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The Risks of Hiding Accounts and Assets in Korea Are Going Up

Most Koreans living and working in the United States and Korean-Americans living and working in Korea are subject to U.S. tax laws on reporting their overseas financial accounts in Korea. Even if not a green card holder or a resident alien, a Korean living and working in the U.S. may be required to file a U.S. income tax return, and report his or her Korean bank or financial accounts, if he or she was in the United States 31 days during the current tax year and 183 days during the prior three year period. Also, Korean-Americans living and working in Korea with U.S. citizenship are required to file U.S. tax returns and are subject to U.S. taxes on their world-wide income, including interest earned on Korean financial accounts.

1. Requirement to report accounts in Korea

Persons required to file U.S. tax returns have to disclose their foreign financial accounts in three places. First, schedule B of the U.S. income tax return asks filers if at any time during the year they had a financial interest in or signatory authority over a financial account in a foreign country. This question covers more than just accounts held in the person's name but accounts over which the person had control.

If your answer is yes, schedule B directs you to rules on filing Foreign Bank Account Reports (FBAR). One must file an FBAR if he or she had control or a beneficial interest in a financial account with more than $10,000 in the prior year. So a Korean going back and forth to the U.S. may well be required to file an FBAR if he or she maintained financial accounts in Korea and regularly lived in the United States for several years. The requirement covers more than just bank accounts. For instance, brokerage accounts must be disclosed if they meet the threshold limits.

For those filing returns for 2010 and later, the filer may have to file a Statement of Specified Financial Assets (Form 8938). The thresholds for filing are higher than for an FBAR -- $75,000 at any point in the year or $50,000 at the end of the year. But unlike the FBAR, assets not held in an account, must be reported, such as a partnership interest in a Korean partnership. Interest in foreign real estate need not be reported.

Penalties for failing to report the accounts include hefty fines, up to $100,000 or 50 percent of the value in the account for each violation, and, if the person acted willfully, even jail, up to 5 years in prison for each criminal violation.

2. Increasing pressure to report

For decades, the U.S. Department of Justice and IRS largely were frustrated in trying to enforce U.S. tax reporting requirements of foreign financial accounts. Many foreign financial institutions assisted by their governments largely refused to cooperate with the U.S. government. That all changed in 2009. A Russian-American businessman in Southern California facing some very tricky tax problems decided to cooperate with the government and provided information on the Swiss banker who was helping him evade his taxes. The banker was arrested and, in turn, provided information against his employer, one of the world's largest banks, United Bank of Switzerland (UBS).

UBS was prosecuted and agreed to provide account records for some 4,500 U.S. taxpayers with secret accounts in Switzerland. This turn of events scared even more taxpayers to report their accounts. Since 2009, more than 33,000 U.S. taxpayers have reported undeclared foreign accounts and assets as participants in the IRS' amnesty program. As part of the amnesty program, applicants must identify those banks and bankers who assisted them, providing more leads for investigation to the IRS and U.S. Department of Justice.

Adding to this pressure, the U.S. recently passed a law, the Foreign Account Tax Compliance Act (FATCA) which requires all foreign financial institutions to report their U.S. account holders. The financial institutions covered by the law include not only banks and savings and loans, but asset managers and funds. Foreign financial institutions that do not agree to report their U.S. account holders suffer 30% withholding on their U.S. source income, such as equities, real estate sales, etc.

3. <u>What to do if you need to report an account</u>

If you have a foreign financial account or assets which have gone unreported, your options are: (1) do nothing; (2) attempt to make a "quiet" disclosure; or (3) apply for participation in the IRS' amnesty program. Continuing to do nothing entails serious risks. If your account or assets are discovered, either by your bank or other financial institution telling the IRS, you could face fines and possibly criminal prosecution. More importantly, FATCA makes it very difficult for above-board financial institutions to fail to report their U.S. taxpayers.

Making a "quiet" disclosure by simply beginning to report your accounts on your tax returns without formally applying for amnesty also involves risks. The IRS and U.S. Department of Justice do not provide any guarantees that the person disclosing "quietly" will not be prosecuted and nothing in the law prevents a prosecution. On the other hand, in cases where it is clear the person did not act willfully in failing to report the accounts, criminal prosecution may not be an issue.

For cases clearly involving willful failures to report the accounts, the best course of action is to apply for amnesty and self-report the accounts. You may have to pay a penalty, up to 27.5% of the highest balance in the account if the person acted willfully, but you will be able to sleep at night. The penalties, however, could be as low as 5% under some mitigating circumstances. The challenge will be getting sound guidance as to, first, whether to participate in the amnesty program, *i.e.*, whether the facts show one acted willfully, and, if so, to secure the best outcome under the amnesty program.

<u>Overseas Account Reporting Requirements: A Case Study</u>

In order to better understand some of the issues in declaring a Korean bank account, let's consider a hypothetical case study. Mr. Kim was born and educated in Korea. After completing his education at prestigious Yonsei University, he began working for one of Korea's large international chaebols. He quickly rose in the company, moving from entry level to management. He also married and had two children.

About 15 years ago, his company with offices all over the world relocated him to the United States. He moved to the United States with his young children and wife. Before leaving for the United States, he and his wife liquidated all their bank accounts and sold whatever property they had in Korea.

For years, Mr. Kim and his wife filed US tax returns and paid all the taxes they owed. His parents never followed him to the United States, and, unfortunately, about 10 years ago, they passed away leaving Mr. Kim, an only child with a very large sum of money. Not wanting to deal with Korean and American currency transfer restrictions, Mr. Kim kept the money in a Korean bank account in his name.

