STREAMLINED COMPLIANCE PROCEDURES FOR NON-DISCLOSED

FOREIGN BANK ACCOUNTS

BY MANASA NADIG, EA

With the global business environment changing, the world does not seem as vast. Advances in technology have increased awareness of different parts of the world and have made communication cheaper and more efficient. The U.S. citizen is now more mobile than ever before. Additionally, immigrants who may have thought the U.S. was an ultimate destination have begun to move back to their home countries because of equally attractive incomes and lifestyles there.

For a long time, the government had disclosure requirements in place and encouraged taxpayers to disclose income from and balances in foreign financial accounts. This was not stringently enforced and many taxpayers failed to follow the rules (willfully or negligently). Naturally, tax professionals not aware of this requirement did not advise their clients about compliance.

The U.S. government passed the Foreign Account Tax Compliance Act (FATCA) in March 2010. FATCA targets non-compliance by U.S. taxpayers with foreign accounts. It requires reporting by U.S. taxpayers on certain foreign financial assets and also reporting by Foreign Financial Institutions (FFIs) of financial assets held by U.S. taxpayers or foreign entities in which U.S. taxpayers hold a substantial ownership interest. FATCA states that its objective is the reporting of foreign financial assets. Withholding is the cost of not reporting.

This article will trace how the streamlined, offshore procedures came into place and will focus on the streamlined domestic offshore procedures.

Reporting Requirements Under FATCA

FATCA requires certain U.S. taxpayers holding foreign financial assets with an aggregate value of more than the reporting threshold (at least $50,000) to report information about those assets on Form 8938.[1] This must be attached to the taxpayer's annual income tax return. The reporting threshold is higher for certain individuals, including married taxpayers filing a joint annual income tax return and certain taxpayers living in a foreign country (see below).

There are some exceptions to the requirement to file Form 8938. For example, if you do not have to file a U.S. income tax return for the year, then you do not have to file Form 8938 regardless of the value of your specified foreign financial assets for that year.[2] Also, if you report interests in foreign entities and certain foreign gifts on other forms, you may just list the submitted forms on Form 8938 without repeating the details.[3]

Other forms on which a taxpayer may have to report interests in foreign entities and certain foreign gifts are Forms 5471, Information Return of U.S. Persons With Respect To Certain Foreign Corporations; Form 3520, Annual Return To Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts; Form 3520-A, Annual Information Return of Foreign Trust With a U.S. Owner; Form 8621, Information Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund; and Form 8865, Return of U.S. Persons With Respect to Certain Foreign Partnerships.

Taxpayers who meet the Form 8938 reporting thresholds have to also report the same accounts for the same applicable years on the Financial Crimes Enforcement Network (FinCEN) Form 114, Report of Foreign Bank and Financial Accounts (FBAR) (formerly TD F 90-22.1), in addition to Form 8938. These forms are required under the Bank Secrecy

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Act (BSA) regulations issued by FinCEN. Under the Streamlined Filing Compliance Procedures, the taxpayer has to submit information for the previous six years to come into compliance with the BSA regulations.

Penalties on Non-Disclosure

Non-compliance with FBAR reporting, Form 8938 reporting, and most of the other reporting forms mentioned above carry extremely stiff penalties. For non-compliance with filing Form 8938, the failure to file penalty is $10,000. There is an additional penalty up to $50,000 for continued failure to file after IRS notification.[4] There may also be an accuracy-related penalty of 20%-40% imposed on under-payments under IRC Sec. 6662. These very high penalties led the IRS to offer the Offshore Voluntary Disclosure Program so that the defaulting taxpayers could come into compliance with previous years of non-filing and have their penalties reduced.

Offshore Voluntary Disclosure Program (OVDP)

The OVDP was first introduced in 2009 and then again in 2011. However, these programs were not open-ended. The IRS began an open-ended program in 2012 to give taxpayers wanting to come into compliance another opportunity to become current. Terms were further modified and introduced by the IRS on July 1, 2014, the current OVDP program is referred as the "2014 OVDP".

