

Reporting Foreign Accounts in the “Age of Transparency”*

Well, it had to happen sooner or later.....The tax professional community working regularly in the international space has known for some time that a new and improved TD F 90-22.1 Report of Foreign Accounts Form (known as the “FBAR”) was to be introduced.

And now it has arrived...

As part of its enforcement initiative against abusive offshore transactions and clamp-down on the underreporting of worldwide income by “U.S. persons”, the Internal Revenue Service (IRS) has introduced a new and “improved” version of the FBAR. The IRS has sought to tackle some of the unresolved issues regarding the FBAR’s reporting requirements – but sends a note of caution to potential filers at the same time.

It seems clear that the renewed emphasis voiced by the IRS on information reporting and international co-operation is making itself increasingly felt. No-one should doubt the willingness of the IRS to use more fully the growing armory of disclosure requirements and enforcement provisions at its disposal. Recent initiatives to punish non-compliers that have garnered significant media publicity are ample evidence of this fact.

Reporting Foreign Accounts

The FBAR was created under the Bank Secrecy Act. It actually collects information for the database of the Financial Crimes Enforcement Network (FINCEN) as part of the United States Treasury Department in support of federal efforts aimed at countering terrorism, money laundering and tax avoidance. In other words, it is not a tax form per se.

It is not subject to the normal taxpayer confidentiality provisions and, as such, the information on the Form is available to any law enforcement agency.

As of January 1, 2009, taxpayers must use the new FBAR form issued this month. This is also true for late-filed FBARs covering prior years.

Very generally, a “United States Person” must report a financial interest in, signature authority over or other power of disposition over an account in a foreign bank or other financial institution, if the value of such accounts held by the person at any time during the calendar year is greater than US\$10,000 **in aggregate**. Once this threshold is triggered, the requirement to file the Form then applies to ALL foreign accounts as defined by the Form. The FBAR must be filed by US persons on an annual basis and is due on June 30 of the year following the year in which the filing requirements are met.

Unlike for tax return filings, there are no extensions to the filing date available, and the form is considered late if *received* after June 30 (i.e. postmarking the filing date is not sufficient). Somewhat new, however, is that the filer of the Form now has the option to hand deliver the FBAR to any local IRS office within the U.S. and, for filers located outside the US, to tax attachés located in U.S. embassies in certain foreign countries. The Form is filed at:

The Department of Treasury

P.O. Box 32621

Detroit

MI 48232

It is not filed with the income tax return Form 1040.

The duty to file the FBAR exists independently of the obligation to file an income tax return, although the FBAR is cross-referenced on Form 1040, Schedule B, Part III.

Any dividends and interest are earned by U.S. person on such accounts are also reportable on Schedule B, and one is also required to check the box on Part III Line 7a and indicate the country or countries where the accounts are located.

A Multitude of Sins?

So now we know that a filing needs to be made and it is taken somewhat seriously. But what about the fine print? That, unfortunately, seems to get progressively finer, commensurate with the increase in penalties for non-compliance.

What is often overlooked about the Form 90-22.1 reporting is that it is not restricted to simply bank accounts. Indeed, the instructions to the updated Form issued this month specifically address the fact that the filing requirement encompasses foreign mutual fund accounts. Moreover, other investment accounts, including foreign retirement accounts, are also included.

Indeed, the same also seems to be true of offshore variable life insurance contracts and annuities. It also includes debit card or prepaid credit card accounts. Individual bonds, notes, or stock certificates held by the filer are not financial accounts per se, nor is an unsecured loan to a foreign trade or business that is not a financial institution.

Important to note is that it is the geographical location of the account that counts, not the nationality of the financial entity institution in which the account is found, that determines whether one is dealing with a foreign account.

"United States Person"

The instructions to the *previous* edition of the FBAR defined the term "United States person" to mean:

- (1) a citizen or resident of the United States
- (2) a domestic partnership
- (3) a domestic corporation, or
- (4) a domestic estate or trust

The revised FBAR, however, defines the term "United States Person" to mean "a citizen or resident of the United States, *or a person in and doing business in the United States.*"

The instructions to the revised FBAR also add a new reference to 31 Code of Federal Regulations (CFR) 103.11(z) for the definition of a "United States person."

