A Tax Wake up Call for Americans with Unreported Assets and/or Income

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TOPICS IN THE SEMINAR INCLUDE:

The I.R.S. New Amnesty Program

Foreign Account Tax Compliance Act (FATCA)

Foreign Financial Institutions (FFI's) Report On Americans

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- Masters in Tax Law from New York University Law School

- Four years of U.S. Tax Court and Internal Revenue Service experience in Washington D.C.

- The firm regularly works with law firms, accountants, businesses and individuals struggling to find their way through the complexities of the tax law.

- In short, the firm is a valuable resource to each of these audiences.

- With over 38 years as a tax lawyer in Florida, Lehman has built a tax law firm with a national reputation for being able to handle the toughest tax cases, structure the most sophisticated income tax and estate tax plans, and defend clients before the IRS.

SEMINAR INTRODUCTION
by Richard S. Lehman, Esq.

Two pieces of Tax Legislation have been phased in over the last few years

a. **Foreign Account Tax Compliance Act (FATCA)**
(Beginning Taxable Year 2011)

b. **Foreign Financial Institutions (FFI's) Report On Americans**
(Beginning in 2013)

I.R.S Grants NEW

Amnesty Program
(Beginning Taxable Year 2012)

Two pieces of Tax Legislation have been phased in over the last few years

Those two pieces of legislation, together with existing law, now make sure that <u>every U.S. taxpayer's </u>assets and source of income, both foreign and domestic, will be included in an information return or a tax return that **must be filed** with the Internal Revenue Service of the United States.

1. **The "FATCA"**
2. **"FFI" Reporting**

EXISTING LAWS

U.S. VOLUNTARY DISCLOSURES

1. Income Tax Return
2. Estate Tax Return
3. Gift Tax Return
4. FBAR Reporting
5. Form 1099
6. Form W-2
7. Information Returns – Numerous

REPORTING INFORMATION FROM U.S.BANKS ALL PAYORS AND FINANCIAL INSTITUTIONS

1. Form W-2 Wages Taxes
2. Form 1099 Investment income

NEW LAWS

1

U.S. VOLUNTARY DISCLOSURES (BEGINNING TAXABLE YEAR 2011)

Foreign Account Tax Compliance Act ("FATCA")
All Foreign Financial Assets Reported.

2

INSTITUTIONAL FOREIGN FINANCIAL REPORTING ("FFI") (BEGINNING 2013)

All Foreign Financial Institutions
Complete Reporting all U.S. Accounts

3

Foreign Financial Institution to Withhold Tax on allU.S. Accounts Thirty (30%) Percent of Gross Income

Beginning taxable year 2012

AMNESTY

The I.R.S. Amnesty Program works - but there are legal safeguards and different levels of payments and taxes.

1.
8-Years Prior Taxes

2.
Pay Tax all Omitted Income

3.
20% Accuracy Penalty On Taxes Due

4.
Interest on Taxes

5.
27.5% Highest Bank Account Value and Other Asset Values with Omitted Taxes

THIS SECTION:

The I.R.S. New Amnesty Program

Beginning taxable year 2012

1. 8-Years Prior Taxes
2. Pay Tax on all Omitted Income
3. 20% Accuracy Penalty On Taxes Due
4. Interest on Taxes
5. 27.5% Highest Bank Account Value and Other Asset Values with Omitted Taxes

The I.R.S. has provided an open ended Amnesty Program for unreported income and unreported foreign accounts.

- The IRS will be looking for offshore unreported income.
- Several thousand new agents have just been approved.
- The penalties, fines and taxes that can result from unreported foreign income could be life ruining.

Penalties Avoided

The following is a list with a short explanation of each potential civil and criminal penalty that is avoided by accepting the Amnesty terms.

Civil Penalties

1. There is a penalty for failing report a direct or indirect financial interest in, or signature authority over any financial account maintained with a financial institution located in a foreign country that exceeds $10,000.
2. There is a penalty for failing to file an Annual Return to Report large foreign gifts and transactions with Foreign Trusts.
3. There is a penalty for failing to report any ownership interest in foreign trusts.
4. A penalty for certain United States persons who are officers, directors or shareholders in certain foreign corporations who do not report such information to the United States.
5. There is a penalty for U.S. persons that fail to file and report ownership of foreign partnerships

Fraud Penalties

There are Fraud Penalties that result only in Civil Penalties. These penalties can be almost as high as the tax that has been avoided.

