**Giving Practical FBAR Advice**

**Materials for the December 17, 2012 Meeting**

**of**

**The Allegheny Tax Society**

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GIVING PRACTICAL FBAR ADVICE

**I . General Overview**

1. Bank Secrecy Act Mandates Reporting.
2. The stated purpose of the Bank Secrecy Act is “to require certain reports or records where they have a high degree of usefulness in criminal, tax, or regulatory investigations or proceedings, or in the conduct of intelligence or counterintelligence activities, including analysis, to protect against international terrorism.” 31 U.S.C. § 5311.
3. The relevant statute provides:

Considering the need to avoid impeding or controlling the export or import of monetary instruments and the need to avoid burdening unreasonably a person making a transaction with a foreign financial agency, the Secretary of the Treasury shall require a resident or citizen of the United States or a person in, and doing business in, the United States, to keep records, file reports, or keep records and file reports, when the resident, citizen, or person makes a transaction or maintains a relation for any person with a foreign financial agency. The records and reports shall contain the following information in the way and to the extent the Secretary prescribes:

**(1)** the identity and address of participants in a transaction or relationship.

**(2)** the legal capacity in which a participant is acting.

**(3)** the identity of real parties in interest.

**(4)** a description of the transaction.

31 U.S.C. § 5314(a).

1. The Secretary of the Department of Treasury is granted the powers to exempt certain classes of persons from reporting, the reporting dollar amount and other matters the Secretary considers necessary. 31 U.S.C. § 5314(b).
2. A person shall be required to disclose a record required to be kept under this section or under a regulation under this section only as required by law. 31 U.S.C. § 5314(c).
3. Treasury Department Regulation Provides Reporting Rules.
4. The regulation requires that:

Each **United States 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 Internal Revenue for each year in which such relationship exists and shall provide such information as shall be specified in a reporting form prescribed under [31 U.S.C. 5314](http://www.westlaw.com/Link/Document/FullText?findType=L&pubNum=1000546&cite=31USCAS5314&originatingDoc=N23CA44B0A21B11E09BC1E2444B8A3FCC&refType=LQ&originationContext=document&vr=3.0&rs=cblt1.0&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)) to be filed by such persons.

31 C.F.R. § 1010.350(a) (emphasis added in bold).

1. United States Person. A “United States Person” is defined as a citizen, resident (as defined under 26 U.S.C. § 7701(b), and entity “including but not limited to, a corporation, partnership, trust, or limited liability company created, organized, or formed under the laws of the United States, any State, the District of Columbia, the Territories and Insular Possessions of the United States, or the Indian Tribes. 31 C.F.R. § 1010.350(b).
   1. Definition of resident under § 7701(b) generally includes those with green cards and H-1B work visas, but excludes those on F-1 Student Visas.
2. Financial Interest or Signature Authority.
   1. *Financial Interest.*

i. A person has financial interest when he is the owner of record or has legal title, whether the account is maintained for his own benefit or for the benefit of others. 31 C.F.R. § 1010.350(e)(1). If an account is maintained in the name of more than one person, each United States person in whose name the account is maintained has a financial interest in that account. *Id.*

ii. A person also has a financial interest in an account if the owner of record or holder of legal title is:

1. A person acting as an agent, nominee, attorney or in some other capacity on behalf of a United States person;
2. A corporation, partnership, or other entity in which the United States person owns, directly or indirectly, more than 50% of the voting power or total value of the company.

1. A trust, if the United States person is the trust grantor and the trust is taxed as a grantor trust.
2. A trust in which the United States person has either a present beneficial interest in more than 50% of the assets or from which such person receives more than 50% of the current income.

31 C.F.R. § 1010.350(e)(2).

iii. A person that causes an entity or a trust to be created for the purpose of evading the FBAR reporting requirement is deemed to have a financial interest in the account in the name of the entity or trust. 31 C.F.R. § 1010.350(e)(3).

