SEYFARTH SHAW LLP
ATTORNEYS

Management Alert

New Rules Require Disclosure of Foreign Financial Accounts and Foreign Assets: Expats and Inpats Face Severe Penalties for Failure to Disclose Offshore Bank Accounts By June 30

In the past three years, Congress, U.S. Department of Treasury, and Internal Revenue Service ("IRS") have introduced new laws and regulations designed to cause U.S. persons to disclose interests in foreign accounts and foreign assets. As a result of these laws and regulations, there are now two separate reporting regimes: (i) Form TD F 90-22.1, Report of Foreign Bank and Financial Accounts ("FBAR Regime") and (ii) Form 8938, Statement of Specified Foreign Financial Assets ("FATCA Regime").

Citizens of other countries who are temporarily working in the United States but who maintain bank accounts or other financial interests in their home country, and US citizens working and maintaining a bank account abroad, may not realize that they are required to report under either the FBAR or FATCA Regime. The deadline for FBAR reporting for 2011 is June 30, 2012, and cannot be extended.

Because of the overlap between the two regimes, a person who is advised by his or her accountant to file a tax form under FATCA may not realize that he or she has a separate FBAR reporting requirement.

This Management Alert will briefly explain the requirements and penalties under both regimes.

FBAR Regime

Subject to limited exceptions, the FBAR Regime requires each U.S. person with financial interest in, or signature authority over, financial accounts in a foreign country to report those accounts annually to the Treasury Department if the aggregate value exceeds $10,000 at any time during the calendar year. The FBAR was designed to assist the U.S. government in identifying persons who may be using foreign financial accounts to circumvent U.S. law, specifically money laundering and other types of illegal activities.

Who: A person is subject to the FBAR Regime if he or she is a (i) a U.S. person (ii) with either financial interest in or signature authority over (iii) foreign financial accounts with an aggregate value exceeding $10,000.

- U.S. person. The term "U.S. persons" includes both U.S. citizens and U.S. residents, as well as entities and trusts formed under the laws of the United States. Notable exceptions to the broad definition of U.S. persons include: individual retirement account owners and beneficiaries, tax-qualified retirement benefit plan participants and beneficiaries, and trust beneficiaries. (Note, however, there is no exemption from the report for pension or welfare benefit plans- just the participants and beneficiaries.)
- Financial Interest In or Signature Authority Over. A U.S. person does not have signature authority over an account merely because the individual participates in the decision to allocate assets or has the ability to instruct or supervise others with signature authority over reportable accounts. The test for determining whether an individual has signature or other authority over an account is whether the foreign financial institution will act upon a direct communication from that individual (alone or in conjunction with another) regarding the disposition of assets in the account.

- <u>Foreign Financial Accounts Exceeding $10,000</u>. A foreign financial account includes a foreign bank account, securities account, or mutual fund or a similarly pooled fund which issues shares to the general public that have regular net asset value determinations and regular redemptions. An account is not a foreign account if it is maintained with a financial institution located in the United States (i.e. a U.S. global custodian). The regulations reserve the question of whether private investment funds organized outside the United States, such as private equity funds and hedge funds, are subject to reporting. Most practitioners are advising that reporting of such accounts is not required.

What: A person required to report must file Form TD F 90-22.1, Report of Foreign Bank and Financial Accounts ("FBAR").

When and Where: The FBAR must be filed and received by the Department of Treasury in Detroit, Michigan on or before June 30 of the year following the calendar year being reported. There are no extensions for filing the FBAR. Although June 30, 2012, falls on a Saturday, because the FBAR is not a tax form, the deadline for filing the 2011 FBAR is not extended to the following Monday. Note, however, the FBAR filing deadline has been extended until June 30, 2013 for two groups of individuals who solely have signature authority and no financial interest in the relevant foreign accounts: (1) certain employees and officers who are part of a controlled group of a specified federally regulated financial entity or publicly traded company and solely have signature authority for entities within the controlled group, and (2) employees and officers of investment advisers registered with the Securities and Exchange Commission who solely have signature authority for foreign financial accounts of one or more persons that are not registered investment companies.