1. A fraud penalty for failing to file a tax return.
2. A fraud penalty for failing to pay the amount of tax shown on the return.
3. An accuracy-related penalty on underpayment of tax.

Criminal Penalties

The failure to report and pay taxes on foreign income and bank account by US. Taxpayer can also result in Criminal Penalties.

1. Possible criminal charges related to tax returns include filing a false return and failure to file an income tax return.
2. A person convicted of tax evasion is subject to a prison term of up to five years and a fine of up to $250,000.
3. Filing a false return subjects a person to a prison term of up to three years and a fine of up to $250,000.

Amnesty - Cost

The present Amnesty program provides a tax, interest and penalty framework.

1. Individuals must pay their taxes on any unreported income,
2. Pay a 20% penalty on the total unpaid taxes, and interest on the amounts due.
3. In addition, individuals must pay a one time penalty of 27.5 percent of the highest aggregate balance at any one point in time of their foreign bank accounts or entities

Eligibility

Taxpayers who have undisclosed offshore accounts or assets are eligible to apply for IRS Criminal Investigation's Voluntary Disclosure Practice and penalty regime for an eight year maximum disclosure period.

- Corporations, partnerships, and trusts and other entities are eligible to make voluntary disclosures.

Amnesty Not Available – Investigation Commenced

If the IRS has initiated a civil examination, regardless of whether it relates to undisclosed foreign accounts or undisclosed foreign entities, the taxpayer will not be eligible to come in under the Amnesty.

Eligibility

Taxpayers who reported and paid tax on all their taxable income for prior years but did not file FBARs should file the delinquent FBAR reports according to the FBAR instructions and attach a statement explaining why the reports are filed late.

- The IRS will not impose a penalty for the failure to file the delinquent FBARs if there are no underreported tax liabilities,

Payment

The terms of the Amnesty require the taxpayer to pay the tax, interest and accuracy related penalty and other penalties with their submission.

- However, it is possible for a taxpayer who is unable to make full payment of these amounts to request the IRS to consider other payment arrangements.

Amnesty Documents

- Copies of previously filed original (and, if applicable, previously filed amended) federal income tax returns for tax years covered by the voluntary disclosure.
- Complete and accurate amended federal income tax return
- A completed Foreign Account or Asset Statement for each previously undisclosed foreign account or asset during the voluntary disclosure period.

Amnesty Documents

- A check payable to the Department of Treasury in the total amount of tax, interest, accuracy-related penalty, and if applicable, the failure to file and failure to pay penalties, for the voluntary disclosure period.
  a) The total amount of tax, interest and penalties as described above cannot be paid, submit a proposed payment arrangement and a completed Collection Information Statement.
- For those applicants disclosing offshore financial accounts with an aggregate highest account balance in any year of $500,000 or more, copies of offshore financial account statements reflecting all account activity for each of the tax years covered by your voluntary disclosure.
- Properly completed and signed agreements to extend the period of limitations.

The Amnesty Penalty Framework

The values of accounts and other assets are aggregated for each year and the penalty is calculated at 27.5% percent of the highest year's aggregate value during the period covered by the voluntary disclosure. If the taxpayer has multiple accounts or assets where the highest value of some accounts or assets is in different years, the values of accounts and other assets are aggregated for each year and a single penalty is calculated at 27.5% percent of the highest year's aggregate value.

The Amnesty Penalty Framework

The offshore penalty is intended to apply to all of the taxpayer's offshore holdings that are related in any way to tax non –compliance, regardless of the form of the taxpayer's ownership or the character of the asset.

- The penalty applies to all assets directly owned by the taxpayer, including financial accounts holding cash, securities or other custodial assets, tangible assets such as patents or stock or other interests in a U.S. foreign business.
- If such assets are indirectly held or controlled by the taxpayer through an entity, the penalty may be applied to the taxpayer's interest in the entity or, if the Service determines that the entity is an alter ego or nominee of the taxpayer, to the taxpayer's interest in the underlying assets.

