



*Excerpt from eBook*

# Expatriation: The IRS and U.S. Taxes

FATCA/FBAR

Prepared by:  
Gary S. Wolfe  
THE WOLFE LAW GROUP

**LORMAN**<sup>®</sup>  
EDUCATION SERVICES

September 2016

Excerpt from eBook, Expatriation: The IRS and U.S. Taxes - FATCA/FBAR, ©2016 Lorman Education Services. All Rights Reserved.

## INTRODUCING

Lorman's New Approach to Continuing Education

# ALL-ACCESS PASS

The All-Access Pass grants you **UNLIMITED** access to Lorman's ever-growing library of training resources:

- ☑ Unlimited Live Webinars - 120 live webinars added every month
- ☑ Unlimited OnDemand and MP3 Downloads - Over 1,500 courses available
- ☑ Videos - More than 700 available
- ☑ Slide Decks - More than 1700 available
- ☑ White Papers
- ☑ Reports
- ☑ Articles
- ☑ ... and much more!

Join the thousands of other pass-holders that have already trusted us for their professional development by choosing the All-Access Pass.



**Get Your All-Access Pass Today!**

**SAVE 20%**

Learn more: [www.lorman.com/pass/?s=special20](http://www.lorman.com/pass/?s=special20)

Use Discount Code Q7014393 and Priority Code 18536 to receive the 20% AAP discount.

\*Discount cannot be combined with any other discounts.

# THE WOLFE LAW GROUP

Gary S. Wolfe has over 34 years of experience, specializing in IRS Tax Audits and International Tax Matters including: International Tax Planning/Tax Compliance, and International Asset Protection.

As of July 2016, Gary Wolfe has internationally published 15 books and 28 articles. Gary has received 14 international tax awards from five different Global expert societies in LONDON/UK including being voted one of the 100 leading world's law firms with votes from over 150,000 voters in over 160 countries with the following award: Global 100 (2016) (KMH Media Group) - CA/US International Tax Planning Law Firm of the Year.

For more information please visit our website: [gswlaw.com](http://gswlaw.com)

Gary S. Wolfe, A Professional Law Corporation  
6303 Wilshire Blvd., Suite 201  
Los Angeles, CA, 90048  
Tel: 323-782-9139  
Email: [gsw@gswlaw.com](mailto:gsw@gswlaw.com)

## Chapter 6 – FATCA/FBAR

### Summary of HIRE and Foreign Account Tax Compliance Act

On March 18, 2010, President Obama signed the Hiring Incentives to Restore Employment (“HIRE”) Act (P.L. 111-147) (The “Act”), which included the Foreign Account Tax Compliance Act containing new foreign account tax compliance rules.

Under the Act, new reporting and disclosure requirements for foreign assets will be phased in between 2010 – 2014:

1. Foreign Institutional Reporting: Foreign Institutions have new reporting and withholding obligations for accounts held by U.S. Persons (generally effective after 12/31/12, commencing 1/1/13).
2. Foreign Financial Assets (\$50,000): Individuals with an interest in a “Foreign Financial Asset” have new disclosure requirements. If foreign financial assets are valued in excess of \$50,000, the U.S. Taxpayer must attach certain information to their income tax returns for tax years beginning after March 18, 2010. (U.S. Taxpayers are not required to disclose interests that are held in a custodial account with a U.S. financial institution).

The penalty is substantial (\$10,000, plus additional amounts for continued failures, up to a maximum of \$50,000 for each applicable tax period). The penalty may be waived if the individual can establish that the failure was due to reasonable cause and not willful neglect.

3. 40% Penalty: A 40% accuracy-related penalty is imposed for underpayment of tax that is attributable to an undisclosed foreign financial asset understatement. Applicable assets are those subject to mandatory information reporting when the disclosure requirements were not met. The penalties are effective for tax years beginning after March 18, 2010.

4. 6 Year Statute of Limitations: Statute of limitations re: omission of income in connection with foreign assets: The statute of limitations for assessments of tax is extended to six (6) years if there is an omission of gross income in excess of \$5,000 attributable to the foreign financial asset. The six-year statute of limitations is effective for tax returns filed after March 18, 2010, as well as for any other tax return for which the assessment period has not yet expired as of March 18, 2010.

