IRS Focuses on Compliance with Reporting Requirements for Offshore Accounts

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INTRODUCTION

While it is well known that U.S. persons are obligated to file income tax returns on an annual basis, it is not as well known that such persons have additional reporting requirements if they have an interest in a foreign financial account. Form TD F 90-22.1, the "Report of Foreign Bank and Financial Accounts," more commonly known as the FBAR, must be filed by U.S. persons on an annual basis if at any point during the calendar year such persons have a financial interest in or signature authority or other authority over a financial account (or several such accounts) in a foreign country, with an aggregate value in excess of $10,000.[1] While the FBAR is an information return that does not result in a calculation of tax, the failure to file an FBAR may be subject to substantial civil and criminal penalties. This article will outline some of the reporting requirements of the FBAR form as well as discuss the penalty structure associated therewith.

RECENT DEVELOPMENTS

Though information regarding individual investigations is not released by the Internal Revenue Service or the U.S. Department of Justice, recent developments in the arena of off-shore banking will undoubtedly result in an increased number of civil and/or criminal investigations of U.S. persons who have failed to meet the FBAR filing requirements. The disclosure of information to the U.S. Government by Heinrich Kieber, a former LGT Group employee, provides the IRS with the opportunity to assert FBAR penalties on an unprecedented scale.

In addition, the U.S. Department of Justice is seeking to obtain account records from Zurich, Switzerland-based UBS AG. In the summer of 2008, a U.S. District Court in Florida issued an order authorizing the IRS to serve a John Doe summons on the Swiss bank. If the information provided by Bradley Birkenfeld, a convicted former UBS banker, is correct, there could be $20 billion in assets in "undeclared" accounts.[2] The potential penalties involved could be staggering. This fact has already lead many U.S. taxpayers to start cleaning up their compliance with respect to off-shore accounts.

HISTORY

The FBAR is a product of the Bank Secrecy Act (BSA), which was first enacted in 1970.[3] Congress enacted the BSA out of concern that financial institutions in tax haven jurisdictions were being used by U.S. persons to hide the proceeds of their illegal activities (e.g., drug dealing, tax evasion, and for other criminal purposes). The FBAR filing requirements are codified under 31 U.S.C. § 5314. The Code of Federal Regulations (31 C.F.R. § 103.24) contains a summary

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[1] Although the FBAR is not filed as part of the individual income return (Form 1040), a taxpayer who is subject to the FBAR filing requirement is required to check a box on the Schedule B to Form 1040 indicating the existence of a reportable account and disclose the foreign country in which the account(s) is held.

[2] *See* U.S. Department of Justice News Release of July 1, 2008 (http://www.usdoj.gov/opa/pr/2008/July/08-tax-584.html).

[3] Bank Secrecy Act, Pub. L. 91-508, Secs. 241, 242, 84 Stat. 1124 (October 26, 1970).

explanation of the requirement for an FBAR to be filed. This regulation has remained unchanged for over 20 years.

More recently, concerns over both the financing of terrorism and off-shore tax evasion have increased the government's enforcement of financial reporting requirements including FBARs, CMIRs,[4] CTRs[5] and Forms 8300.[6] In October of 2001, as part of the USA PATRIOT Act, Congress asked the Secretary of the Treasury to study the methods for improving compliance with the requirements of 31 U.S.C. § 5314.[7] One of the recommendations made in the study was the delegation of penalty enforcement from the Financial Crimes Enforcement Network (FinCEN) to the Internal Revenue Service (IRS).[8] Less than two years later, in April of 2003, FinCEN did in fact delegate its enforcement authority over FBARs to the IRS.[9]

Since 2003, the Internal Revenue Service has embarked on an education campaign regarding the FBAR filing requirements and has made resources available to taxpayers and practitioners. In practice, the application of penalties was rare. Over five years later, although the education campaign continues, the application of civil penalties and criminal investigations related to FBARs is on the rise.

If measured by the number of FBARs filed each year, the education campaign appears to be working. The number of filings reached an all time high of 320,937 in fiscal year 2007. As detailed by the table below, there has been a steady increase in filings in recent years.

