SHOP TALK

Update on FBAR Developments—New Enforcement Efforts Likely

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.

In "FBAR—Foreign Bank Account Reporting Obligations: A Primer for the Practitioner," 106 JTAX 44 (January 2007), Kevin E. Packman and Andrew H. Weinstein, respectively an associate and a senior international tax partner with the law firm of Holland & Knight LLP in Miami, discussed the origins and scope of the FBAR filing requirement, as well as the penalties for failure to comply. Messrs. Packman and Weinstein write to us as follows regarding post-publication statements made by IRS personnel or Members of Congress affecting the FBAR.

1. Nina Olson, the National Taxpayer Advocate, released her 2006 Report on 12/31/06. In the report, Olson suggested three alternatives for closing the tax gap. The second pertained to improving third-party reporting, premised on the idea that increased reporting from foreign institutions will lead to an increase in U.S. taxpayer compliance. While the FBAR itself (Form TD F 90-22.1) is not an income tax return, and does not generate income such that improved compliance would help reduce the tax gap, the penalties associated with noncompliance could generate significant revenue.

2. During a panel discussion at the Florida Bar's 25th Annual International Tax Conference held January 25th and 26th, Frank Ng, IRS Deputy Commissioner (International), Large and Midsize Business Division, said "international tax compliance is now really a major emphasis for the Service." When the conversation turned to the FBAR and IRS enforcement, K. Steven Burgess, Director of Examination for Service's Small Business/Self-Employed Division, stated that IRS does have discretion when imposing penalties for noncompliance. Penalties for noncompliance prior to the Americans Jobs Creation Act of 2004 include penalties of up to $100,000 per account for each year that the account was unreported. Subsequent to the AJCA, there is a penalty of up to $10,000 for a non-willful violation, and the maximum willful violation penalty is the greater of $100,000 or 50% of the balance of the account at the time of the violation. Because the IRS does have discretion when imposing penalties, the penalties may differ based on the taxpayer's particular facts and circumstances.

Rodney L. Hare, an SB/SE Territory Manager for the South Atlantic Area, indicated that if the foreign account is referred to on the taxpayer's Form 1040 but an FBAR is not filed, the IRS will follow a facts and circumstances approach to determine penalties. The Service may simply issue a warning letter, but the Form 1040 otherwise has to be complete, including interest from the foreign accounts.

Finally, Hare was asked a question dealing with the lack of extensions on FBARs. He stated that because the FBAR is a Title 31 filing requirement rather than a Title 26 requirement, the June 30 deadline for the FBAR is the same as for any other Title 31 filing. When he was asked why the FBAR was simply not changed to a Title 26 filing requirement, Hare stated that making such a change was not easy to do. Under Title 31, other government agencies like the FBI have access to the documentation, which is not the case with Title 26 filings. Additionally, the statute of limitations on the FBAR is six years, again because it is a Title 31 filing.

3. The Stop Tax Haven Abuse Act (S.681) was introduced by Senator Carl Levin (D-Mich.), the Chairman of the Permanent Subcommittee on Investigations, Senator Norm Coleman (R-Minn.), the ranking Republican on the committee and Senator Barack Obama (D-Ill.), a member of the committee, on 2/17/07. The legislation is designed to deter the use of tax havens for tax evasion. It also suggests FBAR-related changes to Title 31.

Section 101 of the bill provides a presumption that any taxpayer who has an account in one of the 34 jurisdictions deemed to be secretive has sufficient income within the account to trigger an FBAR reporting. Section 104 requires any bank or securities firm that knows from its anti-money-laundering due diligence that the beneficial owner of one of its foreign-owned financial accounts is a U.S. taxpayer, to file, in its role as withholding agent, a Form 1099 reporting account income of that beneficial owner to the IRS.

Section 205 of the bill is designed to enhance enforcement of the FBAR by (a) clarifying the authority of IRS agents investigating FBAR violations to use tax information in the investigations and (b) simplifying the calculation of FBAR penalties by tying the penalty to the highest balance in the account during the reporting period.

4. On 2/27/07, the IRS issued a Fact Sheet designed to remind U.S. taxpayers with foreign accounts that there are responsibilities associated with such ownership. While the Fact Sheet briefly explains who is required to file the FBAR and when, it also summarizes the penalties for failure to comply as well as states that there are no extensions provided.

The IRS states that "the FBAR is required because foreign financial institutions that do not conduct business in the United States may not be subject to the same reporting requirements that domestic financial institutions are subject to (such as the requirement to file a Form 1099 to report interest paid to an account holder). Although there are legitimate purposes for having a foreign account, the FBAR is a tool to help the U.S. government identify persons who may be using foreign financial accounts to circumvent U.S. law."

Whether the Stop Tax Haven Abuse Act becomes law or not, it is clear that Congress and the IRS are focused on reducing the tax gap. While compliance with the FBAR filing requirements will not generate revenue, failure to comply most certainly will generate revenue. Between statements made by IRS personnel regarding the increase in international compliance and the February 2007 Fact Sheet, it should be clear that FBAR enforcement is on the uptick. Taxpayers and tax preparers should realize that these are not isolated attempts to increase compliance.

In our January 2007 article, we summarized the report prepared by the Joint Committee on Taxation entitled "Additional Options to Improve Tax Compliance." The purpose of the JCT Report, which was prepared on 8/3/06 but not released for distribution by the Senate Committee on Finance until 10/19/06, was to discuss options that may help bring about a reduction in the tax gap. Section E of the JCT Report was dedicated to offshore bank accounts. The report's proposals would put the responsibility for determining whether a taxpayer has an FBAR filing requirement on tax preparers, by extending to the FBAR the Section 6695(g) due diligence requirement, which currently imposes the responsibility on preparers to determine a taxpayer's eligibility for the earned income tax credit as well as the amount of the credit permitted.

Shop Talk thanks Messrs. Packman and Weinstein for their input and asks our readers for their experiences with FBAR reporting.