Reporting Foreign Accounts & Assets
FBAR vs. Form 8938

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Summary

Do we really have to file both the FBAR and Form 8938?! This session distinguishes between foreign accounts and foreign assets, reviews reporting thresholds, outlines the harsh consequences for non-compliance and provides a comparison of relief programs. Learn what to do to ensure that your clients satisfy their reporting obligations and what to do if they don't.

Includes updates with regards to COVID-19 relief legislation

The information contained herein is for educational use only and should not be construed as tax, financial, or legal advice. Each individual's situation is unique and may require specialized treatment. It is, therefore, imperative that you consult with tax and legal professionals prior to implementation of any strategies discussed.

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I. Introduction

No more "secret" Swiss bank accounts! In January 2020, Union Bancaire Privée became the 84th bank[1] to join the US Department of Justice's Swiss Bank Program which allows banks to avoid criminal prosecution in exchange for providing complete disclosure of all cross-border activities, detailed account information for accounts in which US taxpayers have an interest, as well as information about other banks which transferred or accepted funds when secret accounts were closed.

Gone are the days of hiding money abroad. Whether by corporate decision to cooperate with US tax prosecutors or by multi-national agreement between governments, the time has come for US taxpayers to come clean. Just over a year ago, Her Excellency Datin Paduka Malai Halimah Malai Yussof, Ambassador Extraordinary and Plenipotentiary of Brunei Darussalam recently became the 113th signatory of the Multilateral Convention on Mutual Administrative Assistance in Tax Matters which provides for international administrative cooperation and exchange of information to combat tax avoidance and evasion. In January 2020, Armenia, the island nation of Cabo Verde off the coast of West Africa, and North Macedonia joined the proverbial club.[2] Informally referred to as "GATCA", or Global FATCA (Foreign Account Tax Compliance Act), the exchange of tax information between countries mandated by the convention is quickly becoming de rigueur.

"International laws, whistleblower bounties and embarrassing data breaches such as the one being dubbed the Panama Papers[3] have made the lives of would-be US tax cheats increasingly perilous."[4] To date, more than 56,000 taxpayers have voluntarily disclosed previously hidden offshore accounts and paid over $11 billion in back taxes, interest and penalties.[5] Those who have not (yet) disclosed foreign accounts and assets face stiff penalties and potential criminal prosecution. That means that time is up!

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II. Reporting Requirements for Foreign Accounts and Assets

A. Foreign Accounts

Mandated by the Bank Secrecy Act of 1970,[6] a US person must file a report with the US Treasury if**,** at any time during the calendar year, he had a financial interest in or signatory authority over one or more foreign financial accounts with an aggregate value in excess of $10,000.

B. Foreign Assets

In addition to foreign account reporting, certain taxpayers may be required to file supplemental forms. Indeed, some reporting requirements may seem annoyingly duplicative but are nevertheless required based on differing legislative mandates and regulatory oversights. As an example, a bank account report must be filed with the US Department of Treasury while an asset

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[1] The US Department of Justice, *Swiss Bank Program* [available at https://www.justice.gov/tax/swiss-bank-program, last accessed May 4, 2020].

[2] As of February 2020, the Organization for Economic Co-operation and Development (OECD) lists 136 participating countries [available at https://www.oecd.org/tax/exchange-of-tax-information/Status_of_convention.pdf, last accessed May 4, 2020].

[3] A trove of 11.5 million files leaked from the world's fourth largest offshore law firm, Mossack Fonseca, identifying international politicians, business leaders and celebrities involved in suspicious financial transactions.

[4] Higham, *For US Tax Cheats, Panama Papers Reveal a Perilous New World*, The Washington Post (April 8, 2016).

[5] IR-2018-176.

[6] Codified as Title 31 of US Code.

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disclosure statement must be submitted to the IRS along with the taxpayer's income tax return;[7] yet both forms report almost identical information to the regulatory authorities.

III. Foreign Bank Account Report (FBAR)

A. FinCEN114

This form has replaced **Form TDF 90-22.1 Report of Foreign Bank and Financial Accounts** (FBAR) effective April 2013. It must be *electronically* filed.

B. Definitions

A US person is defined as a US citizen[8] or resident[9] or any entity created (organized) under US law.[10] An individual defined as resident alien as per the Green Card or Substantial Presence tests must report foreign accounts, as does a non-resident alien (NRA) who has made an election to be treated as US resident. However, an NRA who files a joint return with a US citizen spouse[11] is not subject to FBAR filing; nor is a US resident treated as a non-resident as per an applicable treaty provision. Lastly, diplomats residing at foreign embassies in the US are generally not considered US residents since foreign embassies are deemed to be a part of the sovereign nation they represent.

Signature authority allows an individual to control the disposition of assets by written or oral communication. Authority may be exercised alone or in conjunction with others. Accounts may have multiple signatories, and all will be required to comply with foreign account reporting requirements. **NOTE:** If the US person cannot directly access the foreign account but must, instead, communicate through a US entity or branch, no FBAR filing is required.

Financial interest means that the US person holds title to the account directly, is the beneficial owner of an account held by a third party or holds title indirectly (e.g. through majority ownership of an entity that holds title to the account).

A foreign account is any account held outside of the US. **EXCEPTION:** An account in an institution known as a US "military banking facility" is not considered to be an account in a foreign country, regardless of its geographic location.

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[7] IRC §6038D.

[8] US citizenship is permanent unless voluntarily renounced or forfeited under specified circumstances (e.g. holding political office or serving in the military of foreign country, applying for citizenship abroad with the *intention* of giving up US citizenship, or committing an act of treason) [8 U.S.C. 1481(a)(5)]. In some cases, individuals may be "accidental" or unwitting US citizens if they were born and always lived abroad but have at least one American parent, or they were born in the US to foreign parents who were only in the US temporarily. Such individuals – unless proactive steps are taken – remain subject to FBAR filing requirements.

[9] For purposes of determining residency, the US includes the 50 states, the District of Columbia, Indian lands as defined by the Indian Gaming Regulatory Act of 1988, as well as all US territories (American Samoa, Northern Mariana Islands, Puerto Rico, Guam and the US Virgin Islands) and US possessions [IRC §7701(b)].

[10] Entities include, but are not limited to corporations, partnerships, limited liability companies, trusts and estates. **NOTE:** An entity disregarded for income tax purposes is nevertheless subject to the foreign account reporting mandate.

[11] IRC §6013(g) and (h).

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Financial accounts may include monetary and non-monetary assets (e.g. banks, brokerage accounts, insurance cash values, annuities, mutual funds, bitcoin,[12] and online gambling accounts[13] amongst others). Real and personal property is generally not included.

C. Rules

Valuation

Each account must be valued separately at its highest value as reported to the account holder on periodic statements, regardless of when the valuation was achieved during the calendar year. The value must then be converted to US currency using the applicable exchange rate on December 31.[14] After each separate account has been valued and converted, all account values are aggregated to determine whether the foreign account reporting threshold ($10,000) has been met for the reporting period.

> A US taxpayer has a foreign account valued at $8,000 at Bank A. He closes the account and transfers the entire balance to Foreign Bank B during the year. Although the value of both accounts totals $16K, the filing threshold was not met at any given time during the year since assets are not double counted.

> A US taxpayer has a foreign account valued at $8,000 at Bank A and another account valued at $4,000 at Bank C. He closes the Bank A account and transfers the entire balance to Foreign Bank B during the year. The aggregate value of the accounts at Bank A [later Bank B] and Bank C now exceed the reporting threshold.

Joint and Consolidated Reporting

Spouses may file a single, combined FBAR to report jointly held accounts if all foreign accounts are in fact held jointly. However, if either spouse also holds one or more separately held accounts, each spouse must file a separate FBAR which then includes the *entire* value of each jointly held account.

Entities of all types may file consolidated reports. Truncated filing is permitted for more than 25 foreign accounts.

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[12] The Treasury has still not offered definitive guidance whether bitcoin wallets are reportable. Taxpayers have argued that bitcoin is comparable to gold, hard currency and real estate which are not reportable when held directly but become reportable when stored in a foreign financial account. Applying comparable logic, cryptocurrency held in a virtual wallet hosted overseas is reportable for FBAR and FATCA purposes but identical currency that is stored in a digital wallet in which the taxpayer retains control over the private keys is likely not subject to reporting. Nevertheless, it might be best to simply report all virtual currency-related holdings; particularly on the assumption that the currency is held for legitimate investment purposes and not intended to help secrete assets offshore. **WARNING:** Taxpayers seeking to report anything less should seek legal counsel from an experienced tax attorney.

[13] *US v Hom*, US District Court, N.D. California, Case No. 3:13-cv-03721 (June 4, 2014).