Year	Number of Filings
CY 1991	116,600[10]
CY 2000	174,528[11]
CY 2001	177,151[12]
CY 2003	204,689[13]
FY 2004	218,667[14]
FY 2005	283,895[15]
FY 2006	287,356[16]
FY 2007	320,937[17]

[4] FinCEN Form 105 (Report of International Transportation of Currency or Monetary instruments).
[5] FinCEN Form 104 (Currency Transaction Report).
[6] IRS Form 8300 (Report of Cash Payments Over $10,000 Received in a Trade or Business).
[7] USA PATRIOT Act, U.S. H.R. 3162, Public Law 107-56, Section 361(b).
[8] A Report To Congress In Accordance With the USA PATRIOT Act of 2001 (April 26, 2002).
[9] Memorandum of Agreement and Delegation of Authority for Enforcement of FBAR Requirements, dated April 8, 2003.
[10] 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 (April 26, 2002).
[11] 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 (2004).
[12] 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 (April 26, 2002).
[13] 199,738 (FY 2003) per FinCEN Annual Report Fiscal Year 2004.
[14] FinCEN Annual Report Fiscal Year 2004.
[15] FinCEN Annual Report Fiscal Year 2005.
[16] FinCEN Annual Report Fiscal Year 2006; (287,469 per FinCEN Annual Report 2007).
[17] FinCEN Annual Report Fiscal Year 2007.

The increase in filings is understandable, since anyone familiar with the FBAR filing requirement and the associated penalties would be ill-advised to ignore the requirement.

REQUIREMENTS

The goal of the sections immediately below is to review the major substantive requirements surrounding FBAR compliance. For many years, the best resource in this regard has been the instructions to the FBAR form. More recently, as a result of the education campaign and internal guidance to its employees, the Internal Revenue Service has published a substantial amount of information helpful to those who practice in this area.

The Basics

The basic requirements for filing the form are relatively simple. The filing is required of each U.S. person who has a financial interest in, *or* signature authority, *or* other authority over financial account(s) in a foreign country, which at any time during the year exceed $10,000 in aggregate value.[18] In completing the form, the filer provides basic information about him or herself as well as the accounts subject to the reporting requirement. This information includes, but is not limited to, the type and value of the account, financial institution with which the account is held, account number, etc.

The filing deadline for the report for any calendar year is June 30th of the succeeding year. It should be noted that since the filing requirement arises under Title 31 of the United States Code, rather than Title 26 (Internal Revenue Code), the "timely mailing equals timely filing" rule under I.R.C. § 7502 does *not* apply. Thus, the form must be *received* by the IRS by June 30th in order to be considered timely.[19] Also, there are no extensions of time to file the FBAR (i.e., extension of time to file IRS Form 1040 until October 15th does *not* extend the time to file the FBAR). Likewise, I.R.C. § 7508 (time for performing certain acts postponed by reason of service in combat zone or contingency operation) does not extend the time to file the FBAR.[20]

The FBAR should be filed by mail with the Department of the Treasury, Post Office Box 32621, Detroit, MI 48232-0621, or by hand-carrying it to any local office of the Internal Revenue Service for forwarding to the Department of the Treasury, Detroit, MI.[21] Although the taxpayer is required to check a box on IRS Form 1040, Schedule B, disclosing the existence of such account(s), the FBAR is not filed as part of the income tax return.

Nuts and Bolts

While the basic requirements for filing the FBAR appear relatively straight forward, the devil is invariably in the details. The newly revised form, which is required to be used after December 31, 2008, clarifies and expands the requirements over the previous version of the form.[22] The

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[18] *See* TD F 90-22.1 (Rev. October 2008).
[19] *See* I.R.M. § 4.26.16.3.7(6) (07-01-2008).
[20] *See* I.R.M. § 4.26.16.3.7.1(2) (07-01-2008).
[21] TD F 90-22.1 (Rev. October 2008).
[22] *Compare* TD F 90-22.1 (Rev. October 2008) *versus* TD F 90-22.1 (Rev. 7/2000).

instructions to the form, which are discussed in large part immediately below, should be carefully reviewed.

Who Must File

The filing of the form is required by each U.S. person meeting certain criteria. The definition of the term "U.S. person" now includes, in addition to a citizen or resident of the United States, a person in and doing business in the United States.[23] Notably, the Internal Revenue Manual (IRM), instructs that the definition of "resident alien" under I.R.C. § 7701(b) does not apply for purposes of the FBAR.[24] Instead the IRM instructs that "[t]he plain meaning of the term 'resident' (in this context, someone who is living in the U.S. and not planning to permanently leave the U.S.) should be used for FBAR examination purposes."[25] On the other hand, certain provisions of I.R.C. § 7701(b) if not met can be used to disqualify a person from the definition of "resident."[26]

