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Update of current status of FBAR rules for Americans with foreign financial accounts  
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Dear Clients and Friends:

A great many of you have expressed a lot of anxiety to me over the rules for FBAR - Foreign Bank Account Reporting. Although the status of this issue is changing almost daily, let me give you the latest information available to aid you in your decision about reporting your foreign bank accounts.

I am a member of the Tax Advisory Committee, and also a Country Representative for American Citizens Abroad (ACA). I will be quoting extensively from papers prepared by ACA, and am also attaching PDF files their position papers directly if you wish to read for detailed information about the issues surrounding FBAR reporting (and, later, FACTA)

Please pass on this letter to anyone who wish, and/or refer them to my website, [www.taxesinmexico.com](http://www.taxesinmexico.com).

### **Background**

The FBAR rules were originally passed for the legal means to pursue organized crime, drug dealers, money launderers, tax evaders, and other criminals. The rules have been in effect for over 30 years, but were essentially dormant. Under a series of new acts by Congress after 9/11, the enforcement of the law moved specifically to the IRS, and substantially increased the penalties for not filing the FBAR.

The essence of the rules is:

1 If you have any accounts outside the US - bank accounts, securities, annuities, currencies, cash value life insurance, or other financial accounts [but not real estate, yet, under this particular rule]:

a) For aggregate amount, at the highest level at any time during the year of under \$10,000, you must check the box at the bottom of Schedule B on your 1040 tax return, and fill in the country (ies) where you have such account. For under \$10,000, no FBAR is required

b) For aggregate amount from all institutions, again at the highest level at any time during the year of over \$10,000, you must file an FBAR (IRS Form TD F 90-22.1) for each account which you own or have signatory power over. This would include if you are the officer of a company, signor on a bank account for a charity, or anything similar. The form asks the name, address, and account number of the institution, the highest balance at any time in the year, and whether you own the account in your own

name, jointly, or as signatory power for some other entity. You must file an FBAR form for each separate institution, and for each ownership status.

The FBAR form is filed separately from your tax return, is due June 30th without any extensions, and is mailed (not e-filed, not yet) to a Detroit address. The FBAR form does not impose any tax. It only asks you what accounts you have, but obviously part of the purpose is to see whether you have been reporting any income that these foreign accounts have generated.

If you do have interest income from a Mexican account, for example, you should report it. You will also get a credit for the taxes that are withheld from your account paid to Mexico, so you shouldn't have to pay taxes on the same money twice. I have had some clients with Banamex accounts, for example, (which is owned by Citibank) receive actual 1099s for their interest, and there is also shown the 'foreign taxes paid', which is usually more than would be owed to the US on the same amount of income. For a Banamex account, I generally do not include that on the FBAR, but in effect it "looks" like an American account with a 1099, not like an unknown Mexican account.

Stock trading accounts are another matter. Mexico does not tax capital gains in stocks; the US does. If you have gains (and losses) in a Bolsa account (actually realized by a sale, not just a change in value of the index), you should be reporting these on Schedule D of your tax return, and should include the account in your FBAR.

2. Starting in 2011, there is going to be a new form, Form 8938 that the IRS has released (but has not released the instructions for it yet), which will apply to Americans owning more than \$50,000 in assets in foreign institutions. This can possibly include the value of real estate, just the value, again nothing relating to income unless this is a rental property in Mexico. If you have property bought through a trust in Mexico, if you have interest in a business in Mexico, there may be other forms required to file, which I will write more about in a separate notice.

### **Filing Prior Year FBARS**

There has been a LOT of press about a program the IRS has had to allow people to file their past year FBARS (back to 2003) if they had not previously done so. This was billed as an "amnesty" program, in that the normal \$10,000 fine for not filing the form would be waived (any amended returns to include unreported income, however, would be subject to interest and penalties). Many people participated in this program, particularly those knowing they owed no additional taxes. [To be clear, this was for "non-willful" violators - "I didn't know I had to do it; I wasn't trying to hide income" - as opposed to the drug lords and money launderers that this was all supposed to be for in the first place]

However, "amnesty" turned out to be deceptive. 18 months after the 2009 program, the IRS retroactively changed the rules and stated that all participants would be treated as

"willful" violators, putting them into the Criminal Investigation side of the IRS, extending the statute of limitations to 6 years, and making them subject to a fine of 20% of the ASSETS each year for not filing (again, highest balance at any time during the year). A similar program was offered in 2010, extending to August 31, 2011 (and then September 9, 2011, because of Hurricane Irene), only this time the penalties would be up to 25% of the assets because you didn't take advantage of taking part in the prior year.