[14] The Bureau of the Fiscal Service provides current and historical exchange rates to convert foreign currency into US dollars [available at https://www.fiscal.treasury.gov/fsreports/rpt/treasRptRateExch/treasRptRateExch_home.htm, last accessed May 4, 2020]. In the alternative, any other verifiable exchange rate may be used if its source is disclosed on the FBAR.

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Exempt from Filing

The following persons are not required to file an FBAR:

- Participants and beneficiaries of tax-qualified retirement plans. **BEWARE:** Most foreign-based retirement accounts are not, in fact, "qualified" as per the Internal Revenue Code and are, therefore, subject to the FBAR mandate.
- A trust beneficiary with a greater than 50% interest in a US trust's assets if the trust has filed an FBAR.
- A US entity that is named in a consolidated FBAR filed by a greater than 50% owner.
- Individuals who have signature authority but no financial interest in a foreign account if the individual is an officer or employee of a regulated bank, an SEC-regulated financial institution or a listed stock exchange and the account is owned or maintained by the bank, financial institution or exchange.

Recordkeeping

Records of accounts required to be reported on an FBAR must be kept for five years from the due date of the report and must include the account owner's name, the account number, the name and address of the financial institution at which the account is held, the type of account, and its maximum value during the calendar year. **NOTE:** Maintaining a copy of the submitted FBAR satisfies this recordkeeping requirement.

D. How to File

Due Date

The annual reporting cycle is on a calendar year basis (January to December). The deadline for filing **FinCEN 114** is April 15th, with an *automatic* extension to October 15th. For taxpayers residing abroad, the initial deadline is deferred until June 15th, with an *automatic* 4-month extension.[15]

While many tax filing deadlines that fell between April 1st and July 15th, 2020 were extended due to the COVID-19 pandemic, the FBAR deadline was not included.[16] Indeed, because taxpayers receive an automatic six-month extension regardless, relief legislation that would have postponed filings from April 15th until July 15th, 2020 was superfluous. The filing deadline for FBARs due in the current year is October 15th, 2020.

Mandatory e-File

Filers have the option to prepare and submit individual reports online at http://bsaefiling.fincen.treas.gov/NoRegFBARFiler.html or engage the services of a Bank Secrecy Act (BSA) e-Filer.[17] Step-by-step instructions are available online to enroll in the BSA e-filing system as a Supervisory User with primary responsibility for the preparation and submission of all BSA filings by authorized users within a professional organization. Users may submit single reports or process multiple reports in batches through third-party software. Acknowledgments of all filings are sent to the user's secure inbox.

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[15] The Surface Transportation and Veterans Health Care Choice Improvement Act of 2015.

[16] IRS Notice 2020-23.

[17] Some professional tax preparation packages offer FBAR e-filing which eliminates the need to enroll with the BSA System.

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Form 114a Record of Authorization to Electronically File FBARS must be completed and signed by the client to authorize a registered BSA user to e-file on the client's behalf. The signed form must be kept on file for 5 years.[18]

Corrections to previously filed reports may be made by opening the saved file, checking the box at the top of the form marked "Amendment", making the necessary corrections on affected lines of the form, entering the current date, saving the changes as a new file, and resubmitting the form electronically.

Effective in late 2019, the IRS will no longer accept verbal requests for verification of FBAR filings. Such requests must now be made in writing.[19]

IRS Helplines

- (866) 270-0733 for callers within the US (toll-free).
- (313) 234-6146 for callers outside of the US (not toll-free).

E. Penalties

Unintentional failure to file may result in a maximum fine of $10,000 per unreported account. However, if the government can prove that there was "willful violation" of the filing mandate, the penalty can be raised to the greater of $100,000 or 50% of the account value,[20] along with potential criminal sanctions (maximum $250,000) and/or up to five years jail time.[21] The "willful" penalty is computed on a *per year* basis for up to six tax years!

NOTE: The US Treasury through its Financial Crimes Enforcement Network (FinCEN) recently announced inflation adjusted FBAR penalty amounts. Effective February 19, 2020, the maximum penalty for non-willful failure to file has been increased to $13,481 and the minimum penalty for willful failure has been set at $134,806.[22]

To impose the "willful" penalty, the government must prove that failure to file was the result of the taxpayer's voluntary, conscious and intentional act. The Supreme Court explained that the term willful "consistently has been read by the Courts of Appeal to require both knowledge of the reporting requirement and a specific intent to commit the crime."[23] The IRS Internal Revenue Manual goes a step further by suggesting that "willfulness may be attributed to a person who has

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[18] 31 CFR 1010, 430(d).

[19] A $5 processing fee will be charged for verifying the status of up to five FBAR filings; each additional request will be charged $1 [IRM 4.26.16.4.13(4)(b)].

[20] A recent court ruling found that the IRS could not – despite the governing statute – assess a willful penalty in excess of $100,000 since the higher threshold conflicted with an earlier rule that had not been properly repealed (*United States v Colliot*, W.D. Texas, May 16, 2018). The IRS has, of course, moved for reconsideration of the decision in this and a similar case (*United States v Wadham*, D. Col, July 18, 2018), while the rulings in two further cases have held that statutory language automatically supersedes and over-rides earlier legislation. As a result, the potential amount of the penalty for willfully failing to file FBARs remains uncertain at this time.

[21] If other laws have been violated, the criminal penalty may be increased to $500,000 and/or 10 years in jail.

[22] The Federal Civil Penalties Inflation Adjustment Act of 2015 mandated an initial catch-up adjustment since FBAR penalties had last been set by Congress in 2004, along with annual adjustments thereafter. **NOTE:** The filing threshold was set to $10,000 in 1970, lowered to $1,000 in 1978, increased to $5,000 in 1983, and returned to $10,000 in 1985 (the equivalent of roughly $65,000 today).

[23] *Ratzlaf v United States*, 114 S. Ct. (1994).

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made a conscious effort to avoid learning about the FBAR recordkeeping requirements."[24] The courts have consistently upheld the IRS Chief Counsel's position that willfulness is determined by a preponderance of the evidence of a taxpayer's "willful blindness" to and "reckless violations" of FBAR requirements.[25]

FBAR failure to file penalties should not be taken lightly: In a well-publicized case,[26] penalties totaling $3.4 million were assessed against a taxpayer who failed to disclose his Swiss bank account which, at its highest, had a balance of only $1.7 million. By applying the 50% penalty to each year and aggregating the years in question, the taxpayer faced a total penalty that was more than double his account holdings![27]

NEW in 2015: The IRS has issued guidance to its employees[28] in an attempt to rein in FBAR penalties which were found in the National Taxpayer Advocate's 2014 annual report to Congress to be excessive and disproportionate. As a result, the penalty for willful violations over a period of multiple years will be limited to 50% of the highest-ever aggregate balance of all unreported foreign accounts; this penalty, then, will be the maximum amount that can be assessed and will be allocated on a pro-rata basis for each year of failure.

A US taxpayer willfully failed to report foreign accounts totaling $200K in 2018, $100K in 2017 and $50K in 2016. The maximum penalty that the IRS will assess totals $100,000 (= 50% of $200K), which will be allocated as follows: $57,143 for 2018 (= $200K ÷ $350K x $100K); $28,571 for 2017 (= $100K ÷ $350K x $100K); and $14,286 for 2016 (= $50K ÷ $350K x $100K).

For non-willful violations, the penalty will generally be limited to $10,000 for each year, regardless of the number of accounts that were not reported. The examiner may waive the penalty altogether if failure to timely file the requisite FBAR was due to reasonable cause[29] and the taxpayer has since corrected the oversight.

In the case of co-owned accounts, penalties will be assessed against each co-owner independently based on individual facts and circumstances. The penalty will be based on the highest balance of the unreported account(s) and prorated for the co-owner's ownership percentage.

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[24] Rettig, *Jury Determines 150-Percent FBAR Penalty and US Seeks FBAR Related Forfeiture of $12 million!*, Journal of Tax Practice and Procedure (June-July 2014).

[25] Technical Advice Memorandum 2018-013.

[26] *United States v. Carl R. Zwerner*, Case # 1:13-cv-22082-CMA (SD Florida, June 11, 2013).

[27] On appeal a jury reduced the penalty to $2.2 million; the taxpayer eventually settled with the IRS for a mere $1.8 million, still more than the maximum account value at any time during the taxpayer's tenure.

[28] IRS Internal Memorandum SBSE-04-0515-0025 (May 13, 2015).

[29] Reasonable cause exists when a taxpayer has exercised ordinary business care and prudence in determining his filing obligations, but nevertheless fails to comply. Typically, reasonable cause will not be considered until the taxpayer fully complies with his filing obligations for all open years.

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Reminder to file Schedule B

Taxpayers must also report interest and dividend income received from foreign sources on **Form 1040, Schedule B** and must check the box in Part III, Line 7 as "Yes" if the aggregate value of all foreign accounts was equal to or greater than $10,000 at any time during the year.