Mr. Kim and his wife continued to file their tax returns and dutifully paid all their taxes after Mr. Kim inherited the money from his parents. However, Mr. Kim did not report the existence of his inherited bank account on his US tax returns or report the interest earned each year on the account. His CPA, while generally very knowledgeable about US tax laws, failed to emphasize to Mr. Kim that he was required to report the existence of the bank account that he controlled in Korea.

Recently, Mr. Kim read articles in the press and on-line about the IRS' and US Department of Justice's increasingly enforcement of overseas bank disclosure laws. He read that recently one person received a jail sentence and paid millions in fines for failing to report his accounts. After years of growth, Mr. Kim's inherited Korean bank account contained several million dollars.

As a result, he went to his CPA and asked about the foreign account disclosure requirements. His CPA claimed that he made clear to Mr. Kim that he was required to report all foreign bank accounts, including the account he inherited in Korea. The CPA explained that there are civil and criminal penalties for failing to report the account.

Disappointed in his prior accountant, Mr. Kim went to another accountant, and is now worried he will go to jail.

What should Mr. Kim do?

Mr. Kim has three options: (1) he can do nothing and continue to fail to report his inherited account hoping he will never be discovered; (2) he can do a "quiet" disclosure by filling amended tax returns reporting his inherited account and the interest he earned on the account; or (3) he can apply for the IRS' amnesty program, the Offshore Voluntary Disclosure Initiative, (OVDI).

4. Doing Nothing

If Mr. Kim does nothing, he runs the risk that someone will report his account to the IRS. He has told a number of friends about the account and the IRS offers a whistleblower reward for those who report income tax violations. More importantly, the Foreign Account Tax Compliance Act (FATCA) requires all participating foreign financial institutions to report the accounts of all US taxpayers. He has his inherited account at one of the largest banks in Korea so it is almost certain the bank will attempt to fully comply with FATCA. His bank likely will disclose the inherited account to the IRS and the IRS may well discover that he has failed to report the account.

5. A "Quiet" Disclosure

Whether to make a "quiet" disclosure involves assessing a number of considerations. The most important issue is assessing the risk he will be prosecuted for a crime. The advantage of participating in the OVDI is that, if accepted into the program, the government grants amnesty to the participant for his or her past non-compliance. In Mr. Kim's case, he needs to assess whether he is really at risk of criminal prosecution if his failure to report his inherited account is discovered.

Among the elements that the government must prove in order to convict someone of a tax crime is that the person acted willfully. For failing to report an overseas account, willfulness means that the person knew he was obligated by law to report the overseas account but failed to do so. This is one of the few exceptions where ignorance of the law is an excuse.

Mr. Kim can make a pretty good argument that he did not know the law required him to report the inherited account. He did not open the account, but simply inherited it. He maintained the account in his own name, not someone else's or in the name of an entity. He did not actively use the account, *i.e.*, unlike a brokerage account that is actively traded, he passively allowed the money to sit in the account. Finally, prior to 2009, most people did not know of the requirement to report foreign financial accounts. While the United Bank of Switzerland (UBS) case changed that, Mr. Kim's former CPA never focused on the fact that the inherited bank account had to be reported.

On the other hand, Mr. Kim's accountant seems to have a different recollection and claims he told Mr. Kim all foreign accounts had to be reported. The accountant plainly has a self-serving motive to blame Mr. Kim, but under pressure from the IRS, it is unclear what he may say. In assessing whether the CPA's will be believed, a very important fact will be whether the CPA alerted Mr. Kim to his obligation to report the inherited account in writing. The government must prove that Mr. Kim knew of his obligation to report the account beyond a reasonable doubt.

6. <u>Participating in the OVDI</u>

If Mr. Kim decides that his bank will report his account under FATCA and that there is too much risk that his CPA will be believed, he may decide to apply for the OVDI. Taxpayers under investigation by the IRS for criminal violations or under any civil audit are not eligible to participate in the OVDI. Mr. Kim's representative can check with the IRS to verify he is not under investigation or audit.

If he participates in the OVDI, Mr. Kim may be liable for as much as a 27.5% penalty on the highest aggregate value in the bank account during the prior eight years. During the past eight years, the balance in the account exceeded several million dollars, therefore, Mr. Kim's offshore penalty could be nearly a million dollars.

The IRS, however, allows for a reduced penalty of 5% under certain circumstances. One such circumstance is where the person did not open the account, had minimal contact with the bank account, did not withdraw more than $1,000, and paid all taxes on funds deposited to the account. In Mr. Kim's case, he may qualify for a 5% penalty if he had minimal contact with the account and did not withdraw more than $1,000. If he does qualify for a reduced 5% penalty he may want to participate in the OVDI even if his chances of criminal prosecution are small.

The facts of each person's case will vary greatly from Mr. Kim's situation. If faced with a problem like Mr. Kim's, the best thing to do is to contact a professional experienced in handling overseas bank disclosure cases.

<u>About the author</u>: Dean Paik, a Korean-American attorney with over 25 years of experience, served as a top advisor to the Assistant Attorney General of the Tax Division, United States Department of Justice, between 2010 and 2013. He advised on a variety of civil and criminal matters, including the Justice Department's overseas bank account initiatives. He helped devise strategies and policies on the enforcement against banks, bankers, and account holders of the laws requiring the disclosure of foreign bank accounts, including intergovernmental negotiations to resolve conflicts in bank secrecy laws so as to allow for the implementation of FATCA. Today, he is in private practice with the law firm Rogers Joseph O'Donnell in San Francisco and can be reached at 415-956-2828 or dpaik@rjo.com.