The 2014 OVDP has a higher penalty rate than the previous programs, but clearly offers benefits to taxpayers to declare their foreign accounts rather than bear the risk of detection by the IRS and possible criminal prosecution. On acceptance of the taxpayer's OVDP, the delinquent taxpayer will execute a closing agreement via Form 906, Closing Agreement On Final Determination Covering Specific Matters. The presence of a closing agreement is one big difference between the OVDP and the Streamlined Filing Procedures.

The Internal Revenue Service further modified terms on the OVDP in July 2014 via the IR-2014-73. Among other changes announced, the most significant was the increase in the off-shore penalty percentage from 27.5% to 50% if "*it became public that a financial institution where the taxpayer holds an account or another party facilitating the taxpayer's offshore arrangement is under investigation by the IRS or Department of Justice.*"

Streamlined Filing Compliance Procedures

The streamlined filing compliance procedures were introduced in 2012 to encourage taxpayers with undisclosed foreign bank accounts to come into compliance without the risk of high penalties or criminal prosecution, and were revised in June 2014.

These filing procedures are available to taxpayers who can certify that their failure to report foreign financial assets and pay all tax due on those assets did not result from willful conduct.

In 2014, the filing procedures were revised to include U.S. taxpayers residing in the United States. The $1,500 tax threshold and risk assessment process present in the 2012 procedures were eliminated.

Once the returns are submitted under the Streamlined Offshore Domestic Procedures, the OVDP is off the table.

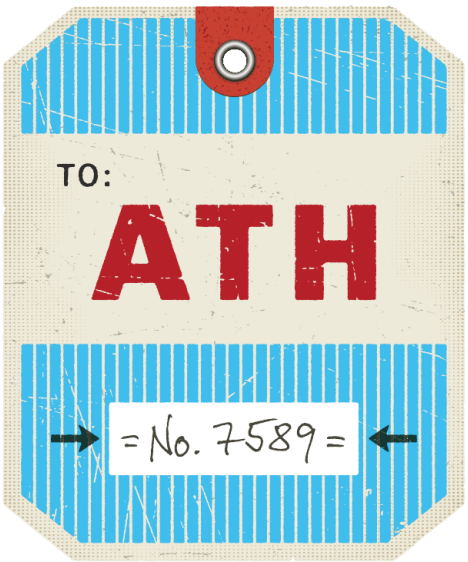
Eligibility Requirements:

1. The 2014 Streamlined Offshore Compliance Procedures are only designed for individual taxpayers and the estates of individual taxpayers.

2. The taxpayers must have a valid Taxpayer Identification Number to participate in the Streamlined Offshore Compliance Procedure. If the taxpayer is ineligible for a Social Security Number, they can file an application for an ITIN along with the forms under this procedure.
3. They are available to both U.S. individual taxpayers residing outside the United States and within the United States.
4. The taxpayers must certify that their conduct in non-disclosure was non-willful in accordance with specific instructions given by the Internal Revenue Service.
5. If the IRS has initiated a civil examination of the taxpayer's returns for any taxable year, they will not be eligible to use the streamlined procedures.
6. Any previous penalties due with respect to foreign financial assets either using "quiet disclosure" or under the OVDP will not be abated even though a taxpayer can still use the Streamlined Compliance Procedure.[5]

The Actual Process for Filing the Streamlined Compliance Offshore Procedures for U.S. Citizens in the Country:

1. Prepare Form 1040X, Amended U.S. Individual Income Tax Return, for each of the most recent three years for which the U.S. tax return due date or properly extended due date has passed. Attach any required information returns (Forms 3520, 3520-A, 5471, 5472, 8938, 926, and 8621) not attached originally. One cannot file delinquent income tax returns using these procedures.
2. The critical criteria to ensure returns are processes through these special procedures is to write in red the words, "Streamlined Domestic Offshore" at the top of the first page of each amended tax return.
3. Complete and sign a statement on the Form 14654, Certification by U.S. Person Residing in the U.S. with the required certifications. The original Form 14654 should be submitted and also a copy attached to each tax return being submitted through these procedures. You should not attach copies of the statement to FBARs. This is the most important form in these procedures. Without this or an incomplete one of these, the returns sent will not be considered under favorable terms.
4. Be sure to send in all tax due as calculated on the tax returns and all applicable interest and penalties.
5. The documents and payments must be sent in paper form (electronic submissions will not be accepted) to:
   Internal Revenue Service
   3651 South I-H 35Stop 6063 AUSC
   Attn: Streamlined Domestic Offshore
   Austin, TX 78741



6. File delinquent FBARs for each of the most recent six previous years for which the FBAR due date has passed including a statement explaining that the FBARs are being filed as part of the Streamlined Filing Compliance Procedures. The delinquent FBARs have to be filed electronically at the BSA Website. This must be accompanied with an explanation that the FBARs are being filed under "Streamlined Filing Compliance Procedures." If you are unable to file electronically, you may contact FinCEN at 1-800-949-2732 or 1-703-905-3975 (if calling from outside the United States) to determine possible alternatives to electronic filing.[6]

Internal Revenue Service Penalty & Response on Submission

A taxpayer who is eligible to use these streamlined domestic offshore procedures will be subject to only a 5% penalty and no accuracy-related penalties, information return penalties, or FBAR penalties. The 5% penalty is substantially lower than the 27.5% penalty offered under the OVDP. This 5% penalty is computed on "all reportable but unreported assets" in the third paragraph of the description of the scope of the Streamlined Domestic Offshore Procedures. Therefore the financial assets which form the penalty base are the same as in the OVDP.

The taxpayers using the Streamlined Domestic Offshore Procedures unlike under the OVDP will not have the receipt of their returns acknowledged by the IRS. This process will also not culminate in a closing agreement with them. The checks will be cashed by the IRS and no formal confirmation of acceptance will be provided.

For U.S. Taxpayers residing outside the United States

The Streamlined Foreign Offshore Procedures are available to U.S. Citizens or lawful permanent residents who meet the applicable non-residency requirement as defined in the procedures. Reference is made to the definition of "abode" under IRC section 911(d)(3) & Treasury Regulation Sec. 1.911-2(b) and those meeting the substantial presence test of IRC section 7701(b)(3) will not be subject to failure-to-file and failure-to-pay penalties, accuracy-related penalties, information return penalties, or FBAR penalties.

Non-Willful Conduct

To choose the streamlined procedure for a taxpayer, the taxpayer has to certify that his or her failure to report foreign financial assets and pay all tax due for the three previous years did not result from willful conduct on

YOU MAY CONTACT FINCEN AT 1-800-949-2732 OR 1-703-905-3975

their part. Making the distinction between willful vs non-willful conduct is not only very important, it is very difficult- like skating on thin ice at best. The IRS states in IR-2014-73, "Non-willful conduct is conduct that is due to negligence, inadvertence, or mistake or conduct that is the result of a good faith misunderstanding of the requirements of the law."

Negligence, includes "any failure to make a reasonable attempt to comply with the provisions of the Code" (IRC Sec. 6662(c)) or "to exercise ordinary and reasonable care in the preparation of a tax return" (Reg. Sec. 1.6662-3(b) (1)). Further, "negligence is a lack of due care in failing to do what a reasonable and ordinarily prudent person would have done under the particular circumstances." (Kelly, Paul J., (1970) TC Memo 1970-250). The court also stated that a person may be guilty of negligence even though he is not guilty of bad faith.

To determine "non-willful conduct", each delinquent taxpayer's case has to be carefully examined for their eligibility to file under the Streamlined Filing Procedures and a conscientious decision is to be made taking into account the taxpayer's facts and circumstances.