* 1. *Signature Authority.*

i. Signature “or other authority means the authority of an individual (alone or in conjunction with another) to control the disposition of money, funds or other assets held in a financial account by direct communication (whether in writing or otherwise) to the person with whom the financial account is maintained.” 31 C.F.R. § 1010.350(f).

ii. Common exceptions include:

1. Officers or employees of a bank;
2. Officers or employees of financial institutions registered and examined by the SEC;
3. Officers or employees of an entity with a class of equity securities listed on any US national securities exchange; and
4. Officers or employees of an entity that has a class of equity securities registered under section 12(g) of the Securities Exchange Act.

31 C.F.R. § 1010.350(f)(2).

1. Bank, Securities, or Other Financial Account

a. *Bank Account.* The term “bank account” means a savings deposit, demand deposit, checking, or any other account maintained with a person engaged in the business of banking. 31 C.F.R. § 1010.350(c)(1).

b. *Securities Account.* The term “securities account” means an account with a person engaged in the business of buying, selling, holding or trading stock or other securities. 31 C.F.R. § 1010.350(c)(2).

c. *Other Financial Account.* The term “other financial account” means:

i. An account with a person that is in the business of accepting deposits as a financial agency;

ii. An account that is an insurance or annuity policy with a cash value;

iii. An account with a person that acts as a broker or dealer for futures or options transactions in any commodity on or subject to the rules of a commodity exchange or association; or

iv. A mutual fund or similar pooled fund which issues shares available to the general public that have a regular net asset value determination and regular redemptions.

31 C.F.R. § 1010.350(c)(3).

1. Severe Penalties **Could** Apply
2. Civil Penalties.
   1. *Willful Failure to File*. Where a taxpayer willfully fails to file an FBAR, the Service may assert a penalty equal to $100,000.00 or 50% of the balance in the account at the time of the violation, whichever amount is larger. 31 U.S.C. § 5321(a)(5)(C).
   2. *Non-Willful or Unintentional Failure to File*. The Service may impose a $10,000.00 per violation (i.e., per account) penalty. 31 U.S.C. § 5321(a)(5)(B)(i).
3. Additional penalty guidance is provided at Section 4.26.16.4.6.2 Internal Revenue Manual.

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| **Aggregate Balance of Accounts** | **Penalty** |
| Does not Exceed $50,000.00 | $500.00 per account, but not to exceed $5,000.00 |
| Over $50,000.00 but less than $250,000.00 | Per account, the lesser of $5,000.00 or 10% of the account balance |
| Exceeds $250,000.00 | Statutory maximum of $10,000.00 per account. |

1. Criminal Penalties. For criminal violations, a taxpayer faces a penalty of up to $250,000 and five years in prison. 31 U.S.C. § 5322(a).
2. Statute of Limitations. There is a six-year statute of limitations on the assessment of the civil penalty. 31 U.S.C. § 5321(b)(1). The criminal statute of limitations is five years. 18 U.S.C. 3282
3. Method of Assessment. FBAR penalties are Title 31 penalties and, therefore, although the IRS can make an administrative assessment, the IRS does not have the power to collect the penalty by way of lien or levy. Instead, the government must bring an action to collect the penalty within two years of the date of assessment. 31 U.S.C. § 5321(b)(2).

**II. 2012 Offshore Voluntary Disclosure Program**

A. IRS Now on Third Version of Program. As of June 2012, the IRS has collected more than $5 billion in back taxes, interest and penalties from 33,000 voluntary disclosures made under the 2009 and 2011 programs.

