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Reporting Requirements for FBAR: Generally and Under the IRS' Amnesty Program

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Introduction

Most individual and business taxpayers generally believe that their obligations to the IRS begin and end with the filing and payment of their annual income tax return. For those taxpayers with foreign financial accounts however, they may face another deadline that is seldom discussed and has again shifted into the spotlight. The information provided herein summarizes the general requirements of the Report of Foreign Bank and Financial Accounts (“FBAR”), the penalties applied and the remedies presently available to taxpayers who have not reported such interests to the U.S. government.

Who, What, When, Where & Why

The U.S. government is once again focusing on capturing tax on funds sent offshore. Thus, any U.S. person with foreign financial account(s) whose aggregate balance exceeds \$10,000 during a tax year with either (a) a financial interest, (b) signing authority or (c) other similar, exercisable authority is required to file an FBAR with the IRS.¹

In this case, a U.S. person includes both citizens and residents of the United States as well as anyone present and/or doing business in the United States including corporations, partnerships and trusts.² Corporations include not only those whose certificates of incorporation are filed in a state, territory, etc. of the United States but also parent corporations with foreign subsidiaries holding foreign financial accounts.³

Filing an FBAR is through the completion and submission of the IRS Form TD F90-22.1. Accounts for which an FBAR must be filed include, but are not limited to, bank accounts, securities and securities derivatives accounts that are located in a foreign country.⁴ To determine the necessity of filing an FBAR, one must take the aggregate of the maximum value of each account at any time during the year.

The filing deadline is June 30th of the following calendar year in which the account qualified for the FBAR. Extensions are not available and the document is remitted separately from the corresponding income tax return. As it is filed with the IRS office in Detroit, Michigan, it is important to note the FBAR is considered filed upon *receipt* by the IRS.⁵ Additionally, annual income tax returns contain a section regarding foreign accounts which must be completed for FBAR compliance.

Penalties

The IRS is pursuing with renewed vigor FBAR violators. In the proverbial net of compliance, both recalcitrant and unsuspecting non-filers are being handled with the same “strong arm.”

A. Civil Penalties – 31 U.S.C. §5321(a)(5)

While the FBAR is codified under the Bank Secrecy Act, responsibility for its enforcement lies with the IRS. Accordingly, the IRS has six years to assess a civil penalty.⁶ Once this deadline has passed, the FBAR that was or should have been filed is no longer open to examination. If the IRS makes an assessment within the six-year window, it will have two years from the date of assessment to recover on the assessed penalty.⁷ Penalties can be assessed for violations involving both reporting and recordkeeping on the same account.⁸

1. Negligence

Negligence penalties are typically assessed against businesses that fail to file an FBAR. It is the only type of civil penalty not applicable to individuals.⁹ The standard for negligence does not require the taxpayer to actually know it has a filing requirement. Rather, negligence will exist if the taxpayer *should have known* of the obligation.¹⁰ Two

potential penalties may be applied when negligence is found to exist. Businesses can face a penalty that is not to exceed \$500 for failure to file an FBAR.¹¹ If a pattern of negligent violations of the FBAR requirements is established, a penalty of \$50,000 or less may also be imposed.¹²

2. Non-Willful Violations

If a taxpayer is able to prove his violation was the result of reasonable cause as he provides a proper FBAR to the examiner, the violation may be considered “non-willful.”¹³ Generally, such violations occur when the taxpayer is unaware of its obligation to file and under these circumstances, the civil penalty may be waived.¹⁴ If such person is found to have committed a non-willful violation of the FBAR requirements and a penalty is still imposed, it is to be at \$10,000 or less.¹⁵

3. Willful Violations

The IRS will determine whether a violation of the FBAR was willful by determining whether the non-filing was essentially both voluntary and intentional. If the IRS establishes a violation occurring prior to October 23, 2004 was willful, a civil penalty equal to the greater of (a) the balance of the account in question at the time of the violation (but not in excess of \$100,000) and (b) \$25,000 may be assessed.¹⁶ After this date, the penalty assessed may be the greater of \$100,000 and 50% of the account’s balance at the time of the violation.¹⁷ The reasonable cause exception that may be used for non-willful civil penalties does not apply to willful violations occurring after October 22, 2004.¹⁸

4. *Mitigation*

The IRS offers an opportunity to lessen the amount of a civil penalty assessment when the following four conditions are met: ¹⁹

1. There are no prior FBAR penalty assessments;
2. Funds in the foreign account(s) are from legal source(s) and not have been used for a criminal purpose;
3. One cooperates with the IRS in its examination; and
4. A civil fraud penalty could not have been assessed and maintained with respect to the tax year in question for the failure to report income from the foreign account(s) at issue.