Some Illustrations of Potentially Non-willful Conduct:

1. Taxpayer A had bank accounts in a foreign country X before he migrated to the U.S. permanently in 2005. He had been preparing his own tax returns through an over-the-counter tax software which did not give him any indication about the need to disclose his foreign accounts. He heard about FATCA disclosure requirements only at the end of 2012 and decided to enter the Offshore Voluntary Disclosure Program. However, he could have also filed his delinquent foreign financial account disclosures through the Streamlined Domestic Offshore Procedures if he could state that the failure to file the foreign bank account disclosures was due to non-willful conduct.
2. Taxpayer B, a naturalized U.S. citizen, received an inheritance on her mother's death in 2004. The mother was not a U.S. citizen and lived in a foreign country. The inheritance was $152,000. She reported this to her tax professional and was advised that she need not take any action on it. Starting 2004, she added more money into the same bank account for four years to fund her daughter's education there. Once her daughter's education was complete, she left the money in that country as the exchange rate worked in her favor. Every year at tax time, she updated the tax professional about these accounts and no action was taken by them. So much so that even the box on Schedule B was not marked. Her circumstances may be construed as being non-willful conduct and the Taxpayer would qualify to file her delinquent returns under the Streamlined Domestic Offshore Procedures. The delinquent Form 3520 was also filed through this procedure.
3. Taxpayers and siblings, F and G, are naturalized U.S. citizens. They came to the U.S. as students and have settled here. The taxpayers were unaware of the fact that their grandparents had set up a trust in the country they are from, for all the grandchildren. This trust had over time made good investments and earnings were being deposited into foreign bank accounts in their name. The family had completely forgotten about the grand-parents' trust and it's earnings until changed bank regulations in the home country required the account-holder's current information for their "Know-Your-Customer" policy. The taxpayers may be able to file delinquent foreign bank account disclosures and Forms 3520-A under the Streamlined Domestic Offshore Procedures, if they can successfully demonstrate non-willful conduct for failure to file required forms.

Conclusion

The IRS is constantly seeking compliance from Foreign Financial Institutions to reveal the names of U.S. citizens who have accounts with them and more of these institutions are complying with the rules. And an increasing number of countries are also signing the FATCA agreement with the U.S. In light of this, practitioners dealing with clients with delinquent foreign bank account disclosures should be familiar with each of the options, whether it is the Offshore Voluntary Disclosure Program (OVDP) or the Streamlined Domestic Offshore Procedures to effectively counsel clients as to which compliance path best fits the particular facts and circumstances of the case. Not every case is the same. **EA**

About the Author

Manasa Nadig, EA, *is the founder/owner of MN Tax and Business Services PLLC and a partner at Harris Nadig LLC, both based in the Metro Detroit, MI. Her practice caters to taxation and business needs of individuals, small enterprises, trusts, and non-profits. Nadig's specialization is in FATCA and FBAR compliance for cross-border entities and U.S. nationals within the country and abroad. She discusses various tax issues on her popular blog "The Buzz About Taxes" at www.thebuzzabouttaxes.com. Contact Manasa at manasa@mntaxsolutionsllc.com.*

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ENDNOTES

1. 26 U.S. Code Sec. 6038D
2. Final Regulations issued via T. D. 9706 dated December 12th, 2014 Part V and Sec. 301.7701(b)-7]
3. 26 CFR 1.6038D-7 New in 2015 Part IV to Form 8938
4. 26 U.S. Code Sec. 6038D(d) and 26 CFR 1.6038D-8
5. As laid down in the Internal Revenue Manual 9.5.11.9 under "Voluntary Disclosure Practice"
6. IRS Makes Changes to Offshore Programs; Revisions Ease Burden and Help More Taxpayers Come into Compliance IR-2014-73, June 18, 2014