

# Anti-Deferral and Anti-Tax Avoidance\*

*By Michael J. Miller*

## The New FBAR Is Here!

In October 2008, the Treasury revised Form TD F 90-22.1 (Report of Foreign Bank and Financial Accounts), commonly referred to as the “Foreign Bank Account Report” or “FBAR.”<sup>1</sup> The new form provides helpful guidance, along with some unwelcome surprises. Further, just in case numerous stories about wealthy Americans hiding cash offshore with the help of UBS were not sufficient to make the point,<sup>2</sup> the FBAR revision emphasizes the increasing amount of attention paid to reporting of offshore accounts. Taxpayers and tax preparers that may have devoted insufficient attention to these matters would be well advised to adjust their attitudes toward FBAR compliance as soon as possible.

### Background

#### Filing Requirement

All “U.S. persons” that have a financial interest in, or signature or other authority over, one or more foreign financial accounts with an aggregate value that exceeds \$10,000 at any time during the calendar year are required to file an FBAR on or before June 30 of the following year.<sup>3</sup> The FBAR is a separate form that is not attached to the income tax return, and an extension of a taxpayer’s deadline for filing its income tax return does not extend the June 30 deadline for filing the FBAR. The FBAR must be filed even if the account generates no income.

The FBAR generally requires disclosure of information regarding each foreign account including the



**Michael J. Miller** is a Partner in Roberts & Holland LLP, New York, New York.

©2009 M.J. Miller

name of the financial institution in which the account is held; the type of account (e.g., bank, securities or other); the account number; information regarding the maximum value of the account at any time during the year; and whether the filer has a financial interest in the account. Where the filer has a financial interest in 25 or more foreign accounts, however, the FBAR need not provide information for each account separately, but such information must be provided to the Treasury upon request.<sup>4</sup> Each U.S. person must retain records of its foreign accounts covered by FBAR.<sup>5</sup>

There are several exceptions to FBAR filing. Persons who do not have to file the FBAR include those with accounts in U.S. military banking facilities abroad, as well as officers or employees of a federally supervised bank with signature or other authority but no personal financial interest in a foreign account of the bank. An officer or employee of a publicly traded domestic corporation (or a private corporation with over \$10 million of assets and 500 or more shareholders of record) with no personal financial interest in a foreign account of the corporation need not report such account if he or she has been advised in writing by the corporation's CFO that the corporation has filed a current report for such account.

## Getting the Word Out

Typically (but, unfortunately, not universally), U.S. persons are aware of their obligation to file annual income tax returns. Quite a few, however, are unaware of their obligation to file an FBAR to disclose their foreign financial accounts. Alas, if only there were some way to alert U.S. persons that an FBAR filing may be required!

Some may be surprised to learn that just such a warning appears, in uncharacteristically comprehensible terms, on a number of returns filed by U.S. persons, including Form 1040 (*U.S. Individual Income Tax Return*),<sup>6</sup> Form 1041 (*U.S. Income Tax Return for Estates and Trusts*),<sup>7</sup> Form 1065 (*U.S. Return of Partnership Income*)<sup>8</sup> and Form 1120 (*U.S. Corporation Income Tax Return*).<sup>9</sup> For example, Line 7a to Schedule B of the 2008 Form 1040 provides as follows:

At any time during 2008, did you have an interest in or a signature or other authority over a financial account in a foreign country, such as a bank account, securities account, or other financial account? See page B-2 for exceptions and filing requirements for Form TD F 90-22.1.

Thus, it seems fair to say that U.S. persons *should* be aware of the FBAR filing requirement. Notably, a box must be checked to indicate whether the answer is “yes” or “no,”<sup>10</sup> and this affirmative obligation can put taxpayers in a difficult position. A taxpayer that would like to conveniently “forget” about the FBAR will not wish to raise a red flag by checking the “yes” box. Checking the “no” box, however, is inadvisable for reasons that the author hopes the reader will consider obvious. Some taxpayers have resolved this issue by simply ignoring the question (*i.e.*, checking neither box) but this does not sit well with the IRS. Query whether taxpayers who do not check the box should be considered to have filed complete returns.