SAFE HARBOR: Presuming that the taxpayer has in prior years reported and paid the tax on income earned from foreign accounts but did not file the required FBARs, the IRS recommends that he should file the delinquent FBARs along with a statement explaining why the submissions are tardy. As per the IRS website, "the IRS will not impose a penalty" under this procedure if the taxpayer has "not previously been contacted regarding an income tax examination or a request for delinquent returns for the years for which the delinquent FBARs are submitted."[30]

Statute of Limitations

Governed by Title 31 of the US Code,[31] penalties for failure to file a foreign bank account report are limited to a statute of six years from the due date of the FBAR, whether or not the form has been filed.[32] Therefore, it "appears that six years is a good benchmark on filing FBARs in non-criminal situations."[33]

WARNING: An executor or trustee who distributes foreign assets to beneficiaries without addressing the decedent's delinquent filings may be held personally liable, both civilly and criminally.[34] Form **4810 Request for Prompt Assessment Under Internal Revenue Code Section 6501(d)** cannot be used to accelerate the tolling of the statute of limitations with regard to foreign account reporting; nor can **Form 5495 Request for Discharge from Personal Liability under Internal Revenue Code Section 2204 or 6905** be used since this form merely discharges the personal representative from income, estate and gift tax obligations. Facing a potential conflict of interest when choosing to make distributions of unreported foreign assets to impatient beneficiaries or diminishing the estate by submitting previously unfiled returns and paying the attendant liabilities, the fiduciary should consult with a competent tax attorney.

F. The Trouble with the FBAR

Although the FBAR filing requirement has been mandated since 1970 to help combat money laundering and related financial criminal activities, reporting requirements were only sporadically enforced. But when Congress linked the FBAR to its counter-terrorism efforts in 2004 without adjusting the decades-old filing threshold,[35] ordinary and unsuspecting taxpayers were soon ensnared in the sticky web of foreign account reporting.

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[30] Delinquent FBAR Submission Procedures [available on at https://www.irs.gov/individuals/international-taxpayers/delinquent-fbar-submission-procedures, last accessed May 4, 2020].

[31] In contrast, the Internal Revenue Code (governed by Title 26) allows the IRS to assess penalties for an indefinite period of time if an income tax return has not been filed. Furthermore, the FBAR penalty is a civil – not a tax – penalty that can only be collected through a civil suit filed by the US Department of Justice. As a result, the penalty cannot be appealed to the Tax Court but may be dischargeable in bankruptcy.

[32] 31 US Code §5321.

[33] Cardoropoli, *FBAR Penalties*, NATP TaxPro, July 2015, p.4.

[34] IRC §6901(a)(1)(B).

[35] The FBAR threshold has been fixed at a mere $10,000; far lower than the income tax filing threshold for most taxpayers which tops out at more than double that amount for married taxpayers.

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Often oblivious to a filing requirement that is separate and distinct from income tax reporting, taxpayers with no criminal intent whatsoever who live, work and study abroad are surprised to discover that they have inadvertently overlooked an important filing obligation. For these individuals, "FBAR noncompliance constitutes nothing but a paperwork crime."[36] On the other hand, those who comply with the filing mandate discover that they must submit personal information to a financial *crimes* enforcement registry. Ain't that just criminal?!

IV. Foreign Asset Reporting

A. Form 8938, Statement of Specified Foreign Financial Assets

This filing requirement was enacted in 2010 to improve tax compliance by US taxpayers with offshore financial accounts.[37] US citizens, residents, non-residents who elect to file a joint return with a US citizen or resident, and certain non-residents who live in a US territory must file if the total value of specified foreign assets exceeds specified thresholds. **Form 8938** must be filed along with the taxpayer's income tax return; although, if the taxpayer is not required to file an income tax return, he does not have to file **Form 8938**.

Due to the COVID pandemic, the filing deadlines for all income tax returns – including requisite attachments – due between April 1st and July 15th were postponed until July 15th. FATCA informational returns, therefore, are eligible for deferred filing in 2020.[38]

FATCA, enacted as part of Hiring Incentives to Restore Employment Act of 2010 (HIRE), is intended to apply to "specified entities" as well as individuals. The implementation of reporting requirements for domestic entities and trusts was temporarily postponed[39] but new rules have since been issued and are effective for tax years 2016 and beyond. Therefore, any domestic corporation, partnership or trust "formed or availed of for purposes of holding, directly or indirectly, specified foreign financial assets," is now subject to the reporting mandate.[40]

Foreign asset reporting is mandated independently of foreign account reporting. While some reporting requirements may seem annoyingly duplicative, they are based on differing legislative mandates and subject to discrete regulatory oversights. On the other hand, foreign financial assets that have been reported on other forms do not also have to be reported on **Form 8938**.[41]

B. Reportable Assets

Specified foreign financial assets include:[42]

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[36] Christians, *Paperwork and Punishment: It's Time to Fix FBAR*, Tax Analysts (October 13, 2014).

[37] IRC §6038D.

[38] **Forms 3520**, **5471**, **5472**, **8621**, **8858**, **8865** and **8938** were specifically enumerated in IRS Notice 2020-23.

[39] IRS Notice 2013-10.

[40] Treas. Reg. Sec. 1.6038D-2.

[41] **Form 926** Filing Requirement for US Transferors of Property to a Foreign Corporation**, Form 3520** Annual Return to Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts, **Form 5471** Information Return of US Persons With Respect to Certain Foreign Corporations, **Form 5472** Information Return of a 25% Foreign-Owned US Corporation or a Foreign Corporation Engaged in a US Trade or Business**, Form 8621** Information Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund, **Form 8865** Return of US Persons With Respect to Certain Foreign Partnerships.

[42] IRC §1471(d).

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- Depository or custodial accounts at foreign financial institutions.
- Stocks or securities issued by foreign persons.
- Foreign pension or deferred compensation plans.
- Any other financial instrument or contract held for investment that is issued by or has a counterparty that is not a US person.
- Any interest in a foreign entity.[43]
- Gold certificates.

Assets that do not have to be reported include:

- Foreign real estate (e.g., personal residence or rental property).[44]
- Foreign currency holdings.
- Directly held shares of a US mutual fund that owns foreign stocks and securities.
- A financial account maintained by a US financial institution that holds foreign stocks and securities, such as IRAs, 401(k) plans, qualified US retirement plans, and brokerage accounts maintained by US financial institutions.
- A financial account maintained by a US branch or US affiliate of a foreign financial institution.
- A financial account (e.g., depository, custodial or retirement account) held through a foreign branch or foreign affiliate of a US-based financial institution.
- Payments or the rights to receive the foreign equivalent of social security, social insurance benefits or another similar program of a foreign government.
- Directly held tangible assets, such as art, antiques, jewelry, cars and other collectibles (once these assets are sold, the resulting proceeds become reportable).
- Directly held precious metals, such as gold.

It is important to note that *qualified* US retirement plans are exempt from reporting, while comparable foreign plans are not. Canadian Registered Retirement Savings Plans (RRSP), for example, are reportable on **Form 8938** (and **FinCEN 114**). Such reporting should not be confused with income tax reporting requirements which have recently changed: As per the US-Canada Income Tax Convention Art. XVIII (7), US citizens and residents could previously elect to treat an RRSP in a manner similar to an IRA, thereby deferring tax on the income accrued under the retirement plan. The election was made by attaching **Form 8891 US Information Return for Beneficiaries of Certain Canadian Registered Retirement Plans** to a timely filed income tax return. Rev. Proc. 2015-55 has since eliminated the **Form 8891** filing requirement; in fact, **Form 8891** is now obsolete effective December 31, 2014. All taxpayers are now deemed to have made the election; thus, RRSP income is automatically tax-deferred in the same manner as other qualified US retirement account income.

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[43] IRC §6038D(b).

[44] **Form 8938** filing is required for a Mexican Land Trust.

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While there are many overlaps between reportable FBAR accounts and reportable **Form 8938** specified assets, there are also notable distinctions:[45]

	Reportable on FBAR	Reportable on Form 8938
Acct at foreign branch of US financial instn	Yes	No
Account with signature authority	Yes	No
Indirect interest through an entity	Yes (if >50% interest)	No
Foreign securities not in financial acct	No	Yes
Foreign partnership interest	No	Yes
Foreign hedge funds & private equity funds	No	Yes

C. Filing Thresholds

The filing requirement applies only to US taxpayers, including US citizens and residents as well as certain non-resident aliens. Thus, the reference to "domestic" and "foreign" filers may be misleading. In fact, the terms merely distinguish between those taxpayers who live in the US and those who live abroad. Pragmatically, the filing thresholds for taxpayers who live abroad are higher than those applicable to stateside taxpayers.

