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FBAR compliance

As the federal government increasingly looks for foreign tax evasion, it is more important for tax practitioners to make sure clients are in compliance with the filing requirements of FinCEN Form 114, *Report of Foreign Bank and Financial Accounts*.

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The Bank Secrecy Act (BSA), P.L. 91-508, requires certain U.S. persons who have a financial interest in or signature authority over a foreign financial account to report the account annually to the Department of Treasury by electronically filing Financial Crimes Enforcement Network (FinCEN) Form 114, *Report of Foreign Bank and Financial Accounts* (commonly called FBAR), through FinCEN's BSA E-Filing System. Financial accounts that must be reported include bank accounts, brokerage accounts, mutual funds, trusts, or other types of foreign financial accounts with balances that exceed certain thresholds.

Individuals who are required to file FBARs need expert advice to ensure proper compliance not only with the FBAR filing requirements, but possibly with other reporting requirements such as the Foreign Account Tax Compliance Act (FATCA), P.L. 111-147. FATCA requires filing Form 8938, *Statement of Specified Foreign Financial Assets*, with the federal income tax return, a separate requirement from the FBAR filing.

FBAR is not a tax return (and it isn't filed with the IRS, unlike Form 8938)—it is an information report. It was

designed, along with other reporting requirements such as FATCA, to deter tax evasion.

As discussed below, to assist U.S. taxpayers, the IRS has implemented streamlined filing compliance procedures to help those who have unreported foreign financial accounts to come into compliance.

WHO MUST FILE AN FBAR?

A U.S. person is required to file an FBAR if:

- The person had a financial interest in or signature authority over (or any other authority over) at least one financial account located outside of the United States; and
- The aggregate value of all foreign financial accounts exceeded $10,000 at any time during a calendar year.

For these purposes, U.S. persons include U.S. citizens; U.S. residents; entities, including but not limited to, corporations, partnerships, or limited liability companies, created or organized in the United States or under the laws of the United States; and trusts or estates formed under the laws of the United States. A child who falls under the FBAR filing criteria is not exempt from filing. If a child cannot file his or her own FBAR, a parent or guardian must file for him or her.

A person with "signature authority" is a person who can control the disbursement of money or other property in the account using his or her signature.

A person with "other authority over an account" is a person who can exercise power over an account by communicating directly, orally or otherwise, to the financial institution or other person maintaining the account.

A U.S. person has a financial interest in an account for which the U.S. person is the owner of record or has legal title, whether the account is maintained for his or her own benefit or the benefit of others, including non-U.S. persons.

A U.S. person also has a financial interest where the owner of record or holder of legal title of the account is any of the following:

- A person acting on behalf of a U.S. person with respect to the account, including agents, nominees, and attorneys;
- A corporation, foreign or domestic, in which the U.S. person owns (directly or indirectly) more than 50% of the total value or more than 50% of the voting power of all shares of stock;
- A partnership, foreign or domestic, in which the U.S. person owns (directly or indirectly) an interest in more than 50% of the partnership's profits or capital;
- A trust in which the U.S. person is the grantor and has an ownership interest in the trust for U.S. federal tax purposes;
- A trust, foreign or domestic, in which the U.S. person has a greater than 50% direct or indirect present beneficial interest in the trust's assets or receives 50% of the trust's income;

- Any other entity in which the U.S. person owns (directly or indirectly) more than 50% of the voting power, total value of equity or assets, or profits interest.

EXCEPTIONS TO THE FILIING REQUIREMENTS

Certain U.S persons or foreign financial accounts are excluded from the FBAR reporting requirements. These include:

- The spouse of an individual who files an FBAR is not required to file a separate FBAR if (1) all the financial accounts that the nonfiling spouse is required to report are jointly owned with the filing spouse; (2) the filing spouse reports the jointly owned accounts on a timely filed, electronically signed FBAR; and (3) the filers have completed and signed Form 114a, *Record of Authorization to Electronically File FBARs* (see discussion below);
- U.S. persons that are entities included in a consolidated FBAR filed by a greater-than-50% owner;
- Correspondent/nostro accounts (bank accounts established by banks solely for bank-to-bank settlements);
- Foreign financial accounts owned by a U.S. governmental entity;
- Foreign financial accounts owned by an international financial institution (if the U.S. government is a member);
- Owners and beneficiaries of IRAs do not have to report foreign financial accounts held in an IRA;
- Participants in and beneficiaries of tax-qualified retirement plans are not required to report a foreign financial account held by or on behalf of the retirement plan;
- Individuals with signature authority over, but no financial interest in, a foreign financial account if the individual is an officer or employee of the entity that owns or maintains the account in certain situations (e.g., an officer or employee with signature authority over an account of a financial institution that is registered with and examined by the SEC or Commodity Futures Trading Commission);
- Trust beneficiaries (but only if a U.S. person reports the account on an FBAR filed on behalf of the trust);
- Financial accounts maintained on a U.S. military installation.

PENALTIES FOR NONCOMPLIANCE

Persons required by law to file an FBAR, and who fail to properly file a complete and correct one, may be subject to civil penalties for negligence, a pattern of negligence, nonwillful violations, and willful violations. When there is a violation, the IRS examiner will either issue Letter 3800, *Warning Letter for Apparent Foreign Bank and Financial Accounts Report Violations*, or determine a penalty based on the violation. The purpose of imposing penalties for violations is to encourage filing compliance. Each IRS examiner has discretion in determining the amount of the penalty, if any, taking into account the facts and circumstances of each case. FBAR penalties are determined per account, for each person required to file.

Negligence penalties

Two negligence penalties apply generally to all BSA provisions:

- A negligence penalty up to $500 may be assessed against a business for any negligent violation of the BSA, including FBAR violations.
- An additional penalty up to $50,000 may be assessed against a business for a pattern of negligent violations.

Generally, these two negligence penalties apply only to trades or businesses, not to individuals.

Nonwillful violations. A penalty, not to exceed $10,000, may be imposed on any person who violates or causes any violation of the FBAR filing and recordkeeping requirements that are not due to reasonable cause (Internal Revenue Manual (IRM) §4.26.16.6.4).

Willful violations. Persons who willfully fail to report an account may be subject to a penalty equal to the greater of $100,000 or 50% of the balance in the account at the time of the violation, for each violation, under 31 U.S.C. Section 5321(a)(5) (IRM §4.26.16.6.5). Willful violations may also be subject to criminal penalties under 31 U.S.C. Section 5322(b) or 18 U.S.C. Section 1001.

Mitigating factors such as natural disasters, emergencies, or other systemic issues may prevent a U.S. person from filing a timely FBAR. Financial institutions and individuals filing FBARs affected by these circumstances should contact FinCEN's Regulatory Helpline at 800-949-2732 (703-905-3975 from outside the United States) to make FinCEN aware of their compliance concerns and to determine possible alternatives for timely reporting. FinCEN will work with financial institutions to develop necessary alternatives and to ensure that their primary federal regulator is informed of the situation and potential remedies.

The statute of limitation for FBAR civil penalties is six years from the date of the transaction with respect to which the penalty is assessed (31 U.S.C. §5321(b)). For purposes of the penalty for failing to file an FBAR, the IRS interprets "transaction" as the due date of the report. For a penalty for failing to maintain required records, it is the date the IRS first asks for the records.

REPORTING AND FILING INFORMATION

A U.S. person who holds a foreign financial account may have a reporting obligation, even if the account is not producing taxable income. The taxpayer's reporting obligation would be met by filing an FBAR and answering the questions about foreign accounts on Form 1040, *U.S. Individual Income Tax Return*, Schedule B, *Interest and Ordinary Dividends*.

On Sept. 30, 2013, FinCEN announced that FBAR Form FinCEN 114 replaced Form TD 90-22.1 and could no longer be filed using a paper form, but only online using FinCEN's BSA E-Filing System. The system allows the filer to enter the calendar year reported, including past years, on the online report. Taxpayers who are unable to file electronically should call FinCEN's help line for alternative filing methods.

On July 29, 2013, FinCEN posted a notice on its website introducing a new report for filers who submit FBARs jointly with spouses or who wish to have a third-party preparer file on their behalf. The new Form 114a, *Record of Authorization to Electronically File FBARs*, is not submitted when filing an FBAR but instead is kept by the filer and the account owner, and must be made available to FinCEN or the IRS upon request.

