

Practice

NEW IRS Guidance Limits FBAR Penalties!

By Charles P. Rettig

U.S. persons having a financial interest in or signature authority over one or more foreign financial accounts—including a bank account, brokerage account, mutual fund, trust or other type of foreign financial account—having an aggregate value exceeding \$10,000 at any time during a calendar year are generally required by the Bank Secrecy Act (BSA) to report their interest in the account by electronically filing, by June 30 of the next succeeding calendar year, a “Report of Foreign Bank and Financial Accounts” (FBAR).¹ A U.S. person may have a reporting obligation even though the foreign financial account does not generate any taxable income.

Failure to File the FBAR

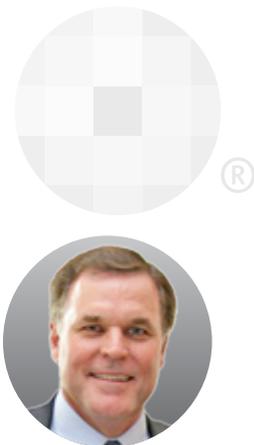
The FBAR is not filed with the federal income tax return. An extension of time to file federal income tax returns does not extend the due date for filing an FBAR. The June 30 filing date may not be extended. The failure to timely file the FBAR can be subject to civil penalties and possibly criminal sanctions (*i.e.*, imprisonment).

The statutory civil penalties might be \$10,000 per year for a nonwillful failure, but a willful failure to file could, by statute, be subject to civil penalties equivalent to the greater of \$100,000 or 50 percent of the balance in an unreported foreign account, per year, for up to six tax years.² Nonwillful penalties might be avoided if there is “reasonable cause” for the failure to timely file the FBAR.

Generally, the IRS will not impose a penalty for the failure to file the delinquent FBARs if income from the foreign financial accounts reported on the delinquent FBARs is properly reported and taxes have been timely paid on the U.S. tax return, 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.³

New IRS Guidance Limiting FBAR Penalties

The IRS recently issued interim guidance to implement procedures to improve the administration of the IRS’s FBAR other than determinations arising from participation in the ongoing IRS Offshore Voluntary Disclosure Program



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(OVDP) or the Streamlined Filing Compliance Procedures (“Streamlined Procedures”).⁴ Penalties determined under the IRS OVDP or the Streamlined Procedures are referred to as a “miscellaneous penalty” (rather than an “FBAR penalty”) determined in lieu of all the penalties a taxpayer is avoiding by entering the OVDP or filing through the Streamlined Procedures.

The statutory FBAR penalty provisions only establish maximum penalty amounts, leaving the IRS to determine the appropriate FBAR penalty amount below that threshold based on the facts and circumstances of each case. In this regard, IRS examiners are instructed to use their best judgment when proposing FBAR penalties, taking into account all the available facts and circumstances of a case.⁵

Willful FBAR Violations

For cases involving willful violations over multiple years, IRS examiners will recommend a penalty for each year for which the FBAR violation was willful. In most cases, the total penalty amount for all years under examination will now be limited to 50 percent of the highest aggregate balance of all unreported foreign financial accounts during the years under examination. In such cases, the penalty for each year will be determined by allocating the total penalty amount to all years for which the FBAR violations were willful based upon the ratio of the highest aggregate balance for each year to the total of the highest aggregate balances for all years combined, subject to the maximum penalty limitation in 31 USC §5321(a)(5)(C) for each year.

Examiners may recommend a penalty that is higher or lower than 50 percent of the highest aggregate account balance of all unreported foreign financial accounts based on the facts and circumstances. The IRS guidance provides that in no event will the total willful penalty amount exceed 100 percent of the highest aggregate balance of all unreported foreign financial accounts during the years under examination.

Nonwillful Violations

For most cases involving multiple nonwillful violations, examiners are now told to recommend one penalty for each open year, regardless of the number of unreported foreign financial accounts. In those cases, the penalty for each year will be determined based on the aggregate balance of all unreported foreign financial accounts, and the penalty for each year will be limited to \$10,000.

For some cases, the facts and circumstances (considering the conduct of the person required to file and the aggregate

balance of the unreported foreign financial accounts) may indicate that asserting nonwillful penalties for each year is not warranted. In those cases, examiners, with the group manager’s approval, may decide to assert a single penalty, not to exceed \$10,000, for one year only.