For this purpose, the term "person" includes "[a]n individual, a corporation, a partnership, a trust or estate, a joint stock company, an association, a syndicate, joint venture, or other unincorporated organization or group, an Indian Tribe (as that term is defined in the Indian Gaming Regulatory Act), and all entities cognizable as legal personalities."[27]

Generally, each person that meets the filing requirements must file an FBAR. This can result in multiple filings with respect to one account. A potential exception exists for joint accounts held by spouses meeting certain requirements.[28]

Financial Account

The term "financial account" includes any bank, securities, securities derivatives or other financial instrument accounts.[29] Notably, the revised form clarifies that debit card and prepaid credit card accounts do constitute a financial account for FBAR filing purposes.[30] Conversely, individual bonds, notes, or stock certificates held by a taxpayer are not a financial account, nor is an unsecured loan to a foreign trade or business that is not a financial institution.[31] Special rules apply to filers with 25 or more accounts.[32]

Foreign Country

The term "foreign country" includes all geographical areas located outside of the United States.[33] For this purpose, the term "United States" includes "[t]he States of the United States, the District of Columbia, the Indian lands (as that term is defined in the Indian Gaming Regulatory Act), and

[23] TD F 90-22.1 (Rev. October 2008).
[24] I.R.M. § 4.26.16.3.1.1(2) (07-01-2008).
[25] *Id.*
[26] *Id.*
[27] 31 C.F.R. § 103.11(z).
[28] *See* TD F 90-22.1 (Rev. October 2008) Instructions to Part III, Items 24-33.
[29] TD F 90-22.1 (Rev. October 2008); *see also* I.R.M. § 4.26.16.3.2 (07-01-2008).
[30] *Id.*
[31] *Id.*
[32] I.R.M. § 4.26.16.3.9 (07-01-2008).
[33] TD F 90-22.1 (Rev. October 2008); *see also* I.R.M. § 4.26.16.3.3 (07-01-2008).

the Territories and Insular Possessions of the United States."[34] Significantly, the geographical location of the account, not the nationality of the financial entity institution determines where the account is located for FBAR purposes.[35] The filing of an FBAR is not required if an account is maintained with a branch, agency, or other office of a foreign bank that is located in the U.S.[36] On the other hand, an account held with a foreign branch of a United States financial institution must be reported.[37]

Signature or Other Authority

The signature or other authority element is a reflection of actual control over the account. Naturally, the ability to control the disposition of funds or other property in an account with the delivery of a document containing such person's signature will satisfy this requirement.[38] It should be noted that the fact that the signature(s) of one or more additional persons may be required does not absolve such person of the reporting requirement.[39]

However, signature authority is not required in order to subject a person to the FBAR filing requirements. Persons having "other authority" over the disposition of assets in an account are also subject to the filing requirement.[40] Naturally, substance over form controls, hence the term "other authority" appears to have an extremely broad meaning.

According to the instructions, other authority exists where a person can exercise comparable power over an account to that of signature authority by communicating with the bank or other person with whom the account is maintained.[41] The communication can be made directly or through an agent, nominee, attorney, or in some other capacity on behalf of the person.[42] Furthermore, the communication can be made orally or by some other means.[43]

The broad definition of "other authority" makes it difficult to imagine a situation where a person has the ability to control assets in a reportable account without having such authority.

Financial Interest

The term "financial interest" in an account also has a broad meaning. As one might expect, this term includes an account for which a U.S. person is an owner of record or to which such person has legal title.[44] For purposes of this definition, it is irrelevant whether the account is maintained for such person's benefit or for the benefit of others (including non-U.S. person(s)).[45]

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[34] 31 C.F.R. § 103.11(nn).
[35] TD F 90-22.1 (Rev. October 2008); *see also* I.R.M. § 4.26.16.3.3 (07-01-2008).
[36] TD F 90-22.1 (Rev. October 2008).
[37] I.R.M. § 4.26.16.3.3(2) (07-01-2008).
[38] TD F 90-22.1 (Rev. October 2008); *see also* I.R.M. § 4.26.16.3.5 (07-01-2008).
[39] *See* TD F 90-22.1 (Rev. October 2008).
[40] TD F 90-22.1 (Rev. October 2008); *see also* I.R.M. § 4.26.16.3.5(2) (07-01-2008).
[41] *Id.*
[42] TD F 90-22.1 (Rev. October 2008).
[43] *Id.*
[44] TD F 90-22.1 (Rev. October 2008); *see also* I.R.M. § 4.26.16.3.4 (07-01-2008).
[45] *Id.*

In addition, a U.S. person has a financial interest in a reportable account for which the owner of record or holder of legal title is:

