

Checkpoint Contents

Tax News

Journal Preview (WG&L)

Journal of Taxation

Significant New FBAR Developments From IRS and the Tax Court, Journal of Taxation

SHOP TALK

By Kevin E. Packman, Esq.

Significant New FBAR Developments From IRS and the Tax Court

EDITED BY SHELDON I. BANOFF, J.D., AND RICHARD M. LIPTON, J.D.

This column provides an informal exchange of ideas, questions, and comments arising in everyday tax practice. Readers are invited to write to the editors: Sheldon I. Banoff, Suite 1900, 525 West Monroe Street, Chicago, Illinois 60661-3693, Sheldon.Banoff@kattenlaw.com, and Richard M. Lipton, 130 East Randolph Drive, Chicago, Illinois 60601, Richard.M.Lipton@BakerNet.com.

The requirement to file the non-tax information return known as an FBAR ("Report of Foreign Bank and Financial Accounts," TD F 90.22-1) is an obligation most taxpayers and many practitioners are unaware of. See Packman and Weinstein, "FBAR—Foreign Bank Account Reporting Obligations: A Primer for the Practitioner," 106 JTAX 44 (January 2007), and Shop Talk, "Update on FBAR Developments—New Enforcement Efforts Likely," 106 JTAX 318 (June 2007).

The FBAR must be filed by all U.S. persons who have a financial account, signature authority, or other authority over foreign financial accounts if in the aggregate at any time during the calendar year the balances of all of the accounts are at least \$10,000. Each of the respective terms is defined quite broadly and multiple persons can have a filing obligation to report the existence of the same accounts.

Kevin E. Packman and Andrew H. Weinstein, respectively a senior associate and a senior international tax partner with the law firm of Holland & Knight LLP in Miami, have provided us with the following broad overview of several new developments affecting taxpayers, including a revised FBAR form released on 9/30/08. In addition, a new Tax Court case considered FBAR jurisdictional issues. The steps leading up to these developments include:

- *IRS outreach.* In June 2007, the Service as part of its IRS National Phone Forum hosted three webinars dealing with the FBAR. On 11/25/07, an e-mail was issued to those who participated, which contained a series of answers approved by IRS Counsel to questions asked by those who participated. This seems to be the greatest extent of IRS guidance on the FBAR filing obligation, and yet it does not appear that the IRS has published this list of questions and answers on its website. We will make copies available; please contact us by e-mail (kevin.packman@hkllaw.com).
- *Investigations.* The Service announced in IR-2008-26, 2/26/08, that it was taking enforcement action against more than 100 U.S. taxpayers "to ensure proper income reporting and tax payment in connection with accounts in Liechtenstein," joining forces with seven major treaty partners to crack down on tax evasion in connection with that principality. The news release indicated that IRS was "working together [with other member countries of the Organization for Economic Cooperation and Development's

Forum on Tax Administration] following revelations that Liechtenstein accounts are being used for tax avoidance and evasion." Then on 7/1/08 the IRS filed a John Doe summons against UBS to obtain the names of up to 20,000 U.S. taxpayers who held accounts with the institution, and who failed to report the accounts. A headline in the 10/1/08 edition of the *International Herald Tribune* reported that "Switzerland said to be sharing client data in UBS tax case."

- *Notices and delegations.* In Delegation Order 4-35, 3/24/08, the IRS delegated numerous FBAR responsibilities among its divisions. On 6/17/08, the IRS issued IR-2008-79, entitled "IRS Reminds Taxpayers to Report Certain Foreign Bank and Financial Accounts by June 30." IRS Commissioner Doug Shulman was quoted as saying "[t]here are responsibilities that go along with owning such foreign bank and financial accounts [and] [f]oreign account owners must remember that they may have to report their accounts to the government, even if the accounts do not generate any taxable income." On 6/18/08, the IRS also released a "Memorandum for BSA Compliance Examiners and Managers," which provides guidance to examiners on how to audit for FBAR compliance. (The BSA is the Bank Secrecy Act, 31 U.S.C. sections 5311-5330.)
- *Internal Revenue Manual.* Section 4.26.16 of the IRM was added as of 7/1/08, and parts of section 4.26.17 were revised on 5/5/08.
- *Audits.* When auditing taxpayers, the IRS is using at least two approaches to determine FBAR compliance with its information document requests (IDRs). The first approach is a simple innocuous request for "[c]opies of all bank statements for all foreign accounts (including but not limited to checking, savings, certificate of deposits, etc.), in which the taxpayer is a beneficiary or has control over (i.e., signature authority, as trustee, nominee, etc.) for the [specified] period...." The second approach is much more aggressive and appears similar to a subpoena with a definitional section. The FBAR related questions run several pages. Taxpayers should understand that if dealing with the IRS alone, they could inadvertently make an admission that will later be used against them in a criminal matter. They also should realize that the innocuous questions can be followed up with the more aggressive approach.

