Foreign Bank Accounts–FBAR Reporting Obligations, Enforcement Exposures and Managing the Risk: What Every Tax and Compliance Advisor Needs to Know Now!

*By Dean Marsan**

Dean Marsan discusses what every tax and compliance advisor needs to know now about FBAR reporting obligations, enforcement exposures and managing the risk.

On October 26, 1970, in response to reports of people bringing bags full of currency of doubtful origin into banks for deposit, such as money from illegal drug sales and other money-laundering schemes, as well as using foreign financial accounts to conceal assets and income illegally for the evasion of taxes and other white collar crime, Congress passed the Bank Secrecy Act (BSA).[1] While the law took effect in 1970, many taxpayers in the past were unaware of it or chose to ignore the fact that they may have had a filing obligation with the government if they had an offshore bank account. In addition, enforcement by the government was not a priority, and FBAR criminal prosecutions were rare.

As recently as June 2008, the IRS reminded taxpayers that there was nothing wrong with setting up a foreign bank account.[2] However, insightful tax advisors were given a heads-up of what was coming when IRS Commissioner Douglas Shulman stated,[3] "There are responsibilities that go along with owning a foreign bank and financial account. Foreign account owners must remember that they may have to report their accounts to the government (by filing an FBAR) even if the accounts do not generate taxable income."

FBAR Enforcement Activity to Ferret out U.S. Taxpayers with Offshore Undisclosed Accounts

It has been estimated that the United States loses an estimated $100 billion in tax revenues each year as a result of offshore tax abuses[4] primarily from the use of concealed and undeclared accounts held by U.S. taxpayers or their controlled foreign entities. In order to eliminate this tax gap in the face of a severe recession, it is not surprising that the government recently ratcheted up its pressure on taxpayers who structured their activities, in many cases, with the active help and assistance of promoters and facilitators to avoid filing FBARs and reporting their taxable income on their tax returns from these offshore accounts to the government.

This has taken the form of a two-pronged strategy by the government: (i) use of a voluntary disclosure program available until October 15, 2009, which permits a taxpayer with undisclosed offshore accounts to become

Dean Marsan was Senior Tax Counsel formerly with Lehman Brothers in New York City for the past 20 years. He can be reached at *dean.marsan@gmail.com*.

compliant, avoid substantial civil penalties and eliminate the risk of criminal prosecution; and (ii) increased civil and criminal audit enforcement of FBAR reporting and compliance by the IRS and civil and criminal prosecutions by the U.S. Department of Justice for failure to file FBARs and tax fraud or evasion. (*See* "Voluntary Disclosure Program" and "FBAR Penalties.")

In addition, there have been several legislative proposals (including one from the U.S. Treasury Department) which have targeted tax havens and offshore accounts owned by taxpayers. (*See* "Recent Legislative Proposals.") The government's attack against taxpayers with undeclared accounts coincides with a fierce international initiative by the G-20 countries to police so-called tax havens and these offshore accounts.[5]

For example, the press reported that HM Revenue and Customs has requested the details of at least 100,000 offshore accounts held by over 300 financial institutions. However, HM Revenue and Customs also announced a New Disclosure Opportunity program (NDO) for U.K. residents to become tax compliant at a reduced penalty of 10 percent. However, to participate in the program, U.K. residents must fully disclose the details about the accounts including the undisclosed income and also whether the assets came from untaxed sources.

IRS International Enforcement and FBAR Compliance Initiatives

The IRS recently announced an aggressive initiative to enforce international tax compliance against taxpayers with offshore accounts and announced the hiring of more than additional 2,400 agents to pursue international tax enforcement and FBAR compliance.

In October 2008 in an internal memorandum,[6] Robert Trujillo, LMSB Director, Planning Quality, Analysis and Support, provided statistics indicating since 2000 the number of FBARs received by the Treasury had increased by nearly 85 percent from 174,528 in 2000 to 322,414 in 2007. However, the memorandum citing an April 2002 Treasury Report[7] to Congress indicated that despite this increase in filings, there may be as many as one million U.S. taxpayers required to file.

FBARs in any given year and recent news articles refer to IRS investigations that identified foreign banks that appear to be helping taxpayers avoid taxes by concealing foreign bank accounts and assets. If these numbers are accurate for 2008, only 30 percent of the U.S. taxpayers who are required to file FBARs are currently doing so.

Mr. Trujillo stated:

> It is critical that LMSB examiners conduct inquiries during Title 26 examinations [Internal Revenue Code examinations] to determine: (i) the existence of foreign bank accounts and whether the FBAR is required (ii) whether the records relating to the accounts are maintained (iii) if the foreign accounts are properly included in taxpayer's financials and U.S. tax returns and (iv) whether, based on a good faith determination identified FBAR violations are in furtherance of an apparent Title 26 income tax violation … .
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> It is recommended that examiners identify corporate executives and/or partners and others associated with the taxpayer entities that have an interest in and/or authority over foreign accounts and trace any income that should be reported on executive returns.

In an internal memorandum dated March 23, 2009,[8] Faris R. Fink, the IRS Deputy Commissioner, SB/SE Division, stated, "Offshore cases sent to the field are work of the highest priority. Examiners should utilize the full range of information gathering tools in properly developing offshore issues, with special emphasis on detecting unreported income. This includes interviewing taxpayers, making third party contacts and timely issued summonses to taxpayers and third parties … . Examiners should be alert for badges of fraud and consult with Fraud Technical Advisors in developing cases for criminal referrals or the assertion of the civil fraud penalty."

Recent FBAR Enforcement by the U.S. Department of Justice– The *UBS* Case and Its Spawn

On August 12, 2009, it was reported that UBS AG (UBS) and the U.S. Department of Justice (DOJ) settled the dispute over the disclosure of UBS clients' names that arose under a civil petition to force UBS to disclose the U.S. account holders' identities. On August 19, 2009, UBS entered into a formal agreement to turn over the names of 4,450 American clients holding undisclosed offshore accounts at UBS. According to a New York Times article,[9] these accounts held over $18 billion at one point. The criteria used to select the names on the UBS list will not be revealed for three months, ostensibly so that the IRS maximizes uncertainty and can put pressure on UBS's 52,000 account holders to come forward voluntarily and disclose their offshore assets. However, the NEW YORK TIMES article suggested that the biggest accounts will be targeted—some containing hundreds of millions of dollars and accounts that made use of offshore entities and sham corporations. While it may take the U.S. government up to one year under the new Treaty with Switzerland to get all of the names, the Swiss authorities have committed themselves to provide the initial 500 names within three months of the date the IRS makes an application for legal assistance in the matter. To avoid the dangers of procrastination, the agreement will have certain targets or milestones that need to be reached before the United States will withdraw its legal action against UBS.

