Are You FBAR Serious?

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I. Introduction

Are you FBAR serious? Seriously, do you know what a FBAR is? If you are a tax attorney or a CPA, you may be well-acquainted with the term, "FBAR," but for many individuals and owners of businesses, the requirements of the Foreign Bank and Financial Accounts Report ("FBAR") are foreign concepts. As a result, when the FBAR reporting requirements are explained to them, a common reaction is akin to a dismayed and shocked "Are you FBAR serious?"

The FBAR is no joking matter, however. With the recent advent of the 2009, 2011, and 2012 IRS Offshore Voluntary Disclosure Programs and the recently proposed Foreign Account Tax Compliance Act ("FATCA") regulations that the U.S. Treasury and the Internal Revenue Service ("IRS") issued during February 2012 in conjunction with the governments of France, Germany, Italy, Spain, and the United Kingdom, the FBAR should be taken seriously by both private citizens and business owners with an interest in foreign financial assets.

This article begins in Part II by addressing what the FBAR is and which individuals and domestic entities it affects. Part III of this article describes a related new IRS filing requirement: IRS Form 8938 or the Statement of Specified Foreign Financial Assets ("SSFFA"). Part IV compares and contrasts the similarities and differences between the FBAR and the SSFFA. Finally, Part V is a succinct discussion of the history of the FBAR and why compliance with the FBAR requirement is crucial for businesses and individuals.

II. What is the FBAR and Who are Affected?

The FBAR is a tool used by the IRS to identify and collect taxes on foreign sourced income and to identify people and businesses that may use foreign financial accounts to circumvent United States tax laws.[1] Pursuant to the Bank Secrecy Act,[2] if you are a United States person who has financial interest in, or signature authority over, a foreign financial account, including a bank account, brokerage account, mutual fund, trust, or other type of foreign financial account, you may be required to report the account yearly to the Internal Revenue Service by filing the FBAR.[3]

More specifically, the FBAR reporting requirement will be triggered in any tax year during which the aggregate value of all foreign financial accounts exceeds $10,000 at any time during the year.[4] To determine the value of the foreign account, the IRS recommends that the filer report the amount in U.S. dollars by using the periodic account statements and converting the amount reported on the statements to U.S. dollars using the exchange rate in effect at the end of the calendar year.[5]

It is important to understand that even though the foreign financial account may have produced no taxable income, the holder of that foreign financial account may nevertheless be required to file a FBAR.[6] Moreover, the FBAR is filed with the filer's federal income tax return, and thus, the extension of the filer's federal income tax return does not likewise extend the filer's FBAR obligation. In fact, a filer is not allowed to request any type of extension for filing the FBAR, and the FBAR must be received by the IRS on or before June 30th of the year following the calendar year being reported.[7] United States persons who do not comply with the FBAR requirements may be subject to severe civil and/or criminal penalties.[8] Such penalties may include up to the greater of $100,000 or 50 percent of account balances and jail time for willful violations.[9]

Under IRS guidelines, a filer is considered a United States person for purposes of the FBAR if the filer is any of the following: (1) a United States citizen; (2) a United States resident; (3) an entity created or organized in the United States or under the laws of the United States, including corporations, partnerships, or limited liability companies; or (4) a trust or estate formed under the laws of the United States.[10]

As with most rules, there are exceptions to the FBAR reporting requirements. Currently, there are exceptions for the following types of United States persons and foreign financial accounts: (1) certain foreign financial accounts jointly owned by spouses; (2)

United States persons included in a consolidated FBAR; (3) correspondent/nostro accounts; (4) foreign financial accounts owned by a governmental entity; (5) foreign financial accounts owned by an international financial institution; (6) IRA owners and beneficiaries; (7) participants in, and beneficiaries of, tax-qualified retirement plans; (8) certain individuals with signature authority over, but no financial interest in, a foreign financial account; (9) trust beneficiaries; and (10) foreign financial accounts maintained in a United States military banking facility.[11] A nostro account is defined as an account held by a bank in a foreign country by a domestic bank denominated in the currency of the foreign country. Typically, nostro accounts are used for currency settlement.

A foreign financial account is defined by the IRS as a financial account maintained by a financial institution physically located in a foreign country.[12] Thus, financial (deposit and custodial) accounts held at foreign financial institutions are reportable on the FBAR as are financial accounts held at a foreign branch of a U.S. financial institution, foreign mutual funds, foreign-issued life insurance or annuity contracts with a cash value, foreign stock or securities held in a financial account at a foreign financial institution, indirect interests in foreign financial assets held through an entity if there is sufficient ownership or beneficial interest, and foreign accounts and foreign non-account investment assets held by foreign or domestic grantor trust for which the filer is the grantor. But financial accounts held at a U.S. branch of a foreign financial institution and foreign real estate held directly or through a foreign entity are not reportable on the FBAR.

