U.S. Foreign Account Tax Compliance Act:
New Reporting Obligations on Foreign Financial
Institutions about U.S. Individuals’ Accounts,
Investments

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The Foreign Account Tax Compliance Act (FATCA),
signed into law on March 18, 2010, was enacted to
combat tax evasion by U.S. citizens and residents who
have offshore accounts and assets.1

Under FATCA, beginning in 2014, the U.S. Internal
Revenue Service (IRS) will receive annual reports
(“FFI Reports”) from certain foreign financial institu-
tions (FFIs)—including foreign banks and foreign in-
vestment funds—that disclose information regarding
accounts and investments held or owned at the FFI by
U.S. citizens and residents, including lawful permanent
residents who hold U.S. “green cards” (“U.S. Per-
sons”).2

Before FATCA, foreign financial institutions were not
required to report to IRS information about accounts
held directly or indirectly by U.S. Persons, except in
limited situations.3

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The filing of FFI Reports with IRS will substantially increase the likelihood that U.S. Persons who have failed to file tax returns and reported income with IRS will face criminal prosecution. However, only persons not currently under investigation are eligible for such treatment. In return, how-ever, IRS frequently agrees not to refer the case to the Department of Justice for criminal investigation and prosecution. Moreover, each person not currently under investigation may apply for aBooks through the IRS voluntary disclosure program to enter into FFI Agreements to report accounts and increase the likelihood that U.S. Persons who have failed to file returns and pay taxes will face criminal prosecution.

In light of this regime, many individuals living and working outside the United States were liable to file tax returns and pay U.S. tax on income anywhere in the world. Foreign-source‘passthru’ payments from other FFIs were likely to be reported to IRS under FATCA, and potential strategies to assess and address individuals' tax liabilities now may be the ideal time for them to address their tax liabilities, and may not have complied with all of their obligations.

As discussed further below, these individuals are liable for U.S. tax and may be subject to increased risk of civil and criminal penalties where IRS Reports begin to be filed. Such individuals who were unaware of these obligations, or thought they would escape detection, now may be the ideal time for them to address their liabilities.

Two factors are critical in determining the potential U.S. civil and criminal exposure individuals face in the wake of FATCA, and potential strategies to assess and address any such exposure:

Pre-FATCA Reporting Requirements Involving Foreign Assets for U.S. Persons

Unlike most other countries, the United States taxes the worldwide income of its citizens and residents. Accordingly, U.S. Persons are generally liable to file tax returns and pay U.S. tax on income anywhere in the world. Foreign-source‘passthru’ payments from other FFIs were likely to be reported to IRS under FATCA, and potential strategies to assess and address individuals' tax liabilities now may be the ideal time for them to address their tax liabilities, and may not have complied with all of their obligations.

For those individuals who were unaware of their obligations, or thought they would escape detection, now may be the ideal time for them to address their liabilities.

U.S. Persons maintaining significant accounts with foreign banks and other financial institutions are very likely to be reported to IRS under FATCA beginning in 2014 with respect to calendar year 2013 accounts and incomes.

Tax Return Filing Obligations, Reporting Requirements Involving Foreign Assets

Generally, a U.S. citizen or resident must file a U.S. income tax return for 2011 if he or she had gross income in excess of $9,500 if single or $19,000 if married and filing jointly ($3,700 if married and filing separately).5 Generally, a U.S. citizen or resident must file a U.S. income tax return for 2011 if he or she had gross income in excess of $9,500 if single or $19,000 if married and filing jointly ($3,700 if married and filing separately).5

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FATCA imposes new requirement for FFIs to Report Information on Foreign Accounts

An individual who holds an interest in foreign accounts or foreign financial accounts with certain foreign financial institutions (FFIs) must report information about those accounts to the IRS under FATCA commencing in 2014 with respect to calendar year 2013 accounts and income.

U.S. Persons or entities with substantial U.S. owners that hold debt or equity interests in, or have financial accounts located outside the United States with foreign financial institutions if the aggregate value of such financial accounts exceeds $10,000 at any time during the calendar year. The obligation to file an FBAR is imposed by the Bank Secrecy Act of 1978, as amended (the Act).

Generally, an FBAR must be filed if the aggregate value of all financial accounts abroad owned or controlled by a person (whether U.S. or non-U.S.) exceeds $10,000 at any time during the calendar year. The obligation to file an FBAR is imposed by the Bank Secrecy Act of 1978, as amended (the Act). Any person who fails to file an FBAR will be subject to a civil penalty equal to the greater of 50 percent of the aggregate value of the individual’s reportable accounts or $100,000 per violation. In the case of willful failure, the individual may be required to pay a fine of at least $10,000 per violation. If the willful failure continues after the taxpayer is notified of the deficiency, plus $10,000 per month for each month such failure continues, plus possible criminal prosecution.

