



# **ATTENTION: US TREASURY DELIVERS "FATCA", NEW LAW REQUIRING ALL PARTICIPATING FOREIGN BANKS TO REPORT US ACCOUNT HOLDERS: *Will Your Bank Report You?***

Issue 9

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## **FOREIGN ACCOUNT TAX COMPLIANCE ACT ("FATCA")**

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The periscope of the US Treasury just got wider and longer; or rather the noose just got tighter and more impending, at least for those US persons who continue to choose not to report their foreign assets and income. On March 18th, 2010, the US Treasury enacted The Foreign Account Tax Compliance Act (FATCA), a key part of the HIRE Act originally put into place in 2010 to spur job growth in the economy. A particular section of the HIRE Act (Section 511, to be exact) added to the Internal Revenue Code, Section 6038D which is effective immediately for tax years beginning after March 18th, 2010. The second section of FATCA, Section 521, adds Internal Revenue Code Section 1298(f), requiring US persons who are shareholders of a passive foreign investment company (PFIC) to file annual reports containing certain information which would be included on a newly revised Form 8621. A portion of the law regarding foreign financial institutions ("FFIs") to report US persons and US source income will be phased in by 2013, with a full phase in by 2015. Some of the specific details of FATCA are listed here, but one can glean more specific information in [IRS Notice 2011-53](#).

Here is what you need to know: FATCA has three very important components which US persons with any sort of foreign assets and income will want to be aware of going forward. They are as follows:

1. **Reporting by US Taxpayers Holding Foreign Financial Assets**. Many are already aware of the relevant FBAR reporting requirements for any foreign assets which, in summation of more than \$10,000, being required to be reported on the Form TD F 90-22.1. However, now, US persons holding foreign financial assets with an aggregate (meaning, total sum) value exceeding \$50,000 must report certain specific information of those assets on a new form (8938) yet to be released. It must be attached to the taxpayer's annual tax return. This specific reporting form is effective immediately for taxable years beginning after March 18th 2010 (for calendar year taxpayers, this means 2011). This form should be available by December 31st, 2011. Some of the required information Form 8938 would include the type of foreign asset one has, the foreign currency it is denominated in, name & address of the foreign bank/institution it resides at, and the account number. A link to what the draft version of Form 8938 looks like is [here](#).
2. **Reporting by Foreign Financial Institutions**. The most intriguing and aggressive portion of the new law will now require foreign financial institutions (known according to the Law as, "FFIs") to report directly to the IRS certain information about financial

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accounts held by US taxpayers, or by foreign entities in which US taxpayers hold a substantial ownership interest. This portion of the law will not come into affect until after June 30th, 2013, which is when FFIs must sign up by, under a special agreement with the IRS. The agreement between each FFI and the IRS will allow each FFI to do the following:

- a. Undertake certain identification and due diligence procedures with respect to its accountholders (meaning FFIs will report any pre-existing accounts of US persons opened prior to enactment FFI);
- b. *Report annually to the IRS* on the account holders who are US persons or foreign entitites with substantial US ownership;
- c. Withhold and pay over to the IRS 30% of any payments of US source income, as well as gross proceeds from the sale of securities that generate US source income, made to
  - i. Nonparticipating FFIs;
  - ii. Individual account holders failing to provide sufficient information to determine whether or not they are a US person;
  - iii. Foreign entity accountholders failing to provide sufficient information about the identity of its substantial US owners;
- d. Required reporting of new account holders to the IRS opened by Sept. 30th, 2014;
- e. Report Special Private Banking Relationship Accounts in excess of \$500,000 by US persons;
- f. Report Private Banking Accounts less than \$500,000 by the later of Dec. 14th, 2014 or the date that is one year after the effective date of the FFI's Agreement witht he IRS;
- g. Account balances and numbers of US persons;

What does this mean? It means if you do not report your foreign accounts, at some point, your foreign bank will. Foreign banks are between a rock and a hard place with this new regulation. If they DO NOT sign up with the IRS, then any payments made to them by US persons (such as mortgage interest payments, US dividends, passthru payments, gross proceeds from the sale of securities generating US source income, etc.) will be subject to a 30% US tax withholding unless a lower treaty rate (e.g., US-India treaty allows a max of 15% withholding) for the country in which the FFI is based applies. In other words, imagine a foreign bank not participating with this new regulation. Also imagine that this FFI receives mortgage payments (i.e., US sourced interest on the loan they've given) from a US person. The interest payments would be reduced by 30% and given to the IRS due to the receiving non-participating FFI not complying with the new US Treasury law. Foreign banks and financial institutions will surely want to keep as much of their interest while not being penalized by the IRS or other international and domestic regulators. Therefore, it would be simpler for FFIs to simply comply with the law. If the country in which the FFI is based already has a tax treaty with the USA in place, chances are, the enactment and compliance to FATCA by FFIs will not be a violation of the treaty due to each country being able to enact something called a "savings clause." The "savings clause" allows any country to tax its own residents as if there were no US income tax treaty in place with the country in the first place. Seeing as how FATCA is simply taxing US sourced income and allowing, but not requireing FFIs to comply, most FFIs might very well simply sign on to this new law. Furthermore, even if the country of the FFI does not have an income tax treaty with the USA, judging by the fact that in today's global world, many FFIs have transnational operations, global stakeholders, other international monetary regulators, and accountholders from various countries, the inevitable reality for FFIs is to adhere to US tax law. So, for e.g., if one has a foreign account and continues to choose to not report foreign

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assets and income and/or pay US taxes on foreign income, chances are, the foreign institution where that person's financial account resides will, in all probability, report to the IRS, that person's name, social security number, and all other necessary and pertinent info as required by FATCA. This is in addition to FFIs withholding and paying that person's US taxes to the IRS. The US Treasury, it seems, is now flexing its muscle on the world stage to enforce US tax law on US persons, even if that means stepping on foreign institutions' toes.