For other cases, the facts and circumstances (considering the conduct of the person required to file and the aggregate balance of the unreported foreign financial accounts) may indicate that asserting a separate nonwillful penalty for each unreported foreign financial account, and for each year, is warranted. In those cases, examiners, with the group manager’s approval, may assert a separate penalty for each account and for each year.

The new IRS guidance provides that in no event will the total amount of the penalties for nonwillful violations exceed 50 percent of the highest aggregate balance of all unreported foreign financial accounts for the years under examination. A nonwillful penalty will not be recommended if the examiner determines that the FBAR violations were due to reasonable cause, and the person failing to timely file correct and complete FBARs later files correct and complete FBARs.

IRS Mitigation Guidelines

In determining the appropriate penalty, IRS examiners are to first determine whether the mitigation threshold conditions in Internal Revenue Manual (IRM)⁶ are satisfied. If the mitigation threshold conditions are met, examiners are to make a preliminary penalty calculation based upon the mitigation guidelines in IRM,[iv] except that the penalty for each year will be limited to \$10,000. Unless the facts and circumstances of a case warrant a different penalty amount, this is the penalty amount to be asserted.

If the IRM mitigation threshold conditions are not met, the mitigation guidelines do not apply, and examiners are told to not make a preliminary penalty calculation based upon the guidelines. Examiners, with the group manager’s approval, are told to assert a separate penalty for each account and for each year. However, the IRS guidance provides that in no event will the total amount of the nonwillful penalties exceed 50 percent of the highest aggregate balance of all unreported foreign financial accounts for the years under examination.

Co-Owned Accounts

Where there are multiple owners of an unreported foreign financial account, the IRS guidance provides that examiners must make a separate determination with respect to each co-owner of the foreign financial account as to

whether there was a violation and, if so, whether the violation was willful or nonwillful. For each co-owner against whom a penalty is determined, the penalty will be based on the co-owner's percentage ownership of the highest balance of the foreign financial account. If examiners are unable to determine a co-owner's percentage ownership, the penalty will be based on the amount determined by dividing the highest account balance equally among the co-owners.

Overview of FBAR Filing Requirements

FBAR filers report their interest for foreign accounts by completing (1) boxes 7a and 7b on Form 1040 Schedule B; (2) box 3 on the Form 1041 "Other Information" section; (3) box 10 on Form 1065 Schedule B; or (4) boxes 6a and 6b on Form 1120 Schedule N and filing the FBAR, to satisfy the account holder's reporting obligation.

A U.S. person having a financial interest in or signature authority over a foreign financial account must file an FBAR if the aggregate value of all foreign financial accounts exceeds \$10,000 at any time during the calendar year. Even if all relevant information is not available, the FBAR should be timely filed with as much information as is available; the FBAR can be later amended (by checking the "Amended" box in the upper right corner of the first page of the FBAR) when the additional or new information becomes available.

U.S. Person

A U.S. person includes U.S. citizens; U.S. residents; entities, including but not limited to, corporations, partnerships or limited liability companies (LLCs) 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.⁷ The term "person" includes an individual and legal entities including, but not limited to, an LLC, corporation, partnership, trust and estate. A U.S. resident includes an alien residing in the United States. To determine whether the U.S. person is a resident of the United States, look for guidance in the residency tests set forth in Code Sec. 7701(b). A single-member LLC, which is a disregarded entity for U.S. tax purposes, is a U.S. person for FBAR filing purposes since the tax rules concerning disregarded entities do not apply with respect to the FBAR reporting requirement (FBARs are required under Title 31, not under any provisions of the Internal Revenue Code ("the Code")).

Financial Account

A financial account includes, but is not limited to, a securities, brokerage, savings, demand, checking, deposit, time deposit or other account maintained with a financial institution (or other person performing the services of a financial institution). A financial account also includes a commodity futures or options account, an insurance policy with a cash value (such as a whole life insurance policy), an annuity policy with a cash value and shares in a mutual fund or similar pooled fund (*i.e.*, a fund that is available to the general public with a regular net asset value determination and regular redemptions).