The 5% Penalty

Taxpayers who meet all four of the following conditions will entitled to the reduced 5% offshore penalty

(a) did not open or cause the account to be opened (unless the bank required that a new account be opened, rather than allowing a change in ownership of an existing account, upon the death of the owner of the account;

(b) have exercised minimal, infrequent contact with the account, for example, to request the account balance, or update accountholder information such as a change in address, contact person, or email address,

(c) have, except for a withdrawal, closing the account and transferring the funds to an account in the United States, not withdrawn more than $1,000 from the account in any year for which the taxpayer was on compliant, and

(d) can establish that all applicable U.S. taxes have been paid on funds deposited to the account (only account earnings have escaped U.S. taxation).

How To Reduce The Penalty For Many Clients

This is becoming extremely important in my practice because it is the way in which I am able to help some people reduce their bank penalties which are extremely high.

Question 17
of the IRS Questionnaire

The purpose of the voluntary disclosure practice is to provide a way for taxpayers who did not report taxable income in the past to come forward voluntarily and resolve their tax matters. Thus, if you reported and paid tax on all taxable income but did not file FBARs, do not use the voluntary disclosure process.

For taxpayers who reported and paid tax on all their taxable income for prior years but did not file FBARs, you should file the delinquent FBAR reports according to the instructions (send to Department of Treasury, Post Office Box 32621, Detroit, MI 48232.0621) and attach a statement explaining why the reports are filed late.

- **The IRS will not impose a penalty for the failure to file the delinquent FBARs if there are no underreported tax liabilities and the FBARs for 2010 are due on June 30, 2011 and must be filed by that date.**

IRS Question 50

The Voluntary Disclosure examiners do not have discretion to settle cases for amounts less than what is properly due and owing. However, because the 25 percent offshore penalty is a proxy for the FBAR penalty, other penalties imposed under the Internal Revenue Code, and potential liabilities for years prior to 2003, there may be cases where a taxpayer making a voluntary disclosure would owe less if the special offshore initiative did not exist.

- Under no circumstances will taxpayers be required to pay a penalty greater than what they would otherwise be liable for under the maximum penalties imposed under existing statutes.

The Amnesty Program must be handled by professionals who know what they are doing.

- There are legal safeguards and different levels of payments and taxes.
- There is a one time payment on Unreported Bank Deposits that can be assessed at penalties ranging from 0% to 27.5% of the Deposit.
- Obtain every tax right you are entitled to.

The Amnesty Program Can Be Terminated At Any Time By The Internal Revenue Service.

THIS SECTION:

Foreign Account Tax Compliance Act (FATCA)

Beginning taxable year 2011

1. U.S. Voluntary Disclosures
2. All Foreign Financial Assets Reported

The United States Taxpayer Required Reporting

U.S. Voluntary Disclosures

1. Income Tax Return
2. Estate Tax Return
3. Gift Tax Return
4. FBAR Reporting - All Foreign Bank Deposits
5. **Foreign Account Tax Compliance Act ("FATCA") – All Foreign Financial Assets Reported. (Beginning taxable year 2011)**
6. Form 1099
7. Form W-2
8. Information Returns – Numerous

Reporting Foreign Assets

A little known new law was enacted for the year 2011 that requires any specified person that holds any interest in a specified foreign financial asset during the taxable year to attach a statement to that person's U.S. tax return and report information that identifies the value of those specified foreign financial assets in which the individual holds an interest. Form 8938.

Specified Foreign Financial Asset

A specified foreign financial asset is

(i) any financial account maintained by a foreign financial institution;

(ii) any stock or security issued by any person other than a United States person;

(iii) any financial instrument or contract held for investment that has an issuer or counterparty that is not a United States person; and

(iv) any interest in a foreign entity.