ABA Tax Section. The FBAR also was a topic of discussion at the Fall meeting of the Section of Taxation held in San Francisco. A panel of the Civil and Criminal Penalties Committee on 9/12/08 discussed the following issues:

- *UBS and LGT.* Taxpayers who have failed to file FBARs and report the income associated with their foreign accounts should not assume that just because their accounts are not held at UBS or LGT (the Liechtenstein Global Trust Group), they will be immune from IRS enforcement. IRS Deputy Chief of Criminal Investigation Victor Song stated that "just because you see a couple of banks that are making the press doesn't mean ... that it's limited to two banks." Song indicated that the IRS has trained 800 law enforcement officers around the world and the implication was that the Service will find noncompliant taxpayers. The IRS is getting good information from its treaty partners through spontaneous exchanges of information. The whistleblower law is also bringing a lot of new information to the Justice Department and IRS.
- *Enforcement.* Practitioners should expect the IRS to increase imposition of FBAR penalties because the IRS has been criticized for not previously penalizing those taxpayers who failed to comply with the law following the 2003 Offshore Voluntary Compliance Initiative. The IRS recognizes that increased use of the FBAR penalties is a useful tool to encourage compliance.
- *Focus.* Mr. Song noted that there are two new senior prosecutors, one who will deal with FBAR and other offshore banking issues, and the other who will deal with national security issues, including some immigration issues. There are currently eight international attaches overseas. Not only are their staffs being increased but they are being educated on the law so that they can enforce it. IRS is working to educate foreign prosecutors and foreign investigators on these issues because the issues are global. The Commissioner is

very interested in this topic. Both civil and criminal agents are being trained to understand the available tools to uncover noncompliance and to specialize in areas of law. This includes training in treaties and MLATs (Mutual Legal Assistance Treaties).

- *Prosecutions.* Recognizing the Service's workload, and its inability to police all taxpayers, prosecutors are encouraging the IRS to look for facts with jury appeal. Offshore accounts are attractive to juries, especially when these accounts are coupled with efforts to conceal large sums of money. Because Congress has provided new enforcement tools, we should expect the IRS to publicize cases that will include FBAR violations. There is now an agent in the Detroit Service Center whose job is to review all late-filed FBARs. The relevant information can be provided to the DOJ the very next day. Even though the IRS may have included FBARs in a voluntary disclosure, the DOJ does not necessarily have to follow the IRS policy. While DOJ may file some major cases to deliver the message that hiding money offshore does not pay, prosecutors should continue to focus on the facts. By prosecuting a taxpayer who is trying to get it right, the DOJ may cause a disincentive for taxpayers to come into compliance. There was no answer given as to how the DOJ will tread or discretion as to what factors it will look to before deciding to prosecute. The new agent based in Detroit is certainly a cause for concern, especially with a stealth disclosure.
- *Voluntary disclosure.* There is no FBAR-related voluntary compliance initiative likely to be offered. There was a suggestion that it "would be nice if the IRS could quickly get names of taxpayers on a DOJ target list to give us a clear answer if this is a good voluntary case or not.... It would also be good if the IRS had a clear position on how much the maximum penalty will be on a voluntary FBAR disclosure." The IRS response was that they utilize a balanced approach, and review the facts of each case. An additional comment was made that there are so many penalties that there needs to be assurance of reasonable determinations. The IRS is being urged by the ABA Tax Section to use discretion, but so far the Service's position is that there has to be reasonable cause to avoid penalties. IRS says to expect stiffer penalties than before, but IRS is being careful because of limited resources and because the law is not always clear. This is definitely an evolving issue. The uncertainty is scaring off some voluntary disclosures because penalties can exceed account balances. Both the IRS and DOJ want increased taxpayer compliance, and both offer voluntary disclosure programs. Therefore, making criminal cases from those filings is not consistent with the carrot-and-stick approach. It would be better for the government agencies to focus on egregious cases, rather than on taxpayers who have proceeded through bona-fide voluntary disclosures.

The revised FBAR. On 9/30/08, and with no pronouncement, the IRS posted a revised FBAR on its website, which is to be used for all filings after 2008. While we provide a brief summary of some of the noteworthy revisions, we do encourage everyone to spend time reviewing the new FBAR and the accompanying instructions. A complete analysis of the new FBAR and its instructions are beyond the scope of this column.