- a person acting as an agent, nominee, attorney, or in some other capacity on behalf of the U.S. person; or
- a corporation in which the U.S. person owns directly or indirectly more than 50% of either the total value of shares of stock *or* the voting power for all shares of stock; or
- a partnership in which the U.S. person owns an interest in more than 50% of the profits *or* more than 50% of the capital of the partnership; or
- a trust in which the U.S. person either has a present beneficial interest, either directly or indirectly, in more than 50% of the assets or from which the U.S. person receives more than 50% of the current income.[46]

According to IRS, the attribution rules under Title 26 do not apply in this context.[47]

Finally, a U.S. person is considered to have a financial interest in a reportable account for which the owner of record or holder of legal title is a trust or a person acting on behalf of a trust that was established by the U.S. person and for which a trust protector has been appointed.[48] According to the FBAR instructions, a trust protector is a person who is responsible for monitoring the activities of a trustee, with the authority to influence the decisions of the trustee or to replace, or recommend the replacement of, the trustee.[49]

<u>$10,000 Threshold</u>

The FBAR is required to be filed only if the aggregate value of the account(s) exceeds $10,000 at any time during the year.[50] Since the $10,000 threshold is based on the aggregate value of *all* foreign accounts, keeping the value of *each* account below the threshold does not absolve a person of the filing requirement if the combined value of the accounts exceeds the $10,000 threshold.

The value of an account is based on both the value of currency and the value of non-monetary assets in the account.[51] A person must report the maximum value of an account during the calendar year, which is the largest amount of assets that appears on any quarterly or more frequent account statement issued for the year.[52] Significantly, it is not the ending balance on each statement that is taken into account in calculating the value of the account but the largest balance that appears on the statement at any time of the year.[53] If such statements are not issued, the maximum value is based on the largest amount of assets in the account at any time during the year.[54]

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[46] *Id.*
[47] *See* FBAR Questions (SB/SE Counsel Approved 10-22-07).
[48] TD F 90-22.1 (Rev. October 2008).
[49] *Id.*
[50] TD F 90-22.1 (Rev. October 2008); *see also* I.R.M. § 4.26.16.3.6 (07-01-2008).
[51] TD F 90-22.1 (Rev. October 2008); *see also* I.R.M. § 4.26.16.3.6(4) (07-01-2008).
[52] TD F 90-22.1 (Rev. October 2008); *see also* I.R.M. § 4.26.16.3.6(1) (07-01-2008).
[53] I.R.M. § 4.26.16.3.6(1) (07-01-2008).
[54] I.R.M. § 4.26.16.3.6(2) (07-01-2008).

In completing the FBAR, which requires the disclosure of the value of the account, the conversion to U.S. dollars must be made.[55] The conversion is made using the official exchange rate at the end of the year.[56] The value of non-monetary assets, including securities, is determined at the end of the calendar year.[57] To the extent that such assets were withdrawn from the account before the close of the year, such assets are valued at the time of the withdrawal.[58] To the extent the value of the account(s) cannot be determined to exceed $10,000, the filer is to complete the applicable portion of the form and enter the value as unknown.[59]

The previous version of the form required an approximate disclosure of the value.[60] This was made by checking one of four boxes: under $10,000, $10,000 to $99,000, $100,000 to $1,000,000, and over $1,000,000.[61] The revised version of the form requires the filer to enter an exact dollar amount.[62] This small change can present a substantial administrative burden for filers who, in the past, were able to complete the form without detailed calculations of the account balances. With the previous version of the form, many filers were able to complete the form without knowing the exact value of the account, but rather knowing that the value of the account fell into one of the four rather broad value categories. This is no longer the case. Advance notice of this change to clients may be warranted in order to avoid running up against the filing deadline or having to amend due to the lack of sufficient documentation.

Record Keeping Requirements

In addition to the FBAR filing requirement, certain record-keeping requirements also exist.[63] Any person having signature or other authority or having a financial interest in a reportable account must maintain records that include the name in which the account is maintained, the number or other designation of the account, the name and address of the foreign bank or other person with whom the account is maintained, the type of such account, and the maximum value of each such account during the reporting period.[64] The failure to retain required records may also be subject to penalties.[65]

These records must be maintained and be available for inspection for a period of five (5) years.[66] However, the running of the five-year period is suspended starting with the date on which the taxpayer is indicted or information is pending with respect to filing a false or fraudulent Federal income tax return and ending with the final disposition of the criminal proceedings.[67]