Why: If a U.S. person who is required to file an FBAR under the FBAR Regime fails to do so, the U.S. person may be subject to substantial civil and criminal penalties. For a non-willful violation, civil penalties may be assessed up to $10,000 for each violation. For a willful violation, civil penalties may be assessed up to the greater of $100,000 or 50-percent of the amount in the account at the time of the violation, and criminal penalties may be assessed up to $250,000 or 5 years in prison or both. Penalties can potentially be reduced if a U.S. person who has failed to properly file an FBAR participates in the IRS's Offshore Voluntary Disclosure Program. However, the penalties under this program, even though reduced, may still be very substantial.

FATCA Regime

Subject to limited exceptions, very generally, the FATCA Regime requires that certain specified persons that have an interest in a broad range of foreign financial assets report those assets annually to the IRS if the aggregate value exceeds a specified amount. The FATCA Regime is designed to improve tax collection by requiring that U.S. taxpayers disclose their overseas assets to the IRS.

Who: A person is subject to the FATCA Regime if he or she is (i) a specified person (ii) with an interest in certain foreign financial assets (iii) with an aggregate value exceeding a specified amount.

- <u>Specified Person</u>. Currently only the following individuals are required to report foreign financial assets: U.S. citizens, U.S. resident aliens, nonresident aliens who make an election to be treated as a resident alien for purposes of filing a joint income tax return, and nonresident aliens who are bona fide residents of American Samoa or Puerto Rico. The IRS anticipates issuing regulations that may require domestic entities to file Form 8938, but until such regulations are issued, only individuals are required to report.
- <u>Interests in Certain Foreign Financial Assets</u>. Foreign financial assets include: financial accounts maintained by a foreign financial institution and the following foreign financial assets if they are held for investment and not held in an account maintained by a financial institution- stock or securities issued by someone that is not a U.S. person, any interest in a foreign entity, and any financial instrument or contract that has an issuer or counterparty that is not a U.S. person. For example, an interest in a foreign trust or currency swap with a foreign counterparty are both foreign financial assets. An individual is considered to have an "interest" if any income, gains, losses, deductions, credits, gross proceeds, or distributions would be required to be reported, included, or otherwise reflected on a U.S. income tax return.
- <u>Exceeding a Specified Amount</u>. Individuals not living abroad satisfy the reporting threshold if the total value of specified foreign financial assets is more than $50,000 on the last day of the tax year or more than $75,000 at any time during the tax year. If an individual lives abroad and meets certain requirements, the reporting threshold is satisfied if the total value of specified foreign financial assets is more than $200,000 on the last day of the tax year or more than $300,000 at any time during the tax year. (In each case, the relevant amounts are doubled if the person is married and files a joint income tax return.)

What: An individual required to report must file Form 8938, Statement of Specified Foreign Financial Assets, as an attachment to his or her income tax return.

When and Where: Form 8938 reporting applies for specified foreign assets in which the taxpayer has an interest in taxable years starting after March 18, 2010. For most individual taxpayers, this means that they will start filing Form 8938 with their 2011 income tax return. The due date for the Form 8938 is the same due date, including extension, if any, for the applicable income tax return.

Why: If an individual who is required to file a Form 8938 under the FATCA Regime fails to do so, the individual may be subject to substantial civil and criminal penalties. For instance, an individual who fails to file Form 8938 by the due date (including extensions) may be subject to a civil penalty of up to $10,000. If an individual fails to file a correct and complete Form 8938 within 90 days after the IRS mails him or her a notice of the failure to file, he or she may be subject to an additional penalty of $10,000 for each 30-day period during which there is a failure to file after the 90-day period has expired for a maximum additional penalty of $50,000. In addition, failing to file Form 8938 may result in an extension of the statute of limitations for the IRS to assess additional tax based on income from foreign sources.

By: *Jim Gehring* and *Jennifer Neilsson*

Jim Gehring is a partner in Seyfarth's Chicago office, and *Jennifer Neilsson* an associate in the firm's Chicago office. If you would like further information, please contact your Seyfarth Shaw LLP attorney, Jim Gehring at *dgehring@seyfarth.com* or Jennifer Neilsson at *jneilsson@seyfarth.com*.