

# WTF: WHAT'S THE FBAR AND WHY THIS FATCA

What Advisors Need to Know  
When Encountering Foreign  
Assets and Accounts

PRESENTED 11/15/18

THE ESTATE PLANNING COUNCIL OF THE FUN COAST



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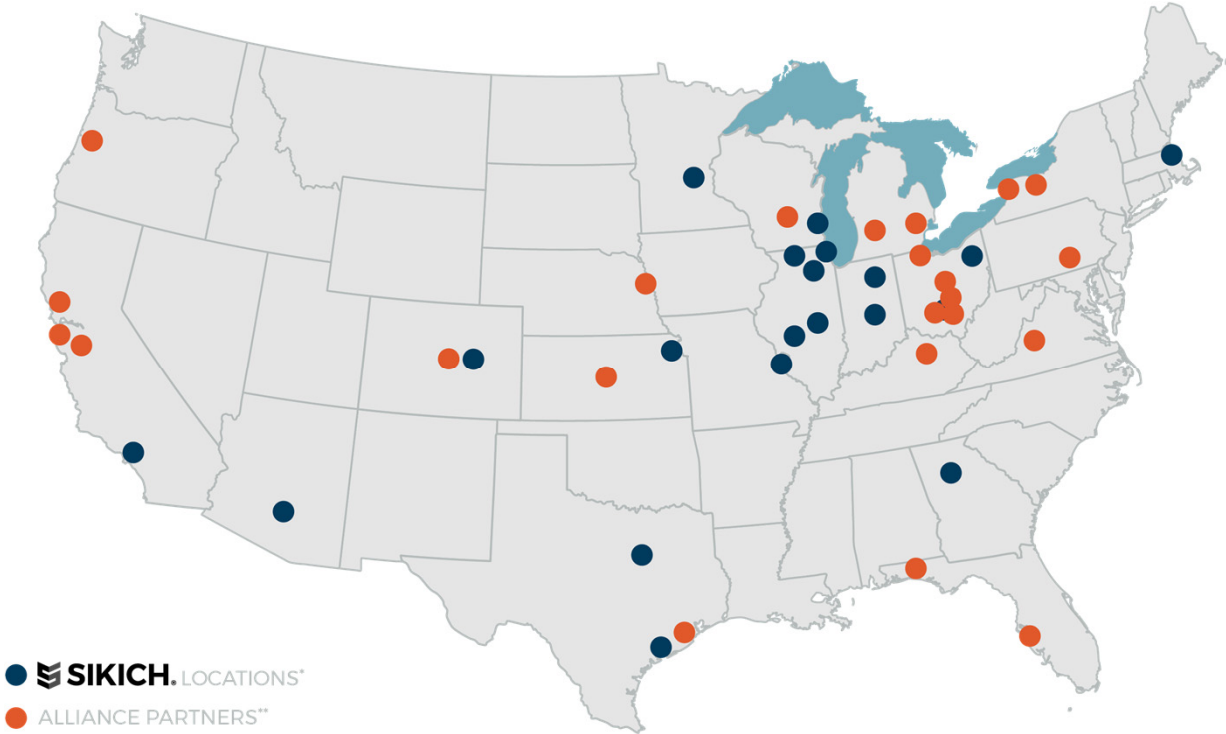
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# AGENDA

- Why does it matter?
- Background
- What's the FBAR?
- Why FATCA?
- Comparing FBAR and FATCA
- What about other Foreign activity?



# WHY DOES IT MATTER?



## U.S. PROSECUTION, SETTLEMENT & ENFORCEMENT OF FOREIGN BANKS

### ■ Switzerland

- UBS - deferred prosecution agreement; information exchange; over \$780 million of fines, restitution.
- Wegelin & Co. - *oldest Swiss private bank; pled guilty and entirely closed*
- Credit Suisse - guilty plea and \$2.6 billion of penalties.
- HSBC Switzerland - private bank list leaked; accountholders from >200 countries; balances over \$100 billion.

### ■ Israel:

- Bank Leumi -deferred prosecution agreement; \$400 million of fines.