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[55] TD F 90-22.1 (Rev. October 2008); *see also* I.R.M. § 4.26.16.3.6(3) (07-01-2008).
[56] *Id.*
[57] TD F 90-22.1 (Rev. October 2008); *see also* I.R.M. § 4.26.16.3.6(4) (07-01-2008).
[58] *Id.*
[59] TD F 90-22.1 (Rev. October 2008).
[60] *See* TD F 90-22.1 (Rev. 7/2000).
[61] *See Id.*
[62] *See* TD F 90-22.1 (Rev. October 2008).
[63] *See* 31 CFR § 103.32.
[64] *Id.*
[65] *See* I.R.M. § 4.26.16.4.5.5 (07-01-2008).
[66] *Id.*
[67] *Id.*

Notable Exceptions

The instructions to the FBAR form carve out several exceptions in situations where the filing requirements would otherwise apply.

Officers or Employees of Certain Banks

Despite having signature or other authority over an account, an officer or an employee of a bank is exempt from the FBAR filing requirements if such officer or employee does not have a personal financial interest in the account with such bank. In order for the officer or employee to qualify for this exception, such bank must be subject to the supervision of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Office of Thrift Supervision, or the Federal Deposit Insurance Corporation. [68]

Officers or Employees of Certain Domestic Corporations

Similar to the bank officer/employee exception, an exception exists for an employee or officer of certain domestic corporations who has signature or other authority over the corporate accounts, but has no personal financial interest in such accounts. In order to qualify for this exception, the domestic corporation must have its equity securities listed upon any United States national securities exchange, or such corporation must have assets exceeding $10,000,000 and have 500 or more shareholders. Moreover, such employee or officer must be advised in writing by the corporation's CFO or similar responsible officer that the corporation has filed a current report for such account.[69] Likewise an employee or officer of a domestic subsidiary of a domestic parent corporation that meets the above requirements[70] need not file the report if such employee or officer has no personal interest in the account and has been advised by the CFO or a similar responsible officer of the *parent* that the *subsidiary* has filed a current report which includes that account. If a United States subsidiary is named in a consolidated FBAR of the parent corporation, the subsidiary will be deemed to have filed a report for purposes of this exception.[71]

Officers or Employees of Certain Foreign Subsidiaries

An exception to the filing requirements also exists for employees or officers of certain foreign subsidiary corporations which are more than 50% owned by a domestic corporation. The exception follows the same general pattern for domestic corporations. The employee or officer, who has signatory or other authority over an account but has no personal financial interest in the account, need not file a report if such employee or officer has been advised in writing by a responsible officer of the *parent* corporation that the parent has filed a current report that includes the account.

It should be noted that the IRM instructs that although a foreign subsidiary of a U.S. person is not subject to FBAR filing requirements, the U.S. parent is considered to have a financial interest

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[68] I.R.M. § 4.26.16.3.5(3A) (07-01-2008).
[69] TD F 90-22.1 (Rev. October 2008); *see also* I.R.M. § 4.26.16.3.5(3B) (07-01-2008).
[70] Equity securities listed upon any United States national securities exchange, or such corporation must have assets exceeding $10,000,000 and have 500 or more shareholders.
[71] TD F 90-22.1 (Rev. October 2008); *see also* I.R.M. § 4.26.16.3.5(3C) (07-01-2008).

in any foreign financial account owned by its subsidiary, and thus subject to the FBAR filing requirement.[72]

Military Banking Facility

Despite the location, certain accounts held with an institution abroad may be exempt from FBAR reporting. To meet this exception the account held with the United States military banking facility abroad must be:

- held with an institution known as a "United States military banking facility" (or "United States military finance facility")
- which is operated by a United States financial institution that is designated by the United States Government to serve U.S. Government installations abroad.[73]

PENALTIES

A taxpayer who fails to file an FBAR may be subject to both civil and criminal penalties under Title 31 of the United States Code. The same violation may be punishable by both civil and criminal penalties. As will be discussed below, the penalties associated with failing to file the FBAR are substantial.

Civil Penalties

Prior to the American Jobs Creation Act of 2004 (effective October 22, 2004), civil penalties could be imposed on negligent or willful violations of the reporting requirement. The Jobs Act added a penalty for non-willful violations and substantially altered the structure of the penalty for willful violations.

Currently, the penalty regime can be thought of as having four major tiers of civil penalties. These include the negligence penalty, the "pattern of negligent activity" penalty, the non-willfulness penalty, and the willfulness penalty.

