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Offshore Accounts: No Place to Hide?

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What a difference a few years can make.

For decades U.S. tax authorities did little to enforce laws on offshore accounts. Some people felt free to hide assets abroad in a web of secret accounts, and many U.S. citizens living abroad didn't bother to file returns with Uncle Sam as long as they paid local taxes.

All that changed in 2009, when U.S. officials began an intense campaign against undeclared accounts after UBS AG UBSN.VX -0.82% admitted that it helped U.S. taxpayers hide money abroad. The Swiss bank paid $780 million and turned over more than 4,000 names to avoid criminal charges.

Now, international tax lawyers like Henry Christensen are telling clients with offshore accounts that "tax havens where people can hide money are a thing of the past." Mr. Christensen, of McDermott, Will & Emery in New York, represents many wealthy multinational families. "Forget about confidentiality," he says he and his peers are telling clients. "Transparency is here to stay."

The crackdown has brought momentous changes. Among other things, the once-impenetrable veil of Swiss bank secrecy is in tatters, following an agreement in late August between the U.S. and Switzerland that will cause dozens of Swiss banks to pay penalties and name names to atone for past misdeeds.

In the U.S., tens of thousands of taxpayers have admitted to having undeclared accounts and paid stiff penalties since 2009. More than 80 of them have been criminally prosecuted, and some have gone to prison. This past week, Ty Warner, the owner of Ty Inc., the maker of Beanie Babies, paid the highest offshore-account penalty ever disclosed: $53.6 million.

Yet the most far-reaching element of the U.S. offshore-account crackdown is still to come: a provision of the Foreign Account Tax Compliance Act, known as Fatca, which Congress passed in 2010.

Set to take effect next July, it requires foreign financial institutions to report information about their U.S. account holders to the Internal Revenue Service. That group includes U.S. citizens and "green card" holders living both in the U.S. and abroad.

That means the new reporting rules could affect a U.S. citizen who has retired to Mexico, a German-born green-card holder working in the U.S. or even a Hong Kong-born green-card holder studying in the U.K.—as long as each has a non-U.S. financial account.

Failing to comply with Fatca will bring stiff consequences. Foreign financial firms that don't cooperate could lose access to U.S. markets, and individual account holders who aren't known to the IRS could face a 30% automatic withholding rate on payments such as interest and dividends. Institutions making such payments are supposed to verify whether the recipient is exempt from withholding, with help from a large public database of entities maintained by the IRS.

Account holders hit by that 30% levy will face a difficult choice: either forfeit the money or file a U.S. tax return to claim a refund, in effect waving a red flag at the IRS. Even if a refund is due, it could be hard to get, says Christine Ballard, an international tax specialist at the accounting firm Moss Adams in Campbell, Calif.

For people engaged in willful evasion, the costs could be steeper yet—including severe financial penalties many times the value of the account, or even prison. U.S. officials hope Fatca will make these people easier to find. "The law is designed to shine light in dark corners," says Bryan Skarlatos, a lawyer at Kostelanetz & Fink in New York who has handled hundreds of offshore-account confessions.

Experts say it is hard to overestimate Fatca's reach or revolutionary intent. "Fatca is a dragnet meant to force transparency and curtail tax evasion around the world," Ms. Ballard says. "It affects millions of U.S. taxpayers both here and abroad. Some people are willfully evading U.S. taxes, while many others aren't aware of the complex rules."

The law's massive changes are being felt already. Nearly 20 countries or other jurisdictions, including longtime havens such as Switzerland, the Cayman Islands and the island of Jersey, have signed or are close to signing agreements with the U.S. to ease the transfer of tax information under Fatca. Almost 30 more, including Israel and Singapore, are in talks to do so (see list on this page). China has taken tentative steps toward a Fatca agreement, and this summer Hong Kong enacted legislation that could lead to one.

Why are these countries willing to help the IRS? Unfettered access to U.S. markets is one reason. Another is that in some cases U.S. officials will provide "reciprocal" information to a country about its citizens who may be using the U.S. as a tax haven. Mexico, for example, has signed a two-way Fatca agreement. U.S. Treasury Department officials have said they would not provide information to countries where it could be misused, however.

For millions of U.S. taxpayers with international ties, Fatca is a reminder of Uncle Sam's long reach. Most countries don't tax nonresidents' earnings abroad, but the U.S.'s world-wide system does. The issues are compounded by the broad U.S. definition of who is a citizen, which includes people born on American soil and to U.S. citizens abroad.

As a result of Fatca, some Americans living abroad say they are finding it hard to open or keep financial accounts. Thomas Ruta, a CPA at Raich Ende Malter in New York, which advises hundreds of international clients, says he is aware of people who have had such difficulties in Switzerland, Sweden, Australia, the Netherlands and Canada.