Foreign Financial Account

A foreign financial account is a financial account located outside of the United States. For example, an account maintained with a branch of a U.S. bank that is physically located outside of the United States is a foreign financial account. An account maintained with a branch of a foreign bank that is physically located in the United States is not a foreign financial account. A "foreign country" includes all geographical areas outside the United States, the commonwealth of Puerto Rico, the commonwealth of the Northern Mariana Islands and the territories and possessions of the United States (including Guam, American Samoa and the U.S. Virgin Islands).

Financial Interest

A U.S. person has a financial interest in a foreign financial account for which:

1. the U.S. person is the owner of record or holder of legal title, regardless of whether the account is maintained for the benefit of the U.S. person or for the benefit of another person; or
2. the owner of record or holder of legal title is one of the following: (a) an agent, nominee, attorney or a person acting in some other capacity on behalf of the U.S. person with respect to the account; (b) a corporation in which the U.S. person owns directly or indirectly: (i) more than 50 percent of the total value of shares of stock, or (ii) more than 50 percent of the voting power of all shares of stock; (c) a partnership in which the U.S. person owns directly or indirectly: (i) an interest in more than 50 percent of the partnership's profits (*e.g.*, distributive share of partnership income taking into account any special allocation agreement), or (ii) an interest in more than 50 percent of the partnership capital; (d) a trust of which the U.S. person: (i) is the

trust grantor, and (ii) has an ownership interest in the trust for U.S. federal tax purposes⁸; (e) a trust in which the U.S. person has a greater-than-50-percent present beneficial interest in the assets or income of the trust for the calendar year, unless the trust, a trustee of the trust or agent of the trust: (i) is a U.S. person, and (ii) files an FBAR disclosing the trust's foreign financial accounts; or (f) any other entity in which the U.S. person owns directly or indirectly more than 50 percent of the voting power, total value of equity interest or assets or interest in profits.

Signature Authority

Signature authority is the authority of an individual (alone or in conjunction with another individual) to control the disposition of assets held in a foreign financial account by direct communication (whether in writing or otherwise) to the bank or other financial institution that maintains the financial account. Other authority exists in a person who can exercise power that is comparable to signature authority over an account by direct communication to the bank or other person with whom the account is maintained, either orally or by some other means. There are specified exceptions to the "signature authority only" filing requirement for officers or employees of certain types of banks and entities.

Financial Crimes Enforcement Network (FinCEN) Notice 2014-1⁹ extended the due date for filing FBARs by certain individuals with signature authority over, but no financial interest in, foreign financial accounts of their employer or a closely related entity to June 30, 2016.

Certain Accounts Jointly Owned by Spouses

The spouse of an individual who files an FBAR is not required to file a separate FBAR if all the financial accounts that the nonfiling spouse is required to report are jointly owned with the filing spouse, the filing spouse reports the jointly owned accounts on a timely filed FBAR electronically signed, and the filers have completed and signed Form 114a, *Record of Authorization to Electronically File FBAR's* (maintained with the filers' records). Otherwise, both spouses are required to file separate FBARs, and each spouse must report the entire value of the jointly owned accounts.

Electronic FBAR Filing Required

Generally, all FinCEN forms must be filed electronically. E-filers will receive an acknowledgement of each submission. The online FinCEN Form 114 allows the filer to

enter the calendar year reported, including past years.

The FinCEN system also offers an option to "explain a late filing," or to select "Other" to enter up to 750 characters within a text box where the filer can provide a further explanation of the late filing or indicate whether the filing is made in conjunction with an IRS compliance program.¹⁰ For longer explanations, some practitioners provide an online statement indicating that a more in-depth factual explanation is in the possession of the filer's counsel and is available upon request.

Verification of FBAR Filing

Ninety days after the date of filing, the filer can request verification that the FBAR was received. An FBAR filing verification request may be made by calling 866-270-0733 and selecting option 1. Up to five documents may be verified over the phone. There is no fee for this verification. Alternatively, an FBAR filing verification request may be made in writing and must include the filer's name, taxpayer identification number and the filing period.¹¹

No Extension of Time to File FBAR

There is no extension of time available for filing an FBAR beyond June 30. Extensions of time to file federal tax returns do *not* extend the time for filing an FBAR. If a delinquent FBAR is filed, attach a statement explaining the reason for the late filing.