5. Passive Foreign Investment Companies: The Act imposes an information disclosure requirement on U.S. Persons who are PFIC shareholders. A PFIC is any foreign corporation if:

- a. 75% or more of the gross income of the corporation for the taxable year is passive income; or

b. The average percentage of assets held by such corporation during a taxable year which produce passive income or which are held for the production of passive income are at least 50%.

6. Foreign Trusts with U.S. Beneficiaries: The Act clarifies if a foreign trust is treated as having a U.S. Beneficiary; an amount accumulated is treated as accumulated for the U.S. Person's benefit even if that Person's trust interest is contingent.

The Act clarifies that the discretion to identify beneficiaries may cause the trust to be treated as having a U.S. Beneficiary. This provision is effective after March 18, 2010.

7. Rebuttable Presumption/Foreign Trust – U.S. Beneficiary: The Act creates a rebuttable presumption that a foreign trust has a U.S. Beneficiary if a U.S. Person directly or indirectly transfers property to a foreign trust (unless the transferor provides satisfactory information to the contrary to the IRS). This provision is effective for property transfers after March 18, 2010.

8. Uncompensated Use of the Foreign Trust Property: The Act provides that the uncompensated use of the foreign trust property by a U.S. Grantor, a U.S. Beneficiary (or a U.S. Person, related to either of them), is treated as a distribution by the trust. The use of the trust property is treated as a distribution to the extent of the fair market value of the property's use to the U.S. Grantor/U.S. Beneficiary, unless the fair market value of that use is paid to the trust.

The loan of cash or marketable securities by a foreign trust, or the use of any other property of the trust, to or by any U.S. Person is also treated as paid or accumulated for the benefit of the U.S. Person. This provision applies to loans made and uses of property after March 18, 2010.

9. Reporting Requirements, U.S. Owners of Foreign Trusts: This provision requires any U.S. Person treated as the owner of any portion of a foreign trust to submit IRS-required information and insure that the trust files a return on its activities and provides such information to its owners and distributees.

This new requirement imposed on U.S. Persons treated as owners is in addition to the current requirement that such U.S. Persons are responsible for insuring that the foreign trust complies with its own reporting obligations. This provision is effective for taxable years beginning after March 18, 2010.

10. Minimum Penalty re: Failure to Report Certain Foreign Trusts: This provision increases the minimum penalty for failure to provide timely and complete disclosure on foreign trusts to the greater of \$10,000 or 35% of the amount that should have been reported.

In the case of failure to properly disclose by the U.S. Owner of a foreign trust of the year-end value, the minimum penalty would be the greater of \$10,000 or 5% of the amount that should have been reported. This provision is effective for notices and returns required to be filed after December 31, 2009.

## Foreign Financial Assets

U.S. Taxpayers who hold any interests in specified foreign financial assets during the tax year must attach their tax returns for the year certain information with respect to each asset if the aggregate value of all assets exceeds \$50,000. An individual who fails to furnish the required information is subject to a penalty of \$10,000. An additional penalty may apply if the failure continues for more than 90 days after a notification by the IRS to a maximum of \$50,000. The penalty may be avoided if the Taxpayer shows a reasonable cause for the failure to comply.

The Joint Committee on Taxation, Technical Explanation of the Hiring Incentives to Restore Employment Act (JCX-4-10) clarifies that although the nature of the information required to be disclosed is similar to the information disclosed on an FBAR, it is not identical.

For example, a beneficiary of a foreign trust who is not within the scope of the FBAR reporting requirements because his interest in the trust is less than 50%, may still be required to disclose the interest with his tax return if the \$50,000 value threshold is met. In addition, this provision is not intended as a substitute for compliance with the FBAR reporting requirements, which remain unchanged.

