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Foreign Bank Account Reports: Will There Be More Scrutiny of FBARs and Other Disclosure Returns?

This article summarizes the past and current implementation of the FBAR reporting system and its interplay with the Offshore Voluntary Disclosure Program.

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Many events and occurrences, including the 2001 terrorist attacks, the rise of international drug cartels, and the increased ease of transferring funds through the internet, have reshaped American perspectives on security and international relations, with profound ripple effects that continue to be felt in everything from how we travel to how we move and monitor our money.[1]

One of these changes is an increased awareness of the importance of monitoring overseas financial accounts. The U.S. government has taken a number of legislative and regulatory steps in recent years to alleviate growing concerns about potential security vulnerabilities and preventing financial fraud.[2] The increased scrutiny of offshore accounts—and the individuals and institutions that hold them—gained additional momentum after 2009, when it became public that Swiss banking institutions such as UBS and Credit Suisse (among others) had advised American citizens on techniques they could use to avoid paying U.S. taxes on assets transferred to foreign accounts.

Among the legislative solutions and IRS enforcement measures that were strengthened, arguably the most significant is the increased emphasis on the filing of a Foreign Bank Account Report (FBAR).[3] While the U.S. government mandates that all international income must be reported on an income tax return, U.S. taxpayers, whether citizens or tax residents, who have a financial interest in or signature authority over foreign financial accounts must also file an FBAR if the aggregate value of that individual's foreign financial accounts exceeds $10,000 at any time during the calendar year. There are also new disclosure requirements, such as the requirement to file IRS Form 8938, on which other foreign assets must be disclosed.[4]

Because more rigorous enforcement efforts have emerged as a clear priority in recent years, holders of foreign accounts would be wise to educate themselves on the legislative and regulatory changes that have taken place to ensure that they are thoroughly familiar

[1] See, e.g., The United and Strengthening America by Providing Appropriate Tools Required to Interact and Obstruct Terrorism Act (USA PATRIOT Act) of 2001, P.L. 107-56, 115 Stat. 272 (2001).

[2] See, e.g., The Foreign Account Tax Compliance Act (FATCA) (consisting of IRC §§ 1471–1474 and introduced as part of the HIRE Act, P.L. 111–147, 124 Stat. 71 (March 2010).

[3] See 31 U.S.C. § 5321, as amended by the JOBS Act, P.L. 112-106, Stat. 306 (2012).

[4] Examples of assets to be disclosed on IRS Form 8938 include currency not in an account, ownership interests in entities such as partnerships and other foreign investment assets; all subject to specific reporting thresholds.

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with their filing obligations. Moreover, if someone has made an error in filing or has failed to file her FBAR for any number of reasons, that person needs to understand what her options are to remedy the situation by filing needed returns, paying any penalties, and otherwise seeking the advice of legal counsel.

FBAR BASICS

Filing Details. Previously identified as IRS Form TD F 90-22.1, the FBAR is now renumbered and known as FinCEN Form 114 from the Department of the Treasury's Financial Crimes Enforcement Network. The FBAR is no longer sent to the Department of the Treasury, but directly to FinCEN itself.[5] The FinCEN Form 114 still includes the same information and is associated with the same filing obligations, but the form itself is filed with a different governmental department.

Even if the financial institution involved is based in the United States, an account that is held in an overseas branch of that bank is considered to be a foreign account. An account held with a branch of a foreign bank that is physically located in the U.S. is not considered to be a foreign financial account.

Some of the deadlines and submission details have changed recently, as well. Previously, the FBAR must have been received by the Department of the Treasury on or before June 30 of the year immediately following the calendar year being reported, and that filing date could not be extended. Effective for tax years beginning after December 31, 2015, however, FBARs are due by April 15, in conjunction with standard income tax return filings.[6] It is important to note that FBARs now *must* be filed electronically. Another important change is that individuals looking for an extension *can* now receive an extension because the time for filing an FBAR is now automatically extended with an approved income tax return extension.

