

Global Citizen, Global Taxpayer

written by JARGAL OYUNBILEG

Don't let your globetrotting catch up to you when tax time comes around.

Our firm is comprised of colleagues from diverse backgrounds. You're likely to hear a conversation in Russian or Mandarin while visiting our office. Yet we all speak two common languages: English and Taxes.

The United States Citizenship and Immigration Services (USCIS) website states that paying income and other taxes to federal, state and local taxing authorities honestly and timely is one of the civic responsibilities legally required of every U.S. citizen. This ensures that America remains a free and prosperous nation.

Every U.S. citizen, regardless of their domicile, has tax compliance and reporting obligations to the United States. Although this may be obvious to most, some have been caught and penalized for their lack of reporting. For example, if you lived in Europe for the past decade and filed income taxes in your resident country, you may assume you have been compliant. This is a common misconception because, as a United States citizen, you still had a reporting obligation in the U.S. regardless of where you lived.

This civic duty regarding taxes is not only limited to citizens of the U.S. Foreign citizens, documented or undocumented, with or without permanent residency cards, share the same civic responsibility for income taxes as do U.S. citizens. They, too, need to report their

worldwide income, and have reporting requirements for their financial assets in foreign countries.

Determining your residency is important in figuring out your tax filing requirements, especially since within the same U.S. tax regime, definitions of tax residency can vary. For example, a foreign citizen may be considered a resident for income tax purposes, but may be considered a nonresident for estate and gift taxes. The requirements for reporting can be like an endless fog for those who try to navigate through it on their own. The simple questionnaires that are provided with most at-home tax software may not have the capability to capture the true reporting requirements on a case-by-case basis.

From what we have seen in our office, foreign citizens who qualify as U.S. tax residents have more reporting obligations than many U.S. citizen taxpayers, by virtue of having financial ties to their countries of citizenship. A lot of people move to the United States leaving their bank, investment and retirement accounts intact, not knowing how the presence of these foreign financial accounts will add to their tax compliance requirements in the U.S.

We are still surprised to meet prospective clients who just recently found out that they failed to report information about their foreign bank accounts. Per the IRS, penalties for failing to file Form

114 (Report of Foreign Bank and Financial Accounts) is up to \$10,000 if non-willful, and up to the greater of \$100,000 or 50% of account balances if willful.

The penalty for failure to file Form 8938 (Statement of Specified Foreign Financial Assets) is up to \$10,000 for failure to disclose, and an additional \$10,000 for each 30 days of nonfiling after an IRS notice of a failure to disclose. The potential maximum penalty is \$60,000. In addition, criminal penalties may apply.

Reporting Foreign Bank Accounts and Financial Assets

U.S. resident taxpayers who have financial interests in and/or signing authorities on at least one foreign financial account are subject to disclosure reporting requirements, even if the account did not generate any taxable income. These disclosure requirements are satisfied by filing Form 114 and/or Form 8938 in a timely, accurate and complete manner when the relevant reporting thresholds are met.

Although for some taxpayers it may seem that reporting the same information on two forms is duplicative, the filing of one form does not replace the filing requirement for the other, even if the same asset is being reported on both. To make things even more confusing, you are required to send this duplicate information to two separate places at different times (yes, different deadlines). And in some cases, you may also have a filing requirement for one form but not the other. The penalty for a failure to file is significant for both forms. We will expand on both forms

below, but beware that this is the tip of the iceberg. It is extremely important to contact a tax professional if you fear that any of this applies to you.

Form 114 and Form 8938

Form 114 is commonly known as FBAR. This form is filed to report information about the taxpayer's foreign bank and financial accounts. Every U.S. taxpayer who has financial interest in and/or signing authority on at least one foreign financial account where the combined value exceeded \$10,000 at any given time during the tax year is required to file an FBAR.

Per instructions on Form 114, the definition of a financial account is as follows:

A financial account includes, but is not limited to, a securities, brokerage, savings, demand, checking, deposit, time deposit, or other account maintained with a financial institution (or other person performing the services of a financial institution). A financial account also includes a commodity futures or options account, an insurance policy with a cash value (such as a whole life insurance policy), an annuity policy with a cash value, and shares in a mutual fund or similar pooled fund (i.e., a fund that is available to the general public with a regular net asset value determination and regular redemptions).

