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Farmers and Foreign Accounts

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The IRS has taken steady, effective steps over the past several months in the area of offshore asset reporting, with serious civil and criminal penalties at stake for taxpayers who are not reporting assets located outside the United States. These severe penalties not only apply to taxpayers willfully attempting to dodge the rules but even for those unknowing taxpayers, including farmers, who run afoul of the rules without knowing what to do to comply. Farmers with assets outside the United States must be aware of these rules, especially because of the substantial civil and criminal penalties for failure to comply with the relevant rules each year.

Accordingly, farmers with bank, investment or other assets located outside the United States need to be aware of two separate filing requirements that may apply to them depending upon the nature of the foreign assets and the asset value during each year. While deliberately holding foreign accounts within an investment portfolio may trigger an annual filing requirement under one or both sets of rules, a change of circumstances in the farmer's financial situation can inadvertently require the unknowing farmer to comply with these rules.

Example 1. Joe and Sabrina operate a family farm in central Illinois. They have never held any foreign accounts or assets. However, Sabrina's aunt in Germany dies during 2014 and Sabrina inherits substantial money in the form of German bank and security accounts. Sabrina may have to comply with these foreign account reporting rules at least for 2014.

Example 2. Martin operates a dairy farm south of Chicago. His mother in Canada is ill. Martin visits her and places his name on his mother's Canadian bank accounts and investments so that he is able to pay her bills and reinvest funds for her periodically because she can no longer make those decisions. Martin may have to comply with these foreign account reporting rules even though the accounts on which his name was placed really belong to his mother.

Example 3. Glenda runs her family farm along with her children. Her oldest child, Billy, finishes high school and is accepted at a university in London, England. As a condition of his university attendance in England, Glenda must deposit an amount equal to Billy's entire tuition into a U.K.

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bank account. After doing so, Glenda may have to comply with these foreign account reporting rules because she has a foreign bank account in her name.

Each of the two separate filing requirements have different applicable rules. The two areas that the farmer must be aware of are as follows.

- The Bank Secrecy Act filing requirements (and FinCen Form 114)
- The Foreign Account Tax Compliance Act (and Form 8938)

The Bank Secrecy Act and FinCen Form 114

The foreign asset filing requirements under The Bank Secrecy Act generally has nothing directly to do with the Tax Code or the IRS. This form is administered by the Financial Crimes Enforcement Network (FinCen), which is a division of the Department of the Treasury. FinCen Form 114 must generally be filed by a farmer who is either a U.S. citizen or resident if the farmer has a “**financial interest** in or **signature authority** over” **foreign financial accounts** that exceed **\$10,000** in value at any time during the year.¹ Foreign Account. A foreign account under these rules is generally any account physically located outside the United States. An account that is located within the United States that holds foreign investments is generally not considered to be a foreign financial account that is reportable under these rules. Similarly, if the farmer has a bank account with a foreign bank, but the account is located in the U.S. at a U.S. branch of that foreign bank, the account is not considered to be a foreign account under the rules because the account is not physically located outside the United States, even if the account holds foreign investments or currency.

***Note.** Online gaming has recently become another issue with regard to whether an account is outside the United States. A California federal district court has recently ruled on June 4, 2014 that a digital online account with a poker website is deemed to be located wherever the poker website has been created that establishes and maintains the online account, regardless of whether the funds are physically located within the United States.²*

Examples of the types of accounts that are subject to these rules if physically located outside the United States are as follows.

- Bank savings and checking accounts
- Certificates of deposit
- Securities accounts
- Insurance or annuity policies that have a cash value component
- Futures or options accounts
- Mutual fund investments

There are many other types of accounts that may be subject to these rules, but those listed previously may be the most common. To determine whether there is a FinCen Form 114 filing requirement in connection with the farmer's accounts that are physically outside the U.S., the farmer must have either a **financial interest** in or **signature authority** over those accounts.

Financial Interest. Ownership of the foreign account means that the farmer has a financial interest in that account. If more than one person's name is on the account, each of those persons is deemed to have a financial interest in that account. But circumstances other than direct ownership are also considered to be sufficient to meet the financial interest requirement. If the farmer has another person acting as the farmer's power of attorney or agent or other type of representative with respect to a foreign account, the farmer is still considered to have ownership and a financial interest in that account.

¹ 31 CFR §1010.350(a).

² U.S. v. J.C. Hom, 2014 U.S. Dist. LEXIS 77489 (N.D. CA, 2014).