However, unlike somewhat fixed application of the penalties under Title 26, the IRS has a fair amount of discretion as to the amount of penalty, if any, actually assessed. The examiner may opt for a warning letter instead of a monetary penalty.[74]

The penalties are applied per each account, rather than per the unfiled FBAR.[75] Moreover, penalties apply for each year and for each violation.[76] Finally, since the penalty may be asserted against each person required to file the FBAR, there may be more than one penalty asserted with respect to one account.[77]

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[72] I.R.M. § 4.26.16.3.1.1(3) (07-01-2008).
[73] TD F 90-22.1 (Rev. October 2008); *see also* I.R.M. § 4.26.16.3.3(2C) (07-01-2008).
[74] I.R.M. § 4.26.16.4(4) (07-01-2008).
[75] I.R.M. § 4.26.16.4(7) (07-01-2008).
[76] *Id.*
[77] I.R.M. § 4.26.16.4(8) (07-01-2008).

Negligence Penalty

A $500 penalty under 31 U.S.C. § 5321(a)(6)(A) can be imposed on any financial institution or a non-financial trade or business for a negligent violation of the FBAR filing requirement. This penalty does not generally apply to individuals.[78] Prior to October 27, 2001, the negligence penalty applied to financial institutions.[79] Currently, it applies to all businesses.[80]

Pattern of Negligent Activity Penalty

The Internal Revenue Service may apply a $50,000 penalty where a financial institution or a non-financial trade or business engages in a pattern of negligent violations.[81] This penalty is in addition to the negligence penalty discussed above.[82] The IRM instructs that this penalty should be applied only in "egregious cases."[83]

Non-willfulness Penalty

For violations occurring after October 22, 2004, there is a penalty of up to $10,000 for a non-willful failure to file the FBAR.[84] There is no limitation as to against whom the penalty is applied (e.g., it can be applied to individuals as well as businesses). If, however, the amount of the transaction or the balance in the account at the time of the transaction was properly reported, the penalty may be eliminated if reasonable cause exists.[85] According to the IRM, the examiner must receive the delinquent FBAR from the taxpayer in order to avoid this penalty.[86]

Willfulness Penalty

For willful violations occurring prior to October 23, 2004, the maximum penalty is the greater of $25,000 or the account balance, not to exceed $100,000.[87] The violation is deemed to occur on June 30th of the following calendar year.[88] Since civil penalties can be assessed at anytime up to six years after the date of the violation,[89] the pre-October 2004 willfulness penalty remains relevant where older violations are involved.

For violations after October 22, 2004, the maximum willfulness penalty is a fine equal to the greater of $100,000 or 50% of the amount of the transaction or of the balance of the account at the time of the offense.[90] Significantly, unlike the pre-October 2004 penalties, no maximum

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78 I.R.M. § 4.26.16.4.3(2) (07-01-2008).
79 I.R.M. § 4.26.16.4.3.2(1) (07-01-2008).
80 *Id.*
81 *See* 31 U.S.C. § 5321(6)(b).
82 *Id.*
83 I.R.M. § 4.26.16.4.3.6(2) (07-01-2008).
84 31 U.S.C. § 5321(5)(b)(i).
85 31 U.S.C. § 5321(5)(b)(ii).
86 I.R.M. § 4.26.16.4.4(2A) (07-01-2008).
87 I.R.M. § 4.26.16.4.5(3) (07-01-2008).
88 I.R.M. § 4.26.16.4.5(1) (07-01-2008).
89 *See* 31 U.S.C. § 5321(b)(1).
90 31 U.S.C. § 5321(a)(5)(C).

dollar limit exists for the willfulness penalty. Violations deemed to be willful are not subject to the reasonable cause exception.[91]

According to the Internal Revenue Service, willfulness exists where there is a "voluntary, intentional violation of a known legal duty."[92] Moreover, the Service takes the position that under certain circumstances "willful blindness" may lead to a finding of willfulness.[93] The IRM provides examples of what the IRS views as willful versus non-willful violations.[94]

Civil Action

The government may commence a civil action to recover the penalty within two years of the later of the date the penalty was assessed or the date any judgment becomes final with respect to criminal action in connection with the violation that gave rise to the penalty.[95]

Mitigation

The civil penalties described above can be onerous when applied to their full extent. This point is not lost on the Internal Revenue Service and the examiners are instructed to use discretion in applying the penalty provisions.[96]

To aid examiners in determining the appropriate amount of the penalty, the IRM sets out mitigation guidelines. Notably, the IRM instructs that the mitigation guidelines are only an aid and that the examiner must still consider whether a warning letter or a lesser penalty than what is called upon by the mitigation guidelines is appropriate.[97] Nevertheless, it appears a decision to depart from the mitigation guidelines must be made with a written approval by the examiner's group manager and documented in the work papers.[98]