For purposes of IRC Code §6038(D) as added by the HIRE Act, a specified foreign financial asset includes:

1. Any depository, custodial, or other financial account maintained by a foreign financial institution, and
2. Any of the following assets that are not held in an account maintained by a financial institution:
  - a. Any stock or security issued by a person other than a U.S. Person
  - b. Any financial instrument or contract held for investment that has an issuer or counterparty other than a U.S. Person, and
  - c. Any interest in a foreign entity (IRC §6038(D)(b) as added by the 2010 HIRE Act).

The information required to be disclosed with respect to any asset must include the maximum value of the asset during the tax year (IRC §6038(D)(c) as added by the 2010 HIRE Act).

For a financial account, the Taxpayer must disclose the name and address of the financial institution in which the account is maintained and the number of the account.

In the case of any stock or security, the disclosed information must include the name and address of the issuer and such other information as is necessary to identify the class or issue of which the stock or security is a part.

In the case of any instrument, contract, or interest, a Taxpayer must provide any information necessary to identify the instrument, contract, or interest along with the names and addresses of all issuers and counterparties with respect to the instrument, contract, or interest. Under these rules, a U.S. Taxpayer is not required to disclose interests held in a custodial account with a U.S. financial institution. In addition, the U.S. Taxpayer is not required to identify separately any stock, security instrument, contract, or interest in a disclosed foreign financial account.

An individual who fails to furnish the required information with respect to any tax year at the prescribed time and in the prescribed manner is subject to a penalty of \$10,000 (IRC §6038(D)(d) as added by the 2010 HIRE Act). If the failure to disclose the required information continues for more than 90 days after the day on which the notice was mailed (from the Secretary of Treasury), the individual is subject to an additional penalty of \$10,000 for each 30-day period (or a fraction thereof) with the maximum penalty not to exceed \$50,000.

In addition to the \$10,000 penalty (up to \$50,000) under IRC §6038(D) a 40% accuracy-related penalty is imposed on any understatement of tax attributable to a transaction involving an undisclosed foreign financial asset.

The statute of limitations for omission of gross income attributable to foreign financial assets (omission of gross income in excess of \$5,000 attributable to a foreign financial asset), is extended to six years.

The IRC §6038(D) penalties are not imposed on any individual who can show that the failure is due to reasonable cause and not willful neglect. (IRC §6038D(g), as added by the 2010 HIRE Act.)

The information disclosure with respect to foreign financial assets supplements the FBAR reporting regime. The HIRE Act broadens reporting requirements and extends the rules to ownership of foreign assets such as foreign stocks, securities, interests in foreign companies not covered by the FBAR reporting. The threshold reporting requirement amount for FBARs (\$10,000) is increased to \$50,000. While the FBAR reporting covers those having signatory or other authority, the new reporting regime focuses on ownership.

## **IRS Form 8938: Statement of Specified Foreign Financial Assets**

### “FATCA” Tax Reporting

Under the Foreign Account Tax Compliance Act (“FATCA”) for tax years beginning after March, 18, 2010, specified persons (i.e. U.S. Citizens, resident aliens), who have an ownership interest in specified foreign financial assets (i.e. foreign financial accounts, foreign stock, any interest in a foreign entity) must file Form 8938 (attached to their form 1040 tax return) if the value of the foreign financial assets exceeds applicable “reporting threshold”.

The value of a specified foreign financial asset, for Form 8938 reporting purposes is the asset's fair market value.

For Individuals: more than \$50,000 on the last day of the tax year, more than \$75,000 at any time during the tax year. If living abroad; \$200,000 on the last day of the tax year or more than \$300,000 at any time during the tax year.

For Married Taxpayers: more than \$100,000 on the last day of the tax year, more than \$150,000 at any time during the tax year, if living abroad: \$400,000 on the last day of the tax year, or more than \$600,000 at any time during the tax year.

The IRS anticipates issuing regulations that will require domestic entity to file Form 8938, if it holds specified foreign financial assets whose value exceeds the applicable reporting threshold. Until the IRS issues such regulation, only individuals must file Form 8938.