III. What is the Statement of Specified Foreign Financial Assets?

Now that we have a basic understanding about the FBAR, we can turn to a new related IRS requirement for foreign financial accounts: the Form 8938 or the Statement of Specified Foreign Financial Assets ("SSFFA"). Like the FBAR, the SSFFA is designed to combat tax avoidance. The SSFFA does not replace the FBAR but, rather, it requires United States persons with specified foreign financial assets that exceed certain thresholds to report those assets on the SSFFA.[13] For example, a married couple living in the U.S. and filing a joint tax return would not be required to file the SSFFA unless their total specified foreign assets exceed $100,000 on the last day of the tax year or more than $150,000 at any time during the tax year.[14] In contrast, a married couple residing abroad and filing a joint return would not be required to file the SSFFA unless the value of their specified foreign assets exceeds $400,000 on the last day of the tax year or more than $600,000 at any time during the year.[15] An unmarried taxpayer living in the United States, on the other hand, would not be required to file the SSFFA unless the value of the specified foreign assets exceeds $50,000 on the last day of the tax year or more than $75,000 at any time during the tax year.[16]

As with the FBAR, failure to file the SSFFA may result in hefty civil penalties of $10,000, with an additional penalty of up to $50,000 for continued failure to file after IRS notification and a 40-percent penalty on any understatement of tax attributable to non-disclosed assets.[17] Jail time is also a possibility.[18]

IV. What are the Differences Between the FBAR and the SSFFA?

Although the respective purposes of the FBAR and the SSFFA are similar, there are clear differences between the filing requirements for each. For example, as described in Part II and III of this article, the reporting threshold for the SSFFA is much higher than the threshold for the FBAR.[19] Unlike the FBAR, for which the requirement to file is unaffected by whether the filer is required to file a federal income tax return, individuals not required to file an income tax return also need not file the SSFFA.[20] Perhaps one of the most important differences between the FBAR and the SSFFA is that the SSFFA applies only to specified individuals, including United States citizens, resident aliens, and certain non-resident aliens that have an interest in specified foreign financial assets and meet the reporting threshold.[21] In contrast, the FBAR also applies to entities created or organized in the United States or under the laws of the United States. In other words, the SSFFA, unlike the FBAR, does not affect domestic entities, trusts or estates.

V. Why is Compliance with the FBAR and SSFFA Increasingly Vital?

Offshore tax evasion is an expensive dilemma for the United States Treasury and the IRS. In fact, according to a tax gap overview article published by the Internal Revenue Service on January 6, 2012 ("Tax Gap Overview"), the main source of nine out of the ten tax gap dollars lies in the underreporting and underpayment in forms of compliance.[22] The gross tax gap is defined as the amount of taxpayer liability that is not paid to the IRS in a timely manner.[23] According to the Tax Gap Overview, the gross tax gap for 2006 was estimated to be $450 billion.[24] The net tax gap is the amount of tax liability that is neither collected by the IRS despite its enforcement efforts nor paid voluntarily to the IRS by the taxpayer.[25] For 2006, the net tax gap is an astounding $385 billion.[26]

Although self-reporting requirements such as the FBAR have been in place for decades, enforcement for violations of the FBAR was not stringent, and the tax gap continued to grow according to the Tax Gap Overview.[27] In 2008, in a renewed effort to combat tax evasion and to reduce the tax gap, the IRS went to battle against the Swiss bank UBS and accused UBS of aiding United States tax evaders in the concealment of assets overseas.[28] As part of UBS's settlement with the IRS, UBS paid a significant fine and was required to disclose the financial details of thousands of taxpayers who have, according to the IRS, evaded their tax obligations by hiding money offshore at UBS.[29]

Hot off its UBS win, the IRS in 2009 unveiled its Offshore Voluntary Disclosure Program, which offered filers who have not yet been audited by the IRS reduced civil and criminal penalties in exchange for their voluntary disclosure to the IRS of their past non-disclosure activities, such as disclosure of their failure to file timely FBARs. The 2009 Voluntary Offshore Disclosure Program was so successful in the number of voluntary disclosures that the IRS received and in the amount of tax revenue generated that the IRS offered a similar program to filers in 2011 and again in 2012.