(1) *Multiple parts.* Similar to Form 3520 ("Annual Return to Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts"), there are now multiple parts to the FBAR, and taxpayers only need to complete the relevant sections. Part I always will be completed, as it contains the filer's information; Part II is completed by those reporting a financial interest in a foreign account; Part III by those reporting a joint interest in a foreign account; Part IV by those filers who need to report signature authority or other authority over foreign accounts; and Part V is completed by those corporations filing a consolidated FBAR.

(2) *U.S. person.* The instructions reflect that the definition of "U.S. person," and thus who is required to file the FBAR, includes "a citizen or resident of the United States, or a person in and doing business in the United States." Reference is made to 31 CFR section 103.11(z) for a complete definition of U.S. person. As a result of the expanded definition, question 4 now requires a person in and doing business in the U.S. to report that

person's foreign identification number. The instructions explain that only if the filer does not have a Social Security number should the filer report an official foreign government document number evidencing the filer's nationality or residence (i.e., foreign passport number).

(3) *Filing due date.* The instructions reiterate that the FBAR must be filed by June 30 of the year following the calendar year to be reported, and there are no extensions. Whereas the FBAR must be filed with the Detroit Service Center, filers now have the option of hand delivering the FBAR to any local IRS office. For those filers located outside of the U.S., tax attaches are located in the U.S. embassies in certain foreign countries. Finally, filers are advised that they can contact the Detroit Computing Center Hotline at 800-800-2877.

(4) *Amended/late filings.* There is now a box to be checked if the filer is submitting an amended FBAR. Whether the FBAR is filed late or is an amendment, the instructions advise the filer (and thereby practitioners) to attach a statement explaining why the FBAR is filed late, or the reason for the changes to the previously filed FBAR. If submitting an amended FBAR, the original FBAR must be attached.

(5) *Financial accounts.* The definition of financial account found in the instructions has been expanded to make clear that it also encompasses debit card or prepaid credit card accounts.

(6) *Financial interest.* The definition of financial interest also has been expanded. Under the prior definition, a U.S. person who created a trust, or was deemed to own a trust (for example under the grantor trust rules), could be classified as having a financial interest if the trust owned foreign accounts. Now, the U.S. person will be deemed to have a financial interest if the trust that owns foreign accounts has a "trust protector." Trust protector is defined as a "person who is responsible for monitoring the activities of a trustee, with the authority to influence the decisions of the trustee, or to replace, or recommend the replacement of the trustee." As we mentioned in our January 2007 article, the trust protector's powers could rise to the level that the trust protector could have his or her own filing requirement under signature or other authority.

(7) *Account valuations.* Prior versions of the FBAR asked the filer to check one of four boxes reflecting the value of the foreign accounts, with each box reflecting a range of values. The new FBAR requires the filer to report the "maximum value" of the account. Foreign currencies are to be converted at the end of the year, and there are specific instructions provided for valuing assets, including how to report accounts with an unknown valuation.

(8) *Signature or other authority.* In the new Part IV, to be completed when an individual is reporting signature or other authority over foreign accounts, the filer also must report the name, address, and identifying number of the owner of the foreign account (in addition to the address of the foreign financial institution where the account is held). While much of this information was previously requested in prior drafts of the FBAR, we have heard instances in which filers would simply report that no U.S. person had a financial interest, and not report the identifying information of the account owner. The instructions make it clear that this information is now required.

Tax Court. On 10/2/08, the Tax Court released its decision in *Williams*, 131 TC No. 6, in which it stated it did not have jurisdiction to address the taxpayer's liability for FBAR penalties. The IRS had issued a notice of deficiency to the taxpayer, including penalties and additions to tax for the years 1993-2000. The taxpayer sought a deficiency redetermination for the years at issue as well as for the 2001 tax year. In addition, the taxpayer sought to have the court abate interest that may be assessed as well as the FBAR penalties.

The Tax Court began its review by noting that the FBAR filing and penalty are authorized by Title 31, not Title 26. It then found that civil penalties for violations of the FBAR filing requirements are permitted by section 5321(a) of Title 31. The court noted that section 5321(b)(1) permits Treasury to assess those penalties, and to "commence a civil action to recover" the penalties.

Treasury has delegated its authority to the IRS. Because FBAR penalties are not subject to the deficiency procedures of Title 26, and the Tax Court's jurisdiction is conferred on it by Title 26, the court found it did not have jurisdiction to address the propriety of the FBAR penalty.

© 2008 Thomson Reuters/RIA. All rights reserved.