### Foreign Trusts

The value of an interest in a foreign trust, during the tax year, (if taxpayer doesn't know its fair market value is the Maximum Value of the interest in the foreign trust calculated as the sum of the following amounts:

1. The value of all of the cash (or other property) distributed during the tax year from the trust to the beneficiary, plus
2. The value (using the IRC§7520 Valuation Tables) to receive mandatory distributions as of the last day of the tax year;

### Foreign Grantor Trusts

A U.S. Taxpayer, who is the owner of a foreign grantor trust, does not have to report specified financial assets, held by the trust if:

1. The US Taxpayer reports the trust on a timely filed form 3520 for the same tax year;
2. The trust timely files Form 3520-A (Annual Information Return of Foreign Trust with a U.S. owner) for the same tax year;
3. Taxpayer identified on form 8938 how many of these forms they filed.

### Specified Foreign Financial Assets

Foreign financial accounts include any depository (or custodial) account maintained by a foreign financial institution, any equity or debt interest in a foreign financial institution including any financial account maintained by a financial institution organized under the laws of a U.S. possession (America Samoa, Guam, The Northern Mariana Islands, Puerto Rico or the U.S. Virgin Islands)

A foreign financial institution is any financial institution that is not a U.S. entity, and satisfies one of the following conditions:

1. It accepts deposits;
2. It holds financial assets for the account of others;
3. It is engaged in the business of investing or trading in securities, partnership interests, or commodities;
4. It includes investment vehicles such as foreign mutual funds, hedge fund and private equity funds.

#### Interests in Specified Foreign Financial Assets

A U.S. Taxpayer:

1. has an interest in a specified financial asset if any income, gains, losses, deductions, credits, gross proceeds, or distribution from asset dispositions is required to be reported on U.S. income tax returns;
2. who is the owner of a disregarded entity, has an interest in any specified foreign financial assets owned by the disregarded entity;
3. who has an interest in a financial account that holds specified foreign financial assets, do not have to report the assets held in the account;
4. does not own an interest in any specified foreign financial asset held by a partnership, corporation or estate, as a result of their status as a partner, shareholder or beneficiary;
5. who is the owner, under the grantor trust rules of any part of a trust, has an interest in any specified foreign financial asset held by that part of the trust;
6. does not have an interest in a foreign trust or a foreign estate specified foreign financial asset, unless they know (or have reason to know) of the interest. If they receive a distribution from the foreign trust or foreign estate, they are considered to know of the interest.

#### Exceptions to Tax Reporting (Form 8938)

U.S. Taxpayers do not have to report a specified foreign financial asset on Form 8938:

1. If the financial account is maintained by a U.S. payer which includes: a U.S. financial institution, a domestic branch of a foreign bank or insurance company, a foreign branch or subsidiary of a U.S. financial institution;

2. If the U.S. Taxpayer reports the specified foreign financial asset on timely filed IRS forms:

a. Form 3520: Annual Return to Report Transactions with Foreign Trusts and Receipt of certain foreign Gifts

b. Form 5471: Information Return of U.S. Persons with Respect to Certain Foreign Corporations

c. Form 8865: Return of U.S. Persons with Respect to Certain Foreign Partnerships

#### Civil Penalties (Form 8938)

1. Failure to File Penalty: A penalty of \$10,000 for each 30 day period not filed, (within 90 days after the IRS notifies of the failure to file) after the 90 day period has expired, up to \$50,000 maximum penalty.

2. Accuracy-Related Penalty: A 40% penalty on a tax underpayment as a result of an undisclosed, specified foreign financial asset.

3. Fraud: A 75% penalty on a tax underpayment, due to fraud.

#### Criminal Penalties (Form 8938)

Criminal penalties may be imposed for:

1. Failure to file Form 8938;

2. Underpayment of tax;

3. Failure to report asset.

#### Statute of Limitations

1. For failure to file Form 8938, failure to report a specified foreign financial asset, the statute of limitations remains open until 3 year after the date Form 8938 is filed.

2. For failure to include in gross income, an amount relating to one or more specified foreign financial assets, and the amount omitted in more than \$5,000, any tax owed for the tax year, can be assessed at any time within 6 years after the tax return is filed.