The reinvigorated effort to combat foreign financial account tax evasion continued in 2010 with the Foreign Account Tax Compliance Act ("FATCA").[30] The FATCA was enacted as part of the Hiring Incentives to Restore Employment Act and includes the launching of a new reporting and withholding system for foreign financial institutions ("FFIs").[31] On February 8, 2012, the U.S. Treasury and the IRS issued proposed regulations regarding FATCA, which lay out the account identification and withholding requirements for FFIs, other foreign entities, and U.S. withholding agents.[32] Five European Union (EU) nations (France, Germany, Italy, Spain, and the United Kingdom) joined the U.S. Treasury and the IRS in their February 2012 statement regarding the proposed regulations for FATCA.[33] Obviously, this combined effort will most likely prove to be a significant boon to the U.S. Treasury as the IRS will have access to tax data from foreign financial institutions.[34]

Given the renewed vigor that the IRS is directing toward thwarting offshore tax evasion activities by individuals and businesses alike, it is evident that compliance with the requirements of FBAR, SSFFA, and FATCA is becoming increasingly important, especially in light of the severe civil and criminal penalties involved. A failure to file the FBAR or SSFFA may be considered tax fraud.[35] The statute of limitations never expires on civil tax fraud.[36] The possibility of jail time is also a serious risk. The statute of limitations for criminal tax fraud is six years.[37] If you or your client is in a situation where a FBAR or SSFFA has not been timely filed or there has been an underreporting of foreign sourced income on the FBAR or SSFFA, it would be wise to seek the counsel of a competent tax attorney. ■

Endnotes

1 Report of Foreign Bank and Financial Accounts (FBAR), http://www.irs.gov/businesses/small/article/0,,id=148849,00.html (last visited March 28, 2012).

2 31 U.S.C. §§ 5311-5332.

3 Report of Foreign Bank and Financial Accounts (FBAR), http://www.irs.gov/businesses/small/article/0,,id=148849,00.html (last visited March 28, 2012).

4 *Id.*

5 Comparison of Form 8938 and FBAR Requirements, http://www.irs.gov/businesses/article/0,,id=255986,00.html (last visited March 28, 2012).

6 Report of Foreign Bank and Financial Accounts (FBAR), http://www.irs.gov/businesses/small/article/0,,id=148849,00.html (last visited March 28, 2012).

7 *Id.*

8 *Id.*

9 Comparison of Form 8938 and FBAR Requirements, http://www.irs.gov/businesses/article/0,,id=255986,00.html (last visited March 28, 2012).

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11 *Id.*

12 Comparison of Form 8938 and FBAR Requirements, http://www.irs.gov/businesses/article/0,,id=255986,00.html (last visited March 28, 2012).

13 Report of Foreign Bank and Financial Accounts (FBAR), http://www.irs.gov/businesses/small/article/0,,id=148849,00.html (last visited March 28, 2012).

14 IRS Releases Guidance on Foreign Financial Asset Reporting, http://www.irs.gov/irs/article/0,,id=251216,00.html (last visited March 27, 2012).

15 *Id.*

16 Do I Need to File Form 8938, "Statement of Specified Foreign Financial Assets"?, http://www.irs.gov/businesses/corporations/article/0,,id=251217,00.html (last visited April 12, 2012).

17 IRS Releases Guidance on Foreign Financial Asset Reporting, http://www.irs.gov/irs/article/0,,id=251216,00.html (last visited March 27, 2012).

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21 Comparison of Form 8938 and FBAR Requirements, http://www.irs.gov/businesses/article/0,,id=255986,00.html (last visited March 28, 2012).

22 Tax Gap for Tax Year 2006 Overview Jan. 6, 2012 (Internal Revenue Service), http://www.irs.gov/pub/newsroom/overview_tax_gap_2006.pdf (last visited March 28, 2012).

23 Tax Gap for Tax Year 2006 Overview Jan. 6, 2012 (Internal Revenue Service), http://www.irs.gov/pub/newsroom/overview_tax_gap_2006.pdf (last visited March 28, 2012).

24 *Id.*

25 *Id.*

26 *Id.*

27 *Id.*

28 Excerpts from IRS Commissioner Doug Shulman's Press Remarks on UBS (August 19, 2009), http://www.irs.gov/newsroom/article/0,,id=212203,00.html (last visited March 27, 2012).

29 *Id.*

30 Hiring Incentives to Restore Employment Act H.R. 2847, Pub. L. No. 111-147, 124 Stat. 71 (2010).

31 Treasury, IRS Issue Proposed Regulations for FATCA Implementation (February 8, 2012), http://www.irs.gov/newsroom/article/0,,id=254068,00.html (Last visited April 2, 2012).

32 *See id.*

33 *Id.*

34 Hiring Incentives to Restore Employment Act H.R. 2847, Pub. L. No. 111-147, 124 Stat. 71.

35 *See* Comparison of Form 8938 and FBAR Requirements, http://www.irs.gov/businesses/article/0,,id=255986,00.html (last visited March 28, 2012).

36 I.R.C. §§ 6501(c)(1)-(2).

37 §§ 7201, 7203, 7206(1)-(2), 7207.