If an FBAR violation occurs after October 22, 2004, the taxpayer's previous ten years will also need to be free of any criminal tax or Bank Secrecy Act convictions. ²⁰ It is also possible that the IRS will issue a warning letter in lieu of assessing a penalty, depending on the facts and circumstances of the situation.²¹

B. Criminal Prosecution – 31 U.S.C. §5322(a)

The assessment of a civil FBAR penalty does not prevent the imposition of a criminal penalty which must be made within five years of the date the FBAR was or should have been filed.²² It applies only to willful violations and the fine is of an amount not to exceed \$250,000, imprisonment for up to five (5) years or both.²³

Voluntary Disclosures

In an effort to increase overall compliance with FBAR requirements, two months ago the IRS established an amnesty period. From March 23, 2009 through September 23, 2009, taxpayers who voluntarily disclose to IRS Criminal Investigation their FBAR reporting requirements for any years from 2003 through 2008 may be excused from some civil penalties and criminal prosecution. While full disclosure need not be

completed during the amnesty period, one should notify the IRS of his/her intent to voluntarily disclose by the September 23, 2009 deadline to be considered for amnesty.²⁴

A. Procedure

To make a valid voluntary disclosure it must be “truthful, timely [and] complete.”²⁵ A disclosure is considered “timely” when it is made before:

1. The IRS notifies the taxpayer of its intent to begin an examination or investigation of the taxpayer;
2. The IRS receives third party information regarding the taxpayer’s lack of compliance;
3. The IRS begins a civil examination or criminal investigation to which the taxpayer’s liability corresponds; and
4. As a result of a criminal enforcement action, the IRS receives information to which the taxpayer’s liability corresponds.²⁶

Further, the taxpayer must also establish its willingness to cooperate with the IRS and make good faith arrangements to pay the applicable tax, penalties and interest in full.²⁷

In cases when a taxpayer may have properly reported foreign income on its annual returns but failed to file an FBAR, the IRS recommends that such taxpayers not use the amnesty/voluntary disclosure process as they should not be assessed a penalty for failing to file the FBAR.²⁸ The same cannot be said for those taxpayers who filed amended returns in the hopes of “fixing” their reporting deficiencies and did not notify the IRS of their intent. The IRS expects those taxpayers to utilize the voluntary disclosure procedures as it will be paying close attention to the taxpayers taking such actions.²⁹

B. Penalties under the Amnesty Program

Under the amnesty program, the IRS is to assess the following penalties:³⁰

- (i) an accuracy penalty pursuant to IRC §6662 of twenty percent (20%) of the understatement of tax; or
 - (ii) a delinquency penalty in accordance with IRC §6651 of up to twenty-five percent (25%) of the amount required to be reported as tax on the return within the applicable period, exclusive of any credits/taxes paid, without application of the reasonable cause exception,
- and
- (iii) a penalty equal to twenty percent (20%) of the amount in foreign bank accounts in the year with the highest aggregate account or asset value. The penalty will be reduced to five percent (5%) in the case of certain inherited accounts if certain criteria are met.

The IRS has advised that taxpayers not seeking to remedy FBAR deficiencies during the amnesty period could face severe consequences. Unless extended, upon expiration of the amnesty period, the IRS will not be quick to offer relief. During this time it will be on the look-out for “silent” filers. Thus, it is important to remember that amnesty itself may be recommended but not guaranteed under the voluntary disclosure program.

¹ See FBAR Instructions.

² See FBAR Instructions; see also 31 C.F.R. 130.11(z); see also Internal Revenue Manual 4.26.16.3.1.1.

³ IRM 4.26.16.3.1.1.

⁴ See FBAR Instructions.

⁵ See FBAR Instructions. This is in contrast to other filings, which are considered filed when *mailed*. IRM 4.26.16.3.7.

⁶ 31 U.S.C. §5321(b)(1).

⁷ 31 U.S.C. §5321(b)(2).

⁸ IRM 4.26.16.4.5.5.

⁹ IRM 4.26.16.4.3.

¹⁰ IRM 4.26.16.4.3.

¹¹ 31 U.S.C. §5321(a)(6)(A).

¹² 31 U.S.C. §5321(a)(6)(B).

¹³ 31 U.S.C. §5321(a)(5)(B)(ii); see also IRM 4.26.16.4.4.

¹⁴ See CCA 200603026, January 20, 2006; see also 31 U.S.C. §5321(a)(5)(B)(ii); see also IRM 4.26.16.4.4.

¹⁵ 31 U.S.C. §5321(a)(5).

¹⁶ IRM 4.26.16.4.5.1.

¹⁷ 31 U.S.C. §5321(a)(5)(C)(i); see also IRM 4.26.16.4.5.1.

¹⁸ 31 U.S.C. §5321(a)(5)(C)(ii).

¹⁹ IRM 4.26.16.4.6.1.

²⁰ IRM 4.26.16.4.6.1. IRM Exhibits 4.26.16-1 through .4.26.16-4 contain IRS guidelines for determining the penalty.

²¹ IRM 4.26.16.4.7.

²² 31 U.S.C. §5321(d); 18 U.S.C. §3282; see also IRM 4.26.17.5.5.4.

²³ 31 U.S.C. §5322(a).

²⁴ IRS Frequently Asked Questions #18, May 6, 2009.

²⁵ IRM 9.5.11.9.

²⁶ IRM 9.5.11.9.

²⁷ IRM 9.5.11.9.

²⁸ Frequently Asked Questions #9, May 6, 2009.

²⁹ Frequently Asked Questions #10, May 6, 2009.

³⁰ See Memorandum for Commissioner, Large and Mid-Size Business Division; Commissioner, Small Business/Self Employed Division from Linda E. Stiff, dated March 23, 2009.

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