#### **U.S. Taxpayer Tax Compliance Issues**

FBAR rules are not found in the Code. Rather, they are set forth in the Bank Secrecy Act, first enacted by Congress in 1970. Since 2003, however, the IRS bears responsibility for enforcing these rules.

The FBAR rules require that every U.S. Person report (i) any financial interest or authority over a (ii) financial account in a foreign country with (iii) an aggregate value over \$ 10,000 at any time during the taxable year. The report must be filed on a Form TD F 90-22.1, Report of Foreign Bank and Financial Accounts (hence the acronym “FBAR”). U.S. Persons must also disclose the existence of the account on their Form 1040, Schedule B, Part III. This is commonly referred to as “checking the ‘B’ box.”

Taxpayers who fail to disclose the account on their Form 1040 could be subject to criminal sanctions for filing a false tax return.

The FBAR report is due on June 30th. This due date is not subject to extensions. The FBAR report must be filed separately from the U.S. Person’s tax return.

### Financial Interest Or Authority

A U.S. Person has a financial interest in a foreign account if he or she is the legal or beneficial owner. Attribution rules apply in making this determination. A person serving as a shareholder, partner, and trustee may also be deemed to hold a financial interest if the owner of the account is (i) a person acting as an agent on behalf of the U.S. Person, (ii) a corporation where the U.S. Person owns, directly or indirectly, more than 50 percent of the outstanding stock, (iii) a partnership in which the U.S. Person owns more than 50 percent of the profits, or (iv) a trust in which a U.S. Person has either a present interest in more than 50 percent of the assets or from which the U.S. Person receives more than 50 percent of the income. If these thresholds are met, the U.S. Person has an FBAR reporting obligation, regardless of whether he or she has any authority over the account.

Non-owners with authority over a foreign account are also subject to the FBAR reporting rules. Authority means the U.S. Person has the ability to order a distribution or disbursement of funds or other property held in the account. This is not limited to signature authority, but includes the ability to order distributions by verbal commands or other communication. Authority does not include persons who have the right to invest, but not distribute, the foreign account funds.

There is no limitation for taxpayers who have authority over a foreign account, but only in an official capacity. (For example, the president of a corporation, the general partner of a partnership, or the manager of an LLC may be subject to these rules.)

Both the entity, as beneficial owner, and the representative, who has control over the account, may be required to file an FBAR report. Similarly, when more than one U.S. Person has authority over an account, i.e., president and vice president, both persons may have an FBAR reporting obligation.

Even when the account is subject to joint control, and the signature of someone other than the taxpayer is required to cause a distribution, the taxpayer is still considered to have authority over the account for FBAR reporting purposes.

## Financial Account In A Foreign Country

The term financial account is broadly defined as any asset account and encompasses simple bank accounts (checking or savings), as well as securities or custodial accounts. It also includes a life insurance policy or other type of policy with an investment value (i.e., surrender value). Foreign country naturally refers to any country other than the United States. Puerto Rico, U.S. possessions and territories are included as part of the United States (as they should) for these purposes. Accounts held by U.S. Persons in these areas are not foreign accounts subject to FBAR reporting.

The IRS has indicated that a traditional credit card with a foreign bank is not a foreign account. However, use of a credit card as a debit or check card could trigger foreign account status and thus an FBAR reporting obligation.

### \$10,000 Threshold

To be reportable, the account must have assets the value of which during the year, exceeds \$10,000.

The Instructions to the FBAR report state that if the aggregate value of all financial accounts exceeds \$10,000 at any time during the year, the U.S. Person must file an FBAR report. A U.S. Person who possesses multiple foreign accounts, all of which have less than \$10,000, but which collectively exceed \$10,000, may have an FBAR reporting obligation.

Taxpayers may transfer an appreciating asset to a foreign account, such as stock or securities. As these assets increase in value, they may trigger an FBAR reporting requirement. Whether the account generates any income is not relevant.