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Domestic Taxpayers

An individual taxpayer residing in the US must file **Form 8938** if he has an interest in one or more specified foreign financial assets with an aggregate value of either $50,000 on December 31st or $75,000 at any time during the year. Married individuals must file if they exceed the thresholds of $100,000 and $150,000, respectively.[46]

Foreign Taxpayers

If residing abroad,[47] **Form 8938** must be filed if the taxpayer has an interest in one or more specified foreign financial assets with an aggregate value of either $200,000 on December 31st or $300,000 at any time during the year. Married individuals must file if they exceed the thresholds of $400,000 and $600,000, respectively.

	Single or MFS	MFJ
Domestic – living in the US	$50K on 12/31 OR $75K at any time	$100K on 12/31 OR $150K at any time
Foreign – living outside of the US	$200K on 12/31 OR $300K at any time	$400K on 12/31 OR $600K at any time

[45] The IRS's complete list is available at https://www.irs.gov/businesses/comparison-of-form-8938-and-fbar-requirements (last accessed May 5, 2020).

[46] Reg. §1.6038D-2T(a)(1), Reg. §1.6038D-2T(a)(2).

[47] "Foreign" taxpayers must satisfy the Bona Fide Residence (BFR) or Physical Presence (PPT) tests (IRC §911). BFR requires that the taxpayer be a resident of one or more foreign countries for an uninterrupted period that includes an entire tax year. PPT requires that the taxpayer be present for at least 330 full days during any 12-month period that ends during the current tax year.

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The valuation of assets is based on the highest fair market value during the year, converted into US dollars at the applicable exchange rate on December 31st.[48]

D. Penalties

Failure to disclose foreign assets may result in a maximum fine of $10,000 plus an additional $10,000 penalty for each 30-day period after the IRS issues its 90-day failure to disclose notification. The maximum penalty equals $50,000.[49]

Statute of Limitations

The statute for an income tax return (**Form 1040**) remains open until three years after an associated **Form 8938** with *all* reportable assets has been filed – if even just one asset is omitted, the entire return remains at risk! If failure to file **Form 8938** is due to reasonable cause,[50] the open statute will apply only to the item(s) related to the failure.[51] If a taxpayer fails to report gross income in excess of $5,000 attributable to reportable assets, the statute of limitations is extended to six years after the return was filed, whether or not the assets were reported on **Form 8938**.[52]

E. State Conformity

It is left to each state whether to conform to the federal FATCA reporting mandate. California, for instance, has elected to require foreign financial asset reporting from all California taxpayers – including residents, part-year residents and even non-residents who have a California filing requirement – beginning on January 1, 2016.[53] At this time, the state does not provide its own form and instead requires taxpayers to attach a copy of the federal **Form 8938** when submitting the state return.

California has also conformed to the federal penalty structure for failure to comply with foreign asset reporting requirements; therefore, a delinquent taxpayer may find himself subject to a $10,000 federal penalty as well as a $10,000 state penalty. California does not currently have its own voluntary compliance initiative with regards to unreported offshore accounts and foreign income. However, the state will often mirror federal determinations and penalty assessments imposed on taxpayers who have participated in a federal compliance program.

NOTE: California conformity is limited to FATCA reporting requirements and does not apply to the FBAR.[54]

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[48] Taxpayer may use the Treasury Department Financial Management Service rate [available at https://www.fiscal.treasury.gov/fsreports/rpt/treasRptRateExch/treasRptRateExch_home.htm, last accessed May 2, 2020) or any accepted currency converter.

[49] IRC §6038D(d).

[50] The IRS requires that a taxpayer exercise business care and prudence. He cannot claim a lack of knowledge or exclusive reliance on professional advisers. In fact, a taxpayer who conducts international transactions is expected to have the same knowledge of filing international information returns as he does for filing **Form 1040**. [Lovejoy, *Reasonable Cause for International Information Return Penalties*, The CPA Journal, April 2017.]

[51] IRC §6501(c)(8).

[52] Additionally, a penalty equal to 40% of the resulting under-payment of tax will be assessed [IRC §6662(b)(7)].

[53] Rev & Tax Code §19141.5(d).

[54] However, California has conformed to some of the other federal filing requirements and penalties for non-compliance: **Forms 5471** and **8865** (with a reduced penalty of $1,000), **Forms 5472** and **8865** ($10,000 penalty).

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V. Non-compliance

Failure to file – whether under the FBAR or FATCA regime – comes at a high price. The IRS has designed a variety of programs to encourage delinquent taxpayers to become compliant, to mitigate civil penalties and even avoid criminal prosecution.

WARNING: These programs are outlined in this section to educate the tax practitioner but because critical aspects of each program involve proper interpretation of minute but consequential details, tax pros should not discuss specifics with their clients. Instead, taxpayers should seek competent legal counsel to determine which program (if any) is best suited to their specific situation. Once an attorney has provided guidance and established which strategy to pursue, the tax pro may re-enter the case to assist with the mechanics and prepare the requisite forms. In fact, it may be best that the tax practitioner is henceforth engaged by the attorney under the provisions of a Kovel Letter rather than working directly for the client.

Privilege

It is important to note that clients enjoy only limited privilege with their tax preparers which may be asserted only in non-criminal matters.[55] It is certainly not comparable to the attorney-client privilege which is for all intents and purposes inviolable. In a case wherein an accountant (Louis Kovel) was held in contempt of court and sentenced to one year in prison when he refused to provide information about his client to a grand jury, the ruling was reversed on appeal when the court found that the attorney-client privilege did in fact extend to the accountant who had been engaged by the law firm which was representing the same client.[56]

Citing the case as precedent, privilege has often been successfully extended to a tax practitioner if communications with the accountant were made in confidence for the purpose of obtaining legal advice from the lawyer. But courts have become increasingly wary of the tactic, particularly if the Kovel Letter used by an attorney to engage the accountant is not properly drafted or other finer points of the relationship are ignored.[57] Additionally, a pre-existing relationship between the practitioner and the taxpayer – albeit not always preclusive – may indicate to the courts that the Kovel arrangement is a sham established merely to achieve privilege where it would otherwise not exist.

In any case, the tax practitioner should tread lightly! Because the penalties are high and the consequences extreme, tax practitioners should be wary of offering advice outside of their areas of expertise.

Willfulness

A crucial element when deciding which delinquency remedy to pursue involves an analysis of the taxpayer's behavior to determine if his actions were willful or merely due to negligence, inadvertence, mistake or conduct that was the result of a good faith misunderstanding of the requirements of the law. Did the taxpayer act with intentional disregard or carelessness?

Willfulness is a term of art interpreted more stringently by the IRS than by the courts in most cases. The facts and circumstances of each case will be used to establish the taxpayer's mindset. While it may, at first blush, seem easy to discern between deliberate conduct and a lapse in judgment, it is best left to the experts to navigate these treacherous waters.

[55] IRC §7525(a)(2).

[56] *US v Kovel*, 296 F.2d 918 (1961).

[57] *US v Adlman*, 134 F.3d 1194 (1998).

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Once the question of willfulness has been addressed, relief can be sought. Certain of the IRS programs are available only to those who acted willfully and others to those who acted non-willfully.

A. Not Willful

1. The Streamlined Filing Compliance Procedures

In 2014,[58] the IRS introduced a new program for resident and non-resident taxpayers whose failure to comply with FBAR filing requirements was not willful. In fact, the program requires taxpayers to sign a self-certifying statement under penalty of perjury that "failure to report all income, pay all tax, and submit all required information returns, including FBARs, was due to non-willful conduct [caused by] negligence, inadvertence, mistake or conduct that is the result of good faith misunderstanding of the requirements of the law." False certification will expose the taxpayer to civil fraud penalties.

Separate procedures are available for individual taxpayers (and estates of taxpayers) residing in- and outside of the US.[59]

- Streamlined Foreign Offshore Procedure – individuals who did not have a US abode and were physically out of the US for at least 330 full days in any one or more of the most recent three years must use **Form 14653.**
- Streamlined Domestic Offshore Procedure – all other filers must use **Form 14654**.[60]

William was born in the US but moved to Germany with his parents when he was five years old, lived there ever since, and does not have a US abode. William meets the non-residency requirement applicable to individuals who are US citizens or lawful permanent residents.

The streamlined procedures require that taxpayers submit the most recent three years of US tax returns for which the due date or a properly applied-for extended due date has passed. If a tax return has not been previously filed, a complete and accurate return must be submitted with all requisite forms and schedules. If a return was previously filed but was not complete, an amended return must be submitted with all requisite forms and schedules. **FILING TIP:** The notation "Streamlined Foreign [Domestic] Offshore" must appear at the top of the first page of each return submitted.