Specified Person

A specified person is defined as a specified individual who is a U.S. citizen, a resident alien or a nonresident who elects to be taxed as a U.S. resident filing Form 1040; and U.S. entities required to file an annual tax returns such as a 1041 (Trust and Estate), 1120 (U.S. Corporation), 1120-S and 1065 (Partnership).

Specified Person

A specified person that is the owner of an entity disregarded as an entity separate from its owner is treated as having an interest in any specified foreign financial assets held by the disregarded entity.

Interest in a Specified Foreign Financial Asset

A specified person has an interest in a specified foreign financial asset if any income, gains, losses, deductions, credits, gross proceeds, or distributions attributable to the holding or disposition of the specified foreign financial asset are or would be required to be reported, included, or otherwise reflected by the specified person on an annual return. A specified person has an interest in a specified foreign financial asset even if no income, gains, losses, deductions, credits, gross proceeds, or distributions are attributable to the holding or disposition of the specified foreign financial asset for the taxable year.

The Minimum Reporting Requirements

Unmarried Taxpayer Living in the United States.

- Unmarried individuals living in the U.S. have a reporting threshold only if the total value of their 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.

Married Taxpayers Filing a Joint Income Tax Return and Living in the United States.

- Married persons filing a joint income tax return that do not live abroad, satisfy the reporting threshold only if the total value of their joint specified foreign financial assets are more than $100,000 on the last day of the tax year or more than $150,000 at any time during the tax year.

The Minimum Reporting Requirements

Taxpayers Living Abroad.

- Taxpayers whose tax home is in a foreign country that meets a presence test in that foreign country, satisfy the reporting threshold if they are not filing a joint return if the total value of their specified foreign financial assets is more than $200,000 on the last day of the tax year or more than $300,000 at any time during the tax year.

- Married and file a joint income tax return satisfy the reporting threshold only if the total value of all specified foreign financial asset the couple owns is more than $400,000 on the last day of the tax year or more than $600,000 at any time during the tax year.

Penalties

- There are penalties for the failure to disclose the information required to be reported. If the failure to comply continues for more than 90 days after the day on which the failure is reported to the individual, the individual must pay an additional penalty of $10,000 for each 30-day period (or fraction thereof) during which the failure to disclose continues after the expiration of the 90-day period, to a maximum of $50,000.

- However, no penalty will be imposed for any failure to report that is shown to be <u>due to reasonable cause and not due to willful neglect.</u> But one cannot excuse the failure to disclose assets just because disclosing the information required could lead to violations of foreign laws. There also can be criminal penalties for the failure to file the report.

Helpful Definitions

Financial Account maintained by a Foreign Financial Institution

A financial account is defined as respect to any financial institutions

1) Any depository account maintained by such financial institution;
2) Any custodial account maintained by such financial institution; and
3) Any equity or debt interest in such financial institutions (other than interests which are regularly traded on an established securities market).

Other Financial Assets

Examples of other specified foreign financial assets include the following, if they are held for investment and not held in a financial account.

- Stock issued by a foreign corporation.
- A capital or profits interest in a corporation.
- A note, bond, debenture, or other form of indebtedness issued by a foreign person.
- An interest in a foreign trust or foreign estate.
- An interest rate swap, currency swap, basis swap, interest rate cap, interest rate floor, commodity swap, equity swap, equity index swap, credit default swap, or similar agreement with a foreign counterparty.
- An option or other derivative instrument with respect to any of these examples or with respect to any currency or commodity that is entered into with a foreign counterparty or issuer.

There are also certain Exclusions for Assets Not Subject to Reporting

These include:

1) Assets such as those which specified persons, such as traders and others in the securities business use mark-to-market accounting method and

2) Interests in a social security, social insurance, or other similar program of a foreign government. However, this generally does not include similar programs that are funded by the Taxpayer's voluntary payments such as I.R.A.'s,

There are also certain Exclusions for Assets Not Subject to Reporting

3) Foreign assets used in a trade or business are not subject to the reporting requirements. An asset is used in, or held for use in, the conduct of a trade or business and not held for investment if the asset is:

   a) Held for the principal purpose of promoting the present conduct of a trade or business.
   b) Acquired and held in the ordinary course of a trade or business, as, for example, in the case of an account or note receivable arising from that
   c) trade or business; or
   d) Otherwise held in a direct relationship to the trade or business.