What Qualifies as a Foreign Account? Filing details aside, one of the most common reasons for failing to file an FBAR is misunderstanding or misinterpreting what constitutes the definition of a foreign account. The bottom line is that any account located outside of the United States is considered to be a foreign financial account.[7] Even if the financial institution involved is based in the United States, an account that is held in an overseas branch of that bank is considered to be a foreign account.[8] Many people are surprised to find that funds held in Canadian bank accounts are considered "overseas" also. The same geographic principle applies in reverse: an account held with a branch of a foreign bank that is physically located in the U.S. is not considered to be a foreign financial account. The term "foreign accounts" refers to traditional bank accounts, as well as to a wide range of financial assets or interests including securities and brokerage accounts, insurance policies with a cash value, commodity futures, and annuities.

Non-traditional accounts, such as retirement accounts, can be a particular source of confusion and uncertainty. If a person was born in the U.S., for example, and had a retirement account in Canada, she is obligated to report that account on her FBAR. If a person worked in England and accrued the British equivalent of Social Security benefits (or opened a British retirement account), even if that person moved back to the U.S., he would still have to report that income and pay taxes on it, subject to foreign income tax credits.

VOLUNTEERS WANTED—THE OFFSHORE VOLUNTARY DISCLOSURE PROGRAM

While the precise number and value of offshore financial accounts is unknown, it is clear that a staggering amount of overseas financial activity previously was either unreported or underreported for many years.[9]

The Department of the Treasury and the Department of Justice have done a great deal of work to publicize the changes outlined above particularly with respect to establishing clarity around foreign-account-holder reporting obligations. Those efforts were combined with a corresponding stiffening of the

[5] See generally Fin. Crimes Enforcement Network, BSA Electronic Filing Requirements for Report of Foreign Bank and Financial Accounts (FinCEN Form 114) 4 (2014), available at http://www.fincen.gov/ forms/files/FBAR%20Line%20Item%20 Filing%20Instructions.pdf.

[6] Id.

[7] See Instructions to FinCEN Form 114, supra note 5.

[8] Id.

[9] Hale E. Sheppard, "Evolution of the FBAR: Where We Were, Where We Are, and Why It Matters," 7 Hous. Bus. & Tax L.J., 1, 5 (2006) (citing U.S. Dep't of the Treasury, *A Report to Congress in Accordance with § 361(b) of the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001* (USA PATRIOT Act) 12 (Apr. 26, 2002)).

penalties associated with a failure to file informational tax returns. The increased monetary penalties for non-compliance with the new and modified regulations were accompanied by incentivized programs specifically designed to provide viable options for taxpayers who have failed to report offshore income or accounts in years past and are looking to remedy their situation.

The Carrot: No Criminal Charges. The most creative and most popular of those incentive programs is the Offshore Voluntary Disclosure Program (OVDP), which was designed to bring "taxpayers with foreign accounts and entities into tax compliance,"[10] while simultaneously "stop[ping] undisclosed and unreported accounts." The OVDP was conceived to motivate taxpayers who may have missed one or more years of required informational filings and/or failed to report offshore income in past years to voluntarily disclose those missing filings and pay what they owe in income taxes and modified financial penalties in exchange for not facing criminal prosecution.

It is not difficult to see the appeal of the OVDP program. From the government's perspective, a program that could motivate negligent or delinquent foreign account holders to voluntarily pay what they owe is a lucrative and relatively low-impact way to solve a thorny problem. For many taxpayers who owe back taxes connected to foreign assets, the ability to amend prior returns, report unreported income, pay those back taxes (plus a comparatively modest penalty) all while avoiding the potential for criminal prosecution is an appealing proposition. In many cases people have inherited foreign accounts and OVDP also gives a pathway to repatriate unreported financial accounts and obtain open use of the assets. Given that context, the OVDP program has been an unqualified success. Originally intended to be a one-time offer in 2009, the OVDP program's popularity helped transform it into a permanent fixture. By the beginning of 2018, the program was responsible for more than 56,000 taxpayer disclosures and had brought in over $11.1 billion in previously unpaid taxes and penalties.[11]

The Stick: Substantial Penalty in Lieu of the FBAR Penalty. The financial penalty for OVDP program participants was initially set in 2009 at 20 percent of a taxpayer's highest year's aggregate value of foreign accounts and assets during the applicable reporting period, in lieu of the higher applicable FBAR penalty for failure to file an FBAR. The OVDP penalty has been increased incrementally over the years, and today is permanently set at the current level of 27.5 percent. An *additional* 20 percent "accuracy penalty" and accrued interest must also be paid on any additional income taxes reported as part of the OVDP disclosure.

