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# How the IRS Plans to Track Down Secret Offshore Accounts

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*The U.S. Treasury hopes new legislation could collect $8 billion in taxes from offshore accounts. Find out what that means for you...*

At a recent town hall meeting in Maine, Republican presidential candidate Mitt Romney was forced to defend the millions he holds in offshore bank accounts.

"Do you think it's patriotic of you to stash away your money in the Cayman Islands?" one woman asked. Romney assured the audience he doesn't receive any tax benefits on his at least $8 million, but possibly up to $32 million, stowed away in the Caribbean. But Romney is still getting other benefits -- like lower management fees and foreign interest.

#-ad_banner-#But these benefits might not last forever. The federal government is rolling out legislation meant to keep Americans from stashing their cash overseas.

In 2010, the IRS and the Treasury Department passed legislation called the Foreign Account Tax Compliance Act (FATCA), and those regulations will force many foreign banks to divulge the identities and account information of U.S. customers with sizeable offshore accounts that until now may have remained hidden for decades. Some parts of the legislation won't take effect for a few years, but this year, many American expatriates must divulge personal information about their overseas accounts to the IRS.

But let's back up a minute and lift the veil off those often scandalously portrayed offshore accounts, whether you have one, are considering opening one or just want to know more about them.

### Offshore overview

An offshore account is essentially an account that you open in a foreign country, like a bank account or a brokerage account.

They serve a lot of legitimate purposes. But in the movies and in the news, offshore banks are famous because they help people evade taxes. Generally, the deal is that foreign banks have no obligation to report their interest payments or other account information to other tax authorities.

So if you're an American citizen who lives in, say, Ohio, and you decide to open a savings account in an Italian bank in Rome, that Italian bank generally has no obligation to tell the IRS or any other country's tax authority about what its customers are earning or who its customers even are. And so when these accounts pay interest, for example, it's pretty easy to assume that the IRS won't know about it and thus won't tax it. That can essentially become a source of tax-free income, and it's especially tempting if the bank's interest rates or the account's returns are higher than what you could get in the United States.

Make no mistake -- banks do divulge information begrudgingly to foreign law enforcement authorities if they have to, but in some countries, bank secrecy laws are so tight (think Switzerland) that it takes a court order and a lot of legal wrangling to get at any information at all about customers.

**How FATCA works**

Back to FATCA. You might not have heard of it, but your bank sure has. Congress enacted FATCA in 2010 to root out people who are using foreign bank accounts to evade taxes. The IRS just released hundreds of pages of proposed regulations regarding how to implement the law, and they focus on the basic requirement that foreign financial institutions (including banks, insurance companies, real estate companies, hedge funds, mutual funds and private equity firms) must report to the IRS information about financial accounts held by U.S. taxpayers or by foreign entities in which U.S. taxpayers hold a substantial ownership interest.

#-ad_banner_2-#So far, five countries have agreed to play along (France, Germany, Italy, Spain and the United Kingdom), provided that the United States returns the favor by reporting information about accounts held in American banks by French, German, Italian, Spanish or British citizens. Notably, Mexico, Switzerland, China and Canada are not party to the agreement.

Through 2014, banks would only have to provide identifying information (name, address, taxpayer identifying number, and account number) and the account balance or value of the U.S. accounts. Beginning in 2016, though, they will be required to report income. And by 2017, full transactional reporting will be required. Creating systems to follow these new rules is a huge undertaking for banks (which is, of course, just what the banking industry needs right now, no?).

But here's the kicker: if your bank doesn't sign the agreement and it's in France, Germany, Italy, Spain or the UK, the IRS can just assess a 30% tax on the income you're earning on your account anyway.

The banks aren't the only one with new forms to fill out. If you're an American citizen and you have a foreign account in one of these countries, you'll have to report the account (not just income, the assets) to the IRS as well on Form 8938. For most individual taxpayers, this means they'll need to start filing Form 8938 with this coming tax season.

There is some relief for people with small accounts, though. For instance, if your account has less than $50,000 in it, it's excluded from the FATCA reporting rules. And if the account is worth more than $1,000,000, the IRS may now be able to manually review the paper records associated with your account. (These exclusion amounts all double for married taxpayers, and they're also different for companies and U.S. taxpayers living abroad.)

The IRS may even question your foreign bank's relationship manager to confirm that he or she doesn't have any knowledge that you're a "U.S. person." The typical bank, brokerage, and money market accounts are included, but some debt and equity securities issued by banks and brokerage firms will be excluded.

Some interesting points, though: If you don’t have to file an income tax return for the tax year, you don't have to file a Form 8938, even if the value of your foreign assets exceeds the reporting threshold. You also don’t have to report accounts in foreign branches of American institutions (say, a Bank of America branch in Rome) or American branches of foreign institutions (such as an account at the New York branch of Societe Generale).

**The Investing Answer:** The main objective of FATCA is to detect and deter tax evasion, and the Treasury expects it will help collect $8 billion in new taxes over 10 years. But the law could have unintended consequences. Someone with dual citizenship could be forced to pay taxes in the United States even though they live, work and already pay taxes in their "home" countries.

Banks may also have to cooperate even if they don't do business in the United States. Many critics argue that in this light, FATCA could turn banks into extensions of the IRS, forcing the banks to pay for the costs of investigating tax evasion. Privacy concerns have also become an issue because the IRS says it needs to see account balances and account activity rather than just the account holder’s name, address, taxpayer identification number and income paid.

It's too soon to know how successful FATCA will be for the Treasury, and how troublesome for banks and account holders. But for now, if you have an offshore account, you should be prepared to comply with these new regulations.

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