### Penalties

In an attempt to improve compliance, Congress enhanced the FBAR penalties in 2004. Under pre-2004 law, civil penalties applied only to willful violations. In 2009, civil penalties up to \$10,000 may be imposed on non-willful violations. This penalty may be avoided if there was reasonable cause and the U.S. Person reported the income earned on the account. 31 U.S. C. §5321(a)(5).

Although reasonable cause is not defined, the IRS will likely apply the reasonable cause standard for late-payment/late-filing penalties.

The penalty for willful violations is far more severe. It is equal to the greater of \$100,000 or 50 per-cent of the balance of the account at the time of the FBAR violation. No reasonable cause exception exists for a willful violation. 31 U. S. C. §5321(a)(5)(c).

The IRS has six years to assess a civil penalty against a taxpayer that violates the FBAR reporting rules.

### **Amended Tax Returns (Voluntary Disclosure)**

U.S. Taxpayers who fail to report offshore accounts by filing FBAR (TD F 90.22-1) face criminal and civil penalties:

1. Failure to Report Income

(3 Felonies and 1 Misdemeanor) up to 14 years in jail, plus 75% Civil Tax Fraud Penalty, 25% Failure to Pay Tax Penalty.

2. Failure to File FBAR's

(a maximum annual penalty of 50% of the account balance, up to 10 years in jail a \$500,000 fine).

3. Perjury

Taxpayers Form 1040/Schedule B must declare whether Taxpayers have any authority over, or interest in foreign accounts with a total of more than \$10,000.

In the IRS 6/24/09 FAQ update the IRS stated:

What is the distinction between filing amended returns to correct errors and filing a voluntary disclosure?

An amended return is the proper vehicle to correct an error on a filed return, whether a taxpayer receives a refund or owes additional tax. A voluntary disclosure is a truthful, timely and complete communication to the IRS in which a taxpayer shows a willingness to cooperate (and does in fact cooperate) with the IRS in determining the taxpayer's correct tax liability and makes arrangements in good faith to fully pay that liability. Filing correct amended returns is normally a part of the process of making a voluntary disclosure under IRM 9.5.11.9. Taxpayers and practitioners trying to decide whether to simply file an amended return with a Service Center or to make a formal voluntary disclosure under the process described in IRM 9.5.11.9 and the March 23, 2009 memoranda should consider the nature of the error they are trying to correct.

Taxpayers with undisclosed foreign accounts or entities should consider making a voluntary disclosure because it enables them to become compliant, avoid substantial civil penalties and generally eliminate the risk of criminal prosecution. Making a voluntary disclosure also provides the opportunity to calculate, with a reasonable degree of certainty, the total cost of resolving all offshore tax issues. It is anticipated that the voluntary disclosure process is appropriate for most taxpayers who have underreported their income with respect to offshore accounts and assets. However, there will be some cases, such as where a taxpayer has reported all income but failed to file the FBAR (FAQ 9), or only failed to file information returns (FAQ 42), where it

remains appropriate for the taxpayer to simply file amended returns with the applicable Service Center (with copies to the Philadelphia office listed in FAQ 9).

The IRS stated position is that a Taxpayer's voluntary disclosure entitles the Taxpayer to become compliant, avoid substantial civil penalties and generally eliminate the risk of criminal prosecution.

In reality, a taxpayer who makes a voluntary disclosure may:

1. Spotlight their "tax crimes"
2. If the voluntary disclosure is not accepted, jeopardize them and subject them to criminal prosecution

The IRS SBSE 3/23/09 memorandum, Subject: Routing of Voluntary Disclosure Cases, which addresses a change in the processing of voluntary disclosure requests containing offshore issues.

1. Such requests will continue to be initially screened by Criminal Investigation to determine eligibility for voluntary disclosure, and, if involving only domestic issues will be forwarded to Area Planning and Special Programs for Civil Processing;
2. Voluntary disclosure eligibility for offshore issues will be initially screened by Criminal Investigation and forwarded to the Philadelphia Offshore Identification Unit (POIU) for processing.