## TAXPAYER ENFORCEMENT – CRIMINAL CASES

- *Ahuja* (D.Wisc. 2012)
  - Omitted income = \$2.7m; no FBAR filed
  - Jury trial, guilty 1 count FBAR, 1 count false return
  - \$350,000 penalty plus probation
  
- *Warner* (N.D. Ill. 9/18/13) (“Beanie Babies” founder)
  - Warner is #209 on Forbes 400 list
  - Account balance of \$96.6 million (UBS, then transferred out to Zurcher; use of nominee foundation to hide)
  - Taxes underpaid of about \$885,000
  - Paying \$53.5 million civil FBAR penalty and \$16m+ of back taxes; sentenced 1/14/14 to 2 years probation
  
- See WSJ: “Leniency for Offshore Cheats” (May 5, 2013)
  - Your results may vary
  - DOJ is still pursuing very substantial jail time and fines
  - *Curran* (S.D. Fla. 2013)



## U.S. AGENCIES WANT TO KNOW ABOUT YOUR FOREIGN ASSETS

- U.S. Treasury
  - Requires FBAR filing – Foreign Bank Account Report
- Internal Revenue Service
  - Requires disclosure of various foreign activity and Income
- Department of Commerce – Bureau of Economic Analysis
  - Require information on U.S. Investments abroad and foreign investments in the U.S.
- State Governments
  - Reporting for Income, estate and inheritance taxes



# BACKGROUND



## BANK SECRECY ACT

- Enacted in 1977, but expanded in 2004 and again in 2008
- FinCEN – Financial Crimes Enforcement Network
  - Bureau of the U.S. Treasury Department
  - Safeguarding the financial system by maintaining transaction data
- Obtain information on accounts and flow of funds
- Prevent - money laundering, terrorism and tax evasion

# INTERNATIONAL INVESTMENT AND TRADE IN SERVICES SURVEY ACT



- Originated 1976
- Obtain information on U.S. investments abroad (and vice versa)
- Delegated to Dept of Commerce – Bureau of Economic Analysis (BEA)
- Expanded in 2014 - Requiring surveys by taxpayers with foreign business relations
- Failure to submit survey result in penalties – civil up to \$32,500 and criminal of \$10k and one-year imprisonment

## U.S. TAX SYSTEM

- A worldwide tax system vs. a territorial system
  - As of 2018 quasi territorial system, but only for C Corporation
  - Most other countries have a territorial system
- A U.S. citizen is taxed on worldwide income
  - regardless of country of residence or where income is earned

# IRS REPORTING

- Familiar Reporting Forms:

- W-2
- 1099's
- W-9
- 1040



- Less Familiar:

- FBAR Form 114
- FATCA Form 8938 & W-8
- 3520
- 5471



## FILING - BY THE NUMBERS

2014 - Estimated 7.6 million US Citizens living abroad yet only 1 million FBARs filed

- Approximately 13%
- Does not include US residents with foreign accounts

Expatriation increasing

Tax Year	Exit Filings
2008	225
2014	> 3,400
2016	> 5,400
2017	> 5,100





# WHAT'S THE FBAR?



## FOREIGN BANK ACCOUNT REPORT (FBAR) OVERVIEW

- Any U.S. person:
  - with a financial interest in,
  - or signatory authority over,
  - any foreign financial accounts
  - with an aggregate value
    - at any time during the year
    - in excess of \$10,000
- Must file FinCEN Form 114 (FBAR) by the due date.



## FBAR DEFINITIONS – “U.S. PERSON”



- U.S. citizens or residents
- Any entity created or organized in the U.S., or under the laws of the U.S. (corporations, partnerships, LLCs, trusts, estates)
- Single-member LLCs (revocable trusts, etc.) – though disregarded for tax purposes, are not disregarded for FBAR purposes – so they must file FBARs.
- No special exemptions for minors

## FBAR DEFINITIONS – “FOREIGN FINANCIAL ACCOUNT”

- Very broadly interpreted
- Does not include assets held solely in U.S. person’s own name
  - (i.e., which are not in any kind of account)
- “Foreign” = physical location of account / branch
- Pension plans and IRAs – reporting by participants
  - U.S. qualified plan/IRA – participants don’t FBAR report
  - Foreign retirement accounts – can vary considerably; rules get complex.
- Insurance policies and annuities – policy holder reports if there is cash value
- Misc. Accounts:
  - Mutual/pooled funds; Commodity futures and option accounts = yes
  - Foreign hedge funds/private equity funds = generally no



## FBAR DEFINITIONS – “AGGREGATE VALUE”

- \$10,000 Aggregate Value

- At any time during the year – even if funds land in account for moments
  - Determine each account’s high Current Year balance, then total.

- Example:

Kristin, a United States person, owns foreign financial accounts A, B and C with account balances of \$3,000, \$1,000 and \$8,000, respectively. Kristin is required to report accounts A, B and C because the aggregate value of the accounts is over \$10,000. It does not matter that no single account exceeded \$10,000.

