On March 18, 2010 President Obama signed into law the Hiring Incentives to Restore Employment (HIRE) Act which provided tax incentives to employers who hire and retain workers. To pay for these benefits, the HIRE Act implemented new foreign withholding and information reporting requirements.

The HIRE Act contains several provisions of interest to clients with foreign accounts and foreign trusts including the FATCA provisions.

Under FATCA, certain U.S. taxpayers holding financial assets outside the U.S. must report those assets to the IRS. In addition, FATCA will require foreign financial institutions to report directly to the IRS certain information about financial accounts held by U.S. taxpayers, or by foreign entities in which U.S. taxpayers hold a substantial ownership interest.

The U.S. government has stepped up its requirements for reporting US and foreign assets and income. Below are some of the more commonly required issues and filing requirements:

1. Form TD F 90-22.1 “Report of Foreign Bank and Financial Accounts” (FBAR)
2. Form 8938 “Statement of Specified Foreign Financial Assets”
3. Form 3520 “Annual Return To Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts”
4. Foreign Rental Properties
5. IRS Offshore Voluntary Disclosure Initiative (OVDI)
6. Expatriation (877A)

1. ***Form TD F 90-22.1 "Report of Foreign Bank and Financial Accounts" (FBAR)***

The FBAR is required because foreign financial institutions may not be subject to the same reporting requirements as domestic financial institutions. The FBAR is a tool to help the United States government identify persons who may be using foreign financial accounts to circumvent United States law. Investigators use FBARs to help identify or trace funds used for illicit purposes or to identify unreported income maintained or generated abroad.

Who must file Form TD F 90-22.1?

Form TD F 90-22.1 is required by United States persons that have a financial interest in or signature authority over foreign financial accounts must file an FBAR if the aggregate value of the foreign financial accounts exceeds $10,000 at any time during the calendar year.

A United States person means United States citizens; United States residents; entities, including but not limited to corporations, partnerships, or limited liability companies created or organized in the United States under the laws of the United States and trusts or estates formed under the laws of the United States.

What is considered a foreign financial account?

The location of where the account is maintained determines if it is foreign. Generally, the Treasury Department has defined the term "bank account" to mean a savings deposit, demand deposit, checking or any other account maintained with a person engaged in the business of banking.

Reportable accounts include bank, securities and brokerage accounts, commodities or futures options, mutual and pooled funds and insurance or annuity policies with a cash value.

2. Form 8938 "Statement of Specified Foreign Financial Assets"

The form is required to report your specified foreign financial assets if the total value of all the specified foreign financial assets in which you have an interest is more than the appropriate reporting threshold.

Taxpayers have long been required by the Bank Secrecy Act to report certain foreign accounts. Now, there is a new reporting requirement in the Foreign Account Tax Compliance Act of 2010. The IRS is requiring certain taxpayers to report their specified foreign financial assets in which they have an interest in tax years starting after March 18, 2010. For most individual taxpayers, the IRS has explained that this means they will start reporting by filing new Form 8938, Statement of Specified Foreign Financial Assets, with their 2011 income tax return. This is in addition to any reporting requirement under the Bank Secrecy Act using the so-called "FBAR" form. The new reporting requirement is significant and is expected to impact many taxpayers. This letter highlights some of the key elements of the new reporting requirement.

Who must file Form 8938?

Form 8938 must be filed by "specified individuals" with "specified foreign financial assets." The IRS has explained in the Instructions to Form 8938 and in guidance that a specified individual is a U.S. citizen; a resident alien of the U.S. for any part of the tax year; a nonresident alien who makes an election to be treated as resident alien for purposes of filing a joint income tax return; or a nonresident alien who is a bona fide resident of American Samoa or Puerto Rico.

The IRS also reported that in the future it intends to require specified domestic entities to file Form 8938 if the entity is formed or availed of to hold specified foreign financial assets, and the value of those assets exceeds the appropriate reporting threshold. The IRS has issued proposed regulations which provide that specified domestic entities include certain domestic corporations, domestic partnerships, and trusts. At this time, there is no Form 8938 filing requirement for specified domestic entities. More guidance about specified domestic entities is being developed by the IRS.

Specified foreign financial assets

The IRS has described what constitutes a specified foreign financial asset in the Instructions to Form 8938 and in guidance. Generally, the IRS has explained that specified foreign financial assets include foreign financial accounts, and foreign non-account assets held for investment (as opposed to held for use in a trade or business), such as foreign stock and securities, foreign financial instruments, contracts with non-US persons, and interests in foreign entities.

Along with knowing what assets meet the definition of a specified foreign financial asset, it is important to know what assets are excluded from the definition of a specified foreign financial asset. The IRS has explained that certain assets of a foreign nature are not specified foreign financial assets that require Form 8938 reporting. Additionally, certain specified foreign financial assets reported elsewhere do not need to be reported on Form 8938.

