Interviewing Clients With Foreign Assets

Featuring Tax and Financial Expert Abby Eisenkraft

In our global world,

with so many people from foreign countries coming to live and work in the US, and with people from the US living and working overseas, there is more of a need than ever to know how to properly interview your client for the purpose of reporting foreign financial assets.

So we checked in with Abby Eisenkraft, CEO of Choice Tax Solutions Inc., to learn more about how you should properly interview clients with foreign assets. But first, it's important to know when foreign financial assets can occur, such as:

- **If the taxpayer was born outside of the United States but is now a citizen, green card holder, or resident alien.**
- **If the taxpayer was born a U.S. citizen. (Some have never set foot in the U.S., while others left as children.)**
- **If the client has ties, such as family, to a foreign country or countries.**
- **If a client's employer is headquartered overseas and sets up a foreign account on behalf of the client.**
- **If a client is interested in investing outside of the United States.**

The IRS imposes enormous penalties for the failure to file certain forms as well as any omission of foreign income. As a practitioner, you must know the IRS's reporting requirements and how they may apply to your client, so interview your client carefully!

Leaving off anything on the tax return is a problem, but with foreign financial assets, it is especially heightened. Among the punishments threatened by tax authorities for noncompliance are considerable interest and penalties and even jail time metered out to certain tax offenders.

Financial institutions abroad comply with United States government reporting regulations while observing client privacy in other instances, so clients with foreign assets can neither run nor hide.

Should a foreign financial account be discovered, and your client has a $10,000 penalty letter from the IRS, they may say you didn't advise him or her of the regulations. In that case, you want to be able to prove that you did ask your client the necessary questions.

Top 10 Questions to Ask Clients With Foreign Assets

1

Do you have any financial accounts outside of the United States in which you are one of the following?

- Sole or joint owner
- Signature authority (this can include those who act as Power of Attorney)
- Financial interest
- Manager with or without financial interest

Depending on the response from your client, there may be a filing requirement for FinCEN 114, Form 8938, Form 8621, Form 5471, Form 3520, and Form 8865.

2

Do you have any of the following foreign financial accounts (held at non-U.S. locations)?

- Bank account
- Brokerage account (securities, options, hedge funds, private equity funds, etc.)
- Mutual funds
- Life insurance or annuity contract with cash value
- Pension/retirement plan (Depending on the country, this might have a different name, i.e. Australian or New Zealand have superannuations.)
- Real estate held via an entity

3

Do you hold any interest in a foreign trust, corporation, or partnership?

Depending on the response, the client may have an income to report on Form 1040, as well as a filing requirement for Form 3520 and Form 3520A, Form 5471, Form 5472, Form 8858, Form 8865, as well as FBAR and FATCA.

4

Did you receive a gift and/or an inheritance from a Non-Resident Alien during the tax year?

Depending on the response and the amount(s) received, the client may have a filing requirement for Form 3520. Note that gifts and inheritances of property will also count here, not just cash or the equivalent.

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5 Did you receive a distribution from, or were you the grantor of or transferor to, a foreign trust?

This could include pension contributions and distributions, as many non-U.S. pensions are considered foreign trusts. Check the tax treaty to see if there are rules that would affect the reporting. There may be income to report on Form 1040, as well as reporting on Form 3520 and Form 3520A.

6 Did you own a disregarded entity (directly or indirectly) overseas?

A foreign disregarded entity is an entity not created or organized in the United States, and it is disregarded as an entity separate from its owner (i.e., foreign LLC/sole proprietorship, foreign partnership, etc.). Depending on the response from the taxpayer, there may be a filing requirement for Form 8858, Form 8865 as well as FBAR, FATCA, and potentially other forms to report financial accounts.

7 Did you receive any foreign income and/or pay any foreign taxes?

Clients often don't understand that if they are considered a U.S. person (citizen, resident for tax purposes, etc.), they will be paying tax on worldwide income, and you have reportable income from these accounts for the tax return.

8 Did you receive any interest or dividends from a financial institution outside of the U.S.?

Depending on the responses to questions #7 and #8, the client may have to report these items as income. Check if they are eligible for the foreign tax credit if they paid taxes to another country on the same income.

9 Did the client have a foreign life insurance or annuity policy with cash value have any capital gains during the tax year?

Depending on the response, the client may have to report the gains as income on Form 1040.

10 Is the client an investor in a publicly traded partnership?

Many of these partnerships have overseas investments. The taxpayer may be subject to reporting due to the flow-through nature of these investments. Be sure to read all of the documentation along with Form K-1 to ascertain the client's exposure.

Foreign Pensions | Retirement Accounts

Depending on the country, foreign interest, dividends, and capital gains earned in a foreign pension will not be deferred, because the account does not qualify as a U.S. 401(k) plan and may taxable each year. These pensions may be considered foreign trusts, so additional reporting will be required. For more information on foreign pensions, the tax treaty is a good place to start.

Foreign Mutual Funds

The U.S. has a penalty regime attached to foreign mutual funds, to discourage foreign investments. These funds are called Passive Foreign Investment Companies (PFIC). If the fund is considered a PFIC, there is a great deal of complex reporting. Familiarize yourself with Form 8621 and watch for reinvested dividends, distributions, and dispositions.

Summary

The most important takeaway bears repeating: Interview your client carefully! And document, document, document!

Finally, if the client has unreported accounts for prior years, there may be amnesty programs available to them. There are different programs depending on whether the oversight was willful or not. Check the IRS website for the latest information.

Resource Links

Instructions Form 926

Instructions Form 8938

Instructions Form 5471

Instructions Form 5472

Instructions Form 8858

Instructions Form 8865

IRS Publication 901 – U.S. Tax Treaties

BSA E-Filing System for FBARs

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