreign accounts during 2009. That program, along with the recently announced 2011 Offshore Voluntary Disclosure Initiative (OVDI), are aimed at taxpayers with unreported income held in foreign accounts.

During February, 2011, the Financial Crimes Enforcement Network of the Department of the Treasury (FinCEN) issued amended regulations that clarify when an account is considered foreign and therefore reportable as a foreign financial account. The regulations also expand the definition of key terms like “signature or other authority.” These final rules are effective for FBARs due June 30, 2011. A new version of Form TD-F 90-22.1 is expected to be issued soon along with revised instructions. As of this writing, the most recent version was dated October 2008.

A preamble was issued with the final regulations which includes a number of explanations, including the following:

- Definition of a foreign financial account and the treatment of custodial arrangements (based generally on an account being issued by a foreign financial institution).
- Explanation of “signature or other authority” to more clearly apply to individuals with the authority to control the disposition of assets in the account by direct communication to the foreign financial institution.
- Clarification that an officer or employee who files an FBAR because of signature or other authority over an employer’s foreign financial account is not expected to personally maintain the records of such account.

Because the FBAR applies to “mutual funds or similar pooled funds,” concern had existed as to whether foreign hedge funds or private equity funds were subject to reporting. The final regulations restrict the fund definition to those which issue “shares available to the general public.” Further, there is no current requirement to report interests in commingled funds other than mutual funds or similar pooled funds, although the regulations leave that interpretation open to future consideration.

The OVDI offers taxpayers a second chance to report previously undisclosed foreign accounts and comply with the terms of the program in order to avoid otherwise applicable civil penalties and criminal prosecution. The 2011 OVDI requires taxpayer participants to move quickly as it expires August 31, 2011. It is modeled on the IRS’ 2009 offshore voluntary disclosure program, which resulted in voluntary disclosure by some 15,000 taxpayers. The IRS reports that more than 3,000 taxpayers have come forward since the 2009 program ended October 15, 2009.

The 2011 program imposes higher penalties than the 2009 program did, and it requires participants to report and pay taxes for eight years (2003-2010) instead of the six years required in the earlier program.

Under the 2011 OVDI, taxpayers will pay a penalty of 25% of the highest aggregate account balance in their foreign bank accounts during the years 2003 to 2010. This penalty is in lieu of all other penalties that might apply, except for the failure to file, failure to pay, and accuracy-related penalties. For individuals whose offshore accounts or assets did not exceed \$75,000 in any calendar year covered by the 2011 initiative, a lesser penalty of 12.5% applies. In certain narrow circumstances, some taxpayers may qualify for a 5% penalty rate, including the case of foreign residents who are unaware that they are U.S. citizens.

Participants in the program must also pay back taxes and interest for up to eight years as well as pay accuracy-related and/or delinquency penalties. Their original and amended tax returns for the affected years must be filed by August 31, 2011, and should include their payment for taxes, interest and accuracy-related penalties.

On its website, the IRS has issued 52 questions and answers that give extensive details about the 2011 program and about the civil and criminal penalties that may apply to taxpayers that do not come forward voluntarily. In instances where FBARs have not been filed, but all income has been properly reported on income tax returns, Q and A number 17 advises taxpayers not to use the voluntary disclosure process for filing the delinquent FBARs. Instead, individuals are instructed to file the FBARs by August 31, 2011, and include a statement explaining why the forms are filed late. FBARs for 2010, however, are still due on June 30, 2011. No penalties for failure to file the delinquent FBARs will be imposed, provided there was no unreported income, and the August 31 deadline is met.

The IRS intends to continue its focus on offshore accounts and other aspects of international tax issues. As a further sign of the importance placed on the 2011 OVDI, the program has now been translated into eight additional languages for taxpayers not using English as their first language. As IRS Commissioner Doug Shulman has stated, “this new disclosure initiative is the last, best chance for people to get back into the system.”

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