Taxpayers must submit payment of all taxes due (plus statutory interest resulting from late paid amounts). Unfortunately, the IRS does not acknowledge receipt of a taxpayer's submission and reaches out if more information is needed. Nor does the tax authority issue a closing letter upon acceptance. The taxpayer must grab the initiative to contact the IRS for peace of mind and to determine if his efforts to retroactively comply with his filing obligations have been satisfactory.

And, of course, the taxpayer must electronically submit FBARs for each of the most recent 6 years for which the FBAR due date has passed. **FILING TIP:** When asked to provide

[58] IR 2014-73.

[59] An eligible taxpayer must have a valid Social Security Number (SSN) or Individual Taxpayer Identification Number (ITIN).

[60] These forms allow the taxpayer to provide a narrative of his non-willful failure to comply with his foreign account reporting responsibilities.

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an explanation for late filing, the taxpayer should select "Other" and then enter "Streamlined Filing Compliance Procedures" in the explanation box.

Although the IRS will not impose accuracy-related, information return or FBAR penalties on program participants, US taxpayers will nevertheless be subject to a "miscellaneous" penalty equal to 5% of the highest aggregate balance of the taxpayer's foreign accounts during the most recent six-year period. **NOTE:** US taxpayers who lived abroad in any one or more of the most recent three years are exempt from the penalty.

Taxpayers already under civil or criminal examination by the IRS may not avail themselves of the program. On the other hand, a taxpayer who has made a Quiet Disclosure [see below] may still use the streamlined procedure but penalties previously assessed due to the Quiet Disclosure will not be abated.

While the program offers participants the benefit of simplified reporting and reduced penalties, taxpayers should beware that the program is only available to those who acted unintentionally. Regulatory interpretation of willful and fraudulent conduct may differ from the taxpayer's understanding and lay opinion; expert counsel should be engaged before applying to the program.

2. Delinquent Submission Procedures

This process may be best used by individuals who have previously and properly reported all income attributable to foreign accounts but failed to file requisite FBARs. It is recommended that taxpayers submit a brief statement of explanation when e-filing the missing FBARs. **NOTE:** The IRS retains the right to assess penalties.

Similarly, taxpayers who do not need to amend **Form 1040** – whether because all foreign income was previously reported or because no reportable income was received – may submit missing information returns (e.g. **Form 8938**). Once submitted, the statute of limitations (previously open) now begins to toll for the taxpayer's entire income tax return.

3. Quiet Disclosure

Alternatively, taxpayers may choose to "quietly" file amended income tax returns to report previously omitted income from offshore accounts and pay the resulting tax, penalties and interest. **NOTE:** A quiet disclosure offers no guaranteed protection against civil fraud penalties.

4. Relief Procedure for Certain Former Citizens

This program is available only to individuals who have not filed US tax returns as US citizens or residents in the mistaken belief that as "accidental Americans"[61] they have no filing obligations. To qualify for relief, these individuals must have renounced (after May 18, 2010) or plan to renounce their US citizenship, own net assets of less than $2 million and owe less than $25,000 back taxes to the IRS for the current and five previous years. Filers must submit a current income tax return plus **Form 1040** for the most recent five years including all requisite schedules and form attachments (e.g., **Form 8938**), as well as submit FBARs (if applicable). If all criteria are satisfied, any tax due (!) and penalties will be forgiven.

[61] Accidental Americans are foreigners who were born with the right to US citizenship but have always lived abroad and never availed themselves of their citizenship rights. In fact, some individuals may remain blissfully ignorant of their status until some unexpected event occurs that brings the issue to the forefront.

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5. Reasonable Cause Statement

Depending on the timing of the request, a taxpayer may apply for a pre-assessment penalty waiver or post-issuance penalty abatement.[62] Since the IRS has not drafted a request form, success of the submission will rest solely upon the persuasiveness of the arguments presented on the taxpayer's behalf. Relief may be granted if it can be shown that the taxpayer exercised ordinary business care and prudence in determining his filing obligations but nevertheless failed to comply, and that granting relief is in the interest of equitable treatment and effective tax administration.[63] **NOTE:** Reasonable cause applies to most but not all penalties.

> A physician established an offshore trust to protect his assets against potential malpractice claims and relied upon the advice of his accountant that he need not file **Form 3520**. The court held that when the practitioner checked "no" on **Form 1040**, Schedule B in answer to the question, "Did you receive a distribution from, or were you the grantor of, or transferor to a foreign trust?", he effectively advised his client that he did not have a filing requirement; so the court granted relief to the client.[64]

6. Non-disclosure

Taxpayers who choose not to disclose, run the risk of eventual audit, full assessment of penalties, and referral to the Department of Justice for criminal prosecution for all applicable years. It's an option but not a good one!

B. Willful

1. OLD Offshore Voluntary Disclosure Program (OOVDP)

The IRS recently closed[65] version 4.0 of its OVDP program[66] designed to encourage taxpayers who have failed to file requisite foreign account reports to provide full disclosure in exchange for reduced civil penalties and no criminal prosecution.[67] Taxpayers already under civil examination or criminal investigation were ineligible for the program. The penalty imposed under the OVDP was equal to 27.5% of the highest year's aggregate value during the period covered by the voluntary disclosure – the most current 8 years.

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[62] Golding & Golding, online article regarding *Reasonable Cause or IRS Voluntary Disclosure* (available at https://www.goldinglawyers.com/fbar-penalties-reasonable-cause-statement-international-tax-lawyers/, last accessed May 5, 2020).

[63] IRM, Part 20.1.1.3.2.

[64] *James v US* [110 AFTR 2d 2012-5587 (MD Florida, 2013)].

[65] The 2014 OVDP program was closed on September 28, 2018 due to increased taxpayer awareness of offshore reporting obligations and a continued decline in the number of OVDP participants.

[66] The 2003 program was offered to taxpayers who used offshore credit, debit and other payment cards. The 2009 program was intended to encourage taxpayers who held Swiss bank accounts to come forward voluntarily before global banking giant UBS was required to disclose the names of roughly 4,450 US clients. In 2011, taxpayers were encouraged to make voluntary disclosures of foreign accounts held in Israel, India, Hong Kong and Asia while the Department of Justice pursued HSBC, a financial services firm headquartered in the UK. The IRS introduced the fourth incarnation of the program in 2014.

[67] OVDP was available for all foreign reporting, including **Forms 8938, 3520 and 5471**, as well as **FinCEN 114**.

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2. NEW Offshore Voluntary Disclosure Program (NOVDP)

The latest program differs from its predecessor in a number of ways:

- The civil penalty framework has been significantly increased to include a 50% penalty on undisclosed offshore assets and a 75% civil fraud penalty on unpaid taxes that can, in certain circumstances, be applied for multiple years.
- Taxpayers deemed to be "non-cooperative" may face even greater penalties.

On the other hand, program participants must – as before – self-disclose before the IRS discovers non-compliance. NOVDP was designed for taxpayers who willfully failed to meet their filing obligations but wish to become compliant in exchange for protection against criminal exposure, but it should be noted that this safeguard is not guaranteed. Taxpayer cooperation is expected to go beyond mere full disclosure and payment of any assessed liabilities and penalties. Although NOVDP grants participants the right to appeal any adjustment made by IRS examiners, the program perplexingly deems that appellant to be uncooperative with the civil process, opening the door to a criminal investigation. Yep, you read that right: Taxpayers are expected to assent to all adjustments that result from the audit and not exercise their legal right to contest audit determinations."[68]

The process begins with the submission of a preclearance request (**Form 14457**) that must be screened by the Criminal Investigations Division (CID) of the IRS. Once cleared, the taxpayer must promptly follow-up with details of his non-compliance, including a narrative of assets, entities, related parties and any professional advisors involved, along with tax returns, information returns and FBARs for the previous six years. These materials will be forwarded for audit to the IRS Large Business and International Unit. **NOTE:** The IRS may, at its discretion, expand the disclosure period to cover the full duration of non-compliance.[69]

Assessed penalties will depend largely on the taxpayer's level of cooperation throughout the process, with the promise of penalty mitigation available only to the most cooperative. Civil penalties for fraud and for fraudulent failure to file[70] will generally apply only to the tax year with the highest tax liability but the IRS may assess penalties for as many as six years (and beyond) if, for example, the taxpayer does not agree to the tax liability as determined by the auditor. Additionally, standard FBAR penalties will be assessed but penalties for failure to file information returns will not automatically be imposed.

> US citizen and stateside resident has several Swiss accounts but never informed the foreign banks of his American citizenship, did not disclose the accounts to his tax practitioner and checked "no" to the Schedule B question whether he had accounts abroad. Despite his willful non-compliance, the taxpayer was fully cooperative once in the NOVDP program. As a result, the IRS assessed the civil fraud and willful FBAR penalties for "only" one year.

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[68] Lee & Kingman, *The New IRS Voluntary Disclosure Regime: Worth the Price of Admission?* (available at https://www.foxrothschild.com/publications/the-new-irs-voluntary-disclosure-regime-worth-the-price-of-admission/, last accessed May 6, 2020).

