

DEADLINES APPROACH FOR OFF-SHORE REPORTING

Federal/International Tax Alert
June 22, 2009

Any U.S. person or business with a foreign financial account should be aware of approaching reporting deadlines and the severe penalties for failure to comply with reporting rules. June 30 is the deadline to file reports of foreign bank accounts, and no extensions are allowed. Failure to file could result in 5 years in jail. September 23 is the deadline to voluntarily disclose foreign bank accounts that have not previously been reported to the IRS and to the Treasury Department as required. Failure to participate in the program could also result in criminal prosecution.

Any U.S. person (or corporation) with a financial interest or signature authority over one or more financial accounts in a foreign country must file Form TD F 90-22.1 (generally referred to as foreign bank account report or "FBAR") if the aggregate value of the accounts exceeds \$10,000 at any point during the calendar year.

The definition of a financial account includes debit card and prepaid credit card accounts. The definition of financial interest includes accounts for which the owner of record or holder of legal title is a trust, or a person acting on behalf of a trust, that was established by such U.S. person and for which a trust protector has been appointed. In addition, a U.S. person now has a financial interest in a corporation's bank or other financial account if that person owns more than 50 percent of its shares' voting power. Previously, the test was based strictly on the value of the shares held. Similarly, a financial interest in a partnership's bank or other financial account is now attributed to a U.S. person who owns more than a 50 percent interest in partnership capital.

FBARs are not filed with the returns. They are filed in Detroit, and the annual due date is June 30. Extensions are not available.

To encourage compliance with this offshore financial account and entity reporting, the IRS announced a voluntary disclosure offer: from March 23, 2009, to September 23, 2009, U.S. persons have a six-month window to voluntarily and timely disclose unreported offshore accounts and assets. A U.S. person who meets the terms of the voluntary disclosure offer must pay applicable back taxes and interest on newly

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disclosed assets for six years, and must pay either a 20 percent accuracy or a 25 percent delinquency penalty on any unreported income for all six years. No reasonable-cause exception is available. A one-time 20 percent penalty also applies on the highest total annual value in the unreported account or entity in the six-year period. However, that penalty is reduced to 5 percent if (1) the taxpayer did not open the account or form the entity, (2) there has been no activity in the account or entity during the period that it was controlled by the taxpayer, and (3) all applicable U.S. taxes have been paid on the principal in the account or entity and only the earnings therein have escaped U.S. taxation.

The IRS will forgo other potentially applicable penalties — for example, for civil fraud (75 percent of unpaid tax), for failure to file various information returns, and for willful failure to file the FBAR (the greater of \$100,000 and 50 percent of the foreign account balance), all of which apply annually. Moreover, those who come forward during the six-month voluntary disclosure window mitigate their risk of criminal prosecution. Before the voluntary disclosure offer was in effect, an individual who wished to come forward and comply with his U.S. tax obligations, including FBAR reporting, was often uncertain about, for example, what penalties the IRS would apply; how many years of back returns might be required to be filed or amended; and potential criminal prosecution. The voluntary disclosure offer provides some certainty on those issues. In announcing the initiative, IRS Commissioner Schulman warned that “the situation will only become more dire” for a U.S. person who does not take advantage of this limited-time offer.

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