## Penalties

Over the last few years, there has been a renewed focus on FBAR compliance. Prior to 2005, only persons who willfully failed to file the FBAR were liable for civil or criminal penalties. The 2004 Jobs Act, however, imposed a new civil penalty for nonwillful violations of certain recordkeeping or reporting obligations with respect to transactions or relationships with a “foreign financial agency,” including the FBAR filing requirement.<sup>11</sup> Pursuant to the 2004 Jobs Act, nonwillful violations are subject to a civil monetary penalty of up to \$10,000.

The applicable statute provides for a waiver of the penalty if (1) “such violation was due to reasonable cause,” and (2) “the amount of the transaction or the balance in the account at the time of the transaction was properly reported.”<sup>12</sup> The Senate Finance Committee Report, however, states that the penalty for failure to report an account on the FBAR “may be waived if *any* income from the account was properly reported on the income tax return and there was reasonable cause for the failure to report.”<sup>13</sup> Based on the formulation of the Senate Finance Committee, the penalty may potentially be waived even if most of the income from the account was not reported, provided that there is reasonable cause for the failure to report.<sup>14</sup>

A willful failure to file the FBAR may result in both civil and criminal penalties. The civil penalty for willful violations is the *greater* of \$100,000 or 50 percent of the balance in the account at the time of the violation (*i.e.*, the June 30 filing deadline).<sup>15</sup> Criminal violations of the FBAR rules can result in a fine of not more than \$250,000, imprisonment for up to five years, or both.<sup>16</sup> If the failure to file an

FBAR occurs while violating another U.S. law, or in connection with a pattern of illegal activity involving more than \$100,000 over a 12-month period, the criminal penalty may be increased to a fine of up to \$500,000, imprisonment for up to ten years, or both.<sup>17</sup> Unsurprisingly, there is no reasonable cause exception for willful violations.<sup>18</sup> The civil penalty can be imposed even if a criminal penalty is imposed with respect to the same violation.<sup>19</sup>

Taxpayers are not the only ones that should be concerned about penalties. For reasons known only to them, some return preparers apparently check the no box (on Line 7a of Schedule B to Form 1040) as a matter of course without asking their clients if they have any foreign accounts and without advising their clients that an FBAR filing may be required. Such return preparers may well face the prospect of preparer penalties under Code Sec. 6694.<sup>20</sup> Furthermore, they may face claims from (former) clients subject to stiff penalties for noncompliance with their FBAR reporting obligations.

## The New FBAR

### Overview

The new form and instructions (generally referred to collectively as the new form) introduce a fair amount of new guidance to the FBAR filing requirements. Much of it is helpful or at least noncontroversial. Some of the new guidance, however, is surprising to say the least.

### Definition of “United States Person”

The most significant change is that the new form expands the scope of “United States persons” potentially required to file the FBAR to include certain foreign persons with U.S. activities.<sup>21</sup> The old form defines a “United States person” (hereinafter, “U.S. person”) to include only U.S. citizens, U.S. residents, domestic corporations, domestic partnerships and domestic trusts or estates.<sup>22</sup> Under the new form, however, the term includes “a citizen or resident of the United States, or a person in and doing business

in the United States.”<sup>23</sup> To emphasize the point, the new form further states that “[a] branch of a foreign entity doing business in the United States is required to file this report even if not separately incorporated under U.S. law.”<sup>24</sup>

The expansion of the FBAR filing requirement to foreign persons “in and doing business in the United States” is not necessarily objectionable (depending on what exactly those words mean), but accomplishing such objective by defining the term “United States person” to include persons that are clearly foreign seems inappropriate. First, this type of draftsmanship

The expansion of the FBAR filing requirement to foreign persons “in and doing business in the United States” is not necessarily objectionable (depending on what exactly those words mean), but accomplishing such objective by defining the term “United States person” to include persons that are clearly foreign seems inappropriate.

unnecessarily creates a trap for the unwary. Suppose that a foreign corporation (“FC”) does business in the United States and the CFO attempts to determine whether FC is required to file an FBAR. The CFO encounters the following deceptive guidance in the upper left hand corner of page 6 of the form:

#### Who Must File this Report.

Each United States person who has a financial interest in or signature or other authority over any foreign financial accounts, including bank, securities, or other types of financial accounts, in a foreign country, if the aggregate value of these financial accounts exceeds \$10,000 at any time during the calendar year, must report that relationship each calendar year by filing this report with the Department of the Treasury on or before June 30, of the succeeding year.