For 2015 and earlier years, FBARs are or were due on or before June 30 following the calendar year reported, with no filing extensions allowed. Thus, the due date for an individual's 2015 FBAR is June 30, 2016. However, the Surface Transportation and Veterans Health Care Choice Improvement Act of 2015, P.L.114-41, changed the standard FBAR due date to April 15 beginning with the 2016 calendar year report. In addition, for 2016 and later years, a six-month extension for filing FBARs is allowed.

A limited filing extension has also been granted to certain individuals who have filing obligations because they have signature authority over, but no financial interest in, foreign financial accounts of their employer or a closely related entity, through April 15, 2017 (FinCEN Notice 2015-1). This extension applies to the reporting of signature authority held during the 2015 calendar year, as well as all reporting deadlines extended by previous FinCEN Notices 2014-1, 2013-1, 2012-1, 2012-2, 2011-1, and 2011-2. For all other individuals with an FBAR filing obligation, the filing due date remains unchanged.

Recordkeeping

Those required to file an FBAR must retain financial records for five years, from the due date for filing the FBAR for the calendar year. These records must be available for inspection upon request. Records maintained should contain:

- Name on each account;
- Number or other account designation;
- Name and address of the foreign bank or other person with whom the account is maintained;
- Type of account; and
- Maximum value of each account during the reporting period.

Valuation for reporting purposes

For reporting purposes, the U.S. person must disclose the maximum value of financial accounts maintained in a financial institution located in a foreign country. Valuation of these accounts can be determined using periodic account statements, which should be converted to U.S. dollars at the end of the calendar year, applying the official exchange rate for the last day of the calendar year. Filers can find the Treasury Reporting Rates of Exchange at fiscal.treasury.gov (https://www.fiscal.treasury.gov/fsreports/rpt/treasRptRateExch/currentRates.htm).

The maximum value of a financial account is the highest balance of both currency and nonmonetary assets that appear on any quarterly or more frequent account statement issued for the reporting year. For example, if the Dec. 31 balance is $15,500 but the July 31 ending balance in the same calendar year was $25,200, the maximum reportable value is $25,200. In the absence of periodic financial statements, the maximum value will be the largest amount of currency and nonmonetary assets in the account at any time during the year. For reporting purposes, all amounts are rounded up to the nearest whole dollar.

Persons who have financial interests in multiple foreign accounts (but fewer than 25 accounts) and who are unable to determine if the filing threshold has been met anytime during the year, should complete the appropriate Part II, III, IV, or V section for each of these accounts and check the "amount unknown" box, item 15a. Guidelines for persons with financial interests in 25 or more accounts are in the IRM (see IRM §§4.26.16.4.6 and 4.26.16.5.1). Filers with multiple reportable accounts must value each account separately.

Types of reportable foreign assets

Financial accounts include, but are not limited to:

- Securities, brokerage, savings, demand, checking, deposit, time deposit, and other accounts maintained with a financial institution;
- Commodity futures and options accounts;
- Insurance policies with a cash value;
- Annuity policies with a cash value; and
- Shares in a mutual fund or similar pooled fund.

OFFSHORE VOLUNTARY DISCLOSURE PROGRAM

Effective July 1, 2014, the IRS modified the Offshore Voluntary Disclosure Program (OVDP) to make additional options available to U.S. taxpayers with undisclosed foreign financial assets. Since the launch of the first OVDP program, more than 45,000 taxpayers have come into voluntary compliance, paying an estimated $6.5 billion in taxes and penalties.

Modifications to the OVDP included:

- Requiring additional information from taxpayers in their applications.
- Eliminating penalties for certain taxpayers who committed nonwillful violations.
- Requiring taxpayers to submit all account statements and pay the offshore penalty at the time they applied for the OVDP.
- Requiring supporting information to be submitted electronically rather than by paper.
- Increasing the offshore penalty percentage from 27.5% to 50%, if, before the taxpayer's OVDP preclearance request is submitted, it becomes public that a financial institution where the taxpayer holds an account or another party facilitating the taxpayer's offshore arrangement is under investigation by the IRS or U.S. Department of Justice.