Voluntary Disclosure risks include:

1. Heightened risk of criminal prosecution (since initial screening is by the IRS Criminal Investigation Division);
2. A voluntary disclosure may be used as an evidentiary admission of Taxpayer's unreported income;
3. A voluntary disclosure may waive Taxpayer's 5th Amendment right against self-incrimination;
4. While a voluntary disclosure is pending the IRS may request more information, commence an audit or initiate criminal prosecution.

As an alternative strategy to a voluntary disclosure, the "quiet filing" (for the Tax Years at issue) of an amended tax return (or original tax return) may instead:

1. Pre-empt criminal charges for the failure to file FBAR returns, Form 1040 tax returns and failure to pay tax;

2. Pre-empt a 75% civil tax fraud penalty, for failure to file or pay tax and a 25% failure to pay tax penalty;

3. If the income is properly reported (i.e., no substantial understatements which are subject to a 6 year statute of limitations), the tax filing will commence the 3-year statute of limitations (for each year) for IRS audit.

### **Statute of Limitations**

\*On 6/24/09, in FAQ #31, the IRS confirmed they will be able to assess taxes under a 6 year statute of limitations if the IRS can prove a substantial omission of gross income:  
How can the IRS propose adjustments to tax for a six-year period without either an agreement from the taxpayer or a statutory exception to the normal three-year statute of limitations for making those adjustments?

Going back six years is part of the resolution offered by the IRS for resolving offshore voluntary disclosures. The taxpayer must agree to assessment of the liabilities for those years in order to get the benefit of the reduced penalty framework. If the taxpayer does not agree to the tax, interest and penalty proposed by the voluntary disclosure examiner, the case will be referred to the field for a complete examination. In that examination, normal statute of limitations rules will apply. If no exception to the normal three-year statute applies, the IRS will only be able to assess tax, penalty and interest for three years. However, if the period of limitations was open because, for example, the IRS can prove a substantial omission of gross income, six years of liability may be assessed. Similarly, if there was a failure to file certain information returns, such as Form 3520 or Form 5471, the statute of limitations will not have begun to run. If the IRS can prove fraud, there is no statute of limitations for assessing tax.

\*See: 31 U.S.C §5321(b)(1) re: 6 year statute.

### **Annual Filing Requirements and Reasonable Cause Exception**

In April 2003, the Financial Crimes Enforcement Network delegated authority of the TD F 90-22.1 form (i.e., FBAR form) to the Internal Revenue Service (see IR 2003-48 (4/10/03); 31 CFR §103.5(6)(b)(8)). The IRS enforces all penalties associated with the FBAR with the same power it enforces tax reporting and payment compliance.

The IRS has been given the authority to enforce the filing rules and audit the reports as appropriate.

The FBAR filing is due by June 30th of the year following the year of the report with no provisions for extensions. The due date means the date it must be received by the US Treasury. Mailing it on the date it is due will result in a late filing. The FBAR form, filed separately from the income tax, must be mailed to US Department of Treasury, PO Box 32621, Detroit, Michigan 48232-0621.

If there is an emergency, the form can be hand-delivered to a local IRS office for forwarding to the Treasury Department in Detroit.

An amended FBAR may be filed by completing a revised FBAR with the correct information writing the words "Amended" at the top of the revised FBAR and stapling it to a copy of the original FBAR. For Taxpayers amending a late-filed FBAR, they should include a statement explaining their reasons for a late filing (i.e., request a reasonable cause exception from penalty).

A failure to file a FBAR has civil and criminal penalties (which are in addition to any income tax penalties if the income is not reported). The IRS must assess the civil penalties within 6 years of the FBAR violation (31 USC 5321(b)(1)).

For a willful failure to file, the civil penalty increases from \$10,000 (non-willful failure to file) to the greater of \$100,000 or 50% of the account balance in the foreign account for the tax year. The civil penalties for non-willful failure to file may be waived by the IRS if the Taxpayer can show reasonable cause. If the Taxpayer has a reasonable cause exception, the FBAR should be filed with an explanation (i.e., the reasonable cause, with an express request for waiver of penalties).