Other citizens and green-card holders are considering cutting official ties with the U.S. This year reported renunciations are on pace to double the previous high of nearly 1,800, set in 2011—and there are more that aren't reported.

Will Fatca achieve its vast aims? Anthony Cetta, a tax director who advises clients ofCitigroup's C -1.42% Citi Private Bank in New York, thinks it will. Many experts agree, although they think transparency will come sooner to Western Europe than to Asia. Lawyers will always look for loopholes, but there aren't large and obvious ones yet, they say.

Experts also point out that Fatca's approach is going global. In April, France, Germany, Italy, Spain and the U.K. announced their intention to exchange Fatca-type information among themselves. By early June, 19 countries had endorsed the plan. The U.K. also is making arrangements to exchange information with dependencies and territories such as Guernsey, Gilbraltar and the British Virgin Islands.

The upshot: "Taxpayers will have to ask themselves, 'Why do I have a foreign account, and do I really need it?'" Mr. Christensen says.

For people with foreign accounts worried about the new enforcement regime, here are suggestions from experts.

If you have international ties, seek expert help about what you do—and don't—have to report to the IRS.

It can be hard to know, at least initially. At a minimum, many U.S. taxpayers with international ties already should be filing two forms. One is the Foreign Bank Account Report, or Fbar, due at a special Treasury unit by June 30 every year.

The other is Form 8938, required by Fatca for reporting foreign financial accounts, which is attached to the tax return. On its website (www.irs.gov), the IRS has a useful comparison of the two forms' requirements.

They differ in important but subtle ways. The Fbar reporting threshold is $10,000, which applies to the total of all accounts. The threshold for Form 8938 is higher and more variable—as low as $50,000 for single people living stateside but as high as $600,000 for couples living abroad. The amounts aren't indexed for inflation.

The Fbar form can require reporting of indirect interests, such as signature authority over an account, while Form 8938 focuses on direct holdings. But the latter often requires reporting of more types of assets.

Neither form requires reporting of assets such as art, real estate or foreign currency that are held directly. But beware of quirks: PricewaterhouseCoopers tax expert Evelyn Capassakis says that many homeowners in France put their residence in a legal structure that could have to be reported on Form 8938.

While safe-deposit boxes don't have to be reported, they are often tied to bank accounts that could be.

Compliance will bring new costs for many, but helpful advice doesn't have to be high-priced. H&R Block, for example, has a special site devoted to expatriate taxpayers (expats.hrblock.com) and has expanded its services for them.

Consider whether past noncompliance was "willful."

That is the key standard in tax law for the most serious penalties and offenses. For offshore-account holders, evidence of willful behavior could include having an account in a known tax haven; secreting it within a trust or foundation, or both; and moving it from one institution under scrutiny to another perceived to be less so.

The IRS has a continuing Offshore Voluntary Disclosure Program for such taxpayers. It levies stiff penalties but offers protection from criminal prosecution.

"Accidental" tax cheats face tough choices for now.

Experts say the IRS has been slow and stingy in helping nonfiling U.S. taxpayers who weren't truly willful cheats get into compliance. This is a huge group: The U.S. State Department estimates that 7.2 million U.S. citizens live abroad, many of whom surely have reportable bank accounts, yet only a total of 825,000 Fbar reports were filed for 2012.

Fatca reporting will put pressure on these nonfilers, but many face bleak options. Some are choosing to give up their green cards or citizenship, but that means cutting ties and possibly triggering an exit tax. People who want to retain their U.S. ties can comply in the future, but that doesn't protect against past issues.

Expat groups have raised an intense outcry over their plight, however, and Mr. Skarlatos, the lawyer, says that expats' sheer numbers could move the IRS to make it easier for them to become compliant. In 2012 U.S. officials responded to pressure from Canada that eased the burden for some Canadian-Americans.

Keep an eye on foreign pension plans.

Although the rules exempt reporting for foreign Social Security-type programs, that definition leaves out many other plans, such as self-managed Australian "superannuation" funds.

These plans may be subject to U.S. tax or information reporting or both. PwC's Ms. Capassakis notes that some foreign pension plans, such as Canadian retirement accounts, are exempt from U.S. taxes due to treaty provisions, but they could still have to be reported on an individual's U.S. tax return.

Trusts are a target.

It isn't a secret that one of Fatca's central aims is to "out" offshore trusts that have concealed assets from the IRS and others. As a result, says Steven Cantor, a lawyer at Cantor & Webb in Miami who often advises multinational families, "Trusts are the area of most complexity and uncertainty" in Fatca for individuals.

He and others say the law even could require reporting of a foreign trust that a beneficiary doesn't know about or receive money from—if that person has a green card or is a U.S. citizen.

At the same time, smart planning can reduce compliance burdens and avoid the 30% withholding rate, he says. In addition, it also can avoid identifying non-U.S. beneficiaries of the trust.