In addition, indirect ownership through a business entity may constitute ownership. A foreign account owned by a partnership, corporation or other entity is generally considered owned by the farmer if the farmer owns more than 50% of the business entity.¹

Financial Interests with Trusts. If a farmer establishes a trust that owns a foreign account and the farmer has an ownership interest in the trust for federal tax purposes, the farmer is considered to own, and have a financial interest in, the foreign account.²

A farmer may also be considered the indirect owner of an account if the farmer is the beneficiary of a trust that is direct owner of a foreign account. This indirect ownership by the farmer will exist if the farmer, as beneficiary, has a beneficial interest in more than 50% of the trust assets. There are some exceptions to this rule, depending upon the type of beneficiary the farmer is and the type of interest in the trust the farmer has.³

Signature Authority. Under the applicable rules, the farmer generally has signature authority over the account if the farmer can control what happens with the money or other assets in the account by any type of communication with the financial institution or person who holds the account. Control exists even if the farmer only has control if it is exercised jointly with someone else. While there are some exceptions to the definition of “signature authority”, none of these exceptions apply to a typical family farm business.

Value in Excess of \$10,000 Anytime During the Year. Generally, if the farmer has a financial interest in, or signature authority over, foreign financial accounts that are in excess of \$10,000 in value at any time throughout the year, a requirement to file FinCen Form 114 is triggered. To determine whether this value threshold is exceeded, the maximum value of all such accounts are added together. An account’s maximum value is a reasonable approximation of the greatest value of currency or nonmonetary assets in the account during the year.⁴ It is permissible to use periodic statements to determine the maximum values of any accounts. Because these statements provide values stated in a foreign currency, official exchange rates must be used to convert those foreign currency amounts to U.S. dollars in order to determine an account’s the maximum value.⁵

Filing FinCen Form 114 and Penalties for Failure to File. Filing FinCen Form 114 is accomplished by use of an online filing system administered by the Financial Crimes Enforcement Network. Accordingly, this form is not filed with an annual tax return. The form is due on June 30 of the year following the year to which the form applies. Accordingly, FinCen Form 114 for 2013 was due June 30, 2014. The civil penalty for failure to file is generally \$10,000 per account that is the subject of noncompliance, but this penalty may be waived if reasonable cause can be shown for the failure to file the form. The civil penalty for a willful failure to file may be as high as the greater of \$100,000 or 50% of the total balance of the foreign accounts not disclosed.⁶ Moreover, a fine of up to \$250,000 and/or 5 years in prison may be imposed as a criminal penalty for failure to file the FinCen Form 114.

***Note.** Farmers that have not filed FinCen Form 114 but believe they may be subject to the filing requirements for 2014 or prior years should immediately seek assistance from a tax advisor familiar with this filing requirement and its rules. A late FinCen Form 114 may be filed online and the farmer should seek guidance on the “reasonable cause” showing needed to waive any penalty assessed. Prior years for which the form has not been filed should also be addressed.*

Schedule B of the Farmer’s Return. With all the other schedules that may be filed with an annual tax return, many farmers also file Schedule B, *Interest and Ordinary Dividends*. This is a very common form for many farmers and other taxpayers. Previous tax years have seen some big changes to Part III at the

¹ 31 CFR §1010.350(e)(2)(ii).

² 31 CFR §1010.350(e)(2)(iii).

³ FinCEN Final Rule RIN 1506-AB08, 76 FR 10234 (Feb.24, 2011).

⁴ FinCEN Form 114 Instructions (Rev. July 2013).

⁵ Ibid.

⁶ 31 USC §5321(a)(5).

very bottom section of Schedule B, which now provides the IRS with specific information about whether the farmer may have a requirement to file a FinCen Form 114. Below is a “snapshot” of Part III of the 2013 version of Schedule B.

		Yes	No
Note. If line 6 is over \$1,500, you must complete Part III.			
You must complete this part if you (a) had over \$1,500 of taxable interest or ordinary dividends; (b) had a foreign account; or (c) received a distribution from, or were a grantor of, or a transferor to, a foreign trust.			
Part III Foreign Accounts and Trusts <small>(See instructions on back.)</small>	7a		
	At any time during 2013, did you have a financial interest in or signature authority over a financial account (such as a bank account, securities account, or brokerage account) located in a foreign country? See instructions		
	If “Yes,” are you required to file FinCEN Form 114, Report of Foreign Bank and Financial Accounts (FBAR), formerly TD F 90-22.1, to report that financial interest or signature authority? See FinCEN Form 114 and its instructions for filing requirements and exceptions to those requirements		
	b		
If you are required to file FinCEN Form 114, enter the name of the foreign country where the financial account is located ▶			
8			
During 2013, did you receive a distribution from, or were you the grantor of, or transferor to, a foreign trust? If “Yes,” you may have to file Form 3520. See instructions on back			

The Foreign Account Tax Compliance Act

In addition to rules surrounding FinCen Form 114, there is a second, separate filing requirement for farmers with offshore assets to comply with. Under the reporting terms of the Foreign Account Tax Compliance Act (FATCA), a “**specified person**” with an interest in “**specified foreign financial assets**” are required to file a form each year to disclose those assets.