- Example

assume during 2018 client had \$7,000 total in foreign accounts, as follows:

- Jan-May: in Barclays; June moved to Royal Bank of Scotland
- Result: FBAR due: \$7k high at Barclays+ \$7k high at Royal Bank of Scotland = \$14k
- Conclusion: FBAR REQUIRED

## FBAR DEFINITIONS – “FINANCIAL INTEREST” OR “SIGNATURE AUTHORITY”

- Financial interest = direct or indirect ownership
- Authority of U.S. individual:
  - alone or in conjunction with another
  - to control the disposition of money, funds or other assets held in the account,
  - by direct communications
    - in writing or otherwise
    - to the bank or institution with whom the financial account is maintained.
- Limited exceptions apply for certain officers/employees with signature authority over, but no financial interest in their employer/company foreign bank account



## FBAR DUE DATE

Don't Miss the  
**DEADLINE!**

- MUST BE E-FILED
- 2015 & PRIOR – due on June 30<sup>th</sup> with NO EXTENSION
- 2016 New rule
  - (§2006 of Surface Transportation and Veterans Health Care Choice Improvement Act of 2015,)
  - Due date now changed to April 15<sup>th</sup> of following year, with automatic 6-month extension to October 15<sup>th</sup>

## FBAR PENALTIES



- Regular (non-willful) penalty
  - Statute: up to \$10,000 “per violation”
    - Adjusted for inflation – post 2015 violation now \$12,459
  - Up to maximum of 50% of highest aggregate account balance (HAAB) during open years
  
- Willful penalty (willful = voluntary, intentional violation of a known legal duty)
  - Civil
    - Statute: greater of \$100,000 or 50% of highest aggregate foreign account balance during the year
      - Adjusted for inflation – post 2015 violation now \$124,588
    - IRS General Rule: maximum willful civil penalty = 50% of HAAB during open years
  - Criminal
    - Fine of up to \$250,000 or 5 years in prison (or both)
    - Where part of a pattern of illegal activity, up to \$500,000 or 10 years in prison (or both)

## DELINQUENT FBAR PROCEDURES

- Eligibility
  - Properly **reported and paid tax** on all income from the unreported accounts on U.S. income tax returns
  - Just failed to file FBARs
  - Not under examination and has not been contacted by IRS re- delinquent FBARs
  - # of years required: file up to 6 years delinquent FBARs
  - Must include statement explaining why FBARs are late – “Reasonable Cause”
  
- Consequences
  - No penalties will be assessed unless reasonable cause explanation is insufficient
  - May separately be selected for audit





Getting the facts on

**FATCA**

**WHY THE FATCA?**

## FATCA - FOREIGN ACCOUNT TAX COMPLIANCE ACT

- **Purpose** to gather information on U.S. tax evaders with offshore assets earning income not reported to the IRS
- **Requires** foreign payees (banks) to disclose significant U.S. investors & account holders
- **U.S. and Foreign** withholding agents are required to administer the new rules
- Creates an **additional set** of withholding and reporting rules for U.S. persons who make payments to foreign persons

## FATCA - FFI / NFFE *REPORTING* (MINI-OVERVIEW)

- FFI = Foreign Financial Institution
  - General Rule - Must report information to IRS regarding US accounts
  - Any foreign entity that accepts deposits in the ordinary course of banking or similar business
  - holds financial assets for others OR engaged in investing or trading securities, partnership interest or commodities
  - Required to register and enter an agreement with the U.S. Department of Treasury
  
- NFFE = Non Foreign Financial entity
  - Must report to withholding agents on substantial U.S. owners
  - Certify eligible for exempt “low-risk” status

## FATCA - FFI / NFFE *WITHHOLDING* (MINI-OVERVIEW)

- U.S. Payor to FFI: Withholding agent must withhold 30% of “withholdable payments” unless either applies:
  - FFI is shown on the IRS’ list of registered entities (has a “GIIN”)\*; or
  - FFI is shown as “deemed compliant”
  
- U.S. Payor to NFFE: Must withhold unless all of the following are met:
  - Beneficial owner or payee certifies no substantial U.S. owners, or provides name address and TIN of each US owner;
  - Payor has no knowledge and no reason to know info is wrong; and
  - Payor reports the required beneficial owner or payee information
  
