

Criminal Enforcement of FBAR Filing Requirements

By **Steven Toscher and Michel R. Stein**

With this year's June 30 deadline for the Foreign Bank Account Reports (FBAR) fast approaching, it's worth considering the federal government's increased attention to the FBAR rules. Though criminal and civil enforcement relating to persons failing to comply with FBAR reporting requirements has been rare, the IRS (now the agency principally responsible for FBAR compliance) appears to be gearing up to investigate and prosecute willful violators. This new emphasis, together with the IRS's ever-expanding ability to obtain once secret information from foreign jurisdictions, suggests that we will be seeing more investigations and prosecutions in this area.

FBAR REPORTING REQUIREMENTS

The FBAR reporting requirements are grounded in the Bank Secrecy Act of 1970 (BSA), which resulted from congressional concern that financial institutions in countries with bank secrecy laws were being extensively used to violate or evade domestic criminal, tax, and regulatory requirements. Pursuant to the BSA, the Treasury Department promulgated 31 C.F.R. § 103.24, which provides:

(a) Each person subject to the jurisdiction of the United States (except a foreign subsidiary of a U.S. person) having a financial interest in, or signature or other authority over, a bank, securities or other financial account in a foreign country shall report such relationship to the Commissioner of the Internal Revenue for each year in which such relationship exists, and shall provide such information as

shall be specified in a reporting form prescribed by the Secretary to be filed by such persons ...

The prescribed form, Form TD F 90-22.1, is entitled Report of Foreign Bank and Financial Accounts (FBAR). It was last revised in July 2000 and is available on the IRS Web site at www.irs.ustreas.gov.

A BRIEF EXPLANATION

FBAR is not a tax return, but a report filed with the Secretary, stating that the person filing has a financial interest in, or signatory authority over, financial accounts in a foreign country with an aggregate value exceeding \$10,000 at any time during the tax year. As part of the FBAR reporting requirements, taxpayers are instructed to indicate on Schedule B of their federal tax return (Form 1040) whether they have an interest in a financial account in a foreign country by checking "Yes" or "No" in the appropriate box. Schedule B then directs the taxpayer to file the FBAR, which is used to report a financial interest in or authority over bank accounts in a foreign country. The deadline for filing an FBAR for each calendar year is June 30 of the following year, and cannot be extended. The instructions explain how compliance with the statute is achieved and set forth in detail the required information and those persons obligated to file the FBAR.

In 2003, in an effort to raise the dismal FBAR compliance rate (estimated to be *less than 20%* in 2001), Treasury's Financial Crimes Enforcement Network (FinCEN) delegated its enforcement authority for the FBAR to the IRS by means of a Memorandum of Agreement between the agencies. The agreement marked a significant step in the IRS's efforts to seek out people

with undisclosed accounts overseas. The IRS has authority to assess and collect civil penalties for noncompliance with FBAR requirements, investigate possible violations, employ summons power, issue administrative rulings, and take any other action reasonably necessary for enforcement of these provisions, including pursuit of injunctions. Among the reasons cited for delegating enforcement to the IRS is the IRS's ability to devote greater resources to FBAR compliance.

Responsibility for FBAR compliance within the IRS now rests with the Small Business/Self-Employed Division (SB/SE). In further recognition of the importance of the IRS's role in the fight against terror and money laundering, SB/SE established a new organization, the Office of Fraud/BSA, which reports directly to the Commissioner of SB/SE.

The IRS has responsibility for entering the data of all BSA documents into the Currency Banking and Retrieval System (CBRS), including FBARs, Currency Transaction Reports, Form 8300s (Report of Cash Payments Over \$10,000 Received in a Trade or Business), and Suspicious Activity Reports (SARs). The IRS considers the currency information in the CBRS extremely important for tax administration and law enforcement. The information provides a paper trail or roadmap for investigations of financial crimes and illegal activities, including tax evasion, embezzlement, and money laundering. It also helps identify tax cases for potential examination.

In a further effort to improve FBAR compliance and enforcement, Congress included in the American Jobs Creation Act of 2004 (Jobs Act), which will bring heightened awareness and increased

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IRS enforcement — including criminal prosecutions.

Section 821 of the Jobs Act, 31 U.S.C. § 5321(a)(5) — the statute that contains the FBAR penalty — added a new civil penalty for violations of FBAR reporting requirements, whether or not the violation was willful, and an increased the existing penalty for willful violations. Under the changes, the civil penalty for willful violations has been increased to the *greater of* \$100,000 or 50% of the amount of the transaction or of the balance in the account at the time of the violation.

CRIMINAL PROSECUTIONS

The Jobs Act made no changes to criminal FBAR penalties under 31 U.S.C. § 5322. Criminal violations of the FBAR rules can result in a fine of not more than \$250,000, or 5 years in prison, or both. Where the failure to file an FBAR is part of a pattern of illegal activity, the statute provides for a fine of up to \$500,000 and imprisonment of up to 10 years or both. Section 2S1.3 of the federal sentencing guidelines governs sentencing for criminal FBAR violations and provides for a base offense level of “6 plus the number of offense

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levels from the table in § 2B1.1 ... corresponding to the value of the funds ... ” An offense level reduction is available under § 2S1.3(b)(2) if the defendant did not act with reckless disregard, the funds were the proceeds of lawful activity, and the funds were to be used for a lawful purpose. The statute of limitations for criminal BSA violations is 5 years.

Recent history, where data are available, suggests that criminal prosecutions for FBAR violations have been rare. We anticipate this to change. Between 1996 and 1998, Justice Department statistics reveal that only 9 indictments were filed charging failure to comply with the FBAR disclosure requirements. For 1999 and 2000, no one was charged. During the period 1995 to 2002, there were only three convictions.

Reasons stated by the Department of Treasury for these low prosecutorial statistics were strict banking secrecy laws making it difficult to obtain admissible evidence with respect to undisclosed foreign bank accounts and prosecutorial selection of other violations for criminal conduct associated with the concealment of foreign accounts, such as tax evasion, fraud, money laundering, and making false statements on a tax return by failing to check the box on Schedule B. Such charges perhaps were thought to have greater jury appeal than failure to comply with the FBAR disclosure requirements.

FOREIGN BANK ACCOUNTS

Most of the criminal prosecutions with respect to foreign bank accounts arose with respect to non-FBAR crimi-

nal statutes. For example, a taxpayer who provides a false answer to the foreign bank question on Schedule B of Form 1040 can be prosecuted pursuant to Internal Revenue Code (IRC) § 7206(1). That section criminally punishes a taxpayer who willfully makes and subscribes under penalty of perjury any return that he does not believe to be true and correct as to every material matter. A person who knowingly answers “no” on the Schedule B when the answer is “yes” runs the risk prosecution under this provision. Moreover, a person may not avoid criminal prosecution by leaving the foreign bank account question blank. Also, a taxpayer’s omission from his income tax return of income from a foreign bank account in the form of interest, dividends or capital gains can result in criminal exposure under IRC § 7201 and IRC § 7206(1).

CONCLUSION

While the criminal statute for failing to comply with the FBAR reporting rules has been around for quite some time, compliance (or should we say lack of compliance?) has now been elevated on the IRS radar screen. This increased attention, combined with the IRS’s ever-increasing ability to obtain information and other cooperation from foreign jurisdictions, suggest that more prosecutions for violations of §§ 5321 and 5322 are on the horizon.