The DOJ had originally requested UBS to turn over the identities of 52,000 offshore accounts so that they could investigate tax evasion, which presumably would be easy to prove if the U.S. persons did file any FBARs for the accounts, or not admit the existence the offshore bank account on their U.S. tax returns and/or didn't report the income from these accounts on their U.S. tax returns. It can be expected that once a list of names is actually turned over to the IRS, these U.S. persons can no longer qualify for the IRS's voluntary compliance program, which expires in a little over a month on October 15, 2009, and would potentially be subject to both civil and criminal FBAR penalties and civil and criminal tax fraud or evasion charges. (*See* "Voluntary Disclosure Program" and "FBAR Penalties.")

According to the NEW YORK TIMES article, the Justice Department was preparing criminal cases against some of the Swiss agents and intermediaries who helped set up offshore entities for clients and funnel their money to private banks that take a referral fee in the process—sometimes up to 50 percent, according to a UBS private banker.

It can be expected that the DOJ will follow up aggressively to prosecute U.S. taxpayers who have undisclosed accounts in UBS and other foreign banks or their intermediaries, whether or not these accounts have been owned directly or through their controlled offshore entities.[10] As part of this prosecution effort, it is likely the DOJ and the IRS will not only prosecute the U.S. taxpayers who are the owners or who have signature or other authority over such accounts, but also the officers and directors of those financial service companies and promoters, consultants and other professionals who helped to set up or facilitate these structures for these taxpayers.

This UBS settlement followed a Deferred Prosecution Agreement (DPA), which was entered into between UBS and the DOJ on February 18, 2009, in settlement of the criminal prosecution of UBS by the government. Under this agreement, UBS agreed, among other things, to pay $780 million in taxes and penalties and to fully cooperate with the government's ongoing criminal investigation of the offshore accounts and the release of 255 names of American offshore account holders, which has started the investigation of 150 UBS offshore clients, three criminal convictions and one indictment.

UBS DPA Requirements–Increased Corporate Governance and Compliance

As part of the DPA, UBS also agreed to several provisions related to corporate governance and satisfying its compliances obligations, including (i) exiting its U.S. cross-border business which will be overseen by its Board of Directors; (ii) requiring UBS to provide banking and securities services to its U.S. clients solely through SEC registered subsidiaries or affiliates; (iii) obtaining executed IRS information reporting forms (*e.g.,* Forms W-9s); (iv) sending correspondence to their clients of the cross-border business informing them that their accounts will be closed and that if funds were to be transferred to another UBS account that a Form W-9 for the account must be provided; (v) maintaining a compliance program regarding its duties under the qualified intermediary agreement with the IRS; (vi) implementing a revised governance structure for the legal and compliance functions; and (vii) engaging an external auditor to monitor compliance with the exit program under the DPA and qualified intermediary agreement with the IRS.[11]

DOJ Indicts Swiss Banker and Lawyer Charged in Conspiring to Defraud the United States

On August 20, 2009, the DOJ indicted Hansruedi Schumacher, who worked as an executive manager at Neue Zuercher Bank (NZB), a Swiss private bank, and Matthias Rockenbach, a Swiss attorney who provided legal services to U.S. clients.[12] Both are alleged to have aided wealthy Americans conceal assets and income in Switzerland from U.S. authorities by establishing sham and nominee offshore entities to hide their U.S. clients' assets and income while allowing these clients to continue controlling the assets and making investment choices. According to the DOJ press release, the pair helped their wealthy American clients repatriate money back to the United States using several deceptive means, helped their clients obtain offshore credit cards and created sham loan documents. Additionally, they falsified bank documents to generate the appearance that assets of their U.S. clients belonged to Swiss citizens, and falsified documents to disguise their U.S. clients' repatriation of offshore funds as inheritances from foreign citizens.

Schumacher and Rickenbach discouraged their U.S. clients from voluntarily coming into compliance in the United States and instead encouraged their clients to transfer their assets from UBS to NZB, a smaller bank in Switzerland. They told their clients that their assets and identification would be safer at NZB because they had no presence in the United States and therefore would be less likely to be pressured by the American authorities to disclose the identities of their U.S. clients. The prosecution is being handled by Senior Litigation Counsel Kevin M. Downing and Trial Attorney Michael P. Ben'Ary of the Tax Division.

It is noteworthy that the last paragraph of the DOJ press release recites the taxpayer's obligation to file the FBAR with the U.S. Treasury for the foreign financial accounts. IRS Commissioner Douglas Shulman commented on the indictment, stating, "This is another step in our ongoing effort to pursue hidden offshore assets—no matter where they are located. We're in the early stages of our work to crack down on offshore tax evasion. Through our efforts, we are gaining access to more and more information on institutions and individuals involved in offshore tax evasion … ."

History of FBAR Reporting and Recordkeeping Obligations

Section 5314 of the BSA authorized the Treasury to require citizens or residents of the United States or a person doing business in the United States to keep records and to file reports concerning transactions with a foreign financial agency. This provision reflected congressional concern that foreign financial institutions located in jurisdictions with strict bank secrecy laws were being used to violate or evade domestic criminal, tax and regulatory requirements.[13]

BSA Regulation 103.24 requires a report termed "Report of Foreign Bank and Financial Accounts," or FBAR, TD F 90-22.1 to be filed by "each person subject to the jurisdiction of the U.S. (except a foreign subsidiary of a U.S. person) who has a financial interest in, or signature or other authority over, a bank securities, or other financial account in a foreign country for each year in which such relationship exists."[14] The filing requirement applies to corporations, partnerships, estates, trusts and individuals. (*See* "The Filer Must Be a U.S. Person.")

On October 26, 2001, the USA Patriot Act[15] in response to a perceived terrorist threat was enacted into law and Act Sec. 361(b) imposed on the Treasury the responsibility to study methods for improving compliance with the reporting requirements under Act Sec. 5314 of the BSA,[16] and on April 26, 2002, the Treasury, issued its Report[17] to Congress which indicated that among other objectives it will update and improve the FBAR and instructions.[18]

It is noteworthy the Report makes reference to comments received from filers to the Financial Crimes Enforcement Network, or FinCEN, that the updated FBAR should "use understandable definitions" and should include "updated terminology and new types of financial transactions."[19]

Purposes and Lack of Confidentiality of FBAR and Required Records

The principal purpose of the FBAR is to collect information to assure that the report and required records have a high degree of usefulness in criminal, tax or regulatory investigations or proceedings or in the conduct of intelligence or counter-intelligence activities including analysis to protect against international terrorism. The information collected may be provided to officers or employees of any constituent unit of the U.S. Treasury who have a need for the records in the performance of their duties. The records may also be referred to any other department or agency of the United States upon the request of the head of such department or agency for use in a criminal, tax or regulatory proceeding. The information may also be provided to appropriate state, local and foreign law enforcement and regulatory personnel in the performance of their official duties. Disclosure of this information by filers of the FBAR is mandatory.[20]