- Form W-8 BEN / W-8 BEN-E
  - Certificate of status of beneficial owner



## FATCA ACCOUNT HOLDER REPORTING OVERVIEW

- Any U.S. individual:
  - who holds any interest in a specified foreign asset (SFA)
  - must attach certain required information to their income tax return for that tax year for each SFA
  - if the aggregate of the individual's specified foreign assets exceeds the threshold amount – either:
    - \$50,000 on last day of year; or
    - \$75,000 at any point during the year
- Report on **Form 8938** (Statement of Foreign Financial Assets).
- 2016 expanded Form 8938 reporting to require filing by certain entities:
  - Corporations and partnerships
  - Trusts (with some exceptions)

## FATCA DEFINITIONS - “U.S. INDIVIDUAL”

- U.S. citizen
- U.S. resident at any time during the year
- Resident alien who elects to be treated as a resident of a foreign country under the relevant income tax treaty residency tie-breaker tests
  - NOTE: someone not required to file U.S. income tax return may still have to file Form 8938.



## FATCA DEFINITIONS - “SPECIFIED FOREIGN FINANCIAL ASSET”

- Financial account” maintained by a “foreign financial institution” (FFI).
  - Specifically includes:
    - Any stock or security issued by non-U.S. person
    - “Financial instrument or contract” held for investment with issuer or non-U.S. counterparty
    - Any interest in a “foreign entity”
- Financial Instrument or Contract – Includes:
  - Interest and currency swaps
  - Other swaps, options and derivative contracts
  - **Interests in foreign trusts or estates**
    - Exception if no knowledge or reason to know of interest
    - Receiving a distribution confers actual knowledge
  - **Accounts in foreign pension or deferred compensation plans**
  - Some loans (rules in regulations are complex)
- Does *not* include:
  - Gold held in a safety deposit box
  - Artwork
  - Interests in social security or similar program
  - Foreign real estate (unless held via foreign entity)

## FATCA ACCOUNT HOLDER REPORTING PENALTIES

- Failure to disclose
  - \$10,000 for failure to file Form 8938 (or worse if willful)
  - Addl. penalties if still fail after IRS notice
- Accuracy-related penalty for “undisclosed foreign financial asset understatements”
  - Understatement attributable to UFFAUs = 40% penalty
- Extended statute of limitations
  - stays open for SFFAs until 3 years after Form 8938 is filed disclosing the asset
  - New 6-year limitation for SFFAs omitted from gross income





## DELINQUENT FILING PROCEDURES

- Delinquent international information return submission *procedures*
  - *ONLY available if all income from foreign assets has been reported and tax paid*
- Official alternatives:
  - ~~Offshore Voluntary Disclosure Program (ENDED 9/28/18)~~
  - Streamlined Filing Compliance *Procedures*
    - Foreign
    - Domestic



## FBAR AND FATCA COMPARISON

	FBAR - FINCEN 114	FATCA - FORM 8938
DOES THE U.S. INCLUDE U.S. TERRITORIES	YES	NO
REPORTING THRESHOLD	\$10,000 AGGREGATE	VARIABLES BY FILING STATUS AND RESIDENCE
U.S. ENTITIES REQUIRED TO FILE	YES	MAYBE
WHAT IS REPORTED	MAX VALUE OF FOREIGN FINANCIAL ACCOUNTS DURING THE YEAR	MAX VALUE OF SPECIFIED FOREIGN ASSETS DURING THE YEAR
HOW IS VALUE DETERMINED	MAX VALUE USING 12/31 EXCHANGE RATE	MAX VALUE USING 12/31 EXCHANGE RATE
WHEN DUE	APRIL 15 <sup>TH</sup> , AUTOMATIC 6 MONTH EXTENSION	FORM IS ATTACHED TO ANNUAL INCOME TAX RETURN AND FILED BY DUE DATE W/EXTENSION
WHERE TO FILE	ELECTRONICALLY THROUGH FINCEN	FILE WITH INCOME TAX RETURN PER INSTRUCTIONS
PENALTIES	NON-WILLFUL \$12,459 (AFI); WILLFUL - > \$100K OR 50% ACCT BAL CRIMINAL - MAY APPLY	\$10,000 FAILURE TO DISCLOSE MAX \$60,000 FAILURE AFTER NOTICE CRIMINAL - MAY APPLY



# WHAT ABOUT OTHER FOREIGN ACTIVITIES?



## REPORTING REQUIREMENTS

Reporting is often overlooked for its importance in international tax planning and compliance. All too often, it is an afterthought in an otherwise well planned transaction. The cost of inaccurate or missed reporting can be significant, including:

- Conversion of an otherwise non-recognition transaction into a taxable transaction
- Statute of limitations remains open
- Penalties