B. Summary of Program.

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| **Summary of 2012 Offshore Voluntary Disclosure Program ("2012 OVDP")** | |
| **General Benefits** | 1. Eliminates the risk of criminal prosecution  2. Certainty concerning cost of resolving offshore tax issues. |
| **Eligibility** | Individuals and entities with undisclosed offshore accounts or assets who:  1. Are not currently under examination, regardless of whether it relates to undisclosed foreign accounts or undisclosed foreign entities.  2. Are not under criminal investigation by IRS Criminal Investigation Division.  However, those who have paid tax on all taxable income but did not file FBARS **should not** make a voluntary disclosure. Instead, they should file the delinquent FBAR reports. The IRS **will not impose a penalty** for the failure to file the delinquent FBARs if there are no underreported tax liabilities and the taxpayer is not under audit and has not been contacted by the IRS concerning the return. Additionally, those who have failed to file other non-FBAR information returns (e.g., Forms 3520 and 5471) but have reported all income should file delinquent information returns with the appropriate service center.  A John Doe summons or treaty request does not disqualify everyone in group, but once the Service or the DOJ obtains information under a John Doe summons, treaty request or other similar action, the taxpayer is no longer eligible  Non-resident taxpayers may qualify for a new program (discussed below). |
| **Deadline** | Unlike prior programs, there is no set deadline for taxpayers to apply, but the program could close or the terms of the program could change at any time. |
| **Payments Required** | 1. Undisclosed Foreign Asset Penalty of 27.5% (or 5% or 12.5%, if certain requirements are met); payment due on completion of OVDP certification and not required with original submission.  2. 20% accuracy-related penalty under IRC § 6662(a) on the full amount of offshore-related underpayments.  3. Any failure to file or pay penalties that apply under 6651(a)(1) and/or (2).  4. Interest (excluding undisclosed foreign asset penalty) |
| **Penalty Computation** | 27.5% of highest account balance during last eight years. Special 12.5% rate for taxpayers whose highest account balance was less than $75,000. Also, special 5% rate applies if taxpayer:  1. Did not open or cause the account to be opened (unless the bank required that a new account be opened, rather than allowing a change in ownership of an existing account, upon the death of the owner of the account);  2. Exercised minimal, infrequent contact with the account, for example, to request the account balance, or update accountholder information such as a change in address, contact person, or email address;  3. Except for a withdrawal closing the account and transferring the funds to an account in the United States, did not withdraw more than $1,000 from the account in any year for which the taxpayer was non-compliant; and  4. Can establish that all applicable U.S. taxes have been paid on funds deposited to the account (only account earnings have escaped U.S. taxation).  Special 5% rate also applies to taxpayers who are foreign residents and who were unaware they were U.S. citizens.  Taxpayer can also "opt-out" of penalty regime and attempt to pay less than standard penalty rate. |
| **Documents** | 1. Amended income tax returns for 8 years  2. Late or amended FBARs for 8 years  3. Extensions of statute of limitations for income and FBAR matters  4. Foreign Account/Asset Statements  5. Offshore Voluntary Disclosure Letter  6. Penalty Computation Worksheet  7. Closing Agreement (after certification) |
| **Civil Penalties Avoided** | **Income-Tax Penalties:**  1. 75% fraud penalty under IRC § 6651  2. 40% accuracy-related penalty under IRC § 6662  **Information Return Penalties Associated with the Following Forms:**  1. **FBAR** (both willful and non-willful; see above).  2. **FATCA (Form 8938)**  3. **Annual Return to Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts (Form 3520)**  4**. Information Return of Foreign Trust With a U.S. Owner (Form 3520-A)**  5. **Information Return of U.S. Persons with Respect to Certain Foreign Corporations (Form 5471)**  6. **Information Return of a 25% Foreign-Owned U.S. Corporation or a Foreign Corporation Engaged in a U.S. Trade or Business (Form 572)**  7. **Return by a U.S. Transferor of Property to a Foreign Corporation (Form 926)**  8. **Return of U.S. Persons With Respect to Certain Foreign Partnerships (Form 8865)** |
| **Criminal Charges Avoided** | 1. Tax evasion (IRC § 7201) - up to five years in prison and a fine of up to $250,000.  2. Filing a false return (IRC § 7206(1)) - up to three years in prison and a fine of up to $250,000.  3. Failing to file (IRC § 7203) - up to one year in prison and a fine of up to $100,000.  4. Willfully failing to file FBAR (31 U.S.C. § 5322) - up to ten years in prison and criminal penalties of up to $500,000. |