This regulation defines such "person" as:

"An 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.”

The instructions to the revised Form also add the statement that "a branch of a foreign entity doing business in the United States is required to file this report *even if not separately incorporated under U.S. law.*"

Because 31 C.F.R. 103.11(z) is issued under the Bank Secrecy Act (as opposed to under the Internal Revenue Code) changes to the instructions in the revised FBAR leave it unclear whether the terms "U.S. resident" (for this purpose) and the acts necessary to be considered "doing business in the United States," are determined with reference to the law under the Internal Revenue Code, or only under the Bank Secrecy Act. Only through separate IRS communications and guidance have some of these issues been clarified.

So, what do we know?

Aside from U.S. Citizens and other income tax residents (corporations, trusts and estates) being required to file the Form, the IRS has expanded the scope of the FBAR to include foreign corporations with a U.S. presence that have U.S. employees with signing authority over foreign bank accounts.

The FBAR filing requirement applies not only to a corporation itself, but also to its employees who hold signature authority over corporate accounts even if those employees have no financial interest in the account.

Also, according to IRS officials, the new 2009 FBAR requirements apply to self-employed non-resident aliens doing business in the U.S. As such, independent contractors that remain non-resident aliens for income tax purposes but who are, nevertheless, working in the U.S. will be subject to the new 2009 FBAR filing requirement on the basis that the individual is "doing business" in the U.S. , while non-resident aliens who are employees would not be considered to be "doing business in the U.S.

A U.S. person is deemed to have an interest in an account irrespective of whether the foreign account is for his or her benefit. If a U.S. person has a *power of authority* for a different individual who has a foreign bank account, the attorney-in-fact as agent is also required to file an FBAR even if the principal also files an FBAR. Thus, the new form expands the definition of a financial interest.

A fiduciary who is a U.S person and who has control as a trustee for an IRA with a foreign account must also file an FBAR. The requirement also extends to a U.S. person who creates a trust or is deemed to own a trust and who thereby could be classified as having a financial interest if the trust owned foreign accounts.

If a U.S. corporation owns a further foreign corporation with multiple foreign accounts, the U.S. corporation itself must file an FBAR. However, so too must the owners of the US corporation who own directly or indirectly more than 50% of the total value of the shares of the stock in the company.

In summary, the population of those required to file the Form has widened significantly as result of the changes introduced. Who said it was easy!?...

Information Updates

Up until this point, the configuration of the Form has been somewhat cumbersome, and as such the IRS has sought to streamline its configuration. Now, provided that the names and Social Security Numbers of joint owners who are husband and wife are fully disclosed on the FBAR, and the spouses also co-habit, then the IRS will accept one filing for both spouses. Previously, a consolidated filing by both spouses was not permitted.

However, what one hand giveth, the other taketh away, in a sense.

Filers of the Form are also now required to declare the maximum value of an account during the year. This is defined to be the largest amount of currency and non-monetary assets that appear on any quarterly or more frequent account statements issued for the applicable year. If periodic account statements are not issued, the maximum account value to declare is the largest amount of currency or non-monetary assets in the account at any time during the year. Any foreign currency amount is required to be converted to US dollars by using the official exchange rate at the end of the calendar year.

Penalties

The most sobering – if not downright numbing – aspect of the FBAR has to be the package of penalties that await those that choose to ignore its existence by failing to file the Form.

Civil Penalties

Post October 22, 2004, the penalty for a *non*-willful failure to file the FBAR has been up to \$10,000 per violation. The penalty for a non-willful violation, however, is generally not imposed if the violation is due to reasonable cause.

For a willful violation of the FBAR reporting requirement, however, the 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!

Criminal Penalties

The deliberate failure to file the Form with intent to defraud, and which is successfully prosecuted in a criminal action, carries much more draconian penalties.

1. **Failure to File Penalty** – up to \$250,000 and/or up to 5 years in prison for any person "willfully violating" the requirements to file.
2. **Fraud Penalty** – up to \$500,000 and/or up to 10 years in prison for any person "willfully violating" the requirements to file "as part of a pattern of any illegal activity involving more than \$100,000 in a 12-month period".
3. **False Information Penalty** – fine or up to 5 years in prison for any person providing false, misleading, fictitious, or fraudulent statements on TD F 90-22.1; or up to 8 years in prison if the false information involves domestic or foreign terrorism.