There are also certain Exclusions for Assets Not Subject to Reporting

However, stock is never considered used or held for use in a trade or business for purposes of applying this test

4) Elimination of duplicate reporting of assets. . .

   A specified person is not required to report a specified foreign financial asset if the specified person reports the asset on at least one of the following forms timely filed with the Internal Revenue Service for the taxable year. Form 3520, Form 5471, Form 8621, Form 8865, Form 8891.

5) Residents of U.S. Possessions.

Required Information

- Disclosure Requirements
- Stocks and Securities
- Financial Instruments
- Foreign Entities
- Depository/Custodial Accounts
- Income

THIS SECTION:

Institutional Foreign Financial Reporting

Beginning in 2013

1. All Foreign Financial Institutions Complete Reporting all U.S. Accounts

2. Foreign Financial Institution to Withhold Tax on all U.S. Accounts Thirty (30%) Percent of Gross Income

The United States Taxpayer Required Reporting

Institutional Foreign Financial Reporting

1. All Foreign Financial Institutions Complete Reporting all U.S. Accounts
2. Foreign Financial Institution to Withhold Tax on all U.S. Accounts Thirty (30%) Percent of Gross Income
3. Refund Action Required to Collect on Over withholding
4. **(Effective 2013/2014)**

Latest Development
Tax Treaties for
FFI Reporting Purposes

U.S. DEPARTMENT OF THE TREASURY
Press Center 7/26/2012

WASHINGTON: The U.S. Department of the Treasury today published a model intergovernmental agreement to implement the information reporting and withholding tax provisions commonly known as the Foreign Account Tax Compliance Act (FATCA). Enacted by Congress in 2010, these provisions target non compliance by U.S. taxpayers using foreign accounts. The model agreement announced today was developed in consultation with France, Germany, Italy, Spain and the United Kingdom and marks an important step in establishing a common approach to combating tax evasion based on the automatic exchange of information.

- ✓ These five countries, along with the United States, will, in close cooperation with other partner countries, the Organization for Economic Cooperation and Development, and, when appropriate, the European Commission, work towards common reporting and due diligence standards in support of a more global approach to effectively combating tax evasion while minimizing compliance burdens.

U.S. DEPARTMENT OF THE TREASURY
Press Center 7/26/2012

- ✓ The model agreement establishes a framework for reporting by financial institutions of certain financial account information to their respective tax authorities, followed by automatic exchange of such information under existing bilateral tax treaties or tax information exchange agreements.

- ✓ The model also provides for the United States to exchange information currently collected on accounts held in U.S. financial institutions by residents of partner countries and includes a policy commitment to pursue regulations and support legislation that would provide for equivalent levels of exchange by the United States

Summary

The answer for the Foreign Financial Institutions on how to avoid the withholding tax is to do as the I.R.S. requires and

(i) to collect all of the information necessary to determine the U.S. payees of the Institution's accounts

(ii) to report regularly in compliance with I.R.S. requirements on these U.S. accounts and

(iii) withhold taxes on payment being made to a Nonparticipating FFI or a recalcitrant account.

The New Law

The New Law generally requires Foreign Financial Institutions (FFIs) to provide information to the Internal Revenue Service (IRS) regarding the Foreign Financial Institutions' United States accounts (U.S. accounts).

It also requires certain Nonfinancial Foreign Entities (NFFEs) to provide information on their substantial United States owners (substantial U.S. owners).

Fixed or Determinable Income

The types of U.S. income that are identified as being subject to the 30% withholding tax, when that income is paid to Foreign Financial Institutions, is the type of income known as fixed or determinable income.

Also included is gains from the sale of certain capital assets.

This is different than the withholding tax on payments by Americans to non resident aliens and foreign corporations because gains from the sales of capital assets are not included in the existing withholding rules.

I.R.S. Code Section

The New Law is codified in Internal Revenue Code Sections 1471 through 1474.

- Code Section 1471(a) of the Internal Revenue Code ("Section") requires any person required to withhold taxes, (a "Withholding Agent") to withhold 30 percent of any withholdable payment to a Foreign Financial Institution that does not meet certain requirements.