[69] Interim Guidance Memo LB&I-09-1118-014, Updated Voluntary Disclosure Practice (available at https://www.irs.gov/pub/foia/ig/spder/lbi-09-1118-014.pdf, last accessed May 6, 2020).

[70] IRC §§6663 and 6651(f), respectively.

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US citizen and stateside resident failed to disclose ownership of several foreign bank and mutual fund accounts. The taxpayer and the auditor could not agree on calculations attributable to the passive foreign investment company for three of the six-year disclosure period. The taxpayer's assertions were not frivolous and were made in good faith. The taxpayer cooperated fully with the NOVDP audit. Upon the taxpayer's request for appellate review, the IRS assessed the civil fraud penalty for three years, as well as a willful FBAR penalty equal to 65% of the highest aggregate balance in all foreign accounts.

The NOVDP is costly and appears to be unyielding. Tax pros should urge their clients to seek the advice of an experienced attorney, as well as explore other avenues that may allow them to become compliant in a less punitive manner.

C. Summary of Relief Options

Program/Procedure	Willful?	FBAR	Form 8938	Form 1040	Penalty
Streamlined Filing					
a. Domestic	NO	6	3	3	5% of highest balance
b. Foreign (if >330 days abroad)	NO	6	3	3	$0 penalty
Relief for Former Citizens	NO	6	6	6	$0 tax & $0 penalty
Delinquent Submissions					
a. FBAR	NO	6	N/A	No 1040X due	Yes
b. 8938	NO	N/A	3	No 1040X due	Closes SOL on 1040
Quiet Disclosure	NO	N/A	N/A	1040 or 1040X	Late filing & payment
Reasonable Cause	NO	6	3	All	Request penalty waiver (abatement)
Non-disclosure	???	N/A	N/A	N/A	Civil & criminal (if caught)
Offshore Voluntary Disclosure	YES	6	6	6	75% civil fraud + 50% FBAR

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VI. And there's more...

With fresh articles, blogs and e-mail blasts advertising webinars on the "Latest FBAR Voluntary Disclosure" and "FATCA after Tax Reform: Form 8938 Reporting", it may be easy to overlook the myriad of other international reporting requirements imposed by the IRS. To alert practitioners to the potential filing needs of their clients, the following list of forms is provided as a survey – albeit not all-inclusive – of additional forms that may be required.

A. Form 3520, Annual Return to Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts

US persons must report the creation of foreign trusts, as well as transfers of property into and distributions from such trusts whenever there is a reportable transaction.[71] Additionally, US persons who receive gifts or bequests in excess of $100,000 from a nonresident alien individual

[71] IRC §6038. Effective March 16, 2020, tax-favored retirement trusts and non-retirement savings trusts that are operated (almost) exclusively to provide pension, retirement, medical, disability of education benefits are no longer required to file **Form 3520** [Rev. Proc. 2020-17].

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or a foreign estate, or receive gifts in excess of $16,649 [in 2020][72] from foreign corporations or foreign partnerships must file **Form 3520**. Gifts from related parties must be aggregated to determine if the filing threshold has been met.

The filing deadline for **Form 3520** coincides with the taxpayer's timely filed income tax return on April 15th (plus extension).[73] If filing for a US decedent, **Form 3520** is due on the date that **Form 706** is due (including extensions), or would be due if the estate were required to file a return. **Form 3520** must be mailed to the IRS; it is not attached to an income tax return.

As per IRS Notice 2020-23, the COVID extended due date for filing deadlines between April 1st and July 15th, 2020 applies to **Form 3520.**

Penalty for failure to file **Form 3520** is the greater of $10,000 or 35% of the gross reportable amount; although the penalty for failure to report a gift is 5% of the value of the gift per month, up to a maximum penalty of 25%.

B. Form 3520-A, Annual Information Return of Foreign Trust with a US Owner

This form must be filed annually on behalf of a foreign trust with at least one US owner. Each US person treated as an owner of any portion of a foreign trust is responsible for ensuring that the foreign trust files and furnishes the requisite statements to US owners and beneficiaries.[74]

Form 3520-A is due by the 15th day of the 3rd month after the end of the trust's tax year. Filers must also provide copies of the **Foreign Grantor Trust Owner Statement** (page 3 of **Form 3520-A**) and the **Foreign Grantor Trust Beneficiary Statement** (page 4) to all US owners and beneficiaries at the same time so that these individuals may incorporate information about taxable distributions into their personal income tax returns in a timely manner. Taxpayers may request an automatic six-month extension using **Form 7004, Application for Automatic Extension of Time to File Certain Business Income Tax, Information, and Other Returns.**

Because the COVID filing extension was granted only to those returns due between April 1st and July 15th, 2020, the filing deadline for **Form 3520-A** was *not* extended.

Failure to timely file or provide all requisite information exposes the taxpayer to a penalty equal to the greater of $10,000 or 5% of the gross value of the portion of the trust's assets at the close of the tax year, as well as potential criminal penalties.

NOTE: If the foreign trust fails to file **Form 3520-A**, the US owner must attach a substitute **Form 3520-A** for the foreign trust to **Form 3520** in order to avoid a penalty.

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[72] Rev. Proc. 2019-44.

[73] Chief Counsel Advice 201208028 issued on February 24, 2012 appears to resolve these conflicting instructions by granting taxpayers permission to file on April 15th (plus extensions) based on a reading of the phrase "or such later day as the Secretary may prescribe" included in IRC §6048. Should the IRS nevertheless seek to impose a penalty, some practitioners believe that reliance on specifically stated form instructions should constitute reasonable grounds for a waiver of the penalty.

[74] Effective October 27, 2014, custodians of Canadian registered retirement savings plans (RRSPs) and Canadian registered retirement income funds (RRIFs) are not required to file **Form 3520-A** with respect to a US citizen or resident alien who holds an interest in a RRSP or RRIF [Rev. Proc. 2014-55].

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C. Other Entity Filings

Just as the IRS seeks information from US persons who transact with foreign trusts, the agency demands similar information about transactions with foreign corporate, partnership and other entities.

The COVID extended due date until July 15th, 2020 applies to all forms listed in this section, including **Forms 5471**, **5472**, **8621**, **926**, **8858** and **8865**.

1. Form 5471, Information Return of US Persons with Respect to Certain Foreign Corporations

This form must be filed by a US citizen or resident shareholder who acquires, disposes of, or owns a certain percentage of stock, or who serves as a director or officer of a foreign corporation.[75] The form must be attached to the taxpayer's timely filed individual income tax return (or, if applicable, a partnership or exempt organization return). For failure to furnish requisite information in a timely manner, a minimum penalty of $10,000 will be assessed; the penalty may be increased to a maximum of $50,000 computed at $10,000 per month after the taxpayer receives a 90-day warning letter from the IRS.

2. Form 5472, Information Return of a 25% Foreign-Owned US Corporation or a Foreign Corporation Engaged in a US Trade or Business

This form must be filed by a "reporting corporation"[76] that has "reportable transactions" with related parties, either foreign or domestic. The corporation is not required to file if it had no reportable transactions or a US shareholder who controls the corporation files **Form 5471**. A separate **Form 5472** must be filed for each foreign or domestic related party with which the reporting corporation had a reportable transaction during the tax year. The form must be attached to the corporation's timely-filed corporate return. A penalty of $10,000 will be assessed for failure to file. If the failure continues for more than 90 days after notification by the IRS, an additional penalty of $10,000 will apply for each 30-day period (or part of a 30-day period) during which the failure continues; plus, potential criminal penalties.

3. Form 8621, Information Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund

This form must be filed by a US person who is a shareholder of a passive foreign investment company (PFIC)[77] if he receives certain direct or indirect distributions, recognizes a gain on a direct or indirect disposition of stock, or is making a reportable election. A PFIC is an entity that holds mainly passive assets or receives mainly passive income from interest, dividends, capital gains, rents, etc.[78] PFICs typically include foreign mutual funds, money market accounts, pension funds, partnerships and other pooled investment vehicles, such as REITs.

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[75] IRC §§6038 and 6046.

[76] A "reporting corporation" is a US corporation that is at least 25% foreign-owned or a foreign-owned corporation that engages in a US trade or business.

[77] A foreign corporation is defined as a PFIC if at least 75% of the corporation's gross income is derived from passive income or at least 50% of the corporate assets are held for the production of passive income.

[78] IRC §1297.

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Taxpayers who hold one or more PFICs will have to file a *separate* **Form 8621** for *each* PFIC owned. The form(s) must be attached to the taxpayer's timely filed individual, partnership or exempt organization income tax return. Failure to file the form(s) may suspend the statute of limitations with respect to the taxpayer's entire return until the omission is corrected; potentially extending the statute for an unlimited period of time.