Virtually all professional tax preparers dealing with international issues completely disagreed with the participation in this program. The alternative was to submit what was called a "quiet disclosure", stating that you were NOT willful, any back taxes were paid, and that you did not know of the obligation. In some cases, the IRS denied the "quiet disclosure", and automatically put anyone who filed prior year FBARs into the program, meaning they could be subject to the horrendous penalties. This has led to many efforts to change the law, and various organizations are moving forward with court cases to sue the IRS. Please see the attached articles from ACA.

### **Enforcement - and the controversy over FACTA**

FACTA stands for Foreign Account Tax Compliance Act and you will see it referred to in some of the other articles attached relating to FBAR reporting. This law was passed in 2010, and set a date of January 1, 2013, by which time ANY foreign financial institution worldwide that wishes to invest in a US asset, either for themselves or any client (American citizen or not), must sign a contract with the IRS in which it promises to identify all their American clients, and send to the IRS the information regarding the account balances, and any income generated by the account. This will be similar to receiving a 1099 form as you do now from American financial institutions, but those do not include your account balances. If they do not sign this agreement, all income relating to a US asset is subject to 30% withholding, even if the income does not deal with an American citizen.

As expected, the reaction to this law has been extremely negative by the global financial community. It is estimated it would take each institution \$10-15 million dollars to set up their computing systems to meet these requirements. Canada has already stated that they will not comply with these rules. Canada normally does work with the US and the IRS for the collection of back taxes, but has stated that this law deals only with "penalties", not owed taxes, and as such it will not participate. Some other banks, most notably HSBC, have stated that they will no longer keep open any accounts for expat Americans, worldwide.

The US tax system is based on a "paper trail", meaning information on your interest income, dividends, stock sales, alimony payments, Social Security income, pensions, are all already known by the IRS, through the use of 1099s, W-2s, and other forms with which we are all familiar. When opening a bank account in Mexico, no one asks for your Social Security number, or even your nationality. FACTA is trying to create that same paper trail for all foreign accounts, but is meeting very stiff resistance from the global

financial community. There are many efforts to change the amounts for only accounts over \$500,000, to delay the starting date for it, or to repeal it altogether.

The tax/financial press has written a lot about the idea that the two amnesty programs offered by the IRS, particularly the 2nd one ending September 9, 2011, were in essence 'failures', because only a handful of accounts trickled in, with most people scared off by the prospect of significant penalties. However, the IRS is putting its own face on this, and calling it a wonderful success. Because I cannot save this article into PDF format, I am reprinting the most recent announcement from the IRS regarding the programs

[This is IRS talking, NOT ME!]

### IRS Shows Continued Progress on International Tax Evasion

WASHINGTON — The Internal Revenue Service continues to make strong progress in combating international tax evasion, with new details announced today showing the recently completed offshore program pushed the total number of voluntary disclosures up to 30,000 since 2009. In all, 12,000 new applications came in from the 2011 offshore program that closed last week.

The IRS also announced today it has collected \$2.2 billion so far from people who participated in the 2009 program, reflecting closures of about 80 percent of the cases from the initial offshore program. On top of that, the IRS has collected an additional \$500 million in taxes and interest as down payments for the 2011 program — a figure that will increase because it doesn't yet include penalties.

“By any measure, we are in the middle of an unprecedented period for our global international tax enforcement efforts,” said IRS Commissioner Doug Shulman. “We have pierced international bank secrecy laws, and we are making a serious dent in offshore tax evasion.”

Global tax enforcement is a top priority at the IRS, and Shulman noted progress on multiple fronts, including ground-breaking international tax agreements and increased cooperation with other governments. In addition, the IRS and Justice Department have increased efforts involving criminal investigation of international tax evasion.

The combination of efforts helped support the 2011 Offshore Voluntary Disclosure Initiative (OVDI), which ended on Sept. 9. The 2011 effort followed the strong response to the 2009 Offshore Voluntary Disclosure Program (OVDP) that ended on Oct. 15, 2009. The programs gave U.S. taxpayers with undisclosed assets or income offshore a second chance to get compliant with the U.S. tax system, pay their fair share and avoid potential criminal charges.

The 2009 program led to about 15,000 voluntary disclosures and another 3,000 applicants who came in after the deadline, but were allowed to participate in the 2011 initiative. Beyond that, the 2011 program has generated an additional 12,000 voluntary disclosures, with some additional applications still being counted. All together from these efforts, taxpayers came forward and made 30,000 voluntary disclosures.