Bottom Line: A Good Deal. While the OVDP penalty amount is quite significant, the potential penalties assessed for foreign account holders who do not voluntarily come forward are dramatically higher.

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In an audit, in addition to back taxes and all applicable accuracy-related penalties, non-disclosing account holders are responsible for standard failure-to-file and failure-to-pay penalties (plus interest), and the additional FBAR penalties for willful failure to file complete and correct FBARs, which is a figure calculated by adding together 50 percent of the aggregate account balance per each year of non-compliance.

WILLFUL VS. NON-WILLFUL FAILURE TO FILE

Outside of the OVDP Program, one of the most significant considerations to take into account when a foreign account holder has failed to file an FBAR and is under audit is whether or not that failure to file was willful or non-willful.

The legal standard has been shifting in favor of the IRS over the last several years. In the past the IRS was burdened to prove willful non-compliance by providing "clear and convincing evidence" of a person's intent to deceive or hide income and assets. The current standard is much more relaxed for the IRS and puts more of the onus back on the taxpayer. Today "willfulness" can be demonstrated in one of two ways:

1. Pointing to taxpayer conduct designed to conceal information; or
2. Pointing to a taxpayer's "willful blindness" meaning inferences about a taxpayer's conscious effort to avoid learning about filing obligations.

[10] See IRS News Release IR-2014-73 (June 18, 2014), available at https://www.irs.gov/newsroom/irs-makes-changes-to-offshore-programs-revisions-ease-burden-and-help-more-taxpayers-come-into-compliance (announcing the 2014 Changes to Offshore Programs).

[11] IRS News Release IR 2018-52.

The IRS and the courts now essentially consider "willful blindness" the same as willful deceit. The upshot is that the IRS can impose a civil penalty on practically anyone who is required to file an FBAR but fails to do so.

Under another reporting program, the Streamlined Filing Compliance Procedures for Domestic based Account Owners program, (the "Streamlined program") a taxpayer must certify under penalty of perjury that her failure to file an FBAR was not willful. Under the Streamlined program, lesser penalties may be assessed for "non-willful violations," which are characterized by cases of negligence, inadvertent errors, or good-faith misunderstandings.

Again, in audit outside of OVDP, the distinction between willful and non-willful violations has a host of important implications for account holders.

While the penalties under the Streamlined program are almost always significantly less punitive, it should be noted that as a trade-off, the Streamlined program does not provide the same immunity from criminal prosecution as the standard OVDP program nor does it provide a Closing Letter.

For non-willful violations, the maximum penalty is $10,000 per year, and the IRS cannot assert the penalty if failure to pay is due to "reasonable cause." For willful violations, however, the maximum penalty is $100,000 per year or 50 percent of the balance of the account per year, whichever is greater. A non-willful violator may also participate in the Streamlined program, with lesser filing obligations, by filing three years of amended returns and six years of FBARs, (in contrast to the standard OVDP requirements of eight years of returns and eight years of FBARs), provided he formally certifies that his failure to file FBARs was non-willful. While the penalties under the Streamlined program are almost always significantly less punitive, it should be noted that as a trade-off, the Streamlined program does *not* provide the same immunity from criminal prosecution as the standard OVDP program nor does it provide a Closing Letter.

WHAT TO DO IF ONE HAS QUESTIONABLE ACCOUNTS

Legal Advisor vs. Accountant. For taxpayers who have questions about the status of their own accounts, one of the most urgent questions is where to go to find answers. Basic questions—such as determining whether a specific account qualifies as a foreign account under the statute—can be answered by an accountant with demonstrated experience in this arena. Things become more complicated, however, in cases where an account holder suspects that he or she has failed to report foreign income in one or more past years, and is uncertain of how to proceed. There are different pathways to addressing a late or missed filing, and how you proceed matters a great deal. In some cases, the wrong move can end up being legally punitive and financially costly. For example, a taxpayer who applies under the Streamlined program is no longer eligible to participate in OVDP. Consequently, these concerns should be addressed through a trusted legal advisor with specific expertise in overseas finance and tax obligations in general, and in FBAR filings specifically. In some cases, an accountant may recommend consulting with an attorney who specializes in this field.