FBAR Filing Criteria

The current FBAR and instructions were revised in October 2008, and as a result, it can be expected that there will be a substantial increase in the number of FBAR filers which now includes individuals, partnerships, limited liability companies, corporations, trusts and estates and all other entities cognizable as legal personalities who are "in, and doing business in the United States, as well as in the number of foreign bank accounts subject to FBAR. It can be expected the financial exposure for failing to file timely FBARs has gone up considerably as well.[21]

The revised FBAR states that the previous editions of the FBAR should not be used after December 31, 2008. The FBAR revised in October 2008 may be used for all calendar years that are still open under the statute for original, amended or delinquent filings rather than the older FBAR form. However, since the changes to the revised FBAR reflect a change in the reporting requirements, the instructions for the prior version of the form (revised in July 2000) may be relied upon for purposes of determining the filing requirements for properly reporting financial accounts maintained in 2008 and prior calendar years.[22]

The revised FBAR instructions state, "each United States person who has a financial interest in or signature authority over any foreign financial accounts, including bank, securities, or other types of accounts, in a foreign county, if the aggregate value of these financial accounts exceeds $10,000 at any time during the calendar year, must report the relationship each calendar year by filing the FBAR with the Treasury.[23] An FBAR is required whether or not the foreign financial account has any income.[24]

Thus, in order to determine whether or not the FBAR is required, all of the following must apply: (i) the filer must be a U.S. person; (ii) the filer must have a financial account(s); (iii) the financial account must be in a foreign country; (iv) the filer must have a financial interest in the account or signature authority over the foreign financial account; and (v) the aggregate amounts in the accounts valued in dollars must exceed $10,000 at any time during the calendar year.[25]

The Filer Must Be a "U.S. Person"

The term "U.S. person" means a citizen[26] or resident[27] of the United States or a person "*in, and doing business in the U.S.*"[28] (emphasis added). A U.S. citizen who is permanently living outside the United States and who has a foreign financial account must file an FBAR.

Foreign Entities and Other Cognizable Legal Personalities "In, and Doing Business in the U.S."

Under the revised FBAR instructions foreign entities such as foreign corporations, partnerships, limited liability companies and all other entities "cognizable as legal personalities" in, and doing businesses in the United States will be required to file the FBAR.[29] (However, *see* "Temporary Suspension of FBAR Filing Requirements for Persons who are not Citizens, Residents or Domestic Entities with Respect To Foreign Bank Accounts due on June 30, 2009.")

A single-member LLC that is treated as a disregarded entity for U.S. tax purposes will have a separate FBAR filing if it owns a foreign financial account since FBAR filing is required under Title 31, not the Internal Revenue Code.[30] There is no *de minimis* exception for limited U.S. trade or business activity or income by foreign entities or nonresident aliens. The U.S. parent corporation is considered to have a financial interest in any foreign financial account owned by the subsidiary and will likely have to file the FBAR for such account.[31] A foreign subsidiary (that is not incorporated in the United States) of a U.S. person is not required to file an FBAR.[32]

A branch of a foreign entity that is doing business in the United States is required to file the FBAR even if it is not separately incorporated under U.S. law.[33]

Definition of "United States"

The United States includes the states, territories and possessions of the United States.[34]

Charitable, Educational and Tax-Exempt Organizations, Foundations, Endowments, Universities and International, Federal, State and Local Entities

There does not appear to be any exception for FBAR reporting for charitable or other private tax-exempt organizations, such as universities, endowments, private foundations or the employees or officers of such organizations who have signature or other authority over foreign financial accounts. For example, educational and other charitable organizations may have foreign bank accounts which are subject to FBAR reporting, as well as university and other endowment funds.

Presumably, governmental entities are not subject to FBAR reporting; however, it is not clear whether semi-governmental federal, state and local entities will be exempt if they own or have signature or other authority over foreign financial accounts. For example, Freddie Mac, Fannie Mae and Sallie Mae may have FBAR filing and recordkeeping obligations for their foreign financial accounts. It is also possible that international public, semi-public and private charitable, educational and governmental organizations and foundations with offices or branches in the United States may be caught in the FBAR reporting and recordkeeping net.

Consolidated FBAR Filing

A corporation that owns directly or indirectly more than a 50-percent interest in one or more entities is permitted to file a consolidated FBAR on behalf of itself and the other entities. The consolidated FBAR must include a list of the entities and an authorized official of the parent corporation should sign the consolidated report.[35]

Temporary Suspension of FBAR Filing Requirements for Persons Who Are Not Citizens, Residents or Domestic Entities with Respect to Foreign Bank Accounts Due on June 30, 2009

The revised FBAR was issued with a change in the instructions to the definition of "U.S. person" to include not only citizens or residents of the United States and domestic partnerships, corporations or estates or trusts, but also "persons in, and doing business in the U.S."[36]

On June 5, 2009, the IRS issued Announcement 2009-51, temporarily suspending the FBAR filing requirement with respect to foreign bank accounts due on June 30, 2009, for those filers who are not U.S. citizens, residents or domestic entities because the IRS received a number of questions or comments from the public concerning the new expanded filing requirement that may require additional guidance.[37] Presumably, the temporary suspension of FBAR reporting for eligible filers only applies to 2008 and earlier calendar years.

The Announcement points out that the definition of "U.S. person" from the instructions for the prior version of the FBAR[38] may be relied upon for purposes of determining who must file an FBAR, but all other requirements of the revised FBAR and instructions are still in effect and must be used when filing the FBAR. The IRS also has asked for comments regarding the revised FBAR and instructions. It appears that nonresidents and foreign entities have a temporary reprieve under Announcement 2009-51 and can breathe a little easier.

While it is not likely that nonresident aliens and foreign entities who have been doing business in the United States will retroactively have to file FBARs for 2008 and the prior five open years under Announcement 2009-51, it is unclear at this date whether this temporary suspension of FBAR reporting for persons who are not citizens, residents or domestic entities will continue for filers for the 2009 calendar year (which would be due on June 30, 2010) or future calendar years.[39] It would be wise for these filers to plan on having a FBAR filing obligation for the 2009 calendar year and future calendar years.

The Account Must Be a "Financial Account"

The term "financial account" is not defined in the U.S. Code, regulations or the FBAR. Section 103.24[40] states, "Each person subject to the jurisdiction of the United States (except a foreign subsidiary of a United States person) having a financial interest in, or signature authority over, a bank, securities or other financial account in a foreign country shall report such relationship to the Commissioner of the Internal Revenue each year in which such relationship exists … ."

Bank Accounts, Debit and Prepaid Credit Card Account

A financial account includes a bank account such as a savings, demand, checking, deposit, time deposit or any other account maintained with a financial institution or other person engaged in the business of a financial institution, including debit card and prepaid credit card accounts which was issued by a foreign bank or a branch of a U.S. bank was explicitly added by the revised FBAR instructions. A bank account set up by a foreign bank or an offshore branch of a U.S. bank as a financial guarantee or escrow account in order to issue a credit card or for use with a debit card are examples of a financial account.