“My goal all along was to get people back into the U.S. tax system,” Shulman said. “Not only are we bringing people back into the U.S. tax system, we are bringing revenue into the U.S. Treasury and turning the tide against offshore tax evasion.”

In new figures announced today from the 2009 offshore program, the IRS has \$2.2 billion in hand from taxes, interest and penalties representing about 80 percent of the 2009 cases that have closed. These cases come from every corner of the world, with bank accounts covering 140 countries.

The IRS is starting to work through the 2011 applications. The \$500 million in payments so far from the 2011 program brings the total collected through the offshore programs to \$2.7 billion.

“This dollar figure will grow in the months ahead,” Shulman said. “But just as importantly, we have changed the risk calculus. Americans now understand that if they try to hide assets overseas, the chances of being caught continue to increase.”

The financial impact can be seen in a variety of other areas beyond the 2009 and 2011 programs.

**Criminal prosecutions.** People hiding assets offshore have received jail sentences running for months or years, and they have been ordered to pay hundreds of thousands and even millions of dollars.

**UBS.** UBS AG, Switzerland's largest bank, agreed in 2009 to pay \$780 million in fines, penalties, interest and restitution as part of a deferred prosecution agreement with the U.S. government.

The two disclosure programs provided the IRS with a wealth of information on various banks and advisors assisting people with offshore tax evasion, and the IRS will use this information to continue its international enforcement efforts.

## **So What Do I Do?**

This is the question that everyone has, and I cannot promise you a perfect answer. Further, as an Enrolled Agent, I am technically required to say that if I know of your foreign assets and you're not reporting them, I should refuse to prepare your tax return (so Don't Ask Don't Tell may not be dead after all ☺). So the following is my opinion only, nothing more:

1. If you do decide you'd feel more comfortable reporting your foreign assets, at least begin this coming tax year. The deadline each year is June 30th, with no extensions, so it doesn't make sense to open the issue up for the 2010 tax year just finished. You'll need the income and also the Mexican taxes paid for your account, which is sometimes hard to obtain, so speak with your financial institution early. The net effect shouldn't really cost you anything more in taxes.

2. If you don't want to report the assets, it is your choice and I respect it. Right now there is no paper trail. I don't want to know about it. About half of my clients fall either way, as a guess.

3. To avoid the FBAR altogether, you can use Banamex/Citibank as a bank because then you will receive a 1099. I would also recommend this if you are having problems opening a US bank account, which I have received from numerous clients, especially this

year. I have spoken with their USA 800 number for Banamex USA on behalf of a client whose Indiana bank had changed owners, and now would no longer issue her checks because she lived in Mexico. The Banamex USA representative, after I described her problem, stated that she could open an account over the phone; it was OK that she lived in Mexico, and she could have checks in dollars or move money back and forth to pesos. You might want to look into this if you having trouble with a US bank account.

If you are dealing with investment accounts, I highly recommend Tom Zachystal of Individual Asset Management, who as an independent investment advisor, can work in markets all around the world, and can accept accounts for expats. Expats, because of receiving money in one currency and spending it in another, should always have a program for hedging against currency changes. Because the Bolsa is such a small market (75% of it is in 3 companies only; 30% of the index is Carlos Slim), keeping only dollars and pesos is often not enough, but an international money manager can help you diversify in other currencies to protect against changes in the value of the dollar. I will also write more on this area later.

4. Stay out of the IRS "amnesty" programs, and please talk to me separately if you are considering reporting back years. It is very complex, could open you up to very substantial penalties even without owing any taxes, and will probably take several years of court cases before this issue is resolved.

Related to this is the idea of "if I start reporting now, will they be able to go back and look for all the years that I didn't report?". Should FACTA ever take effect, in whatever form, I have to believe it would only be "from that point forward." The procedures for setting up the computer systems, with account balances at differing exchange rates, etc. would be much more monumental trying to go back several years

Some people have stated to me that their bank official has said "don't worry - I'll protect you." Nice thought, but if the institution decides and has to comply with reporting rules, it may not be possible for one official to protect the knowledge of one client. This would be done on an institutional basis, and I wouldn't necessarily trust what you hear from local customer service representatives here.

I am sending this letter to all my current tax clients, and others who have contacted me regarding tax question. I will also be updating any changes through my website, and will include other articles relating to tax issues for American expatriates at [www.taxesinmexico.com](http://www.taxesinmexico.com)