



The Tax Lawyer

Ten Things To Know About Offshore Bank Accounts

Robert W. Wood, 07.26.10, 1:00 PM ET

If you are a U.S. citizen or resident and maintain an undisclosed foreign bank account, beware. As numerous prosecutions trumpeted by the IRS make clear, the stakes have never been higher and the potential liabilities can be staggering. Why worry?

The vaunted secrecy of Swiss and other tax havens turns out not to be so secret after all. They've already named names to the IRS and more are on the way. Although the UBS case was most publicized, HSBC, Credit Suisse, and many other banks are in the mix now, as are many foreign countries besides Switzerland. So putting your head in the sand won't work in the long term.

The IRS had a special "Voluntary Disclosure Program" to bring violators into the fold, but the cutoff for participating in it was Oct. 15, 2009. If you are in that program, you are probably still slogging through filings and disclosures to the IRS. But if you missed that deadline--and many thousands did--beware. Sooner or later you'll have to address this problem one way or another.

Here's what you need to know:

1. You Must Report Worldwide Income

You must report your worldwide income on your U.S. income tax return. Plus, you must check "yes" (on Schedule B) if you have an interest in a foreign bank or financial account. Worldwide income means everything, including interest, foreign earnings, wages, dividends and other income. Even if the foreign income is taxed somewhere else, you still must report it to the IRS. You might be entitled to a foreign tax credit, or if you are living and working abroad, you may be entitled to an exclusion from U.S. tax for some or all of the income you earn abroad. But you still must report it.

2. Tax Return Disclosure Isn't Enough

Tax return filing alone isn't enough. All U.S. persons with foreign bank accounts must also file annually a Treasury Department Form, TD F 90-22.1 Report of Foreign Bank and Financial Accounts--commonly called an FBAR. The FBAR is due each June 30 for the preceding year. You must file an FBAR if the aggregate value of your foreign financial accounts exceeds \$10,000 at any time during the year. All your foreign accounts are aggregated, so if you have two small accounts, say one in Germany with \$5,000, and one in England with \$6,000, you need to file an FBAR. If your foreign account balances *at all times* during the year total less than the equivalent of \$10,000 U.S., you do not need to check the box on your tax return or file an FBAR, but you must still report any account earnings on your tax return.

3. There Are Big Tax Penalties

If you don't comply with one or both sets of obligations the penalties are severe. You sign tax returns under penalties of perjury, so if you fail to report your worldwide income--or even fail to check the box disclosing you have a foreign account--it can be considered tax evasion and fraud. The statute of limitations on such criminal acts is six years. Plus, the statute of limitations never expires on civil tax fraud, so the IRS can pursue you 10 or 20 years later for back taxes, interest and penalties. If you failed to report income, your civil liability to the IRS can include a 20% accuracy-related penalty or a 75% civil fraud penalty.

4. FBAR Penalties Are Even Bigger

The penalties for failure to file an FBAR are even worse. Failing to file an FBAR can carry a civil penalty of \$10,000 for each non-willful violation. But if your violation is found to be *willful*, the penalty is the greater of \$100,000 or 50 percent of the amount in the account for *each* violation--and each year you didn't file is a separate violation.

5. You Can Go To Jail

Filing a false tax return is a felony, while *failing* to file is only a misdemeanor--think of it as the Wesley Snipes rule. A person convicted of tax evasion can face a prison term of up to five years and a fine of up to \$250,000. Filing a false return can mean up to three years in prison and a fine of up to \$250,000. A person who fails to file a tax return can face up to one year of prison and a fine of up to \$100,000. Failing to file FBARs can be criminal too, and the penalties are even more severe. The monetary penalties can be up to \$500,000 and the potential prison term is up to ten years.