3. **Reporting Passive Foreign Investments:** The third component of FATCA is also immediately effective for tax years starting after March 18th, 2010 (i.e., 2011 for calendar-year taxpayers). Section 521 of the HIRE Act adds a new section, 1298(f) to the Internal Revenue Code. It requires US persons who are shareholders of foreign investment companies ("PFIC") to file an annual report containing such information as the Secretary of the Treasury may require, (on Form 8621). Previous to the passing of FATCA, there was a requirement for an 8621 filing; however, the new provisions of FATCA make 8621 reporting more stringent such that many who may not have been required to file an 8621 prior to the passing of FATCA will now inevitably have to file an annual 8621. This form also gets attached to US persons' tax returns or information returns (i.e., attached to their 1040, or 1065, whichever entity owns the foreign passive investment company). The new Form 8621 under this new regulation is not yet released and the IRS advises that those US persons with current requirements under the old instructions to the 8621 must still continue to file the original 8621 until the new form is released. Those without any requirement to file under the old 8621 provisions but required to file an 8621 under the new Section 1298(f) requirements under FATCA will not have to file an 8621 until the new form 8621 is released.
4. **Penalties:** There is a **\$10,000 per incidence penalty** (for any year starting after March 18th, 2010) in addition to a **possible \$50,000 penalty** for failing to comply with the new reporting requirements after IRS notification. Furthermore, any underpayments of tax attributable to non-disclosed foreign financial assets will be subject to an additional substantial understatement penalty of 40%.
  - o For e.g., if you had \$75,000 in a foreign bank account which you failed to disclose next year, the highest penalty would be \$60,000 (\$10,000 per incidence, and \$50,000 after IRS notification) on the account. However, whatever interest income you would have made in that year which you may not have reported would first be subject to income tax at your bracket (maybe 25%) plus a penalty of 40% and statutory interest charged to you by the IRS on the whole income tax & penalty balance.

**Specific Filings:** The forms which the IRS now would like US persons to fill out as a result of the passage of FATCA, i.e., Forms 8938 and 8621, are not meant as a replacement to other information form returns. The Form 8938 and 8621 is supplementary information. Indeed there is a specific section of the Form 8938 (Part II) which has redundant information as other specific Forms discussed below here, and therefore Part II of Form 8938 would not be required to be filled out. However, as of now, just because a US person fills out one of the following reporting forms does not necessarily absolve them of relevant 8938 or 8621 (if applicable) filings. Here are some **other reporting forms also required to be provided by US persons (not part of FATCA), if applicable:**

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**"Now let's talk about that loophole you've claimed!"**

- **Form TD F 90-22.1, "report of Foreign Bank and Financial Accounts," (FBAR) where the summation of all foreign balances ever reaches \$10,000 in any one day of the fiscal or calendar year.**
- Form 3520 (Annual Return to Report Transactions With Foreign Trusts & Receipt of Certain Foreign Gifts);
- Form 3520-A (Information Return of Foreign Trust With a US Owner);
- Form 5471 (Information Return of US Persons w/Respect to Certain Foreign Corporations);
- Form 5472 (Information Return of a 25% Foreign-Owned US Corporation or a Foreign Corporation Engaged in a US Trade or Business).
- Form 926 (Return by a US Transferor of Property to a Foreign Corporation);
- Form 8865 (Return of US Persons with Respect to Certain Foreign Partnerships).

**Deadline for OVDI 2011 is this Sept. 9th, 2011:** Do keep in mind that the deadline for reporting foreign income and assets for the 2011 OVDI Disclosure Window for 2011 has been extended to Sept. 9th, 2011 (this coming Friday). Anyone who has not yet taken an extension and still wishes to report their missing income on tax returns and unreported foreign assets on the FBARs for the 2003-2010 period should do so by filing the **Form 872** and the **Section 31, Consent to Extend FBAR Statute Form**. Once those are filled out, they must be sent, by Sept. 9th postmark, to Austin (Internal Revenue Service, 3651 S. IH 35 Stop 4301 AUSC, Austin, TX 78741, ATTN: 2011 Offshore Voluntary Disclosure Initiative). In addition, a completed **OVDI letter** must be sent via mail (or courier) by Sept. 9th postmark to Philadelphia. That address is on the letter itself. The grids do not need to be filled out with numbers..simply "Xs".

Our office does help with OVDI filings. Do call us or your CPA should you have more specific international tax questions as it relates to your scenario. And as always, please be advised that, based on current IRS rules and standards, any U.S. Federal tax advice contained herein is not intended to be used, nor can it be used, for the avoidance of any tax penalty that the IRS should assess related to this matter

**Happy Trails!**

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