It would be understandable if the CFO (or possibly its U.S. tax advisor) stopped reading and mistakenly concluded that no FBAR filing was required. In this situation, FC may be subject to penalties or may avoid penalties only after a greater deal of heartburn is suffered and professional fees are incurred. It is difficult to understand why the Treasury would wish to put FC in this position.

Furthermore, foreign persons that understand the rules quite clearly may choose not to file the FBAR in the hope that, if ever put to the question, they can pretend to have been confused by the misleading

instructions quoted above. It is equally difficult to understand why the Treasury would wish to create fertile ground for such plausible deniability.

Another important question is what precisely it means for a foreign person to be “in and doing business in the United States.” The new form provides no guidance on this issue. Presumably, this threshold would be satisfied by any foreign person that is considered to be engaged in a trade or business in the United States within the meaning of Code Sec. 864. But what if the foreign person trades in securities or commodities in the United States in a manner that qualifies for one of the safe harbors under Code Sec. 864(b)(2)?<sup>25</sup>

Similarly, what about a foreign person that sells a U.S. real property interest but is not otherwise engaged in a trade or business within the United States under U.S. tax principles?<sup>26</sup> Further guidance on these issues would be helpful, to say the least.

The expanded filing requirement is also noteworthy in that the obligation to disclose foreign financial accounts is not by its terms limited to those accounts having some U.S. connection. Thus, for example, a foreign corporation that has 135 foreign financial accounts used solely for offshore activities, and one U.S. bank account used solely for its modest U.S. business, would presumably be required to disclose all 135 foreign accounts, even though they have no connection whatsoever with the U.S. business. This seems a bit much.<sup>27</sup>

### Foreign Identification Information

The new form provides that a filer with no U.S. taxpayer identification number must provide information about an official foreign government document evidencing the filer’s nationality or residence. The information to be provided includes a description of the type of document, the identification number shown on such document, and the name of the country of issuance. Thus, for example, an individual who is not a U.S. citizen would check off “passport” as the type of document, provide his or her passport number and state the name of the country that issued the passport.

### Attribution of a Financial Interest

The new form also expands the “attribution rules” that deem U.S. persons with a certain specified interest in an entity to have a financial interest in any financial account of which the entity is the owner of record. For example, under the old form, a U.S. person had a financial interest in a corporation’s foreign account if the U.S. person owned, directly or indirectly, more than 50 percent of the total value of the stock of the corporation. The new form expands this attribution rule to apply if the shareholder owns, directly or indirectly, more than 50 percent of either the total value or the total voting power of the stock of the corporation.

Similarly, under the old form, a U.S. person had a financial interest in a partnership’s foreign account if the U.S. person owned a greater-than-50-percent interest in the profits of the partnership. The new form expands such attribution rule to apply if the U.S. person owns a greater-than-50-percent interest in

either the profits or the capital of the partnership.

The new form also supplies an entirely new attribution rule whereby a U.S. person that establishes a trust is considered to have a financial interest in any foreign account in the name of the trust if the trust has a protector.<sup>28</sup> Whether the U.S. settlor is a beneficiary of the trust, or has any control over the trust protector, is apparently irrelevant. This new attribution rule appears to rest upon the questionable assumption that all such trusts are essentially shams, and that the trust protectors invariably do the bidding of the settlor. Many U.S. settlors of irrevocable trusts in which they are not beneficiaries are unlikely to be aware of their FBAR filing obligations since they do not, in the usual sense of the term, have any financial interest in the trust account and the attribution rule described above is far from intuitive. Moreover, they may in some instances have difficulty acquiring the necessary information.

### Definition of Financial Accounts

The new form expressly provides that the definition of “financial accounts” includes debit card and prepaid credit card accounts.<sup>29</sup> Non-prepaid credit card accounts, however, appear to be excluded.

The new form also supplies an entirely new attribution rule whereby a U.S. person that establishes a trust is considered to have a financial interest in any foreign account in the name of the trust if the trust has a protector.

