

Overseas Bank Accounts: Understanding compliance and disclosure of foreign bank accounts

The U.S. taxes its citizens and most resident aliens on a worldwide basis. Therefore, their income is subject to U.S. income tax and reporting requirements, regardless of where they reside.



Sometimes, to avoid penalties or because they were not aware of their filing obligations, numerous U.S. taxpayers with foreign accounts or living abroad have failed to file U.S. income tax returns to properly disclose foreign accounts and income in a timely manner.

The IRS originally announced the Offshore Voluntary Disclosure Program (OVDP) in January 2012, requiring submission of income tax returns and Foreign Bank Account Reports (FBARs) for eight tax years to avoid significant penalties and criminal prosecution. This program is modeled after the 2011 Offshore Voluntary Disclosure Initiative (OVDI), but it increases the maximum FBAR-related penalty from 25 to 27.5

percent. Although there is no set deadline for people to apply, the terms of the program could change at any time.

The voluntary disclosure program is part of a wider effort by the IRS to stop offshore tax evasion and ensure tax compliance. This effort includes criminal prosecution and third-party reporting under the Foreign Account Tax Compliance Act (FATCA). FATCA was signed into law in 2010, aimed at Foreign Financial Institutions (FFIs) to

prevent tax evasion by U.S. citizens and residents through offshore accounts. Under FATCA, an FFI may agree to report information on U.S. accounts. FFIs that choose not to enter into this agreement are subject to a 30 percent withholding tax on all U.S. sourced payments.

But now the clock is ticking, as foreign banks work hard to identify their account holders that are US citizens. Since some banks do not wish to comply with the reporting requirement they must force their U.S. customers to close the accounts while notifying them of their obligations.

Some U.S. citizens living abroad and dual citizens raised concern that they



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should not be subject to this level of scrutiny since they have always complied with the tax rules in the country where they reside and were simply unaware that they were still required to file US tax returns or disclose their foreign accounts. In response, the IRS created a Streamlined Filing Procedure (SFP) for non-resident U.S. taxpayers. It is intended to encourage current non-residents and dual citizens who have not filed U.S. income tax to file delinquent returns and become compliant.

The streamlined procedure is designed for taxpayers who present a low compliance risk. The new procedures are for non-residents including, but not limited to, dual citizens who have not filed U.S. income tax or Reports of Foreign Bank and Financial Accounts (FBARs). Taxpayers who believe they are low-risk account holders should consult an expert to determine if they are an appropriate candidate for the program.

The IRS will determine the level of compliance risk present by analysis of the responses to the questionnaire required for the submission, as well as on information provided on the income returns filed. The IRS has indicated that the review of the submission will be expedited and they will not present penalties or pursue follow-up actions for taxpayers who present a low compliance risk. Submissions that present higher compliance risks are not eligible for the new procedure and will be subject to a more thorough review and possibly full examination.

Taxpayers utilizing the streamlined procedure will be required to file delinquent tax returns (with appropriate related information returns) for the past three years and to file delinquent FBARs for the past six years. Payment for tax and interest, if applicable, must be remitted along with delinquent tax returns. Additionally, taxpayers must complete a questionnaire identifying the taxpayer's financial interests in foreign financial accounts, including interests in and signature authority over financial accounts outside their country of residence and other questions relating to their foreign interests and compliance. The questionnaire must be signed under penalty of perjury.

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