2014 Foreign Account Alert: Increased Governmental Scrutiny Increases Importance of Voluntary Disclosure Programs and Timing Issues

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For many years, the Internal Revenue Service and the United States Department of Justice have pursued owners of undisclosed foreign bank accounts for both unreported income and unreported foreign assets. The most publicized, recent cases involved UBS and undisclosed Swiss bank accounts. However, there are many other banks and countries in which United States citizens or residents possess financial accounts, and these accounts and countries also have become targets of United States governmental enforcement.

Foreign Bank Account Reports, Form TD F 90-22.1 and Fin CEN Form 114

For many years, the United States Treasury Department required United States persons to report interests in foreign financial accounts of more than $10,000 by filing Form TD F 90-22.1 with the Internal Revenue Service in Detroit each June 30 following the year in which the account existed. Beginning in 2014, foreign accounts must be reported using Fin CEN Form 114, and this form must be filed electronically.

Importantly, a failure to file the applicable form—in the absence of reasonable cause—results in a penalty of up to $10,000 if the failure to file is non-willful. However, if the failure to file the form is deemed to be willful, the penalty can be as high as 50 percent of the account balance—per year. Penalties for willful failures over multiple years can exceed the total value in all foreign accounts that are not reported. This draconian penalty structure can make these types of non-reporting cases very financially risky, and taxpayers are well advised to proceed cautiously.

Income Tax and Income Tax Return Considerations

If the unreported accounts generate interest, dividend or other income that has not been reported on an individual income tax return, there can be material under-reporting of income, which also can create material exposure to tax, penalty and interest assessments, along with potential criminal investigation issues. Importantly, the form in which interest and dividends are reported (i.e., Schedule B to IRS Form 1040) contains an affirmative representation question at the bottom of the form that also can create very serious problems for taxpayers.

FATCA

The Foreign Account Tax Compliance Act (FATCA) is complex and beyond the scope of this release. However, readers should note that FATCA was created, in part, to encourage the disclosure of foreign accounts, and to aid the United States government in tracking both foreign assets and foreign-earned income. In general, under FATCA, a foreign financial institution (an "FFI") may be required to disclose the identities of United States persons with investments in foreign countries in which the FFI operates. In fact, many agreements between the United States and other countries have been reached, and many FFIs are beginning to notify United States investors that, pursuant to these agreements, investor identities and asset information will be disclosed to the United States.

Unreported Accounts, FATCA and the 2012 Offshore Voluntary Disclosure Program

For United States taxpayers with unreported foreign account balances of more than $10,000—in the aggregate—there can be significant exposure to both criminal and civil penalties. And this exposure has increased with the increased disclosure requirements under FATCA. With respect to unreported foreign accounts, the IRS has offered specific Voluntary Disclosure Programs since 2009. In addition, an ongoing Offshore Voluntary Compliance Program (the "OVDP") was announced in 2012. Many taxpayers have taken advantage of these programs as a way of clearing up past errors and becoming currently compliant with IRS and Treasury requirements. Importantly, each case is dependent on its facts and any person with

potential exposure should consider contacting an experienced tax professional.

For taxpayers with foreign accounts that remain undisclosed, the current, 2012 OVDP may be a viable option in many cases as this program can minimize exposure to both civil and criminal penalties. Under the 2012 OVDP, taxpayers may be able to clear up prior failures to report foreign accounts and foreign income using a fairly streamlined disclosure process. The current OVDP can have material costs (e.g., a penalty of 27.5 percent of the highest aggregate balance in unreported accounts over a period of years, plus some of the ordinary underpayment penalties), but these costs are certain and, under normal circumstances, participation in the 2012 OVDP can minimize or eliminate exposure to both (1) criminal indictment; and (2) more severe “willful” failure to file penalties.

Timing Issues

If a taxpayer determines that a disclosure under the 2012 OVDP is appropriate, then timing can be of the essence and it can be imperative to act quickly to minimize the potential that the taxpayer’s identity is disclosed before a protective, voluntary disclosure can be perfected under the terms of the 2012 OVDP. Due to FATCA and the general increase in United States enforcement efforts, many foreign countries, foreign banks and FFI’s are beginning to notify United States depositors that the investor identities, along with the account information and earnings records, will be disclosed to the United States in the near future. Such a disclosure can be problematic because a voluntary disclosure normally is precluded once a taxpayer’s identity has been disclosed to the Internal Revenue Service.

Taxpayers, CPAs, investment advisors, and others may contact Jeffrey A. Goldman (312-627-2188) or William C. Lentine (313-568-537) with questions, or to discuss any matters related to foreign accounts.

Practice Areas

Taxation

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