## REPORTING - U.S. OWNER OF FOREIGN CORPORATION

- Transfer of cash or property > \$100k in 12 month period outside the U.S.
- Owning 10% or more of a Foreign corporation
  - Including exchange of shares resulting in above or below 10% ownership
- 100% owner of foreign corporation
  - Annual informational disclosure filing requirement
  - New 2017 Tax Act – may want to analyze ownership due to new taxes
- Officer or director of foreign corporation

## REPORTING – FOREIGN PASS-THROUGH ENTITIES

- **Foreign Partnership**
  - Income reportable/taxable in US by US owner
  - Separate form required annually for each applicable foreign partnership
  - Required by U.S. person owning 50% or more of the partnership interest at any time during the year.
  - Required by an individual whose ownership interest is at least 10% immediately after contributing property
  - Required by an individual contributing property during the year when the total value of property contributed exceeds \$100,000 during the 12-month period ending on the date of the transfer
- **Foreign Disregarded Entity**
  - Form required annually for each applicable foreign disregarded entity (FDE)
  - Required by U.S. person that is tax owner of the FDE at any time during the year
- **Passive Foreign Investment Company (PFIC)**
  - A separate form required for each PFIC in which stock is held
  - U.S. persons may have ownership through a U.S. pass-through entity

## FOREIGN OWNER OF U.S. REAL PROPERTY



- Foreign Investment in Real Property Tax Act (FIRPTA)
  - Taxes foreign persons selling U.S. real estate
  - **Buyer** is required to withhold 15% on amount realized & submit to the IRS.
  - Look through to underlying owners if property is held in an entity
- Non-resident Aliens are subject to 10% withholding on sales proceeds from disposition of U.S. partnership that owns real property

## REPORTING FOREIGN TRUSTS, GIFTS & INHERITANCE

### ■ Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts



- Contribution to a foreign trust
- Beneficial owner of foreign trust or recipient of a distribution during the tax year
- Responsible party for reporting a reportable event during the tax year (Trustee)
- Recipient of more than \$100,000 from nonresident alien individual or foreign estate or more than \$15,601 from foreign corporation or partnership treated as gifts or bequests.
  - Caution – there are states with an inheritance tax.



## US GIFT AND ESTATE LIMITATIONS NONCITIZEN SPOUSE

- Careful planning is required when one spouse is not a U.S. Citizen
- Lifetime gifts to a noncitizen spouse do not qualify for the marital deduction (unlimited deduction)
  - 2018 Annual exclusion gift of \$152,000 is allowed
- Assets passing upon death to a noncitizen spouse qualify for the marital deduction if:
  - Assets pass to the spouse in a qualified domestic trust (QDOT) or
  - The spouse is a U.S. resident who becomes a U.S. citizen before the due date of the estate tax filing form 706
- Lifetime exemption for noncitizen spouse is \$60,000



## INDIVIDUAL TAXPAYER IDENTIFICATION NUMBER (ITIN)

- Is a tax processing number issued by the Internal Revenue Service.
- Issued to individuals required to have a U.S. taxpayer identification number
  - But who do not have, and are not eligible for a Social Security number (SSN).
  - Looks just like an SSN, 9-digit number beginning with 9
- Are required to furnish a tax ID or file a federal tax return.
- ITIN's expire!
  - Must have filed tax return once in last 3 years
  - If issued before 2013 – check middle digits for those set to expire 12/31/18
- Complete Form W-7 to apply or renew



## LASTLY ... PASSPORT REVOCATION

- Passport revocation for “seriously delinquent tax debts”
  - Effective 12/4/15
  - Discretionary
    - Can include denial, revocation or limitation
    - Applies separately re spouses (i.e., no carryover of “taint”)
  - “Seriously delinquent” tax debt:
    - Assessed Federal tax liability;
    - Greater than \$50,000 (including interest and penalties); and
    - Either
      - Notice of federal tax lien which is no longer appealable; or
      - Levy
    - Exceptions
      - Debt being paid timely under installment agreement;
      - Collection due process hearing is pending; or
      - Innocent Spouse relief has been requested
  - Notice required to taxpayer, who can petition U.S. Tax Court or sue in U.S. District Court for determination of whether revocation was improper (or whether IRS failed properly to reverse certification).





## KEY TAKE AWAYS

- No “SAFE” countries anymore
- Transparency is the new international norm
- Voluntary disclosure/remedies narrowing
  - No longer OVDP – ended September 28, 2018
  - Foreign banks disclosing information
- Clients blaming advisors/accountants
- Consider modifying best practices



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