In order for the mitigation guidelines to apply, certain threshold conditions must be met.[99] These conditions are:

1. The person has no history of past FBAR penalty assessments and, in addition, for violations occurring after October 22, 2004, the person has no history of criminal tax or BSA convictions for the preceding ten years;[100]
2. No money passing through any of the foreign accounts associated with the person was from an illegal source or used to further a criminal purpose;[101]
3. The person cooperated during the examination (i.e., the Service did not have to resort to a summons to obtain non-privileged information; the taxpayer responded to reasonable

[91] However, one would argue that where reasonable cause exists for a violation, willfulness does not. This point is not lost on the Service. *See* I.R.M. § 4.26.16.4.5.3(4) (07-01-2008).
[92] *See* I.R.M. § 4.26.16.4.5.3(1) (07-01-2008).
[93] *See* I.R.M. § 4.26.16.4.5.3(6) (07-01-2008).
[94] *See* I.R.M. § 4.26.16.4.5.3(8A-D) (07-01-2008).
[95] *See* 31 U.S.C. § 5321(b)(2).
[96] *See* I.R.M. §§ 4.26.16.4(5) & 4.26.16.4.7(4) (07-01-2008).
[97] I.R.M. § 4.26.16.4(6) (07-01-2008).
[98] I.R.M. § 4.26.16.7.7 (07-01-2008).
[99] *See* I.R.M. § 4.26.4.6.1 (07-01-2008).
[100] I.R.M. §§ 4.26.4.6.1(2A) & 4.26.4.6.3 (07-01-2008).
[101] I.R.M. § 4.26.4.6.1(2B) (07-01-2008).

requests for documents, meetings, and interviews; or the taxpayer back-filed correct reports); [102] and

4. The Service did not sustain a civil fraud penalty against the person for an underpayment for the year in question due to the failure to report income related to any amount in a foreign account.[103]

If the threshold conditions are met, multiple levels of penalties may be applied generally depending on factors such as the type of the penalty (non-willful versus willful), date of the violation (pre- or post-Jobs Act), and/or the value of the accounts.[104]

With the non-willful penalty, there are three mitigation levels which are based on the highest amount in the account during the period for which the FBAR should have been filed.[105] The first level, applicable to violations where the aggregate balance of all accounts during the year does not exceed $50,000, includes a penalty of $500 per violation with a cap of $5,000.[106] The second level, applicable to violations where the aggregate balance of all accounts during the year is over $50,000 but less than $250,000, includes a penalty of the lesser of: $5,000 per violation or 10% of the highest balance in the account during the year for which the account should have been reported.[107] Finally, for violations regarding an account exceeding $250,000, the penalty is $10,000, which is the statutory maximum for the non-willful violations.[108]

The guidelines for mitigation of the willful penalty are more complex. There are four levels that depend both on the date of the violation and the balances in the account(s).

According to the IRM, for violations occurring *prior* to October 23, 2004, the four levels are as follows:

> Level I Willful Violations Occurring Before October 23, 2004 - A Level I penalty applies if the maximum aggregate balance for all required but unreported foreign accounts does not exceed $20,000. For Level I cases, the penalty will be 5% of the maximum balance during the calendar year for each of the unreported foreign accounts that should have been reported.[109]
>
> Level II Willful Violations Occurring Before October 23, 2004 - A Level II penalty applies if the Level I penalty does not apply and the maximum balance during the year for a required but unreported foreign account is not more than $250,000. The balance in each account is analyzed separately to determine the applicable penalty for that account. For an account that falls within Level II, the penalty will be 10% of the maximum balance during the year for

[102] I.R.M. § 4.26.4.6.1(2C) (07-01-2008).
[103] I.R.M. § 4.26.4.6.1(2D) (07-01-2008).
[104] I.R.M. §§ 4.26.4.6.2 & 4.26.4.6.3 (07-01-2008).
[105] I.R.M. § 4.26.16.4.6.2(3) (07-01-2008).
[106] I.R.M. § 4.26.16.4.6.2(4) (07-01-2008).
[107] I.R.M. § 4.26.16.4.6.2(5) (07-01-2008).
[108] I.R.M. § 4.26.16.4.6.2(6) (07-01-2008).
[109] I.R.M. § 4.26.16.4.6.3(2A) (07-01-2008).