4. Form 926, Return by a US Transferor of Property to a Foreign Corporation

This form must be filed by a US citizen or resident, a domestic corporation, estate or trust to report certain transfers of property[79] to a foreign corporation. If the transferor is a partnership, the individual partners, not the partnership itself, must file. Spouses may file **Form 926** jointly if they file a joint income tax return. The form must be filed with the transferor's income tax return for the tax year that includes the date of the transfer. The failure to file penalty equals 10% of the fair market value of the property at the time of the transfer but is limited to $100,000 per return unless the failure to comply was due to intentional disregard. An additional 40% penalty may be imposed on any underpayment resulting from an undisclosed foreign financial asset.[80]

5. Form 8858, Information Return of US Persons with Respect to Foreign Disregarded Entities

This form must be filed by US persons who are "tax owners" of a foreign disregarded entity (FDE); an entity that is not created or organized in the US and that is disregarded as an entity separate from its owner.[81] The tax owner of the FDE is the person who is treated as owning the assets and liabilities of the FDE for purposes of US income tax law.[82] Failure to file timely is subject to a $10,000; up to a maximum of $50,000 based on additional $10,000 per 30-day period after the IRS has issued its 90-day warning letter. Additionally, US taxpayers will forfeit 10% of the foreign tax credit to which they would otherwise have been eligible plus an additional 5% for each 3-month period after the IRS issues a 90-day warning. Criminal penalties may also apply.

6. Form 8865, Return of US Persons with Respect to Certain Foreign Partnerships

This form must be filed by qualifying US persons to report acquisitions, dispositions, transfers and changes in foreign partnership interests. The form must be attached to a timely filed individual, partnership or exempt organization income tax return, as applicable. For failure to furnish requisite information in a timely manner a minimum penalty of $10,000 will be assessed; the penalty will increase to a maximum of $50,000 computed at $10,000 per month after the taxpayer receives a 90-day warning letter from the IRS. Any person who fails to report a contribution will be subject to an additional penalty equal to 10% of the fair market value of the property at the time of the contribution, capped at $100,000 unless the failure is due to intentional disregard.

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[79] These property transfers are defined by IRC §§332 (complete liquidation of a corporate subsidiary), 336 (property distributed in a complete liquidation), 351 (transfer to a controlled corporation), 354 (exchange of stock in a reorganization), 355 (distribution of a controlled corporation's stock), 356 (receipt of additional consideration) and 361(non-recognition of gain or loss to corporations).

[80] IRC §6662(j).

[81] Treas. Reg. §§301.7701-2 and 301.7701-3.

[82] Due to COVID-related travel restrictions and disruptions in 2020, individuals may temporarily conduct activities in a foreign country that otherwise would not have been conducted there. Such activities might – under normal circumstances – give rise to a **Form 8858** filing requirement but are now exempt if conducted during any single consecutive period of up to 60 calendar days [Rev. Proc.2020-30].

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WARNING: You will note that all of the forms listed are mere informational returns; none are tax returns in the sense that a tax liability is computed and due on filing. But all of these forms are subject to significant penalty assessments for failure to file. It is imperative that the practitioner is aware of all requisite filing requirements or refers potentially affected clients to advisors with experience and expertise in this arena.

D. Withholdings and Beneficiary Forms

The COVID extended due date until July 15th, 2020 does not apply to any form listed in this section, including **Forms W-BEN**, **W-8IMY**, **1042-S** and **1042**.

- **Form W-8BEN** must be submitted to payers and withholding agents by non-resident aliens who are the beneficial owners of an amount subject to withholding (e.g., wages, interest, dividends, rents, royalties, annuities, and other investment income) to ensure withholdings at a flat rate of 30% on all US source income.

- **Form W-8IMY, Certificate of Foreign Intermediary, Foreign Flow-Through Entity, or Certain US Branches for United States Tax Withholding and Reporting** must be provided to a withholding agent if receiving a reportable amount or withholdable payment as a flow-through entity or on behalf of a foreign person to ensure withholdings at a flat 30% rate.

- **Form 1042-S, Foreign Person's US Source Income Subject to Withholding** is an informational return that must be filed by every withholding agent for every foreign payee who received US-source fixed, determinable, annual, or periodic income. The withholding agent must indicate the amount of each category of income paid to the foreign payee (e.g., dividends, interest, etc.) and the amount of tax withheld. A separate **Form 1042-S** must be filed for each payee and each type of income. If the withholding agent did not withhold tax because it was exempt from withholding tax under a relevant income tax treaty, the withholding agent must nevertheless file **Form 1042-S** with the IRS and also provide a copy to the foreign payee so that it may be attached to any US income tax return that the payee files.

- **Form 1042, Annual Withholding Tax Return for US Source Income of Foreign Persons** is the associated tax return that must be filed annually by the withholding agent who receives or pays a withholdable amount on behalf of foreign persons, including nonresident aliens, foreign partnerships, foreign corporations, foreign estates, and foreign trusts. The withholding agent is personally liable for any tax that is required to be withheld plus interest and applicable penalties. **Form 1042** must be mailed to the IRS Service Center, P.O. Box 409101, Ogden, UT 84409 by March 15th. **Form 7004** may be used to request an automatic extension of time to file but not pay the amount of tax that should be withheld. The penalty for not filing **Form 1042** when due (including extensions) is 5% of the unpaid tax for each month or part of a month the return is late, up to a maximum of 25% of the unpaid tax. Interest is charged on taxes not paid by the due date, even if an extension of time to file is granted. Interest is also charged on penalties imposed for failure to file, negligence, fraud, and substantial understatements of tax from the due date (including extensions) to the date of payment.[83]

[83] IRC §6621.

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E. Cash Transactions

1. FinCEN Form 104, Currency Transaction Report

Formerly Form 4789, this form must be electronically filed by a financial institution (including banks, broker/dealers, money transmitters, currency exchangers, check cashers and travelers check sellers but not a casino)[84] to report any currency transaction or series of transactions over $10,000 within 15 calendar days after the transaction.

2. FinCEN Form 105, Report of International Transportation of Currency or Monetary Instruments

Formerly Form 4790, this form must be filed by any individual who receives or distributes non-US currency or other monetary instrument, whether shipped, mailed or physically transported, in excess of $10,000 at one time. Monetary instruments include foreign coins and currency, money orders, traveler's checks, securities and negotiable instruments in bearer form. Funds transferred through normal banking procedures are exempt.[85] This form is due within 15 days after taking receipt of the transfer and must be electronically filed using the BSA e-File System. Failure to file may result in civil and criminal penalties, including a fine of not more than $500,000 and imprisonment of not more than ten years. In addition, the currency or monetary instrument may be subject to seizure and forfeiture.[86]

3. Form 8300, Report of Cash Payments over $10,000 Received in a Trade or Business

This form must be filed by any person in a trade or business who receives more than $10,000 in cash in a single transaction or in related transactions. Cash includes US and foreign currencies, as well as cashier's and traveler's checks, money orders and bank drafts with face amounts less than $10,000; but not checks drawn on an individual's personal account.[87]

NOTE: This form may also be used to report suspicious activities if, for example, it appears that a person is trying to purposefully avoid the $10,000 filing threshold[88] or if there is a sign of possible illegal activity.

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[84] Casinos must file **FinCEN Form 103**.

[85] 31 U.S.C. 53.

[86] US Customs and Border Protection (CBP) seized more than $26,000 from a US couple travelling to Greece. During the outbound inspection at the Philadelphia airport, the couple stated that they were carrying $17,000 but CBP officers discovered multiple envelopes in their luggage that contained a total of $27,052. **NOTE:** Such inspections occur routinely; the CBP reports that it typically seizes $356,396 each day in undeclared or illicit currency at our nation's 328 ports of entry. (Byrnes, *International Financial Law Prof Blog*, August 6, 2016).

[87] A cashier's check, bank draft, traveler's check, or money order with a face amount in excess of $10,000 is not considered "cash". Transactions involving these items will be reported by the issuing financial institution on **Form FinCEN 112**.

[88] Structuring transactions to purposefully give the illusion that an applicable reporting threshold has not been met and thereby evade reporting requirements can result in civil and criminal penalties, as well as seizure and forfeiture. Even innocents can be caught in the government dragnet as was a Maryland dairy farmer who routinely deposited the proceeds of small cash sales into his bank account from which the IRS seized $63,000. Similarly, a gas station owner hopes to $59,000 after his banker suggested that he deposit less cash more frequently to avoid the headache of a lot of paperwork. The taxpayer pled guilty to the technicality of the structuring charge but even the court could not identify any criminal intent. Nevertheless, the IRS refuses to return the funds seized!

