

Tax Law Hot Sheet -- Breaking Developments in Tax Law

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American Jobs Creation Act of 2004: Changes to Penalties for Failure to Report Foreign Financial Accounts

On October 22, 2004, the American Jobs Creation Act of 2004 (H.R. 4520) ("AJCA") was signed into law. This new federal tax law includes numerous provisions of particular interest to individuals and businesses. One such provision is Section 821, which modifies penalties for failure to report foreign financial accounts to the Treasury Department. Not only does the AJCA increase existing penalties for a willful failure to report a foreign financial account, but also imposes a new civil penalty on any person that violates the reporting requirements regardless of willfulness. U.S. Businesses must be aware of these provisions if they have employees with any authority over the company's foreign financial accounts. U.S. individuals and expatriates should also be aware of these rules as failure to report their personal accounts in foreign countries to the Treasury Department will leave them open to penalties of \$10,000 or more. The penalties apply to reporting violations taking place after October 22, 2004, the date of enactment of the AJCA.

Reportable Transactions

Generally, any U.S. person who has a financial interest in, or signature authority over, any financial accounts in a foreign country, of which the aggregate value exceeds \$10,000 at any time during the calendar year, must report that relationship to the Treasury Department on Form TD F 90-22.1 by June 30 of the succeeding taxable year and to the Internal Revenue Service on Form 1040 Schedule B. This rule applies to any financial account that is located in a foreign country (excluding Guam, Puerto Rico and the Virgin Islands), even if the account is held at an affiliate of a United States bank. Specific exceptions may apply to employees of financial institutions and domestic corporations whose equity securities are listed upon a national securities exchange, or whose assets exceed \$10 million and have 500 or more shareholders.

Financial accounts generally include any securities or other financial instruments accounts, as well as any savings, demand, checking, deposit, time deposit, or other accounts maintained by a financial institution.

A financial interest in a financial account means an interest in a foreign account for which the U.S. person is the owner of record or has legal title (regardless of who receives the benefit of the account). A U.S. person will also have a financial interest in a foreign financial account if the owner of record or the holder of legal title is: (a) a person acting as a agent, nominee, attorney or

in some other capacity on behalf of the U.S. person; (b) a corporation in which the U.S. person owns directly or indirectly more than 50 percent of the total value of the shares of stock; (c) a partnership in which the U.S. person owns an interest in more than 50 percent of the profits; or (d) a trust in which the U.S. person either has a present beneficial interest in more than 50 percent of the assets or from which such person receives more than 50 percent of the current income.

A U.S. person has signatory authority over a foreign financial account if such person can control the disposition of the money or other property maintained in the account.

Penalties for Failure to Report Interests in Foreign Financial Accounts

The AJCA amends the penalty structure for failure to report foreign financial accounts. Under the AJCA, non-willful failures to report transactions or accounts with foreign financial institutions may result in a penalty of up to \$10,000. While not entirely clear from the statute, the legislative history states that this penalty may be waived if any income from the account was properly reported on an income tax return and there was reasonable cause for the failure to report.

In the case of willful violations there is a maximum penalty, which could be the greater of \$100,000 or 50 percent of the amount of the transaction between the U.S. person and the foreign financial institution or, if the violation involves a failure to report the existence of the account or any required identifying information, the penalty may include the balance of the account at the time of the violation. There is no reasonable cause exception for willful violations of the rule.

What This Means for Businesses

Businesses should make sure that their employees are aware of these annual reporting requirements to prevent surprise penalties of \$10,000 or more to the business, the employee personally, or both. If a U.S. business is maintaining foreign financial accounts, the business and its employee with signatory authority over the account must report the accounts to the Treasury Department on Form TD F 90-22.1. The account must be reported if the amount in the account exceeds \$10,000 at any time during the calendar year.

U.S. persons with personal financial accounts in foreign countries must also report those accounts to U.S. tax authorities and the Treasury Department. U.S. businesses should warn their employees stationed abroad of this requirement so that their employees are not subject to substantial penalties.

What This Means for Individuals

U.S. individuals with financial accounts in foreign countries are also required to report those accounts to U.S. tax authorities and the Treasury Department if the amount in the accounts exceeds \$10,000 at any time during the taxable year. This means that the account you maintain in Whistler, British Columbia, to pay the homeowner dues on your condo must be reported if the balance in the account exceeds \$10,000, even once, during the year.

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