U.S. Persons may be required to submit information to IRS regarding foreign trusts, gifts and bequests from foreign persons, and investments in foreign entities.

Potential Civil and Criminal Penalties

U.S. Persons that have not paid their U.S. tax liabilities and who have not submitted tax returns for years prior to 2009 and have substantial assets in foreign accounts or financial accounts located outside the United States with foreign financial institutions may face severe civil penalties, including substantial fines, the payment of back taxes, and criminal penalties, including possibly imprisonment.

Civil Penalties

Civil penalties can be significant. For example, if a U.S. Person has failed to file a tax return, that person can be required to pay the IRS $10,000 per violation, including a penalty equal to 75 percent of the unpaid taxes.10

As another example, if an individual has failed to file an FBAR, that individual can be required to pay a fine of at least $10,000 per violation. In the case of willful failure to file an FBAR, the individual will be subject to a civil penalty under FBAR regulations. The penalty may be up to $100,000 per violation. If the willful failure continues after the taxpayer is notified of the deficiency, plus possible criminal prosecution.11

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Criminal Penalties

Criminal penalties might also be imposed in some circumstances, resulting in substantial fines and possible imprisonment. Generally, criminal liability will not arise where the U.S. Person acted willfully to avoid tax or filing obligations, but instead only results if the individual acted with willful intent.

The following are just a few of the most potentially relevant federal statutes:

- 26 U.S.C. Section 7203: This statute makes it a federal crime for a person to willfully fail to file income tax returns or other returns or to pay any tax or to file false returns or statements.
- 26 U.S.C. Section 7206: This statute makes it a federal crime for any person to willfully engage in any fraudulent or deceptive acts or practices in connection with any internal revenue matter.
- 26 U.S.C. Section 7201: This statute requires a taxpayer to have exercised ordinary business care and prudence in determining his or her tax liability. The burden of proof is on the taxpayer to demonstrate that he or she exercised ordinary business care and prudence in determining his or her tax liability.
- 26 U.S.C. Section 7203, 7206, and 7201: These statutes provide for criminal penalties for willful failure to file tax returns, willful failure to pay taxes, and willful failure to collect or pay taxes, respectively.

Penalties for failing to file an FBAR or to report information on foreign accounts can be significant, including substantial fines, the payment of back taxes, and criminal penalties, including possibly imprisonment.

A U.S. Person must file an FBAR (Form TD F 90-22.1) with the U.S. Treasury to report information about foreign financial accounts, including that obligation.

In addition, U.S. Persons must annually file an FBAR (Form TD F 90-22.1) with the U.S. Treasury to report information about foreign financial accounts, including that obligation.

Generally, an FFI will be required to report the following information for each calendar year with respect to each account covered by FATCA:

- the name, address, and taxpayer identification number of the account holder;
- such other information as IRS requires in the FFI Agreement or in other reporting forms and instructions.

Accordingly, a U.S. Person, including dual residents, maintaining significant accounts with foreign banks and other financial institutions are very likely to be reported to IRS under FATCA with certain information about the account holder.

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U.S. Persons that have not paid their U.S. tax liabilities and who have not submitted tax returns for years prior to 2009 and have substantial assets in foreign accounts or financial accounts located outside the United States with foreign financial institutions may face severe civil penalties, including substantial fines, the payment of back taxes, and criminal penalties, including possibly imprisonment.
26 U.S.C. Section 7206: A person found guilty of shaving the tax underpayment or failing to file a return must be fined up to $250,000 and imprisoned for up to five years. This statute may be fined up to $100,000, imprisoned for up to five years or both. The statute is applied for up to three years previous violations, and will be verdicts for the crime of evasion.

26 U.S.C. Section 7203: This statute, a federal misdemeanor, and has potential application in matters involving FBAR. A person, in a court or in any proceeding before a U.S. Authority, who under reports, in this return, by a return, or otherwise, any information or returns, to the IRS, is subject to imprisonment for up to five years. A person found guilty of violating this statute must be fined up to $250,000 and imprisoned for up to five years.

18 U.S.C. Section 1001: This statute, a federal misdemeanor, and has potential application in matters involving FBAR. A person, in a court or in any proceeding before a U.S. Authority, who under reports, in this return, by a return, or otherwise, any information or returns, to the IRS, is subject to imprisonment for up to five years. A person found guilty of violating this statute must be fined up to $250,000 and imprisoned for up to five years.

31 U.S.C. Section 5322(a): This statute, a federal misdemeanor, and has potential application in matters involving FBAR. A person, in a court or in any proceeding before a U.S. Authority, who under reports, in this return, by a return, or otherwise, any information or returns, to the IRS, is subject to imprisonment for up to five years. A person found guilty of violating this statute must be fined up to $250,000 and imprisoned for up to five years.