Recordkeeping Requirements

Persons required to file an FBAR must retain records that contain the name in which each account is maintained, the number or other designation of the account, the name and address of the foreign financial institution that maintains the account, the type of account and the maximum account value of each account during the reporting period. The records must be retained for a period of five years from June 30th of the year following the calendar year reported and must be available for inspection as provided by law. Retaining a copy of the filed FBAR can help to satisfy the recordkeeping requirements.

Separate Reporting Requirements by U.S. Taxpayers Holding Foreign Financial Assets (Form 8938)

Taxpayers with specified foreign financial assets that exceed certain thresholds must report those assets to the IRS on Form 8938, *Statement of Specified Foreign Financial Assets*, which is filed with an income tax return. The Form 8938

filing requirement does not replace or otherwise affect the requirement to file the FBAR.¹²

Need FBAR Filing Help?

Assistance regarding the electronic filing of an FBAR is available at BSAEFilingHelp@fincen.gov or through the BSA E-Filing Help Desk at (866) 346-9478. The E-Filing Help Desk is available Monday through Friday from 8 a.m. to 6 p.m. (Eastern time).

Help in completing an FBAR is available by telephone at (866) 270-0733 (toll-free within the United States) or (313) 234-6146 (from outside the United States, not toll-free) from 8 a.m. to 4:30 p.m. Eastern time, or by sending an e-mail to FBARquestions@irs.gov.

Additional information, including Frequently Asked Questions, is available at [www.irs.gov/Businesses/Small-Businesses-&Self-Employed/FAQs-Regarding-Report-of-Foreign-Bank-and-Financial-Accounts-\(FBAR\)--Filing-Requirements#FR5](http://www.irs.gov/Businesses/Small-Businesses-&Self-Employed/FAQs-Regarding-Report-of-Foreign-Bank-and-Financial-Accounts-(FBAR)--Filing-Requirements#FR5).

ENDNOTES

¹ Financial Crimes Enforcement Network (FinCEN) Form 114.

² 31 USC §5321(a)(5) establishes civil penalties for violations of the FBAR reporting and recordkeeping requirements. 31 USC §5321(b) sets forth the six-year statute of limitations, determined whether the FBAR is filed or not; 31 USC §5321(d) confirms that civil penalties and criminal sanctions may be imposed with respect to the same FBAR violation.

³ Available online at www.irs.gov/Businesses/Small-Businesses-&Self-Employed/Report-of-Foreign-Bank-and-Financial-Accounts-FBAR.

⁴ See *Interim Guidance for Report of Foreign Bank and Financial Accounts (FBAR) Penalties* (May 13, 2015), Control Number: SBSE-04-0515-0025;

www.irs.gov/pub/foia/ig/spder/SBSE-04-0515-0025%5B1%5D.pdf.

⁵ See IRM 4.26.16.4.7, FBAR Penalties—Examiner Discretion.

⁶ IRM 4.26.16.4.6.1 and IRM 4.26.16.4.6.2.

⁷ 26 USC §7701(a)(30).

⁸ See 26 USC §§671-679 to determine if a grantor has an ownership interest in a trust.

⁹ FinCEN Notice 2014-1, 2014 ARD 236-12, IR-46,499 (Dec. 11, 2014).

¹⁰ Information regarding and registration for e-filing of an FBAR is available online at www.irs.gov/Businesses/Small-Businesses-&Self-Employed/Report-of-Foreign-Bank-and-Financial-Accounts-FBAR.

¹¹ There is a \$5 fee for verifying five or fewer FBARs

and a \$1 fee for each additional FBAR. A copy of the filed FBAR can be obtained at a cost of \$0.15 per page. Check or money order should be made payable to the U.S. Treasury. The request and payment should be mailed to: IRS Enterprise Computing Center/Detroit, ATTN: Verification, P.O. Box 32063, Detroit, MI 48232.

¹² A chart providing a comparison of Form 8938 and FBAR requirements, and other information to help taxpayers determine if they are required to file Form 8938, may be accessed from the IRS Foreign Account Tax Compliance Act Web page at www.irs.gov/Businesses/Comparison-of-Form-8938-and-FBAR-Requirements.

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