

U.S. Income Tax and FBAR Obligations of U.S. Olim (Updated 2/14/2011)

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U.S. citizens and lawful permanent residents who make Aliyah remain subject to many U.S. laws. This article addresses two areas of law:

- the obligation to file an annual Report of Foreign Bank and Financial Accounts (FBAR)
- the obligation to file annual U.S. income tax and information returns with the Internal Revenue Service (IRS) which report *worldwide* income.

Whether you are required to file any IRS returns or FBARs depends on your personal circumstances. This article is included on the NBN website to make sure that you know your obligations. It's important to be aware that you may be pursued in Israel by IRS for taxes, interest, and penalties which could have been minimized or avoided if you considered whether you were obliged to make filings.

FBARs

An FBAR is a Report of Foreign Bank and Financial Accounts (Form TD F 90-22.1) which must be filed annually by a United States "person" who has an interest in, signature power, or other authority over one or more financial accounts in a foreign country that have an aggregate value of more than \$10,000 at any time in a calendar year. United States "persons" include:

- U.S. citizens
- Lawful permanent residents of the U.S. ("green card" holders)
- Individuals with E,H,L,O,P or R visas who meet the IRS definition of "resident."
- Certain business entities
- Certain trusts and estates

Financial accounts include:

- Bank accounts (savings, checking, time deposits)
- Mutual funds
- Brokerage accounts
- Investment accounts
- Pension accounts, *e.g.*,Kupat Gemel, Keren Hishtalmut

- Accounts for which an individual has a power of attorney or signator power even if s/he doesn't own the account
- Life insurance policies with cash surrender values

Financial accounts do *not* include individual shares of stock held directly, real estate, art and many other assets.

FBARs must be filed with the Treasury Department in Detroit, Michigan by June 30th following each calendar year in which the accounts were valued at more than \$10,000. The FBAR form is available online: www.fincen.gov/forms/files/f9022-1_fbar.pdf

There are fines and penalties for failing to file FBARs which, in some circumstances, can exceed the value of the accounts. There are also criminal penalties.

On February 8, 2011, IRS announced a special program to bring individuals into compliance with the tax return and FBAR requirements. This is called the 2011 Offshore Voluntary Disclosure Initiative (2011 OVDI). (Look for a separate article on 2011 OVDI in the *Aliyahpedia*.)

Despite all the media hype, 2011 OVDI is *not* an amnesty. It has significant monetary penalties and no guarantee of non-prosecution. Participation in 2011 OVDI may be beneficial for some olim who have failed to file complete tax returns and/or FBARs, However, other olim may be able to get into compliance without entering 2011 OVDI. Read the description of 2011 OVDI on www.irs.gov and the FAQs.

No tax is incurred or paid when an FBAR is filed. However, if the account that creates the FBAR filing obligation earned income over the years, IRS may request a copy of tax returns showing that the income was reported. FBAR-related records from years 2003 should be retained.

IRS and FinCen (Financial Crimes Enforcement Network) are constantly refining and expanding the FBAR regulations and interpretations. The following is an excerpt from an April 28, 2010 update by IRS:

Q. A person owns foreign financial accounts X, Y and Z with maximum account balances of \$100, \$12,000 and \$3,000, respectively. Does the person have to file an FBAR and if so, which accounts must be listed on the FBAR?

A. The FBAR instructions require the filing of the FBAR form “ ... if the aggregate value of these financial accounts exceeds \$10,000 at any time during the calendar year ... ” In this scenario, the person has an FBAR filing obligation because the aggregate value of foreign financial accounts X, Y and Z is \$15,100. The person must report foreign financial accounts X, Y and Z on the FBAR even though accounts X and Z have maximum account values below \$10,000.

There are still daily reports in the newspapers about the prosecution of persons who had what they believed to be secret accounts in Swiss banks. In April 2010, the U.S. Attorney's Office in

the Southern District of New York brought charges against a Tel Aviv resident who is alleged to have failed to report overseas accounts, transactions, and income.

No article can address the precise circumstances of every reader. You should review your personal situation with an accountant or tax attorney who is licensed in the United States and routinely gives advice to clients on FBAR requirements, late filing, penalty abatement, and voluntary disclosure.

Income Tax Returns

U.S. citizens and lawful permanent residents must file U.S. income tax returns for any year in which their worldwide gross income meets a certain minimum level. The triggering amount depends on your filing status – married filing jointly, single, retired etc. For 2010, it may be as little as \$3,650. The charts showing the threshold appear in the instructions to IRS Form 1040 and can be found on the IRS website: www.irs.gov. If you are self-employed and have net earnings over \$400, you are required to file a U.S. income tax return even if your worldwide gross income is below the amount listed on the IRS charts.

With FBARs in mind, remember to report interest and dividends earned on accounts in Israel – even though they are taxed in Israel.

Also, when you are compiling records for your individual income tax returns, ask your accountant or preparer whether you have to file any information returns *with* your income tax return. For example, if you have an ownership interest in an Israeli or other non-U.S. corporation, or are an officer of a foreign corporation owned by U.S. citizens, you may be required to file an information return with IRS (Form 5471). If you have a similar interest in an Israeli or other-non-U.S. partnership, you may be required to file Form 8865. If you have investments in a trust, participate in a pension trust, set up a trust for your children, or receive a gift of over \$100,000 from a foreign individual or company, you may have to file an information return with IRS (Form 3520). There are hefty penalties for non-filing of such forms.

U.S. citizens and residents who reside outside the U.S. have an automatic extension of time to file until June 15th. Even if you have to file a U.S. tax return, you may not owe U.S. tax. There is a tax treaty between the U.S. and Israel to avoid double taxation. The Internal Revenue Code includes many complex provisions such as the foreign earned income exclusion and foreign tax credit.

No article can address the precise circumstances of every reader. You should review your personal situation with an accountant or tax attorney who is licensed in the United States and routinely gives advice to clients on U.S. tax return concerns, preparation, remediation, penalty abatement, and voluntary disclosure.

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