Withholding Requirements under the FFI Agreement

- Identification of Account Holders under the FFI Agreement
- Reporting Requirements of Participating FFIs
- Expanded Affiliated Group Requirements

“FFI Agreement”

The U.S. Treasury has now made foreign banks, brokers and companies similar to U.S. bankers and brokers, when it comes to supplying information about U.S. taxpayers.

The FFI can avoid the responsibility to withhold these taxes – if they comply.

The withholding on payments to and by a (FFI) Foreign Financial Institution or a Non Financial Foreign Entity can be avoided if the Foreign entities comply with new U.S. Treasury requirements.

- To comply, the U.S. now wants full disclosure of every U.S. account holder in that Foreign Institution and on every substantial shareholder in the Non Foreign Financial Enterprise.

Definitions

The best way to provide an understanding of the overall purpose of the new statute and what it is all about is to start off with a list of new terms that are now going to show up as a result of this new law.

Definitions

- U.S. Account
- Financial Account
- Depository Account
- Debt/Equity
- U.S. Owned Foreign Entity
- Financial Institution (FFI)
- Excluded Foreign Entities
- Recalcitrant Account Holder
- Pass thru Payments
- Substantial U.S. Owner
- Specified U.S. Person
- Withholdable Payments to Non Financial Foreign Entities (NFFEs)

A withholdable payment is defined to mean

(i) any payment of interest, dividends rents, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, and other fixed or determinable annual or periodical gains, profits, and income if such payment is from sources within the United States (Fixed Income) and

(ii) any gross proceeds from the sale or other disposition of any property of a type which can produce interest or dividends from sources within the United States. ("Sale Income").

The Term *Financial Account* Means

With respect to any financial institution, **any depository** account maintained by such financial institution; **any custodial** account maintained by such financial institution; and any **equity or debt interest** in such financial institution (other than interests which are regularly trade on an established securities market).

Helpful Definitions

A Foreign Financial Institution

A foreign financial institution is a financial institution that is a foreign entity that:

1) Accepts deposits in the ordinary course of a banking or similar business;

2) Holds financial assets for the account of others as a substantial portion of its business; or

3) Is engaged, or holds itself out as being engaged, primarily in the business of investing, reinvesting, or trading in securities, or any other financial interest such as forward contracts or options on securities, partnership interests, or commodities

Excluded Foreign Entities

Many Foreign Entities are excluded from the definition of a financial institution or are treated as Non-Financial Institutions that do not need to meet any of the withholding and/or reporting requirements.

These entities include certain nonfinancial holding companies, certain startup companies, non-financial entities that are liquidating or emerging from reorganization or bankruptcy, hedging/financial centers of a nonfinancial group, and charitable entities.

Recalcitrant Account Holder

- A recalcitrant account holder is defined as any holder of an account maintained by a Participating FFI if the account holder is not an FFI and the account holder either
  - (i) fails to comply with the Participating FFI's request for documentation or information to establish whether the account is a U.S. account,
  - (ii) fails to provide a valid Form W-9 upon the request of the Participating FFI,
  - (iii) fails to provide a correct name and TIN upon request of the FFI after the Participating FFI receives notice from the IRS indicating a name/TIN mismatch or
  - (iv) fails to provide a valid and effective waiver of foreign law if foreign law prevents reporting with respect to the account holder by the Participating FFI.

Substantial U.S. Owner

Generally, the term substantial U.S. owner means any specified U.S. person that owns, directly or indirectly, more than ten percent of the stock of a corporation, or with respect to a partnership, more than ten percent of the profits interests or capital interests in such partnership.

For trust, a substantial U.S. owner is any specified U.S. person that holds, directly or indirectly, more than ten percent by value of the beneficial interests in such trust, or with respect to a grantor trust, any specified U.S. person that is an owner of such grantor trust. There are attribution rules to determine indirect ownership of stock.

What America does not know is the I.R.S. now has all of the tools necessary to find an American's assets and sources of income.

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Value can be lost without good professional advice.