Bonds, Notes, Lines of Credit and Stock Certificates

Individual bonds, notes, lines of credit or stock certificates held by the filer are generally not financial accounts, nor is an unsecured loan to a foreign trade or business that is not a financial institution. If a U.S. person owns stock, which may or may not pay dividends, such stock will not be treated as a financial interest in a foreign financial account unless the shareholder owns directly or indirectly more than 50 percent of the total value or voting power for the stock.[41]

The New York State Bar Association Tax Section in a 32-page letter to U.S. Treasury dated July 17, 2009, (hereinafter referred to as the "NYSBA Tax Section FBAR Letter") among other matters requested the Treasury to provide clear and definitive guidance to taxpayers relating to a number of important issues relating to the FBAR requirements. While beyond the scope of this article, the NYSBA Tax Section FBAR Letter has raised serious issues, many of which clearly need further thought and guidance by U.S. Treasury Department.

The NYSBA Tax Section FBAR Letter posits the following questions under the heading, "Individual Bonds, Notes" on page 22:

- Is a bond held not "by the filer" but through a clearinghouse (*i.e.,* an interest in a global bond) a financial instrument?
- Is debt of a foreign financial institution a foreign financial account or does it remain an individual bond or note for FBAR purposes?
- Is an option, swap, structured note or repurchase agreement entered into with a foreign financial institution automatically a "foreign financial account"?
- What if, as would typically be the case, the institution establishes an "account" or ledger entry reflecting the rights and obligations of the counterparty?

Life Insurance and Other Insurance Products

An insurance policy having a cash surrender value is an example of a financial account because a cash surrender value insurance policy can be used to store cash and withdraw it at a later time. Similarly, variable annuity, universal life and similar insurance products with investment features would likely be examples of financial accounts.[42] A relevant question is whether the insurance or other financial services companies directly offering these products (and other intermediary companies selling these products to their customers), as well as the customers themselves, will be subject to the FBAR reporting and recordkeeping requirements as either the "owner" of these foreign accounts or assets or because they have "signature or other authority" over these accounts or assets.

Pensions, IRAs and IRA-Type Plans and Deferred Compensation Arrangements

An IRA or IRA-type account is a financial account to be reported on an FBAR. Employer-sponsored tax-qualified plans such as defined benefit and defined contribution plans, governmental and church plans that invest in foreign assets or accounts may also be treated as foreign financial accounts for FBAR purposes.[43] Similarly, non-ERISA plans and other nonqualified plans may also be subject to the FBAR reporting and recordkeeping requirements. Similarly, a question is raised whether the U.S. plan sponsor, the investment manager, trustees and participants must all satisfy the FBAR reporting and recordkeeping requirements as the "owner" of the plan assets or as the ones who have "signature or other authority" over these foreign plans or assets.

While deferred and other compensation arrangements that are W-2 or 1099 reportable typically do not have separate offshore accounts to be treated as a "foreign financial accounts," it is possible the IRS may take a very broad reading of "foreign financial account" and treat notional amounts, as well as phantom or contingent rights (*e.g.,* SARs) as subject to the FBAR rules of reporting and recordkeeping requirements if it thinks there are opportunities for U.S. persons to hide assets or income. Here again, a question is raised as to who has the FBAR filing and recordkeeping responsibilities. Is it the company with the foreign accounts or assets on its balance sheet, its officers and directors who have signature or other authority over the account or the employees or other beneficiaries of these plans? The NYSBA Tax Section FBAR Letter at page 22 under the heading "Additional Questions" questioned whether a deferred compensation obligation of a foreign employer might also constitute a "financial account."

Collectibles, Bullion and Other Noncash Assets

An ownership interest in collectibles is not considered a financial interest in a financial account. However, a financial account maintained with a financial institution in a foreign country that holds noncash assets such as gold or silver or other nonmonetary assets, such as certificate of ownership evidencing ownership over precious metals such as gold, silver or other bullion held through a foreign bank or in a safe deposit box of a foreign bank is likely a financial account and would require an FBAR to be filed.[44]

Real Estate and Indirect Equity Interests in Real Estate, Infrastructure, Renewable and Nonrenewable Energy Interests

Direct interests in commercial or residential real estate held through a partnership or trust should not be treated as a financial account. An indirect equity interest in real estate held through an offshore partnership, limited liability company, trust or other passthrough entities may be FBAR reportable. However, the IRS provided one favorable Q&A with the following example: Because U.S. citizens cannot directly own certain real estate in Mexico, a trust is typically set up to purchase, mortgage and own the property. On these facts, the IRS confirmed no FBAR reporting was necessary.[45]

Presumably, offshore working interests, royalty and overriding royalty interests in nonrenewable resources (*e.g.,* oil and gas) will not be subject to the FBAR reporting and recordkeeping requirements for their offshore interests. It is unclear whether indirect equity interest in funds or other SPVs set up for infrastructure, renewable (*e.g.,* wind power, solar, *etc.*) and nonrenewable energy projects may create independent FBAR reporting and recordkeeping obligation for these offshore entities and their foreign financial accounts for themselves and their U.S. investors.

"Securities Account" and "Equity Interest in Commingled Fund" As Financial Accounts

A financial account also includes securities, securities derivatives or other financial instruments account. Other financial accounts generally encompass any accounts in which the assets are held in a "commingled fund and the account owner holds an equity interest in the fund." A mutual fund account is an example of such account that was added by the revised FBAR instructions.[46] Investments in interest-bearing securities, such as savings bonds, that are issue by a foreign government and that are acquired through a bank located in the United States are not reported on an FBAR.[47] It is possible that sovereign equity and distressed and opportunity debt funds of other countries with a U.S. branch or office and their U.S. investors, if any, may be subject to the FBAR reporting and recordkeeping requirements.

The NYSBA Tax Section FBAR Letter at pages 19–21 requested, among other items, (i) clarification of the definition of "securities account"; (ii) additional guidance on the types of interests that may constitute securities; (iii) clarification on whether "interests in any entities holding real estate or other assets that are not themselves securities, such as the SPV interest … would be considered reportable 'securities'" (*see* "Real Estate and Indirect Equity in Real Estate"); (iv) what is meant by the definition of an "equity interest" in a "commingled fund"; (v) whether other types of financial assets (*e.g.,* commodities) are considered FBAR reportable assets; (vi) whether an interest in foreign stock constitutes a reportable "financial account"; and (vii) whether interests in investment funds are limited, for FBAR purposes, to interests denominated as equity in those funds—*see* page 21 of the Letter—which discusses a collateralized loan obligation with different tranches of securities for an expanded discussion on this issue.

Is Liquidity a Necessary Element for a Financial "Account" or a "Mutual Fund"?

