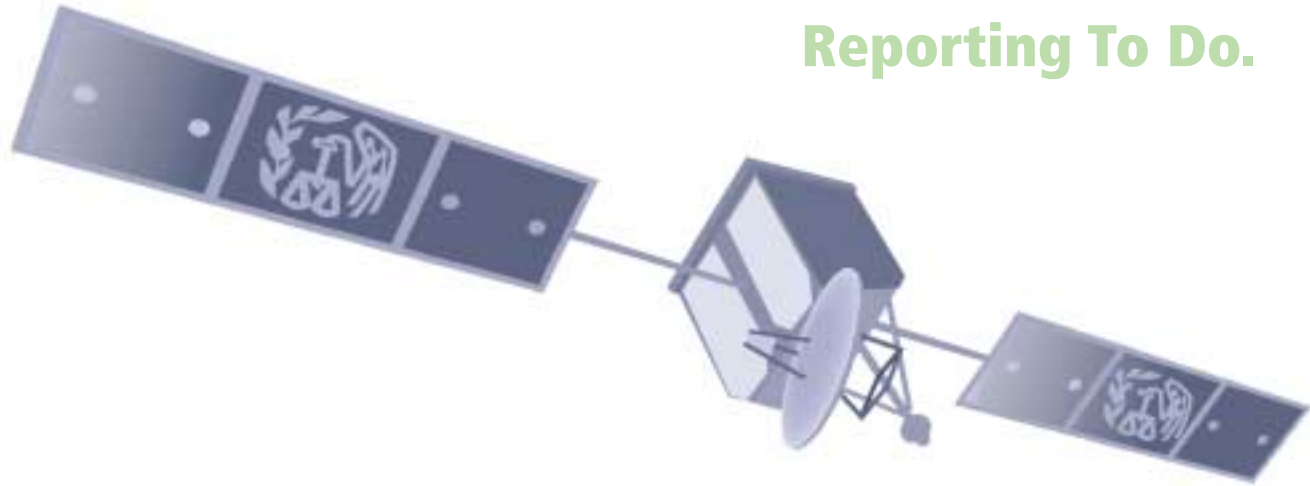


By: David B. Porter, Esq.

# Do You Have a Client Who Owns a Foreign Account, a Foreign Trust, or Foreign Stock?

If You Do, Your Client Has Some Reporting To Do.



When I first started my legal career, the idea of advising a client about the filing of a **Form TD F 90-22.1**, **Form 3520**, or **Form 5471** seemed foreign to me. (Coincidentally, these forms deal with international issues.) However, now it is very common to see the subject of Internal Revenue Service reporting requirements as they pertain to U.S. citizens and their foreign holdings.

U.S. citizens who own a foreign bank account, a foreign trust, or a certain percentage of stock in a foreign corporation are required to file the forms referenced above.

There are many other forms that deal with every conceivable type of foreign holding situation (for example, forms to be filed by partners of a partnership, or forms to be filed by the entities themselves). However, the three forms referenced above seem to be getting the most attention these days, and it is incumbent on all professionals to understand that their client may have reporting obligations to the Internal Revenue Service, which subjects them to penalties for not complying.

Last year, the Senate's investigation into offshore banking produced a rise in voluntary disclosures of

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previously unreported offshore accounts. Then, the IRS amended its form for reporting a foreign financial account and issued an announcement warning U.S. citizens with foreign interests to comply with certain filing requirements. On October 29, 2008, Faris Fink, the IRS Deputy Commissioner of the Small Business/Self-Employed Group, told the American Institute of Certified Public Accounts in Washington, DC that the IRS was getting tough on enforcing foreign reporting requirements, and that taxpayers with foreign accounts would have to file a reporting form or risk the assessment of \$10,000 penalties.

In addition, starting in 2009, a penalty is automatically assessed after the IRS discovers a failure to file a Form 5471, disclosing a certain interest in a foreign corporation. Following a surge in the number of cases handled by the IRS's Whistle-Blower Office dealing with foreign income and assets, the IRS is certain to handle such issues with greater scrutiny. The IRS is currently discussing new ways to deal with foreign tax shelters and administer more careful oversight of foreign banks as a reaction to the investigations into the Swiss banking activities of UBS.

Here's a brief snapshot of some of the requirements connected to the three reporting forms mentioned above, which must be filed by U.S. citizens with foreign holdings.

File a **Form TD F 90-22.1 Report of Foreign Bank and Financial Accounts**: if your client has a financial interest in, or signature or other authority over, any financial accounts in a foreign country, including bank, securities, or other types of financial accounts; and if the aggregate value of these accounts exceeds \$10,000 at any time during the calendar year. The IRS has updated its form to ask for more detailed information, and it must be filed with the Department of the Treasury in Detroit, MI by June 30<sup>th</sup> of the following year. A failure to file penalty of up to \$10,000 can be assessed, which may increase to the greater of \$100,000 or 50% of the transaction amount or account balance for willful violations. Criminal penalties include up to \$500,000 and 10 years in prison.

File a **Form 3520 Annual Return to Report Transactions With Foreign Trusts and Receipt of Foreign Gifts** if your client is a U.S. citizen and has created or transferred property to a foreign trust, or if your client owned any part of the assets of a foreign trust under grantor trust rules. A grantor trust is any trust to the extent that its assets are treated as owned by a person other than the trust (usually the person who set up the trust). Your client must also file the form if he/ she received a distribution from a foreign trust, more than \$100,000 from a nonresident alien individual or a foreign estate, or more than \$13,561 from a foreign corporation or partnership that was treated as a gift. File the form annually with the IRS Service Center in Ogden, UT. A failure to file penalty equals 35% of the gross value of the property transferred to and from a foreign trust.

Criminal penalties may also be imposed for failure to file.

On a taxpayer's **Form 1040 U.S. Individual Income Tax Return**, there is a section called Part III Foreign Accounts and Trusts on Schedule B. You must check "yes" to either or both of the appropriate boxes: if your client has an interest in, or signature authority over, a financial account in a foreign country (and files a TD F 90-22.1); or if your client received a distribution from, or was a grantor of, or transferor to, a foreign trust (and files a Form 3520).

File a **Form 5471 Information Return of US Persons with Respect to Certain Foreign Corporations** if your client is a U.S. citizen who is an officer, director, or shareholder in certain foreign corporations. There are five categories of filers set forth in the IRS's instructions. Generally, a taxpayer needs to file the form if the taxpayer is a U.S. person and has ownership of 10% or more of the stock of a foreign corporation. The form is also required for shareholders of a controlled foreign corporation (CFC), which is a foreign corporation with U.S. shareholders who collectively own more than 50% of the total voting power of all classes of the voting stock, or the total value of the stock of the corporation. The form must be attached and filed with the taxpayer's income tax return. Penalties for failure to file may include a \$10,000 fine for each annual accounting period for each foreign corporation and reductions in foreign taxes available for credit. Criminal penalties may also be imposed.

Again, there are many other situations that require a wide variety of foreign reporting forms to be filed by U.S. citizens, as well as non-U.S. citizens, and even the discussion above is not by any means intended to be inclusive of all of the requirements connected to the three forms discussed. The purpose of this summary is to raise issues so you or your client can seek professional tax advice to deal with the specific situation.

All attorneys must now be aware that there are a whole host of filing requirements with which their client will need to comply, if the client owns an interest in a foreign account, trust, or entity. The consequences for ignoring the deadlines for filing foreign information returns can be serious. ❖



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