If someone has reported all offshore income but has merely failed to file an FBAR informational report, there is an alternative mechanism for filing a late FBAR (and providing an accompanying explanation to show reasonable cause) without penalty. If someone did not report income *and* has not filed an FBAR, she is much more likely to be subject to penalties, and is almost certainly a candidate for the OVDP program. Some account holders in the past have opted for what is colloquially referred to as a "quiet disclosure" which consists merely of filing amended returns and hoping for the best. But this strategy is risky, and late filers who hope to simply slip through the cracks have been much more likely to get flagged or audited in recent years than in the past. No matter what strategy is ultimately pursued, a legal advisor can help determine the best course of action. This article cannot be construed as specific legal advice. There are also new programs to help those who have failed to file other informational returns such as the Delinquent International Information Return Submission Procedure.

Process. While every case is different, a legal advisor can provide an individual with details specific to his own individual circumstances. Moreover, it can be helpful to understand the typical legal and procedural steps that an attorney will recommend once a determination to move forward is made.

Typically, the process begins with establishing power of attorney (IRS Form 2848) and submitting Pre-Clearance authorization to the Department of Justice, a step taken to ensure an account holder is not under investigation and is eligible to apply for OVDP.[12] An OVDP Questionnaire, complete with relevant account numbers, reasons for having a foreign account, and other basic information is filed next. Once accepted into the OVDP program, required documentation will then need to be assembled with the help of an accountant and attorney, including previous foreign bank account information and past statements, to ensure that foreign income is accurately reported and documented on the amended returns. The final submission will include those amended returns and account statements, as well as estimated penalties and other documentation including FBARs. It usually takes six months or more for the IRS to respond.[13]

Other Qualifications and Considerations. Because both accountants and attorneys play an important role in FBAR filings and submissions under the OVDP program, having a productive, positive, and collaborative working relationship between the accountant and attorney is beneficial. Clear and consistent communication can help catch mistakes and oversights, and all parties involved in the process stand to benefit from a unified and complementary approach.

Experience with FBAR filing obligations and the nuances of the OVDP program is essential. A legal advisor should be fully conversant with the differences between the full OVDP program and the Streamlined program, and should be able to identify and consider other non-traditional solutions outside of the standard programs. An advisor, such as a tax attorney, should be comfortable with audits and, above all, should have extensive *hands-on* experience navigating the sometimes murky waters of FBAR filing and compliance. An attorney who has only managed one or two overseas clients might know the letter of the law, but is not likely to be familiar with the specialized nuances, considerations and special circumstances (including things like securing translations and dealing with overseas financial institutions) that characterize this specialized and relatively new area of the law. Time will tell whether the newest changes to the U.S. tax code enacted at the end of 2017 will lead to increased scrutiny and penalization of overseas account holders.[14]

CONCLUSION

The IRS's ability to impose a large penalty for the willful failure to file FBARs is likely the biggest catalyst for the success of the OVDP programs. Taxpayers who have litigated the imposition of these penalties have mostly been unsuccessful, both because of the shifts in favor of the IRS and the unfavorable taxpayer facts. There has been a recent taxpayer victory in *Bedrosian v. The United States*.[15] However, this author does not think this case has shifted the tide in favor of the taxpayer in any substantial sense. As long as people are able to move easily between countries, there will be those who intentionally or inadvertently do not adhere to all the complex reporting requirements related to ownership of offshore assets, leading to deficiencies which require correction. ■

[12] See IRS, *Offshore Voluntary Disclosure Program Frequently Asked Questions and Answers*, IRS.gov, available at http://www.irs.gov/Individuals/InternationalTaxpayers/Offshore-Voluntary-Disclosure-Program-Frequently-Asked-Questions-and-Answers (last updated Dec. 20, 2017).

[13] Id.

[14] While this article was being edited for publication, the IRS issued a news release, IR 2018-52 (March 13, 2018), indicating that this version of the OVDP program would end on September 28, 2018.

[15] 120 AFTR2d 2017-5832 (DC PA, 2017).