CPD 30min VERIFIABLE ARTICLE

Prof. William H. Byrnes | Associate Dean, and Prof. Christopher M. Sove, International Tax and Financial Services Graduate Programme of Thomas Jefferson School of Law

RECENT CHANGES AFFECTING AMERICANS WITH FOREIGN FINANCIAL INTERESTS

The political backlash from the UBS scandal pushed the United States Congress and Treasury to undertake legislation and administrative announcements that will substantially impact current reporting requirements for United States persons holding a financial interest in foreign financial accounts and business entities, and for foreign persons receiving payments from the United States. This two-part article will explain the UBS scandal and its impact on United States persons expanded reporting requirements pursuant to Form TD F 90-22.1 , Report of Foreign Bank and Financial Accounts (FBAR). Next month we will analyse the new Foreign Account Tax Compliance Act (FATCA) which imposes a 30% withholding tax on payments made to foreign financial institutions and non-financial institutions that do not enter into an agreement with the IRS to disclose information about accounts held by United States persons.

Impact of the UBS scandal

In 2009, via a well-orchestrated publicity campaign, the United States' Internal Revenue Service (IRS) accused the Swiss bank UBS of acting in complicity with United States tax evaders to conceal the taxpayer's assets overseas that were managed by UBS Wealth Management. The IRS negotiated a settlement with UBS which included a substantial fine. More importantly to the IRS, UBS agreed to disclose the financial details of 4 450 of its United States customers. However, because UBS would incur Swiss criminal and civil liability for contravening Swiss banking confidentiality laws, a Swiss Parliamentary procedure and a Swiss voters' referendum were required to effectuate the settlement at the level of a treaty mechanism between the two governments. A year later, the United States customers' account details are finally being submitted in electronic form to the IRS.

Partial amnesty

During the 2009 negotiated UBS and political settlement, the IRS offered an olive branch to United States taxpayers who did not report interests in foreign accounts. In order to promote self reporting to obtain information to further pressure UBS and other financial institutions, the IRS established a voluntary disclosure programme (partial amnesty). Pursuant to the partial amnesty, for persons not currently under audit the voluntarily disclosure of previously unreported 'offshore activities' would lead to a reduction of civil and criminal penalties.

See Voluntary Disclosure: Questions and Answers, http://www.irs.gov/newsroom/article/0,,id=210027,00.html (last visited 18 October 18 2010).

Absent the voluntary disclosure programme, failure to file a required FBAR can result in substantial civil and criminal penalties of up to an annual $10 000 for negligent failure to file an FBAR and the greater of $100 000 or 50% of the account value for a willful failure to file, in addition to penalties and fees resulting from the taxpayer's failure to report income on the foreign accounts.

Participation was initially open until 23 September 2009, then extended to 15 October 2009. Prior to the 15 October 2009 deadline, 14 700 persons entered the voluntary disclosure programme. The IRS considers the partial amnesty programme an overwhelming success. In 2009, the IRS announced that it will deploy 800 agents to a newly established international compliance division that will focus on high-net wealth individuals after it closes the audits associated with the UBS disclosures, the partial amnesty programme, and the voluntary disclosures made after the October deadline.

FBAR filing requirements

Form TD F 90-22.1, Report of Foreign Bank and Financial Accounts, must be filed with the IRS by all "United States persons" who hold an interest in a foreign financial account. In general, the report is required to be filed by 30 June of each year for each account which was a reportable account during the previous calendar year. The October 2008 FBAR instructions require an annual FBAR to be filed by anyone located, or doing business, in the US who holds an interest in a foreign account. Though the scope of the FBAR filing requirement is straightforward on its face, there has been significant confusion as to whom the filing requirements applies, and what types of accounts must be reported.

Modifications by announcements

The IRS has issued a series of administrative announcements to clarify the scope of the FBAR filing requirements. Though these announcements are not in themselves permanent regulatory changes, the IRS, in conjunction with the Financial Crimes Enforcement Network (FinCEN), has issued proposed FBAR regulations that generally make the clarifications found in the IRS announcements permanent.

FinCen, like the IRS, is a bureau of the US Department of the Treasury. FinCEN was formed in 1990 "to provide a government-wide multisource financial intelligence and analysis network". Administration of the Bank Secrecy Act, including the FBAR filing requirements, has been delegated to FinCEN by the Secretary. See the FinCEN homepage at http://www.fincen.gov/ for more information.

Announcement 2009-51 clarifies the scope of who is a United States person for the purposes of the FBAR filing requirement. Announcement 2010-16 (which continues the applicability of Announcement 2009-51) suspends the FBAR filing requirement for anyone not satisfying the definition of United States person found in the 2009 and 2010 announcements. Both announcements limit the scope of United States person to:

(1) A citizen or resident of the United States.
(2) A domestic partnership.
(3) A domestic corporation.
(4) A domestic estate or trust.

This substituted limited definition applies only with respect to FBARs due on 30 June 2010 for the 2009 calendar year and FBARs for earlier calendar years as provided by Notice 2009-51 and Notice 2009-62. Notice 2009-62 extended the 30 June 2010 deadline to (i) persons with signature authority over, but no financial interest in, a foreign financial account; and (ii) persons with a financial interest in, or signature authority over, a foreign commingled fund. The notice also provides that the service will interpret "commingled fund" to mean only "mutual fund" for calendar year 2009 and prior years. Thus, a US person with a financial interest in a foreign commingled fund other than a mutual fund (e.g. a hedge fund or private equity fund) will not be required to file an FBAR with respect to those accounts for these previous years. Moreover, Notice 2010-23 further extends the deadline from 30 June 2010 to 30 June 2011 for US persons with only signatory authority and no financial interest in foreign financial accounts in 2010 and prior calendar years.

FBAR proposed regulations

Treasury issued proposed regulations that clarify the scope of the FBAR filing requirement.

Financial Crimes Enforcement Network; Amendment to the Bank Secrecy Act Regulations – Reports of Foreign Financial Accounts (Proposed BSA Regulations), 75 Fed. Reg. 8 844-8 854, 8 844 (proposed 26 Feb 2010) (to be codified at 31 C.F.R. pt. 103).

A United States person must file an FBAR where that person has "a financial interest in, or signature or other authority over" a foreign financial account or accounts and the aggregate amount in those accounts exceeds $10 000. A United States person is deemed by the proposed regulations to have signature or other authority over a foreign financial account if that person has the "authority of an individual … to control the disposition of money, funds or other assets held in a financial account by delivery of instructions … directly to the person with whom the financial account is maintained".

The proposed regulations maintain the definition of United States person provided by the 2009 and 2010 announcements and also include a comprehensive definition of 'reportable account' and 'financial interest'. Exceptions to the scope of reporting coverage include an officer or an employee of a US regulated bank or financial institution not being required to report the officer's signature authority over a foreign financial account owned by the bank if that person does not have a personal interest in the account.

An 'authorised service provider' is an SEC registered entity that provides services to investment companies.

Also, an officer or employee of a US listed companies or authorised service provider is not required to report an interest in a foreign account held on behalf of the company or service provider if the officer or employee does not have a personal interest in the account. Finally, a beneficiary of a trust need not report the beneficiary's interest in a trust if the trustee is subject to the FBAR filing requirement.

The proposed regulations include an anti-avoidance provision that deems a United States person as holding an interest in the property owned by a corporation, partnership, trust or other entity that the US person caused to be formed for the purpose of evading the FBAR regulations.

Next month TaxTalk will examine the impact of FATCA on South African investors and exporters.