The waiver of civil penalties for a reasonable cause exception may include among other factors:

1. All the income from the foreign account was included on the US Taxpayer's return.
2. The Taxpayer was unaware of the requirement to file (for example, lack of understanding of what constitutes a financial interest).
3. Once the Taxpayer became aware of the filing requirements, he filed all delinquent reports (up to 6 years).

### **Civil and Criminal Penalties**

Each U.S. Person who has a financial interest in, or signature or other authority over, one or more foreign financial accounts (value over \$10,000, at any time during a calendar year) is required to report the account on Schedule B/Form 1040, and TD F 90-22.1 (Report of Foreign Bank and Financial Accounts (FBAR)), due by June 30 of the succeeding year (I.R.M. 5.21.6.1. (2/17/09)).

Failure to file the required report or maintain adequate records (for 5 years) is a violation of Title 31 with civil and criminal penalties (or both). For each violation a separate penalty may be asserted.

#### **(I) Non-Willful Violation**

Civil Penalty – Up to \$10,000 for each violation. 31 U.S.C. § 5321(a)(5)(A)

## (II) Negligent Violation

Civil Penalty – Up to the greater of \$100,000, or 35 percent of the greatest amount in the account. 31 U.S.C.

## (III) Intentional Violations

### 1. Willful – Failure to File FBAR or retain records of account

Civil Penalty -Up to the greater of \$100,000, or 50 percent of the greatest amount in the account.

Criminal Penalty -Up to \$250,000 or 5 years or both

31 U.S.C. §5321(a)(5)(C), 31 U.S.C. § 5322(a) and 31 C.F.R. §103.59(b) for criminal

### 2. Knowingly and Willfully Filing False FBAR

Civil Penalty – Up to the greater of \$100,000, or 50 percent of the greatest amount in the account.

Criminal Penalty – \$10,000 or 5 years or both

18 U.S.C. § 1001, 31 C.F.R. § 103.59(d) for criminal

### 3. Willful – Failure to File FBAR or retain records of account while violating certain other laws

Civil Penalty – Up to the greater of \$100,000, or 50 percent of the greatest amount in the account.

Criminal Penalty – Up to \$500,000 or 10 years or both

31 U.S.C. § 5322(b) and 31 C.F.R. §103.59(c) for criminal

## **Criminal Penalties: Willful Failure to File (Defenses)**

Under IRS Form 1040, at the bottom of Schedule B, Part III, on Page 2, Question 7(a) states: “at any time during the previous year, did you have any interest in or signatory or other authority over a financial account in a foreign country, such as a bank account, a security account, or other financial account? The answer is either yes or no. If yes, Question 7(b) requires the name of the foreign country (with the account). Question 8 requires confirmation of receipt of distribution from the account, or if the Taxpayer was a grantor of, or transferor to a foreign trust (which requires filing Form 3520).

A willful failure to file a FBAR can lead to a felony of up to 10 years in jail and a \$500,000 fine. The IRS must prove willfulness in order to assert the \$500,000 monetary penalty and the imprisonment for up to 10 years (see 31 USC 5321(a)(5)(B); CCA 200603026; Eisenstein, 731 F.2d 1540 (CA – 11, 1984)).

Willfulness must be proven by the IRS under the standard of clear and convincing evidence. If the Taxpayer knew about the requirement to file, it would affect his defense. If the Taxpayer failed to report the foreign account interest or other income on his income tax return, it would affect his defense.

If a failure to file is deemed to be part of a criminal activity involving more than \$100,000 in a 12-month period, the penalty limit increases to \$500,000 with up to 10 years in jail. The issue of whether a failure to file is willful or non-willful is based on the facts of each case. Willfulness has been defined as the voluntary, intentional violation of a known legal duty, see Cheek 498 US 192, 67 AFTR 2d 91-344 (Supreme Court 1991).

A Taxpayer's good faith belief that he does not have to file (or even his negligent failure to file) can be a defense to the charge of willful failure to file (i.e., a defense to criminal charges).

A defense may include that the Taxpayer was advised by his advisor that no FBAR was required.

Failure to maintain adequate records of the foreign account for the years the FBAR filing is due may result in additional civil and criminal penalties.