In the NYSBA Tax Section Letter on pages 16–17, guidance was requested about the contours of the term "financial account," for purposes of the FBAR and whether the references to "Account" and "Mutual Fund" (or the Policies of the BSA) identify "liquidity" as a necessary element. As support for the position that liquidity is an essential component of the definition of "account," the Letter looks to the life insurance example (*see* "Life Insurance and Other Insurance Products"), where the IRS confirmed life insurance was a financial account "[s]ince a cash surrender value insurance policy can be used to store cash and withdraw it at a later time."

The Letter also requests clarification of the term "mutual fund" on page 17 by stating, "Similarly, there is no definition of "mutual fund" for FBAR purposes, making it impossible to determine what types of investments will be considered to function similarly to mutual funds. The Securities and Exchange Commission defines a "mutual fund" as a "company that pools money from many investors and invests the money in stocks, bonds, short-term money-market instruments, or other securities. Mutual funds offer their shares continuously and are required to provide their shareholders with the right to redeem shares at net asset value on a daily basis."[48]

The Letter on pages 17–18 goes on to provide:

> Most hedge funds and private equity funds … function very differently. Private equity funds generally buy substantial positions, often controlling interests, in companies, and hold those interests for as much as five to seven years, sometimes longer. Investors in private equity funds generally invest for the life of the fund (10 years is standard, subject to possibility of extension), and do not have the right to withdraw cash on demand (or,

for that matter, at all, unless the fund has first disposed of an investment). Private equity investors do not even control when they transfer money into the fund—instead their commitments are available to be called at any time during which is usually a multi-year commitment period by the general partner (or its equivalent).

Hedge funds often hold investments for much shorter periods, and generally provide for limited investor liquidity rights, but these liquidity rights are light years away from a traditional bank account, securities account or open-ended mutual fund. Investors in hedge funds are frequently subject to lock-up periods on entry, typically of one to two years, and following this initial period have the right to withdraw from the fund only at designated intervals (e.g., at quarterly periods, or sometimes longer intervals, and often with limitations) and typically only upon significant advance notice. Hedge funds and private equity funds thus function very differently from mutual funds, and have been subject to different levels of regulation based on these differences.

Is an Offshore Hedge Fund or Private Equity Fund a "Commingled Fund"? A Firestorm Issue

The issue whether offshore hedge funds and private equity funds are subject to FBAR reporting as foreign financial accounts recently created a firestorm between the industry and the IRS. In 2007, the IRS held a National Phone Forum on FBARs and released questions and answers from the teleconference after the call, which was subsequently published. In a Q&A[49] dealing with an IRA account with a custodian domiciled in the United States, the IRS assumed the owner of the account was a citizen of the United States and that the IRA, which was located in the United States, owned an interest in the account in an off-shore hedge fund. On these facts, the IRS concluded that the owner of the account did not have to file an FBAR, and the custodian did not have to file provided the custodian did not have signature or other authority over the hedge fund account, but instead was only holding the units of the hedge fund as an investment in the IRA and did not control the hedge fund.

In a more recent teleconference with the IRS, which was hosted by the American Bar Association and the American Institute of Certified Public Accounts on June 12, 2009, the IRS panelists suggested (in what many view as a sudden change of position by the IRS) that the definition of "foreign financial account" would include an interest in a foreign hedge fund and would require FBAR reporting if the fund were serving a function similar to a mutual fund.[50] In addition, the IRS panelists advised one tax-exempt questioner who had not filed FBARs with respect to hedge fund investments in previous years to file FBARs for such investments for 2008 and for the preceding five years.[51] On June 26, 2009, the IRS confirmed that "investments in foreign hedge funds and private equity funds are reportable for FBAR purposes."[52] In response to these chilling answers, many investment funds made many prophylactic FBAR filings. Lee A. Sheppard, in *FBAR Filing for Hedge Funds,* TAX NOTES, Aug. 10, 2009, at 517, identified one hedge fund alone that filed more than 15,000 FBARs prior to June 30, 2009 deadline. Similarly, the Private Equity Council, in its *Letter to the Honorable Douglas H. Shulman, RE: FBAR and Private Equity Funds,* Aug. 4, 2009, at 8, estimated for its membership "literally tens of thousands of additional FBAR filings" would be required if limited partner interests are treated by the IRS as interests in financial accounts.

a. IRS Provides Breathing Room for Hedge and Private Equity Funds and Their Investors Until June 30, 2010, and Asks for Comments. The IRS suggested on August 7, 2009, in Notice 2009-62[53] that it may be considering some relief for hedge and private equity funds and their investors from the FBAR filing requirements and agreed to extend the filing date until June 30, 2010, for 2008 and earlier calendar years for filers with a financial interest in, or signature authority over foreign commingled funds. (*See* "Extended Filing Date until June 30, 2010, for Eligible Filers having Signature Authority over, but no Financial Interest in, a Foreign Financial Account, and for Filers with Financial Interest in, or Signature Authority, over Foreign Commingled Funds, and Request for Comments on FBAR Filing Requirements.")

b. Expansive Reading of Foreign Financial Account and Commingled Fund by the IRS. Until more definitive guidance is provided by the IRS, commentators have raised the issue of what entities and individuals will need to file an FBAR assuming that an offshore hedge or private equity fund is a foreign financial account. It is possible that the following U.S. persons will have an FBAR reporting obligation if the IRS continues with its expansive interpretation: (i) a U.S. investor (including for this purpose, taxable investors and tax-exempt investors, such as pension plans, 401(k)s and IRA owners, custodians, investment committee members or trustees and other fiduciaries with the requisite signature authority) in an offshore hedge, private equity, commodity, venture or mutual fund or offshore feeder fund in a master/feeder structure (hereinafter, "fund"); (ii) a U.S. investor that owns more than 50 percent of a U.S. or foreign entity that is a direct investor in an offshore fund; (iii) a U.S. investor in a foreign blocker or other foreign corporation which itself may be considered a commingled fund; (iv) a U.S. fund of funds or U.S. feeder fund that invests in an offshore fund; (v) a U.S. general partner or manager with a financial interest or other incentive or carried interest in an offshore fund and their individual employees with signature or other authority over the offshore fund or any foreign bank or brokerage account of any fund, investment vehicle formed by the offshore fund or blocker entity or general partnership interest in the offshore fund; and (vi) U.S. financial institutions or U.S. affiliates of foreign financial institutions that have invested in the offshore fund or have signature or other authority over the offshore fund (subject to certain limited exceptions to FBAR reporting—*see* "Exceptions to FBAR Reporting").[54]

One commentator[55] has given the following examples of the potential breath of the FBAR reporting requirements with the following examples:

1. **U.S. Investor in a Foreign Hedge Fund.** Assume that a U.S. individual or financial institution owns an interest in a foreign hedge fund. As mentioned above, an IRS official has said that an interest in a foreign hedge fund is a "foreign financial account" and therefore that the taxpayer should file an FBAR for the current year (and may wish to consider filing FBARs, before September 23, 2009, for the prior six years during which the taxpayer held the interest, in order to avoid penalties). The result would be the same if a U.S. affiliate of a foreign financial institution owns the hedge fund interest (even if the U.S. affiliate is a single member limited liability company that is disregarded for U.S. tax purposes).
2. **U.S. Investor in a Domestic Feeder Fund.** Assume that a U.S. individual or financial institution owns an interest in a domestic feeder fund that, in turn, owns an interest in a foreign hedge fund. If the U.S. person owns more than 50 percent of the profits or capital of the domestic feeder, the person should file an FBAR with respect to the foreign hedge fund as well as any bank account of such fund. Moreover, it is unclear whether a domestic feeder fund could be treated as acting "on behalf of" all of its investors, in which case even a U.S. person that owns less than 50 percent of the profits or capital of a domestic feeder fund would be required to file an FBAR with respect to the foreign hedge fund.
3. **U.S. Employees of Financial Institutions.** The FBAR instructions suggest that each U.S. employee of any financial institution who has "signature or other authority" to control the disposition of funds or other property in a foreign account (which may include the ability to direct the redemption of an interest in a foreign hedge fund) should file an FBAR with respect to the account, including a foreign hedge fund, unless the employee qualifies for an exception. Therefore, if a U.S. employee of a financial institution has signature or other authority over (i) a foreign account of a customer, (ii) redemptions from a foreign hedge fund of a customer, or (iii) redemptions from foreign hedge funds of the financial institution, the U.S. employee may also be required to file an FBAR.
4. **U.S. Investment Manager of a Foreign Hedge Fund.** Assume that a U.S. limited liability company acts as the manager of a foreign hedge fund and therefore has the authority to control the disposition of funds or other property of the hedge fund. Because the IRS takes the position that the foreign hedge fund itself is a foreign financial account, the manager (i.e., the limited liability company) will likely have to file an FBAR (possibly even if all of the assets of the hedge fund are held in U.S. financial accounts). Moreover, each employee of the manager that has signature or other authority over the foreign hedge fund (which could conceivably include traders) may be required to file FBARs.
5. **U.S. Broker-Dealer Holding a Foreign Hedge Fund Interest as Collateral or as Custodian.** Assume that a U.S. broker-dealer holds rights over interests that customers have in foreign hedge funds as collateral or as custodian and has the ability to redeem, rehypothecate, or otherwise transfer the hedge fund interests. Al-

though unclear, the U.S. broker-dealer may be required to file an FBAR, and each employee of the financial institution with signature or other authority that would allow that employee to redeem, rehypothecate, or otherwise transfer the hedge fund interests may also be required to file an FBAR.

6. **U.S. Affiliate Maintaining Accounts at a Foreign Financial Institution.** Assume that U.S. broker-dealer affiliate of a foreign financial institution maintains and has control over accounts at the foreign financial institution. The U.S. broker-dealer (and U.S. employees with signature or other authority over the foreign accounts) should file FBARs with respect to the foreign accounts [footnotes deleted].

The Account Must Be "Foreign"

A foreign financial account generally includes account in a foreign country. For this purpose, a foreign country includes all geographical areas located outside the United States.[56]

Geographical Location of the Account, Not the Nationality of the Financial Entity, Is the Test

The geographical location of the account, not the nationality of the financial entity institution in which the account is found, determines whether the account is an account in a foreign country.[57] Thus, any financial account (except any maintained with a U.S. military banking facility[58]) that is located in a foreign country should be reported even if it is held at an affiliate or branch of a U.S. bank or other financial institution. A bank account maintained with a branch of a U.S. bank that is located in a foreign country requires the owner or person with signature or other authority over the account to file an FBAR.[59]

Location of Investment Fund Accounts

The NYSBA Tax Section FBAR Letter at page 22 raises the following question under the heading, "Accounts in a Foreign Country": If interests in the investment funds are "accounts" that must be reported if they are located in a foreign country, then when is the "account" considered located in a foreign country? The Letter raises the following hypothetical. Consider an investment fund organized under non-U.S. law with no foreign bank account, with all key executives located in the United States, with all investment decisions made in the United States and with all fund assets in the United States In this example, the only foreign connection is to place of organization of the issuer.

Discovery of the Existence of Foreign Financial Accounts

According to the Internal Revenue Manual, the existence of a foreign financial account may be discovered when the examining agent (i) inspects a tax return as part of the pre-contact analysis;[60] (ii) conducts an income probe during the income tax examination; (iii) interviews the taxpayer; or (iv) conducts a BSA examination of a business, such as a money transmitter, that may routinely transmit funds overseas.[61]

The Filer Must Have a "Financial Interest" in the Account or "Signature or Other Authority over an Account"

Financial Interest

A U.S. person has a financial interest in each bank, securities or other financial account in a foreign country for which such person is the owner of record or holder of legal title whether or not the account is maintained for his or her own benefit or for the benefit of others including non-U.S. persons.[62] If the account is maintained in the name of two persons jointly or if several persons each own a partial interest in an account, each of those U.S. persons has a financial interest in that account and generally each person must file the FBAR.[63] In the past, however, FinCEN has accepted a single FBAR for an account jointly held by husband and wife and the IRS is generally continuing this practice.[64] (*See* "Combined FBAR Filing by Spouses.")

A bank is not required to file an FBAR to report a financial interest in an international interbank transfer account (commonly called a "nostro" account) that are used solely for purpose of bank-to-bank settlement, but are subject to other BSA filing requirements.[65]

a. FBAR Attribution Rules. A U.S. person also has a financial interest in each bank, securities or other financial account in a foreign country for which the owner of record or holder of legal title is (i) a person acting as an agent, nominee, attorney or in some other capacity *on behalf of* the U.S. person;[66] (ii) a corporation, whether foreign or domestic in which the U.S. person owns directly or indirectly[67] more than 50 percent of the total value or voting power for all shares of stock;[68] (iii) a partnership, whether foreign or domestic, in which the U.S. person owns an interest in more than 50 percent of the profits (distributive share of income)[69] (taking into account any special allocation agreement[70]) or more than 50 percent of the capital of the partnership;[71] or (iv) a trust, whether foreign or domestic in which the U.S. person either has a present beneficial interest either directly or indirectly[72] in more than 50 percent of the assets or from which such person receives more than 50 percent of the current income.[73] The ownership attribution rules in the Internal Revenue Code (*e.g.,* Code Secs. 318, 267) are not applicable with respect to FBARs.

b. Meaning of the Term "On Behalf of." The NYSBA Tax Section FBAR Letter raised questions on the need for additional clarity around the meaning of the term "on behalf of." Under the heading "On Behalf of" on pages 23–24 of the Letter, the following issues were raised:

- Is a U.S. "feeder" fund that owns interests in a Cayman "master" fund holding those interests "on behalf of" its partners who are U.S. persons?
- Is an account at Euroclear or Clearstream a foreign financial account held "on behalf of" (among others) U.S. beneficial owners?
- Is collateral posted by a U.S. person to a foreign person and deposited by the foreign person in a foreign account held "on behalf of" the U.S. person?
- If a U.S. customers has a brokerage account at a U.S. broker-dealer, and the broker-dealer as a matter of course sweeps excess cash in a Cayman account each night (whether the customer know its or not), does it hold that foreign account on the customer's behalf?
- What if the Cayman account is, or has a subaccount that is designated as FBO the customer?
- What about deferred compensation accounts—are they held "on behalf of" the employee whose compensation they hold (or hedge)?

c. Financial Interest in a Trust. Under the revised FBAR instructions, a U.S. person has a financial interest in each bank, securities or other financial account in a foreign country for which the owner of record or holder of legal title is a trust, or a person acting on behalf of the trust that was established by such U.S. person and for which a trust protector has been appointed.[74] A trust protector is a person who is responsible for monitoring the activities of a trustee, with the authority to influence the decisions of the trustee or replace or recommend the replacement of the trustee.[75]

The filing requirement generally applies to the U.S. persons (including for this purpose nonresident aliens and foreign entities in and doing business in the United States) who establish the trust or the grantors and not the beneficiaries or heirs unless the beneficiaries who are U.S. persons own more than 50 percent of the assets or receives more than 50 percent of the current income. The grantor of a foreign grantor trust will be treated as the owner of the assets in the trust under Code Sec. 679 and must file an FBAR.

In a discretionary trust with multiple beneficiaries, it is presently unclear whether all such beneficiaries should be treated as having a greater-than-50-percent interest and required to each file separate FBARs. If the beneficiary's interest in the assets or income of the trust cannot be determined, the beneficiary should file an FBAR.[76]

The NYSBA Tax Section FBAR Letter raises certain issues on pages 24–25 regarding financial interests in trusts, including questions relating to "discretionary trusts," "remainder beneficiaries" and "powers of appointment," which could trigger an FBAR filing obligation.

"Signature or Other Authority" over an Account

A person having "signature or other authority" over a foreign financial account must file the FBAR even if the person has no financial interest in the account.[77]

a. "Signature Authority." A person has signature authority over an account if that person can control the disposition of money or other property in it by delivery of a document containing his or her signature (or his or her signature and that one or more other persons) to the bank, financial institution or other person with whom the account is maintained.[78]

b. "Other Authority." A person has other authority if the person can exercise power comparable to signature authority over an account by communication to the financial institution where the account is maintained either orally or by some other means.[79] The revised instructions to the FBAR go even further and explicitly indicate comparable power over an account includes communication with the bank or other person with whom the account is maintained, either directly or through an agent, nominee, attorney or in some other capacity on behalf of the U.S. person, either orally or by some other means.[80]

The U.S. person who has the power to direct how a foreign financial account is disbursed must file an FBAR.[81] However, if the U.S. person's power is limited to control how the account is invested, no FBAR will be required because the U.S. person has no power to control the disposition of the money or other property in the account and therefore does not have "other authority over a financial account."[82]

c. Reliance on an Intermediary. A U.S. person now cannot rely on the existence of an intermediary to avoid the FBAR filing. In addition, the intermediary may have to file a separate FBAR for the same foreign financial account. For example, if X, an American citizen, gives a person who is a citizen or resident of the United States a power of attorney to X's Canadian bank account, X must file an FBAR as the owner, and the U.S. person having the power of attorney must also file an FBAR because the U.S. person has signature or other authority over the account.[83] The U.S. person with the power of attorney would have to file the FBAR even if he or she never exercised the power. It is the apparent signature authority over the account that triggers the FBAR filing obligation. Similarly, a fiduciary who is a U.S. person has control as a trustee for an IRA of a foreign bank account. The fiduciary must file an FBAR as a U.S. person.[84] because there is no exception for partners or employees of partnerships, a U.S. person who has signature or other authority over a foreign financial account of a partnership or other legal entity may have an independent obligation to file as well as the partnership. However, see below for relief for certain filers and an extension until June 30, 2010.

If a domestic corporation owns a foreign bank account and U.S. person (or employee) has signature authority over that account, both the corporation and the employees will have an obligation to file separate FBARs for the account, unless the limited FBAR exception for reporting applies for officers and employees.[85] (*See* "Exceptions to FBAR Reporting").

d. Back Office and Bank Operations Personnel with "Signature or Other Authority." The NYSBA Tax Section FBAR Letter at pages 26–27 raises the issue whether the language in the FBAR instructions relating to "signature or other authority," if read broadly could pick up operations and other back office personnel at a financial institution where the account is maintained, whose sole authority is to execute instructions given by others, such as the owner of the account or the owner's designee or even another employee who received the instructions and gives as an example someone (*e.g.,* back-office or operations personnel) who has the authority, "as against the account," to control the disposition of its assets, but is not permitted to exercise that authority, as a matter of his or her employment, without instructions from others (*e.g.,* the account's owner, or the employee's superiors). The letter suggests thousands of U.S. employees may meet this criterion, each with respect to many thousands of accounts.

e. Traders with "Signature or Other Authority." Similarly, the Letter questions whether there is authority if a trader at a financial institution can decide whether/when to book and/or terminate a swap between the institution and a client, if the swap is booked by the institution at a non-U.S. location? What if the booking is reflected as an account of the client? What if the collateral associated with that swap is held by the institution in a foreign collateral account? What if a collateral or credit manager can decide each day that some of the assets in that collateral account can be released from the account (*e.g.,* because the mark-to-market value of the client's obligation to the institution declines)? What if they can be released only back to the counterparty? Does this relationship constitute "control over the disposition" or "disposition of" the collateral?

Extended Filing Date Until June 30, 2010, for Eligible Filers Having Signature Authority over, but No Financial Interest in, a Foreign Financial Account, and for Filers with Financial Interest in, or Signature Authority over, Foreign Commingled Funds, and Request for Comments on FBAR Filing Requirements

a. FBAR Extension until June 30, 2010, for 2008 and Earlier Calendar Years for Certain Filers. On August 7, 2009, the IRS issued Notice 2009-62,[86] which extended the due date for eligible filers with no financial interest in a foreign financial account, but with signature authority over, the account ("signature authority"), and for filers with a financial interest in, or signature authority over, a foreign financial account in which the assets are held in a commingled fund ("foreign commingled fund").