Exceptions are also made for certain trusts and assets held by bona fide residents of U.S. possessions. One important exception applies to an interest in a social security, social insurance, or other similar program of a foreign government. If you have any questions about the types of assets that are excluded from the definition of specified foreign financial asset, please contact our office.

Thresholds

The IRS has developed monetary thresholds for reporting. The thresholds vary depending on the taxpayer's status.

1. Unmarried taxpayers living in the U.S.: The total value of the taxpayer's specified foreign financial assets is more than $50,000 on the last day of the tax year or more than $75,000 at any time during the tax year.
2. Married taxpayers filing a joint income tax return and living in the U.S.: The total value of the couple's specified foreign financial assets is more than $100,000 on the last day of the tax year or more than $150,000 at any time during the tax year.
3. Married taxpayers filing separate income tax returns and living in the U.S.: The total value of the taxpayer's specified foreign financial assets is more than $50,000 on the last day of the tax year or more than $75,000 at any time during the tax year.

4. Taxpayers living abroad. An individual is a taxpayer living abroad if (1) the individual is a U.S. citizen whose tax home is in a foreign country and the individual is either a bona fide resident of a foreign country or countries for an uninterrupted period that includes the entire tax year; or the individual is a U.S. citizen or resident, who during a period of 12 consecutive months ending in the tax year is physically present in a foreign country or countries for at least 330 days.

Taxpayers will need to determine the value of their specified foreign financial assets. Generally, the IRS has explained that specified individuals may rely on periodic account statements for the tax year to report a financial account's maximum value unless the taxpayer knows or has reason to know that the statements do not reflect a reasonable estimate of the maximum account value during the tax year. The IRS has provided guidance on valuing other types of specified foreign financial assets.

Form 8938 is filed with the specified individual's federal income tax return. A specified individual does not need to file Form 8938 if he or she is not required to file a federal income tax return, the IRS has explained.

International cooperation

After Congress passed FATCA, the U.S. Treasury began discussing the new reporting and disclosure requirements with foreign governments, especially France, Germany, Italy, Spain, and the United Kingdom. These discussions produced in mid-2012 a model intergovernmental agreement intended to facilitate government-to-government implementation of FATCA. The U.S. is also discussing FATCA implementation with Japan and Switzerland.

Penalties

Penalties for noncompliance with FATCA can be substantial. There is a failure to file (Form 8938) penalty of $10,000 and an additional penalty of up to $50,000 for continued failure to file after notification by the IRS. However, a taxpayer may avoid a penalty if failure is due to reasonable cause and not willful neglect. In addition, penalties for underpayment and fraud may apply as well as criminal penalties.

3. ***Form 3520 "Annual Return To Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts"***

A foreign gift is any amount received from a person other than a U.S. person that you treat as a gift or bequest. If you received more than a certain threshold amount you must furnish certain information to the IRS.

The threshold amount varies with the type of donor. If the gift is from a nonresident alien or a foreign estate, reporting is only required if the total amount of gifts from the nonresident alien or foreign estate is more than $100,000 for the tax year (plus an inflation adjustment that brings the exclusion to $143,000 in 2013, up from $139,000 in 2012). However, if the gift is from a foreign corporation or foreign partnership, the threshold is much lower - $15,102 for gifts made during a tax year beginning in 2013 (previously $14,723 for 2012 gifts).

Although reporting is only required if you know or have reason to know that the donor is a foreign person, the penalty is severe if the IRS determines that you should have filed a report but did not - 5 percent of the gift per month or part of a month, up to a maximum of 25 percent. The penalty doesn't apply to any failure to report a foreign gift if the failure is due to reasonable cause and not willful neglect.

In order to comply with these rules and not be subject to a penalty, Form 3520 must be filed as an attachment to your income tax return by the due date, including extensions. In addition, a copy of the Form 3520 must be sent to the Philadelphia Service Center by the same date.

If you have received, or expect to receive a gift, from an individual who has voluntarily relinquished his or her U.S. citizenship, please contact our office. The special tax rules impose a transfer tax on certain gifts from an expatriate.

There are some planning techniques, such as gift-splitting, which I may be able to advise you on to avoid the reporting requirements. Since the penalty for not reporting can be so severe, it is important that you be certain whether or not the reporting requirements apply to you.

4. <u>Foreign Rental Properties</u>

5. IRS Offshore Voluntary Disclosure Initiative (OVDI)

Increasing numbers of U.S. taxpayers have investments in bank and other financial and security accounts in foreign countries. Although it is not illegal to have foreign accounts, you must disclose the accounts to the IRS and report any related income for tax purposes. In recent years, the IRS has been aggressively pursuing taxpayers that use undisclosed foreign accounts and foreign entities to avoid or evade tax.