## Increased Disclosure

The new form increases the amount of disclosure to be provided when an FBAR must be filed. Under the old form, a filer that had only signature authority over (and no financial interest in) a foreign account was not required to disclose the identity of a non-U.S. account owner. Indeed, the instructions expressly provided that it was sufficient to state that “No U.S. person had any financial interest in the foreign account.” Under the new form, a filer that is not considered to have a financial interest in the foreign account must identify the account owner under all circumstances. The required information includes the account owner’s name, identification number and address. Thus, foreign account owners can no longer take comfort in the fact that their identities will not be disclosed when they give signature authority over accounts to U.S. persons.<sup>30</sup>

Interestingly, it should be possible to avoid this problem if the account is placed in the name of the U.S. signatory. Both the old and new form expressly provide that a U.S. person “has a financial interest in each account for which such person is the owner of record or has legal title, whether the account is maintained for his or her own benefit or for the benefit of others including non-United States persons.” Since disclosure of the beneficial owner is only required where the filer lacks a financial interest, giving the filer a financial interest in this way should suffice to avoid the need for such disclosure. Of course, it would not be surprising if the IRS ultimately asked the filer to provide additional information if it inquires why no income from the foreign account was reported on the filer’s tax return.

The new form also requires more specific information regarding the maximum value of each foreign

account. Under the old form, a box was to be checked for each account indicating whether the maximum value in the account at any time during the year was (1) less than \$10,000; (2) \$10,000 to \$99,000; (3) \$100,000 to \$1 million; or (4) more than \$1 million. Thus, the old form could be completed by estimating the maximum value in each account and aiming high when in doubt. The new form requires disclosure of a specific maximum account value. Accordingly, preparation of the new form will be somewhat more time-consuming as filers, and their tax preparers, make a real effort to determine the appropriate maximum value.<sup>31</sup>

## Amended FBAR and Other Changes

The new form also provides a box to check for an amended FBAR, thereby providing a procedure for amending FBARs that did not previously exist. Of course, whether it is desirable in a given case to file an amended FBAR, highlighting the fact that the original FBAR was incomplete or incorrect, is a separate question. The new form also includes a separate section for disclosing joint accounts.

## Conclusion

The new form includes important revisions, including, among others, a deceptive definition that treats certain foreign persons as “U.S. persons” required to file the FBAR; a questionable rule for U.S. settlors of certain trusts; and increased disclosure requirements. More importantly, the new FBAR underscores the fact that the IRS is extremely serious about the reporting of offshore accounts. Taxpayers and return preparers that continue to overlook the FBAR reporting rules do so at their own peril.

### ENDNOTES

\* The author gratefully acknowledges the assistance of his associate, Libin S. Zhang, in the preparation of this article.

<sup>1</sup> The Treasury’s authority to require filing of the FBAR is found in 31 U.S.C. §5314 and 31 C.F.R. §103.24.

<sup>2</sup> See, e.g., Janet Novack, *UBS Cheats Can Still Come Clean*, FORBES (July 9, 2008), available at [www.forbes.com/2008/07/08/irs-ubs-tax-es-biz-beltway-cz\\_jn\\_0709beltway.html](http://www.forbes.com/2008/07/08/irs-ubs-tax-es-biz-beltway-cz_jn_0709beltway.html).

<sup>3</sup> The maximum account value is the largest amount of currency or nonmonetary assets that appears on any account statement issued for the applicable year or at any time during the year if periodic account statements are not issued. Foreign currency is converted by using the exchange rate at

the end of the year, while stock, securities and other nonmonetary assets are valued at fair market value at end of year or at the time of withdrawal.

<sup>4</sup> This rule does not apply to filers with signature or other authority over such accounts.

<sup>5</sup> 31 C.F.R. §103.32. The records should contain the name in which each account is maintained, the number or other designation of such account, the name and address of the bank or other foreign person with whom such account is maintained, the type of such account, and the maximum value of each such account during the reporting period. The records must be retained for five years and be kept at all times available for inspection.

<sup>6</sup> Form 1040 (2008), Schedule B, Line 7.

<sup>7</sup> Form 1041 (2008), Other Information, Line 3.

<sup>8</sup> Form 1065 (2008), Schedule B, Line 10.

<sup>9</sup> Form 1120 (2008), Schedule N, Line 6.

<sup>10</sup> If the answer is yes, then the country in which the account is located must be set forth on Line 7b.

<sup>11</sup> American Jobs Creation Act of 2004 (P.L. 108-357), Sec. 821, amending 31 U.S.C. §5321(a)(5). The new penalties apply to violations after October 22, 2004, i.e., FBAR forms due on or after June 30, 2005.

<sup>12</sup> 31 U.S.C. §5321(a)(5)(B)(ii).

<sup>13</sup> S. REP. NO. 108-192, at IV.A.11. (Emphasis added.)

