AVAL FINANCIAL STRATEGIES
& INSURANCE SOLUTIONS, INC.

GUIDEPOST

U.S. Reporting Requirements for Foreign Accounts

Prepared for

U.S. Reporting Requirements for Foreign Accounts

With the continued globalization of the economy, more people within the United States have foreign financial accounts. While there are many legitimate reasons to own foreign financial accounts, there are also responsibilities that go along with owning such accounts. Foreign account owners must remember that they may have to report their accounts to the government, even if the accounts do not generate any taxable income.

Foreign Bank and Financial Accounts Report

A U.S. person having a financial interest in or signature authority over a foreign financial account, including a bank account, brokerage account, mutual fund, trust, or other type of foreign financial account, exceeding certain thresholds, may be required under the Bank Secrecy Act (BSA) to report the account annually to the United States Treasury Department by electronically filing a Financial Crimes Enforcement Network (FinCEN) Form 114, called the Report of Foreign Bank and Financial Accounts (FBAR). The annual due date for filing FBAR for foreign financial accounts is April 15. A U.S. person is required to file an FBAR if (1) the U.S. person had a financial interest in or signature authority over at least one financial account located outside of the United States, and (2) the aggregate value of all foreign financial accounts exceeded $10,000 at any time during the calendar year reported. A U.S. person includes U.S. citizens; U.S. residents (both permanent and temporary); entities, including but not limited to, corporations, partnerships, or limited liability companies, created or organized in the United States or under the laws of the United States; and trusts or estates formed under the laws of the United States.

Exceptions to the Reporting Requirement

There are filing exceptions for the following U.S. persons or foreign financial accounts, including, but not limited to, certain foreign financial accounts jointly owned by spouses, foreign financial accounts owned by a governmental entity, foreign financial accounts owned by an international financial institution, owners and beneficiaries of U.S. individual retirement accounts, qualified retirement plan participants and beneficiaries, certain individuals with signature authority over, but no financial interest in, a foreign financial account, and trust beneficiaries (but only if a U.S. person reports the account on an FBAR filed on behalf of the trust).

Reporting and Filing Information

The FBAR is a calendar year report and must be filed electronically through FinCEN's BSA e-filing system on or before April 15 of the year following the calendar year being reported. The FBAR is not filed with a federal tax return, so if the IRS grants a filing extension for a U.S. person's income tax return, then the due date to file an FBAR is not extended. Instead, a separate extension through FinCEN is necessary, and FinCEN will grant a U.S. person failing to meet the FBAR annual filing date an automatic extension to October 15 each year.

U.S. persons who have not filed a required FBAR and who are not under a civil examination or a criminal investigation by the IRS and have not already been contacted by the IRS about any delinquent FBAR, should file such delinquent FBAR, including a statement explaining why the filing is late. The IRS will not impose a penalty for the failure to file any delinquent FBAR in such a circumstance.

A person who is required to file an FBAR but fails to properly file a complete and correct FBAR may be subject to civil penalties. For penalties assessed after February 19, 2020, the IRS may assess a civil penalty not to exceed $13,481 per violation for non-willful violations that are not due to reasonable cause. For willful violations, the civil penalty may be the greater of $134,810 or 50 percent of the balance in the account at the time of the violation, for each violation. Both of these penalties may be adjusted subsequently for inflation.

Foreign Account Tax Compliance Act

The Foreign Account Tax Compliance Act (FATCA) is an important development in efforts by the U.S. federal government to combat tax evasion by U.S. persons holding accounts and other financial assets outside of the U.S. FATCA, which was passed as the revenue-generating component of the Hiring Incentives to Restore Employment (HIRE) Act, generally requires that foreign financial institutions (FFIs) and certain other non-financial foreign entities report on the foreign assets held by their U.S. account holders or be subject to withholding on payments where withholding applies. FFIs include, but are not limited to, depository institutions (such as banks), custodial institutions (such as mutual funds), investment entities (such as private equity funds), and certain types of insurance companies that have cash value products or annuities. FATCA also requires U.S. persons to report, depending on the value, their foreign financial accounts and foreign assets.