Disclosure programs

In 2009 and 2011, the IRS launched two programs to encourage taxpayers to voluntarily disclose their unreported foreign accounts. In exchange, the 2009 and 2011 offshore voluntary disclosure programs offered taxpayers a reduced penalty framework. The 2011 offshore voluntary disclosure program ended in September 2011. The IRS reported in early 2012 that it collected $4.4 billion from the 2009 and 2011 programs and it expects the amount collected to grow as it works more cases.

Reopened program

In January 2012, the IRS announced it was reopening the offshore voluntary disclosure program but with some changes. The IRS explained that it reopened the program following continued strong interest from taxpayers and tax practitioners after the closure of the 2011 and 2009 programs.

Participants in the reopened, third program must file all original and amended tax returns. Participants also are responsible for payment for back-taxes and interest for up to eight years as well as paying accuracy-related and/or delinquency penalties, the IRS explained.

Like the 2009 and 2011 programs, the reopened program offers taxpayers a reduced penalty framework in exchange for their voluntary disclosures. For the new program, the penalty framework requires individuals to pay a penalty of 27.5 percent of the highest aggregate balance in foreign bank accounts/entities or value of foreign assets during the eight full tax years prior to the disclosure. The penalty amount is up from 25 percent in the 2011 program.

Reduced penalties for certain taxpayers

Some taxpayers may be eligible for reduced penalties of 12.5 or five percent. Generally, the 12.5 percent penalty may apply in cases where the taxpayer's highest aggregate account balance is less than $75,000.

IRS Offshore Voluntary Disclosure Initiative (OVDI) (continued)

The five percent penalty may apply if the taxpayer can show that the foreign account was not used to hide income and the taxpayer did not have any withdrawals of more than $1,000 in any year, unless transferred to an account in the U.S. The five percent penalty may also apply in the case of a foreign resident who was unaware that he or she was a U.S. citizen. Additionally, the five percent penalty may apply to taxpayers who are foreign residents and who meet all of their tax requirements in that foreign country. In these cases, the taxpayer must have $10,000 or less of U.S. source income each year.

No deadline

The reopened program has no deadline. However, the IRS reserved the right to change the terms of the reopened program at any time. The IRS explained on its website that it could increase penalties in the program for all or some taxpayers or defined classes of taxpayers; or it could decide to end the program entirely at any point.

Procedures

The procedures and documentation required for the reopened offshore voluntary disclosure program are quite extensive. The IRS generally requires taxpayers to complete a voluntary disclosure package. Assembling this package requires careful preparation of many documents. We would be happy to assist you if you are interested in pursuing this initiative. Please call our office at your earliest convenience to arrange an appointment.

The OVDP can be a significant benefit to affected taxpayers. Penalties outside the program can be onerous and can include, amount others: penalties for failing to file Form TD F 90-22.1, Report of Foreign Bank and Financial Accounts (FBAR); civil penalties; penalties for failing to file a return; and accuracy related penalties. In addition, criminal prosecution is a risk.

The IRS recognized that its success in offshore enforcement and in the disclosure programs has raised awareness related to tax filing obligations, including dual citizens and others who may be delinquent in filing, but owe no U.S. tax. The IRS has also recently rolled out a “streamlined procedure” for certain taxpayers.

*6. **Expatriation (877A)***

The U.S. imposes income tax on the worldwide income of its citizens and green card holders even if they reside overseas. U.S. citizens and certain green card holders residing overseas are also subject to U.S. gift and estate tax on transfers of worldwide assets. As a result, such individuals sometimes consider relinquishing their citizenship or green card with the hope of freeing themselves from the U.S. tax system. In 2008, Congress added some special tax rules for higher income U.S. citizens who expatriate; and may cause the expatriating individual to be subject to an exit tax and treated as if all assets were sold on the day before the expatriation date.

All U.S. citizens who relinquish or "give up" their citizenship status and "former long-term" residents who give up their green cards are subject to the new expatriation rules if they meet any of the following three tests:

1. Net Income Tax Test – For the five-year period before expatriation, the individual had an average annual U.S. income tax liability of at least $XXX,000.
2. Net Worth Test – The individual's net worth is at least $2 million.
3. Certification Test – The individual fails to certify that he or she satisfied all applicable U.S. tax obligations for the five years before expatriation.

An individual who is subject to the expatriation rules is referred to as a "covered expatriate". A "former long-term resident" is an individual who has held a green card for any portion of at least eight of the fifteen tax years preceding expatriation.

An individual who has been resident in the U.S. for eight years under any other immigration status, such as a work visa, is not a long-term resident for purposes of expatriation rules.

4. Foreign Rental Properties