UPDATE: Effective July 1, 2019, the IRS must show probable cause prior to seizing funds or property related to a structuring activity and must provide for a post-seizure hearing. Any interest paid in conjunction with the return of seized property is excluded from gross income [Taxpayer First Act §§1201 & 1202].

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Form 8300 must be filed within 15 days after receiving a payment (or the next business day if the 15th day falls on a weekend or holiday). If the payer is paying in installments, **form 8300** must be filed as soon as any payment in the series raises the aggregate amount above the filing threshold.

The form may be filed electronically on the BSA e-File System or mailed to the IRS at Detroit Computing Center, P.O. Box 32621, Detroit, Michigan 48232. Filers must give a written or electronic statement to each person named on any **Form 8300** and must keep a copy of the form for 5 years. Civil penalties for intentional disregard of the filing requirement are equal to the greater of $25,000 or the amount of cash received but not reported (up to $100,000). Willful failure to file may result in penalties up to $250,000 (individuals) or $500,000 (corporations) and/or up to 5 years jail time.[89]

VII. Is all this reporting working?

It is widely acknowledged that "offshore tax evasion is a significant contributor to the tax gap."[90] And while a US Senate report estimates that more than $100 billion of tax revenues are lost each year, IRS offshore compliance programs have recouped only $11 billion since 2009.

A. The Cost of Bureaucracy

Critics further argue that a large portion of these collections are lost to the cost of regulatory oversight.[91] A report published by the Treasury Inspector General for Tax Administration (TIGTA) found that despite spending nearly $380 million, "the IRS has taken limited or no action on a majority of planned activities outlined in the original FATCA Compliance Roadmap" and cited such administrative problems as the inability to match reported information from foreign financial institutions with individual taxpayers.[92] Still, the IRS continues to pursue scofflaws, prodding them to step forward voluntarily.

B. The Burden of Citizenship

US citizens living abroad are weighted with oft-draconian rules that require the submission of an endless onslaught of reports with American regulators. Looking to escape, some choose to renounce their citizenship but even that comes at a steep price.

> A British citizen, born in the US, moved to the UK as an infant and never knew of her US citizenship until her bank requested some information. To renounce her American citizenship, she had to document her life's movements for each of the 50 years she had not been in the US, obtain a Social Security Number so that she could file 5 years of US tax returns and 6 years of foreign bank account reports, and hire an immigration attorney to guide her through the renunciation process for which the US government charged $2,350. In the end, the reader estimated that her costs totaled more than $10,000 to renounce her "accidental" citizenship![93]

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[89] 18 U.S.C. 3571.

[90] Stack, *Myth vs. FATCA: The Truth about Treasury's Effort to Combat Offshore Tax Evasion* (September 20, 2013).

[91] The *International Financial Law Prof Blog* suggests that "FATCA is a huge failure, a multi-billion dollar program that has not come close to producing its promised outcome" [Byrnes, *What do FATCA & St Patrick's Day Have in Common? Leprechauns!* (March 17, 2016)].

[92] Cohn, *IRS Spent $380M on FATCA, but still can't enforce it* (July 9, 2018).

[93] Connington, *I had to pay £8,200 to escape draconian US tax system* (October 23, 2016).

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Foreign Financial Institution (FFI)[94]

Foreign banks may register with the IRS. These approved FFIs must then comply with certain withholding and reporting requirements with regards to their US account holders in exchange for an exemption from the automatic 30% withholding that would otherwise apply to the banks' US-source income. Currently more than 300 banks report to the US government under the FATCA regime using **Form 8966, FATCA Report**. Failure to file may lead to information return penalties[95] as well as loss of the FFI status.

Motivated FFIs conform to their reporting obligations as soon as a banking client is identified as a US citizen or resident; often because the individual has resided in the US for at least 183 days as per the Substantial Presence Test.[96] Due to recent global travel disruptions resulting from the COVID pandemic, some foreign travelers may find themselves stranded in the US for too long, thereby becoming inadvertent US residents. The IRS has granted an exclusion for any single period of up to 60 consecutive calendar days of physical presence during 2020 to prevent accidental residency.

C. What does the future hold?

FATCA has become the global standard in the universal battle against offshore tax evasion. Increasing numbers of foreign governments join the fight through intergovernmental agreements (IGAs) which have been developed by the US Treasury to facilitate the exchange of tax information between countries.[97] Although American customers abroad were once treated as pariahs due to the onerous reporting regime imposed on foreign banks, many foreign regulatory authorities have recognized the power and benefit of international cooperation; thereby enabling governments to fill their own coffers with tax revenues that previously eluded detection.[98] And, in some instances, mutual cooperation has gone even a step beyond information sharing: Based on a provision in the US-Danish tax treaty, the IRS collected an individual's foreign income tax debt on behalf of the Danish government![99]

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[94] 31 CFR § 561.308.

[95] Failure to file and failure to properly furnish an information return is subject to $250 per failure as per IRC §§6721(a) and 6722(a), respectively. The aggregate maximum penalty per filer is $3 million under each code section, subject to annual inflation adjustments.

[96] IRC §7701(b)(3).

[97] Currently 113 countries have IGAs with the US as per the Foreign Account Tax Compliance Act (FATCA) Resource Center [available at https://www.treasury.gov/resource-center/tax-policy/treaties/Pages/FATCA.aspx, last accessed May 7, 2020].

[98] Reuters reports that Germany has followed in US footsteps and launched its own proceedings against the Swiss Bank UBS, yielding criminal convictions in 14 cases and closing another 340 in exchange for fines totaling roughly $18 million [*German prosecutors launch 2,000 tax cases against UBS clients* (January 14, 2016)]. The United Kingdom (UK) has formulated its own Swiss Disclosure Facility but admits to less success than initially anticipated [Byrnes, *UK Amnesty Not Leading to Disclosure of Tax Evasion in Channels* (July 21, 2015)].

[99] *Dileng v Comm*, 1:15-CV-1777-WSD (ND GA January 15, 2016).

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APPENDIX A
Foreign Activity Reporting Forms

Form #	Form Name	Who must file	Due Date	Text Page
FinCEN 114	Report of Foreign Bank & Financial Accounts (FBAR)	US citizens, resident aliens, trusts, estates & domestic entities that have an interest in foreign financial accts with an aggregate value > $10K	April 15th (+ xtn)	2
926	Return by a US Transferor of Property to a Foreign Corp	US individuals, domestic corps, estates & trusts to report certain direct & indirect transfers of cash or property to a foreign corp	Due date (+ xtn) of 1040, 1041, 1065, 1120 or 990	20
1042	Annual Withholding Tax Return for US Source Income of Foreign Persons	Withholding agent must report & submit withholdings on behalf of Non-resident Aliens (NRAs) & foreign entities	March 15th (+ xtn)	21
3520	Annual Return to Report Transactions with Foreign Trusts & Receipt of Certain Foreign Gifts	US persons to report certain transactions with foreign trusts, ownership of foreign grantor trusts, & receipt of certain large gifts or bequests from certain foreign persons	April 15th (+ xtn) If filing for decedent, due date of 706 (+ xtn)	17
3520-A	Annual Info Return of Foreign Trust with a US Owner	Foreign trusts with > 1 US owner or beneficiary (must provide pp. 3 & 4 with allocable income to owners & beneficiaries	15th day of the 3rd month after the end of the trust's tax year	18
5471	Info Return of US Persons with Respect to Certain Foreign Corp	Certain US persons, including owners & officers, of foreign corps must report specific info regarding their ownership interest in a foreign corp	Due date (+ xtn) of 1040, 1065 or 990	19
5472	Info Return of a 25% Foreign-Owned US Corp or a Foreign Corp Engaged in US Trade/Business	A foreign corp if it had specific reportable transactions with a foreign or US related party	Due date of 1120 (+ xtn)	19
8300	Report of Cash Payments over $10,000 Received in a Trade or Business	US person must report single or related cash transactions > $10K	Within 15 calendar days	22
8621	Info Return by a Shareholder of a Passive Foreign Investment Co or Qlfd Electing Fund	US persons to report distributions from PFIC or gains on sale of PFIC	Due date (+ xtn) of 1040, 1065 or 990	19
8858	Info Return of US Persons with Respect to Foreign Disregarded Entities	US persons to report ownership of a foreign disregarded entity	Due date (+ xtn) of 1040, 1041, 1065, 1120 or 990	20
8865	Return of US Persons with Respect to Certain Foreign Partnerships	US persons, incl. owners & partners of foreign partnerships, must report specific info regarding their ownership interest in a foreign partnership	Due date (+ xtn) of 1040, 1041, 1065, 1120 or 990	20
8938	Stmt of Specified Foreign Assets	Specified individuals, incl US citizens, resident aliens, & certain nonresident aliens who have an interest in specific foreign financial assets & meet the reporting threshold Domestic entities that are formed or utilized to hold specified foreign financial assets	April 15th (+ xtn)	8

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