FATCA Compliance by Foreign Financial Institutions

FATCA requires FFIs such as banks, brokerage firms, and insurance companies to agree to search customer databases to identify those suspected of being U.S. persons, and to disclose the account holders' names, addresses, and taxpayer identification numbers, as well as the transactions for most account types; some account types, such as retirement savings and other tax-favored accounts, may be excluded from reporting on a country-by-country basis according to an intergovernmental agreement between the United States and another country. U.S. entities making payments to non-compliant FFIs are required to withhold tax equal to 30 percent of the amount. Furthermore, a FFI employee having knowledge of a U.S. person's status by other means is also required to identify that person for FATCA purposes. After identification, the FFI has a duty to further investigate whether the individual is a U.S. person. To implement this requirement, the IRS requires completion of Form W-8BEN, whereby all foreign account holders certify their status on such form unless an intergovernmental agreement between the United States and another country is in place authorizing another method of certification. To avoid withholding requirements under FATCA, a FFI may register with the IRS and agree to report to the IRS certain information about its U.S. account holders, including accounts of certain foreign entities with substantial U.S. owners. A FFI that enters into an agreement with the IRS to report on its account holders may be required to withhold 30 percent on certain payments to foreign payees if such payees do not comply with FATCA. Essentially, a FFI becomes an agent of the IRS.

FATCA Compliance by U.S. Citizens

FATCA requires certain U.S. persons who either own or have signature authority over foreign accounts or assets to report such accounts on IRS Form 8938, Statement of Specified Foreign Financial Assets, which is filed with that person's U.S. income tax return if the accounts are generally worth more than $50,000. A higher reporting threshold applies to U.S. persons who are overseas residents and file jointly. If a U.S. person is single or files separately from his or her spouse, the U.S. person must submit a Form 8938 if more than $200,000 of specified foreign financial assets exist at the end of the year and the U.S. person lives abroad. If the U.S. person resides in the United States, then the U.S. person must submit a Form 8938 if more than $50,000 of specified foreign financial assets exist at the end of the year. If the U.S. person files jointly with his or her spouse, the reporting thresholds referenced previously are doubled. A U.S. person is considered to live abroad if he or she is a U.S. citizen whose tax home is in a foreign country and he or she has been present in any one or more foreign countries for not less than 330 days of any consecutive twelve-month period.

This FATCA requirement is in addition to the long-standing requirement to report foreign financial accounts on FBAR, as described above; Form 8938 does not relieve U.S. persons of FBAR filing requirements. However, the information required by the forms is not identical in all cases. Different rules, key definitions (such as for "financial account"), and reporting requirements apply to Form 8938 and FBAR reporting. Because of these differences, certain foreign financial accounts may be reported on one but not both forms.

Non-Compliance with Form 8938 Reporting Requirements

If a U.S. person must file Form 8938 and does not do so, that U.S. person may be subject to penalties which include a $10,000 failure to file penalty, an additional penalty of up to $50,000 for continued failure to file after IRS notification, and a 40 percent penalty on an understatement of tax attributable to non-disclosed assets.

The statute of limitations is extended from three years to six after the U.S. person files its tax return if more than $5,000 that is attributable to a specified foreign financial asset is omitted from gross income, without regard to the reporting threshold or any reporting exceptions. If the U.S. person fails to file or properly report an asset on Form 8938, the statute of limitations for the tax year is extended to three years following the time the required information is provided. If the failure is due to reasonable cause, the statute of limitations is extended only to the item or items related to such failure and not for the entire tax return.

If the U.S. person demonstrates that any failure to disclose is due to reasonable cause and not due to willful neglect, then no penalty will be imposed for failure to file Form 8938. Reasonable cause is determined on a case-by-case basis, after consideration of all relevant facts and circumstances.

Common Reporting Standard

The Organization of Economic Cooperation and Development implemented the Common Reporting Standard (CRS) which was based upon FATCA and the shared objective of preventing taxpayer non-compliance and tax evasion. CRS calls on countries to obtain information from financial institutions within its borders and automatically exchange that information with other countries on an annual basis. CRS sets forth the financial account information to be exchanged, the financial institutions required to report, the various account types and account holders covered, as well as common due diligence procedures to be followed by financial institutions. The CRS rules are more severe than FATCA, as CRS extends to a wider range of institutions including trusts and foundations. Furthermore, CRS has no minimum threshold for new individual accounts and a relatively low threshold of $250,000 for existing accounts. Most important, however, is that CRS participation acts as a reciprocal agreement between countries and not merely as a promise of reciprocity as is the case with FATCA.

Almost 70 percent of the world's countries have signed the agreement, including China and Russia, and, remarkably, so called tax havens such as the Bahamas, Bermuda, British Virgin Islands, Cayman Islands, Channel Islands, Gibraltar, Isle of Man, Hong Kong, Macau, Nevis, Luxembourg, and Switzerland. Perhaps even more remarkably, the U.S. has not signed the agreement, and, as a result, the United States has become the last major jurisdiction where a non-U.S. person can disguise assets from the taxing authorities of such non-U.S. person's country of domicile.

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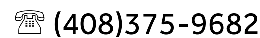
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