each of the unreported foreign accounts that should have been reported. Thus, the maximum Level II penalty is $25,000 per account.[110]

Level III Willful Violations Occurring Before October 23, 2004 – A Level III penalty applies if the maximum balance during the year for an unreported foreign account that should have been reported is greater than $250,000 but not more than $1 million. The balance in each account is analyzed separately to determine the applicable penalty for that account. For an account that falls within Level III, the penalty will be the lesser of: (a) 10% of the maximum amount of the foreign account that should have been reported, or (b) the amount in the account as of the last day for filing the FBAR, unless this amount is less than $25,000, in which case the penalty is $25,000. [111]

Level IV Willful Violations Occurring Before October 23, 2004 - A Level IV penalty applies if the maximum balance during the year for an unreported foreign account that should have been reported was greater than $1 million. The balance in each account is analyzed separately to determine the applicable penalty for that account. For Level IV, the penalty will be the lesser of: (a) $100,000 or (b) the amount in the account as of the last day for filing the FBAR, unless this amount is less than $25,000, in which case the penalty is $25,000.[112]

According to the IRM, for violations occurring *after* October 22, 2004, the four levels are as follows:

Level I Willful Violations Occurring After October 22, 2004 - If the maximum aggregate balance for all accounts to which the violations relate did not exceed $50,000, Level I applies to all accounts . Determine the maximum balance during the calendar year for each account. Add the various maximums to find the maximum aggregate balance. The Level I penalty is the greater of $1,000 per violation or 5% of the maximum account balance during the calendar year for each Level I account.[113]

Level II Willful Violations Occurring After October 22, 2004 - If Level I does not apply and if the maximum account balance to which the violations relate at any time during the calendar year did not exceed $250,000, Level II applies to that account. The Level II penalty assessed for each account is the greater of $5,000 per

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[110] I.R.M. § 4.26.16.4.6.3(2B) (07-01-2008).
[111] I.R.M. § 4.26.16.4.6.3(2C) (07-01-2008).
[112] I.R.M. § 4.26.16.4.6.3(2D) (07-01-2008).
[113] I.R.M. § 4.26.16.4.6.3(3A) (07-01-2008).

> violation or 10% of the maximum account balance during the calendar year for each Level II account.[114]
>
> Level III Willful Violations Occurring After October 22, 2004 - If the maximum account balance to which the violations relate at any time during the calendar year exceeded $250,000 but did not exceed $1,000,000, Level III applies to that account. The Level III penalty assessed for each account is the greater of 10% of the maximum account balance during the calendar year for each Level III account or 50% of the closing balance in the account as of the last day for filing the FBAR .[115]
>
> Level IV Willful Violations Occurring After October 22, 2004 - If the maximum account balance to which the violations relate at any time during the calendar year exceeded $1 million, Level IV, the statutory maximum, applies to that account. The Level IV penalty is the statutory maximum applied to each account. It is the greater of $100,000 or 50% of the closing balance in the account as of the last day for filing the FBAR.[116]

In addition to mitigation in a standard FBAR case, the IRM sets out threshold conditions and mitigation criteria for cases arising under the Last Chance Compliance Initiative.[117]

Criminal Penalties

If the failure to file the FBAR is prosecuted criminally, the penalty can include a fine up to $250,000, imprisonment for up to five years, or both.[118] If the failure to file is deemed to be a part of a criminal activity (i.e., it occurs during the violation of another law or is part of a pattern of any illegal activity involving more than $100,000 in a 12-month period), the maximum fine increases to $500,000 and/or the possibility of imprisonment increases to up to ten years. [119] The typical five-year statute of limitation applies.

CLOSING THOUGHTS

It has been nearly six years since authority over FBAR compliance has been transitioned from FinCEN to the Internal Revenue Service. Due in large part to this transition and the government's education campaign, the FBAR has risen from relative obscurity to become an integral part of annual filings for those U.S. persons having accounts abroad. It is becoming increasingly difficult to plead ignorance of the FBAR filing requirement and the penalties are such that its filing cannot be ignored.

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[114] I.R.M. § 4.26.16.4.6.3(3B) (07-01-2008).
[115] I.R.M. § 4.26.16.4.6.3(3C) (07-01-2008).
[116] I.R.M. § 4.26.16.4.6.3(3D) (07-01-2008).
[117] *See* I.R.M. §§ 4.26.16.4.6.4 & 4.26.16.4.6.5 (07-01-2008).
[118] 31 U.S.C. § 5322(a).
[119] 31 U.S.C. § 5322(b).