New Procedure for 'Low Compliance Risk' U.S. Persons living outside the United States who may have only recently learned of their filing obligations or who have not previously been notified of their filing obligations, may have particular application in matters involving FATCA. It makes it a crime for any person to knowingly make any false or misleading statement to the IRS with respect to any information required to be filed on Form 8938. However, only persons not currently under investigation are eligible for such treatment. IRS will primarily receive FFI Reports in one of two ways: 1) from FFIs themselves, or 2) from foreign governments that will collect FATCA-related information from FFIs on behalf of IRS pursuant to an agreement between the United States and the relevant foreign government. IRS will primarily receive FFI Reports in one of two ways: 1) from FFIs themselves, or 2) from foreign governments that will collect FATCA-related information from FFIs on behalf of IRS pursuant to an agreement between the United States and the relevant foreign government.

Criminal Penalty Exposure

Under these programs, taxpayers generally must pay all back taxes, interest, and at least some percentage of the otherwise applicable civil penalty. In return, IRS will generally reduce the otherwise applicable civil penalty. In certain circumstances, IRS may impose a civil penalty on any person who, after the due date of the return, actually and directly, and as a result of each separate act of the violation, willfully failed to provide all information required to be furnished under this chapter. The violation of this statute, a federal misdemeanor, and has potential application in matters involving FBAR. A person, in a court or in any proceeding before a U.S. Authority, who under reports, in this return, by a return, or otherwise, any information or returns, to the IRS, is subject to imprisonment for up to five years. A person found guilty of violating this statute must be fined up to $250,000 and imprisoned for up to five years.

Strategies to Assess and Address Civil and Criminal Penalty Exposure

Because of the above civil and criminal exposure, and the imminent implementation of FATCA, it is very important that U.S. Persons promptly take steps to satisfy their obligations under the law. IRS has announced a special procedure aimed at individual U.S. Persons living outside the United States. The special procedure has the following three parts:

1. IRS will primarily receive FFI Reports in one of two ways: 1) from FFIs themselves, or 2) from foreign governments that will collect FATCA-related information from FFIs on behalf of IRS pursuant to an agreement between the United States and the relevant foreign government. IRS will primarily receive FFI Reports in one of two ways: 1) from FFIs themselves, or 2) from foreign governments that will collect FATCA-related information from FFIs on behalf of IRS pursuant to an agreement between the United States and the relevant foreign government.

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The special procedure is designed to encourage the voluntary disclosure of FATCA-related information to IRS, to avoid civil and criminal penalties. IRS will primarily receive FFI Reports in one of two ways: 1) from FFIs themselves, or 2) from foreign governments that will collect FATCA-related information from FFIs on behalf of IRS pursuant to an agreement between the United States and the relevant foreign government. IRS will primarily receive FFI Reports in one of two ways: 1) from FFIs themselves, or 2) from foreign governments that will collect FATCA-related information from FFIs on behalf of IRS pursuant to an agreement between the United States and the relevant foreign government.
However, at least currently, there is no requirement to report on FBAR interests in hedge funds and private equity or similar investment funds.

FATCA also requires certain non-publicly traded foreign entities that are not financial institutions (referred to as non-financial foreign entities, or NFFEs) to provide information to their withholding agents (which withholding agents then remit to IRS) about any U.S. person that directly or indirectly owns more than 10 percent of the voting power or value of the NFFE's stock (with similar thresholds for foreign partnerships and trusts), or that 'control' the NFFE, or to certify to their withholding agent that they have no such U.S. owners.

An FFI Agreement will also require the FFI to withhold on any pass-through payments that it makes to 'recalcitrant holders' that do not provide the required information and to FFIs that themselves have not entered into FFI Agreements.

See, e.g., Sections 6651, 6662, and 6663 of the Code.


Section 6038D(d) of the Code.

See, e.g., Section 6664(c) of the Code.

However, according to such guidance, it is generally not invoked in the case of a false statement on a return because, assuming the return is signed under penalties of perjury, 26 USC § 7206(1) is considered a more appropriate charge. See Internal Revenue Manual Section 9.1.3.4.9 (available at http://www.irs.gov/irm/part9/irm_09-001-003-cont01.html).


If a taxpayer has reported and paid all taxes due on all of his or her taxable income for past years, but failed to file an FBAR or other returns, the taxpayer can simply file such forms and attach an explanation as to why the forms were filed late. IRS generally imposes a penalty for such late filing. See 2012 'Offshore Voluntary Disclosure Program Frequently Asked Questions and Answers' at http://www.irs.gov/OffshoreVoluntaryDisclosureProgram/OffshoreVoluntaryDisclosureProgramFrequentlyAskedQuestionsAndAnswers.