Specified Person. Under these rules, a “specified person” is a U.S. citizen or resident alien, or a nonresident alien spouse of a U.S. citizen or resident.¹ In addition, proposed regulations have been drafted to include various business entities under the definition of “specified person”, so a farm corporation or farm partnership may fall under these rules in the future. Currently, however, only the individual farmer may be subject to this filing requirement and the definition does not include business entities.

Specified Foreign Assets. The rules regarding what constitutes a “specified foreign asset” are complex. Specified foreign financial asset includes foreign financial accounts maintained by a foreign financial institution, such as a foreign bank or checking account. Also included are certain types of assets that are not held in a financial account. If the farmer, for example, directly holds stocks or bonds in foreign corporations as an investment, those investments may fall under the definition of “specified foreign financial asset.” The same may be true of any financial instrument or investment contract (including swaps and options) that the farmer as with a non-U.S. person as the counterparty. An interest in a foreign trust or estate may also be a specified financial foreign asset. This means that a farmer inheriting assets that are located outside the U.S. may find that there is a filing requirement under FATCA. These complex rules also include many exemptions, and determining whether an asset falls under the definition of “specified foreign financial asset” is often difficult.

Filing Thresholds. The farmer must file a special form under these FATCA rules if the total amount of accounts falling under the “specified foreign financial account” definition exceed a threshold amount. Generally, the applicable thresholds depend on whether the farmer files a tax return for the year jointly with a spouse. The table below summarizes the applicable thresholds.

¹ IRC §6013(g).

Filing Status	Must File if Specified Foreign Financial Assets are either :
Farmers filing jointly with a spouse	<ul style="list-style-type: none"> · In excess of \$100,000 on December 31 of the year, or · In excess of \$150,000 at any time during the year.
Farmers not filing jointly	<ul style="list-style-type: none"> · In excess of \$50,000 on December 31 of the year, or · In excess of \$75,000 at any time during the year

Generally, to determine whether the specified foreign financial accounts exceed the above thresholds, each account's fair market value is considered.¹ However, it is generally each account's highest fair market value achieved during the year that is reported. Regulations provide some special rules on valuation in order to make the valuation process easier.

Reporting the Assets and Penalties for Failure to Report. Farmers with specified foreign financial accounts with values that trigger the filing requirement must file IRS Form 8938, *Statement of Specified Foreign Financial Assets*. This form is attached to the farmer's annual tax return and is due on the same day of the tax return. If the farmer obtains an extension, the due date of Form 8938 is also extended.

Generally, there is a \$10,000 penalty for any failure to appropriately disclose the required information on Form 8938. If the failure is not corrected within 90 days after the IRS mails a notification to the farmer about the noncompliance, an additional \$10,000 penalty applies. Moreover, an additional \$10,000 applies every 30 day period thereafter, if the farmer does not furnish the required information (and this penalty may reach a maximum of \$50,000). As with the FinCen Form 114 penalty, if the farmer shows reasonable cause, the IRS may decide not to charge the penalty. There are also other penalties that can be assessed under the Tax Code.² Criminal penalties may also be imposed and the limitations period for the farmer's tax return may be extended as well. This means an extended period of time over which the IRS may audit the farmer's return.

***Note.** Another area of the Foreign Account Tax Compliance Act that became effective July 1, 2014, begins to place pressure on certain foreign financial institutions to register with the IRS and disclose account information regarding who owns an account at the foreign financial institution. Generally, if the financial institution does not do so, they may face a 30% withholding tax on payments received from the United States. These measures will likely place significant pressure on certain foreign financial institutions to register provide the IRS with additional substantial information about taxpayers who are not complying with the Bank Secrecy Act or FATCA reporting requirements.*

Farmers with assets outside the United States that may need to comply with either or both sets of rules for 2014 or prior years should consult a tax advisor very familiar with these to determine what measures need to be taken by the farmer and the farmer's family to comply, particularly given the substantial civil and criminal penalties involved for failure to comply.

¹ Temp. Treas. Reg. §1.6038D-5T(a).

² See IRC §6662(b)(7) and (j).