6. Voluntary Disclosure Is Still An Option

If you admit your failures to the IRS and say you want to make it right, you've made a "voluntary disclosure." Don't confuse this with the "Voluntary Disclosure Program," which had an Oct. 15, 2009 deadline. It is too late for that prepackaged program, but it's not too late to make an individual "voluntary disclosure." A voluntary disclosure must be truthful, timely and complete. You must: cooperate with the IRS in determining your correct tax liability; and make good faith arrangements with the IRS to pay the tax, interest and penalties determined by the IRS.

While a voluntary disclosure does not guarantee immunity from prosecution, the government generally will not prosecute you if you come forward voluntarily before you're under investigation. (If the IRS is already investigating you, all bets are off.) Note, however, that in publicizing the IRS Voluntary Disclosure Program in 2009, the IRS made clear it would show no mercy to those with undisclosed offshore accounts who didn't turn themselves in by the Oct. 15, 2009 deadline. For that reason, some tax lawyers fear that the traditional advantage of a voluntary disclosure--no criminal prosecution--is less certain.

Stepping forward should be done through a tax lawyer to the IRS Criminal Investigation Division. Usually the case will be referred to the civil branch of the IRS where all the filings, amending and penalty calculations are done. You then must file amended income tax returns for past years and delinquent FBARs. There's no bright line for how far back you'll have to go, as situations vary. However, the Oct. 15, 2009 program required six years of amended tax returns and FBARs, so that's a good benchmark. The total cost of making a voluntary disclosure is also hard to assess, but it can be more than the amount in your foreign account.

7. "Quiet Disclosure" Is Also An Option

Some practitioners consider a voluntary disclosure "noisy," since it involves going to the IRS Criminal Investigation Division. A "quiet" disclosure involves a correction of past problems without drawing attention to what you are doing and without going to the IRS Criminal Investigation Division. If you amend all past tax returns to report all income, check the box on Schedule B, and file all past due FBARs, haven't you (quietly) fixed everything? Arguably, yes. You would send in all the money you owe or wait to be billed. If you have been paying foreign taxes on your foreign earnings, your foreign tax credits could even net out the U.S. tax, so you might not owe back taxes.

If you reported and paid tax on all your income but did not file FBARs, you should attach a statement explaining why they were late. Perhaps you had never heard of FBARs or were told by your accountant you were in full compliance. You can avoid penalties if you had "reasonable cause" for not filing FBARs, but the grounds for waiving penalties aren't terribly clear.

8. Inconsistency Will Hurt You

Can you amend your tax returns, reporting your worldwide income and checking the foreign account box, but not bother filing delinquent FBARs? By checking the tax return box acknowledging your foreign account, you are admitting you have an FBAR filing obligation. So not also filing the delinquent FBARs seems risky.

Even though FBAR penalties are big, there have been some indications the IRS may not be pushing them too hard. If you don't file a pile of old FBARs, perhaps it won't be obvious you didn't file in the past? A tax lawyer cannot recommend this, but some clients are probably choosing not to file old FBARs.

9. Prospective Compliance Only Is Risky

Can you start filing complete tax returns and FBARs prospectively, but not try to fix the past? Some people think the IRS is so overwhelmed with FBARs and tax returns that you might be OK, but the risks are enormous and I cannot recommend it. The IRS may ask about the lack of prior FBARs and of prior tax returns disclosing a foreign account. If they ask questions, you should respond through your attorney and you can't lie.

10. Keeping Money Offshore Is Still Legal

Should you close all your foreign accounts and bring your money home? You are entitled to have money and investments anywhere in the world as long as you disclose your foreign accounts. If you are considering not trying to clean up your past tax returns and FBARs, you may be tempted to close your foreign account. However, closing your foreign account doesn't relieve you of the obligation to file accurate tax returns and FBARs. Tying off the problem prospectively may make sense, but can make your lack of compliance even worse if your actions are viewed as efforts to conceal your previous offshore activities. For that reason, don't take any of these steps without professional advice.

There's widespread confusion and noncompliance involving foreign bank accounts, and the situation is unlikely to get better. Get some professional advice and try to get your situation resolved.

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