<sup>14</sup> See Steven Toscher & Michel R. Stein, *FBAR*

*Enforcement—An Update*, J. TAX PRACTICE & PROCEDURE, Apr.–May 2006, at 57, 58.

<sup>15</sup> 31 U.S.C. §5321(a)(5)(C). Prior to the 2004 Jobs Act, the penalty was the greater of \$25,000 or the balance in the account at the time of violation, up to a maximum of \$100,000 per violation.

<sup>16</sup> 31 U.S.C. §5322(a); 31 C.F.R. §103.59(b).

<sup>17</sup> 31 U.S.C. §5322(b); 31 C.F.R. §103.59(c).

<sup>18</sup> 31 U.S.C. §5321(a)(5)(C)(ii).

<sup>19</sup> 31 U.S.C. §5321(d).

<sup>20</sup> All “Code” references herein are to the Internal Revenue Code of 1986, as amended. Notably, a return preparer does not appear to be subject to any specific penalty for failing to determine whether its client must file an FBAR. The Joint Committee on Taxation proposed to subject the income tax preparer to a statutory due diligence requirement (See Joint Committee on Taxation, *Additional Options to Improve Tax Compliance*, at 25-26 (Aug. 3, 2006)), but this reform has not come to fruition.

<sup>21</sup> 31 U.S.C. §5314 authorizes the Secretary of the Treasury to impose certain recordkeeping and reporting obligations with respect to transactions or relationships with a foreign financial agency on “a resident or citizen of the United States or a person in, and doing business in, the United States[.]” 31 C.F.R. §103.24 specifically authorizes the Secretary of the Treasury to require a FBAR from “[e]ach person subject to the jurisdiction of

United States (except a foreign subsidiary of a U.S. person).”

<sup>22</sup> It was generally assumed that other types of U.S. entities, such as U.S. limited liability companies, were included within this definition.

<sup>23</sup> The new form also clarifies the definition of “person” to include an individual, a corporation, a partnership, a trust or estate, an association or other unincorporated organization or group, and “all entities cognizable as legal personalities.”

<sup>24</sup> A foreign subsidiary of a domestic corporation is not required to file, presumably because the domestic parent corporation should be required to do so.

<sup>25</sup> If certain requirements are satisfied, a foreign person will not be considered engaged in a trade or business within the United States, even if the trading activity constitutes a trade or business under U.S. tax principles and even if such trading activity is conducted entirely within the United States.

<sup>26</sup> Pursuant to Code Sec. 897(a), any gain or loss recognized by a foreign person upon such a sale is taxed under certain provisions of the Code as if the foreign person were engaged in a trade or business in the United States and as if such gain were “effectively connected” with such U.S. trade or business.

<sup>27</sup> Presumably, such excessive disclosure obligation could be avoided if the U.S. business was separately incorporated, but it is not

clear why this should be necessary.

<sup>28</sup> This is in addition to a more general attribution rule, applicable under both the old and new form, whereby a U.S. person is deemed to have a financial interest in a trust’s foreign account if such U.S. person has a present beneficial interest in over 50 percent of the assets of the trust or receives more than 50 percent of the current income of the trust. The new FBAR clarifies that such beneficial interest may be direct or indirect.

<sup>29</sup> *Id.* This was also the view taken by the IRS with respect to the old form. See CCA 200603026 (Jan. 20, 2006).

<sup>30</sup> See Charles M. Bruce, Michael C. Durney, Yves Bonnard & Stephane Lagonico, *New U.S. Foreign Bank Account Report Makes Big Changes*, 52 TAX NOTES INT’L 235, 236 (Oct. 20, 2008) (calling this change “the most consequential”).

<sup>31</sup> As noted above, the maximum account value is the largest amount of currency or nonmonetary assets that appear on any account statement issued for the applicable year or at any time during the year if periodic account statements are not issued. Foreign currency is converted by using the exchange rate at the end of the year, while stock, securities and other nonmonetary assets are valued at fair market value at end of year or at time of withdrawal.

This article is reprinted with the publisher’s permission from the INTERNATIONAL TAX JOURNAL, a bimonthly journal published by CCH, a Wolters Kluwer business. Copying or distribution without the publisher’s permission is prohibited. To subscribe to the Journal of INTERNATIONAL TAX JOURNAL or other CCH Journals please call 800-449-8114 or visit [www.CCHGroup.com](http://www.CCHGroup.com). All views expressed in the articles and columns are those of the author and not necessarily those of CCH.