Streamlined filing compliance procedures

The IRS announced on June 18, 2014, that streamlined filing compliance procedures would be changed to allow a wider population of U.S. taxpayers with unreported foreign accounts to qualify. Taxpayers living outside the United States continue to qualify, and, for the first time, some U.S. taxpayers residing in the United States qualify as well (see irs.gov (https://www.irs.gov/Individuals/International-Taxpayers/Streamlined-Filing-Compliance-Procedures)).

Originally, the streamlined filing compliance procedures introduced on Sept. 1, 2012, were available only to nonresident U.S. taxpayers who failed to file required income tax returns. These taxpayers were subject to different degrees of review based on current tax liability and their response to a risk questionnaire.

The changes introduced in the streamlined procedures include:

- Eliminating a requirement that the taxpayer have $1,500 or less of unpaid tax per year;
- Eliminating the required risk questionnaire; and
- Requiring the taxpayer to certify that previous failures to comply were due to nonwillful conduct.

All penalties will be waived for eligible U.S. taxpayers residing outside the United States. For eligible U.S. taxpayers residing in the United States, the only penalty will be a miscellaneous offshore penalty equal to 5% of the foreign financial assets that gave rise to the tax compliance issue.

FBAR relief separate from the streamlined procedures

Taxpayers who were required to file FBARs but failed to do so, and who are not under IRS civil examination or criminal investigation, should file the delinquent FBARs electronically through the BSA E-Filing System and include a statement explaining why the filings are late.

A penalty will not be imposed for failure to file delinquent FBARs if income from the foreign financial accounts reported on the delinquent FBARs is properly reported and taxes are paid, and the taxpayer has not previously been contacted regarding an income tax examination or a request for delinquent returns for the years for which the delinquent FBARs are submitted.

Eligibility criteria for the streamlined procedures

The new modified compliance procedures are designed only for individual taxpayers, which includes the taxpayer's estate. Non-U.S. residents are subject to procedures referred to as "Streamlined Foreign Offshore Procedures," while U.S. residents are subject to "Streamlined Domestic Offshore Procedures." The criteria are:

- Taxpayers must certify that their conduct was not willful. Both the foreign and domestic procedures require taxpayers to certify that the failure to report all income, pay all taxes, and submit all required returns, including the FBAR, was due to nonwillful conduct.
- The IRS has not initiated a civil examination of the taxpayers' returns for any tax year, and the taxpayers are not under IRS criminal investigation.
- Taxpayers eligible to use streamlined procedures who have previously filed delinquent or amended returns (so-called quiet disclosures) must pay any penalties assessed on those filings.

- Taxpayers who want to participate in the streamlined procedures need a valid taxpayer identification number (TIN). For U.S. citizens, resident aliens, and certain other individuals, the proper TIN is a valid Social Security number. Others need an individual taxpayer identification number, which, for taxpayers who do not have one, can be applied for when submitting the request to participate in the streamlined program.

CONCLUSION

According to IRS Commissioner John Koskinen, the OVDP, FBAR, and FATCA are intended "to ensure everyone pays their fair share of taxes owed." As the fight continues to secure U.S. tax revenues, Treasury and the IRS continue to implement tax rules and procedures geared at safeguarding the nation's revenues. FBAR and FATCA reporting requirements make it essential for taxpayers domestically and abroad to comply with U.S. tax laws. These regimes have undoubtedly increased revenue and deterred tax evasion.

The penalties for noncompliance are so harsh that it's more prudent to be in compliance. Tax practitioners should be prepared to guide clients through this process and to help them understand that complying with federal income tax requirements or FATCA does not relieve them of their filing obligations for FBAR.

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- "Professional Liability Spotlight: The Tip of the Iceberg: Professional Liability Claims and International Taxation (/issues/2014/oct/international-taxation.html)," Oct. 2014, page 16

- "Tax Matters: Know When to Hold 'Em (and When to Report 'Em) (/issues/2014/sep/online-poker-earnings.html)," Sept. 2014, page 100

- "What to Do When a Client Has an Undisclosed Foreign Account (/issues/2013/dec/20138321.html)," Dec. 2013, page 38

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