One of the key differences between filing an FBAR and filing Form 8938 is that an FBAR is filed by each taxpayer, separate from their income tax returns. The keywords here are "each taxpayer". Each person with an interest must file an FBAR; it is not limited to individuals. In addition, not meeting the requirement to file an income tax return does not relieve the taxpayer's obligation to file an FBAR.

Let's give an example: a husband and wife moved to the U.S. from the United Kingdom with their 14-year-old daughter in late 2013. The husband and wife have both joint and separate bank and retirement accounts. The daughter has a savings account that her grandparents opened when she was born.

The grandparents deposit money into the account every year on her birthday. Who needs to file the family's FBAR if aggregate values of each family member's account reach \$10,000?

If the husband and wife jointly owned all of their foreign bank accounts, only one spouse can report and timely file all reportable jointly owned accounts. But since, in this example, both husband and wife have joint accounts and separate accounts, both spouses are required to file separate FBARs. In addition, the daughter also has a filing requirement. If the daughter is unable to file her FBAR, her parent(s) sign and file the form on the minor's behalf.

Another topic we are often asked questions about is the conversion rate. Once the maximum value is determined, the value must be converted to the U.S. dollar using the year-end exchange rate published by the Department of Treasury's Financial Management Service. This year-end rate should be used even if the maximum value was earlier in the year.

Unlike the FBAR, Form 8938 (Statement of Specified Foreign Financial Assets) is a fairly new form. The filing requirement for this form became effective as of the 2011 tax year. Form 8938 is filed with the taxpayer's income tax Form 1040. Therefore, if there is no income tax return filing requirement, then there is no Form 8938 filing requirement for the taxpayer.

The filing threshold for Form 8938 is higher than the FBAR filing requirement. For a single filer, the filing requirement is met when the fair market value of the filer's foreign financial assets exceeded either \$75,000 at any given time during the tax year or \$50,000 at the calendar year's end. For married filing jointly returns, the filing threshold is double the above fair-market values: \$150,000 and \$100,000 respectively.

Specified foreign financial assets include all the accounts reported as *owned* by the taxpayer on the FBAR, plus fair market values of other assets, such as the value of stocks of foreign corporations not held in a financial account, and interest in a foreign

partnership. Information about accounts with only signatory authority is not reportable on this form.

Determining the fair market value of an asset can be a challenge. The taxpayer should read the instructions on Form 8938 when determining a reasonable estimate.

Delinquent in Filing Forms 8938 and FBAR?

Several different compliance options are available in order for taxpayers with delinquent filings to become current. In a delinquency situation, consulting with tax attorneys or tax advisors is strongly recommended. It is important to receive guidance in selecting the filing procedures that fit the taxpayer's facts and circumstances.

The latest compliance option, Streamlined Domestic Offshore Procedures, is one that has been chosen by numerous taxpayers. This option became available in 2014 and, for those who can qualify to file under it, it is a beneficial program. The penalty under this procedure is reduced to 5%, which pales in comparison to the 27.5% penalty assessed for filings under the Offshore Voluntary Disclosure Program.

If one has not reported foreign assets for years, the filing of these forms may result in a significant amount of taxes and penalties. Typically, once the amount of penalty has been determined, the taxing authority will give two options: pay in full or begin a payment plan.

Working out a payment plan can be challenging, especially when the tax due with penalties is significant. The taxpayer has to complete an additional form divulging all of his or her assets, income and expenses. Based on the information, the taxing authority will determine whether or not the taxpayer needs to pay down a portion first before working out a payment plan. If the taxpayer falls short on payments, liens may be assessed on the assets that were just so generously divulged to the IRS.

A taxpayer must weigh his or her options between the voluntary programs and the standard fines and penalties that come

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when the IRS discovers unreported foreign assets and income. If you are evaluating whether or not to become current, here are two things we'd like to remind you of: criminal penalties (jail time) may apply for willful neglect; and peace of mind is immeasurable.

Jargal Oyumbileg is a CPA at Shwiff, Levy & Polo, LLP. She enjoys going on short hikes, eating dim sum, and picking pine nuts in Mongolia. She can be contacted at jargal@yoursrvc.com.

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phone: 415-563-9300
fax: 415-563-9304
e-mail: Karen@uchlegal.com

1439 Baker Street
San Francisco, CA 94115