It is fair to say that the IRS and other agencies have significant enforcement tools at their disposal!

Civil penalties can be assessed anytime up to six years after the date of the violation pursuant to the Statute of Limitations under the Bank Secrecy Act. The Statute of Limitations on penalties can also run up to six years. Records of accounts required to be reported on an FBAR must generally be retained for a period of five years. Failure to maintain required records may result in civil

penalties, criminal penalties, or both, although in certain circumstances the negotiation of penalties may be possible.

Indeed, the penalties do not end there. Let's not forget Schedule B on the Form 1040 income tax return filing regarding the declaration as to whether one has foreign accounts. The Justice Department apparently lists a deliberately incorrect response of "no" to this question in its Criminal Tax Manual as a basis for a prosecution. Indeed, the government has prosecuted individuals in such cases.

A taxpayer's omission from his return of taxable interest dividends, or capital gains earned on a foreign account is also a separate offense under the Internal Revenue Code if the government can prove a tax deficiency and deliberate tax evasion.

Okay. None of this makes pleasant reading, but some of these reporting requirements have been around a while but yet not rigorously enforced. Does this really all add up to more than a "paper tiger"?

The answer is that the big cat is starting to flex some muscle! The media, over the last year, has broken a number of celebrated stories concerning the intent of the U.S. government to make examples of violators of these hitherto "sleeping" provisions. Further, the Justice Department apparently also has two new senior appointees who specialize in FBARs and tax evasion. The Service is reportedly also training examiners outside the international practice area to target offshore tax evasion issues.

The IRS is also not alone in its endeavor. The recent cases in the newspapers came about in part due to international collaboration. The IRS is also part of a wider initiative domestically due to the nature of this issue. Ultimate enforcement of the FBAR provisions rests with the Financial Crimes Enforcement Network (FINCEN). The IRS is authorized to make a recommendation, house all the forms and recommend a penalty but it is actually the Treasury which collects the money and determines the course of action.

Righting The Ship

There is no extension available for filing the FBAR. If an account holder does not have all the available information to file the return by June 30th, the recommendation is to file as complete a return as possible and amend the document when the additional or new information becomes available. This is stated clearly in the instructions to the Form which goes on to say:

FBAR filers can amend a previously filed FBAR by:

- Checking the "Amended" box in the upper right hand corner of the first page of the form;
- Making the needed additions or correction;
- Stapling it to a copy of the original FBAR; and
- Attaching a statement explaining the changes.

But what if you missed the boat completely first time around? Can you right the ship?

There are Voluntary Compliance Initiative procedures that might be considered in certain cases, and certainly all the circumstances should be considered. However, very often, it may make sense to proceed simply to file the form, but attach a brief explanation as to why you are filing late. While there are stiff penalties for failing to file the FBAR – and no guarantee they will not be imposed by coming forward - the penalties may be waived based in your particular situation. Under no circumstances should you knowingly continue to not file the FBAR, since that would be regarded as a willful failure to file, according to an IRS spokesperson in Washington, DC.

You Don't Need To Shoot the Messenger!

According to the IRS Office of Professional Responsibility in a posting on their website, failure to timely file required tax or information returns, including FBARs, must also be disclosed by tax practitioners themselves on any "Application for Renewal of Enrollment to Practice Before the Internal Revenue Service".

Moreover, a practitioner must make reasonable inquiries when a client provides information that suggests possible participation in overseas transactions/accounts subject to FBAR requirements. He or she may rely on information provided by a client in good faith - but may not ignore implications learned from information provided or actually known. The practitioner is also required to advise a client of potential penalties likely to apply to a position taken, such as failing to abide by FBAR requirements.

Conclusion

As a practitioner in this area for many years, I recognize that it may come as a shock to some that these rules are being taken so seriously. It was really only in 2004 that the tiger awoke from its slumber. However, the warning should now be loud and clear that indifference to these rules entertains the significant risk of severe penalties.

For anyone still unsure, the IRS even invites questions concerning the FBAR form by calling 1 (800) 800-2877, option 2. The Age of Transparency would seem to be in full swing...

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