C. Example. Taxpayer has an offshore financial account and has not reported the interest income generated by the account. Taxpayer inherited the account from his father and, therefore, the original amount on deposit is not unreported income to the taxpayer. Below is a summary of the account's performance:

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| **Year** | **Amount on Deposit** | **Interest Income** | **Account Balance** |
| 2004 | $1,000,000 | $50,000 | $1,050,000 |
| 2005 |  | $50,000 | $1,100,000 |
| 2006 |  | $50,000 | $1,150,000 |
| 2007 |  | $50,000 | $1,200,000 |
| 2008 |  | $50,000 | $1,250,000 |
| 2009 |  | $50,000 | $1,300,000 |
| 2010 |  | $50,000 | $1,350,000 |
| 2011 |  | $50,000 | $1,400,000 |

For the purposes of this example, it is assumed the taxpayer's marginal income tax rate is 35%, that the account does not have an investment in a passive foreign investment company (PFIC), that the taxpayer files a return but does not include the foreign account or the interest income on the return, and the maximum applicable penalties would be imposed.

Under the 2012 OVDP the taxpayer would pay the following:

* Tax of $140,000 (8 years at $17,500) plus interest,
* An accuracy-related penalty of $28,000 (i.e., $140,000 x 20%), and
* An additional penalty, in lieu of the FBAR and other potential penalties that may apply, of $385,000 (i.e., $1,400,000 x 27.5%).

If the taxpayer did not come forward, he could face up to $4,543,000 in tax, accuracy-related penalty, and FBAR penalty. Additionally, taxpayer could be subject to criminal investigation and criminal prosecution.

The civil liabilities outside the Offshore Voluntary Disclosure Program potentially include:

* The tax, accuracy-related penalties, and, if applicable, the failure to file and failure to pay penalties, plus interest, as described above,
* FBAR penalties totaling up to $3,825,000 for willful failures to file complete and correct FBARs (2006 - $575,000, 2007 - $600,000, 2008 - $625,000, 2009 - $650,000, and 2010 - $675,000, and 2011 - $700,000),
* The potential of having the fraud penalty (75 percent) apply, and
* The potential of substantial additional information return penalties if the foreign account or assets is held through a foreign entity such as a trust or corporation and required information returns were not filed.

Additionally, if the foreign activity started before 2004, the Service would be able to examine tax years prior to 2004 if the taxpayer is not part of the OVDP.

**III. SPECIAL PROGRAM FOR U.S. TAXPAYERS LIVING ABROAD**

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| **Summary of Program for Non-Resident U.S. Taxpayers** | |
| **Eligibility** | This procedure is available for non-resident U.S. taxpayers who have resided outside of the U.S. since January 1, 2009 and who have not filed a U.S. tax return during the same period.  The only amended returns accepted through this program are those filed for the sole purpose of submitting late-filed Form 8891s to seek relief for failure to timely elect deferral of income from certain retirement or savings plans where deferral is permitted by relevant treaty.  Same general eligibility requirements as 2012 OVDP. |
| **Requirements** | 1. File up to three years of delinquent returns  2. File up to six years of late FBARs.  3. Payment of tax and interest with submission  4. Program Questionnaire. |
| **Compliance Risk Determination** | Program is only designed for those with a low compliance risk. Generally, a taxpayer will be deemed to have a low compliance risk if submitted returns show less then $1,500.00 in tax due for each of the years.  The risk level may rise if any of the following are present:   * If any of the returns submitted through this program claim a refund; * If there is material economic activity in the United States; * If the taxpayer has not declared all of his/her income in his/her country of residence; * If the taxpayer is under audit or investigation by the IRS; * If FBAR penalties have been previously assessed against the taxpayer or if the taxpayer has previously received an FBAR warning letter; * If the taxpayer has a financial interest or authority over a financial account(s) located outside his/her country of residence; * If the taxpayer has a financial interest in an entity or entities located outside his/her country of residence * If there is U.S. source income; or * If there are indications of sophisticated tax planning or avoidance. |
| **Other Considerations** | Does not provide guarantee of protection from criminal prosecution |