The Notice points out that the revised FBAR instructions provide U.S. persons who have signature authority over, but no financial interest in a foreign financial account are required to file an FBAR even if the owner (or other person that has a financial interest in the account) also files an FBAR for the account.[87] In addition, the revised FBAR instructions also provide that a foreign financial account must be reported on an

FBAR includes any bank, securities derivatives or other financial account and "generally also encompass any accounts in which the assets are held in a commingled fund and the account owner holds an equity interest in the fund, including mutual funds."[88]

The Notice provides eligible filers with signatory authority over a foreign financial account or filers with a financial interest in or signature authority over a foreign commingled fund with an extension to file the FBAR for 2008 and earlier calendar years with respect to these foreign financial accounts until June 30, 2010, in order to give the Treasury additional time to address issues pertaining to FBAR filing requirements and provide such filers with administrative relief. The Notice alerts eligible filers that avail themselves of the extension that they may need to file FBARs for the 2008, 2009 and earlier calendar years on or before June 30, 2010, and that the Notice supplements the filing extension that was granted until September 23, 2009.

FBAR filers who have unreported income from offshore accounts for 2008 and earlier calendar years still must comply with the guidelines and the October 15, 2009, deadline for the Voluntary Disclosure Program. The Notice does not grant a reprieve or any extension for the filers who otherwise qualify under this program. For an expanded discussion of the voluntary disclosure program, *see* "Voluntary Disclosure Program."

b. Request for Comments—Notice 2009-62

A. When should a person who has signature authority over, but no financial interest in a foreign financial account, be relieved of the FBAR filing obligation for such account? The Notice requests comments on certain FBAR filing obligations, including when a person with signature authority in a foreign financial account should be relieved of filing an FBAR for the account. For example, comments are specifically requested regarding whether a person with signatory authority should be relieved from filing if the person with a financial interest in the account has filed an FBAR.[89]

B. Under what circumstances is it appropriate for the exception for officers and employees of banks and certainly publicly traded companies with only signature authority to be expanded to apply to other companies' officers and employees with only signature authority? The Treasury wants comments discussing under what circumstances the exception for officers and employees of banks and certain publicly traded domestic companies might be expanded to apply to all officers and employees with only signature authority over and no financial interest in an employer's foreign financial account, including circumstances in which an individual has been advised that an FBAR has been filed for a foreign financial account for which that person has signature authority.[90] The Treasury also desires comments discussing how the bank and publicly traded company exception, including the requirement of notification that an FBAR was filed by a U.S. person with a financial interest in the account might apply to officers and employees with only signature authority over accounts owned by clients of their employer.[91]

C. When should an interest in a foreign entity be subject to FBAR reporting, and should the passive income and asset principles of Code Secs. 1297 and 1298(b) be used to determine when an interest is subject to FBAR reporting? The Treasury has requested comments concerning when an interest in a foreign entity (*e.g.,* a corporation, partnership, trust or estate) should be subject to FBAR reporting. For example, comments are requested regarding the possibility of applying the passive income and asset principles of Code Secs. 1297[92] and 1298(b)[93] to determine when an interest in a foreign entity should be subject to FBAR reporting and whether the passive asset and passive income thresholds of 50 percent and 75 percent, respectively, are appropriate and whether the tests should be used conjunctively.[94]

D. Should a U.S. person be relieved of FBAR reporting with respect to a commingled fund (such as an offshore hedge or private equity fund) because of duplicative reporting or for other circumstances? The Treasury would like comments on whether a U.S. person should be relieved from an FBAR filing requirement with respect to a foreign commingled fund in other circumstances, such as when filing would be duplicative of other reporting.[95] Interested persons should submit comments to the IRS and FinCEN by October 6, 2009. All comments will be made available for public inspection.

Exceptions to FBAR Reporting

The following are four noteworthy exceptions to FBAR reporting found in both the instructions to the FBAR and the Internal Revenue Manual.

Officer or Employee of Supervised Bank with Signature Authority but No Personal Interest in the Account

An officer or employee of a bank that is subject to the supervision of a federal bank regulator need not file the FBAR reporting that he has signature or other authority over a foreign bank, securities or other financial account maintained by the bank, if the officer or employee has no personal financial interest in the account.[96] Employees of a "bank subsidiary" (that is, not a bank, but is a subsidiary of a large domestic bank that is subject to bank regulator authority) qualify for the exception to file the FBAR provided they only have signature authority and no personal interest in the account.[97]

Officer or Employee of Publicly Listed Domestic Corporation or with Assets Exceeding $10 Million and 500 or More Shareholders with Signature Authority over but No Personal Interest in the Account

An officer or employee of a domestic corporation whose equity securities are listed on a U.S. national securities exchange or that has assets exceeding $10 million and has 500 or more shareholders of record need not file the FBAR concerning his or her signature or other authority over a foreign financial account of the corporation if he or she has no personal interest in the account and he or she has been advised in writing by the chief financial officer or similar responsible officer of the corporation that the corporation has filed a current FBAR that includes the account.[98] The revised FBAR instructions expanded the CFO certification to include a certification by similar responsible officer other than the CFO.

Officer or Employee of More-Than-50-Percent–Owned Domestic or Foreign Subsidiary of a Publicly Listed Domestic Parent Corporation or with Assets Exceeding $10 million and 500 or More Shareholders with Signature Authority over but No Personal Interest in the Account

An officer or employee of a domestic subsidiary of a domestic parent corporation or a foreign subsidiary that is more than 50 percent owned by a domestic parent corporation that has securities listed on a national securities exchange or that has assets exceeding $10 million and has 500 or more shareholders of record need not file the FBAR that he or she has signature authority over a foreign financial account of the subsidiary if he or she has no personal interest in the account and has been advised in writing by the chief financial officer or other responsible officer of the parent corporation that the subsidiary corporation has filed a current FBAR that includes that account.[99]

The revised FBAR instructions now explicitly permit the CFO or other responsible officer of the parent corporation to certify that the subsidiary corporation has filed a current FBAR and that employees of the subsidiary do not need to certify separately the FBAR filing by the subsidiary. Thus, this permits a large U.S. global bank with hundreds of subsidiaries with literally thousands of foreign financial accounts with many officers or employees with signatory authority to make and retain records for such accounts and obtain a blanket certification from the bank's CFO or other responsible officer that a consolidated FBAR has been filed. At present there is no authority for a similar procedure for the bank's unincorporated, limited liability or partnership filings, which may be wholly or partially owned. The IRS has requested comments to certain of these exceptions to FBAR reporting that may indicate a willingness to give banks and other companies some administrative relief from the resource intensive FBAR filing and recordkeeping requirements. (*See* "Request for Comments—Notice 2009-62").

Officer or Employee of Wholly Owned Domestic Subsidiary Named in Consolidated FBAR Filing of the Publicly Listed Domestic Parent Corporation or with Assets exceeding $10 million and 500 or More Shareholders with Signature Authority over but no Personal Interest in the Account

An employee or officer of a wholly owned domestic subsidiary of a domestic parent corporation whose equity securities are listed on a national securities exchange or that has assets exceeding $10 million and 500 or more shareholders of record need not file the FBAR concerning his signature or other authority over a foreign financial account of another domestic or foreign subsidiary of the same domestic parent if he or she has no personal financial interest in the account and has been advised in writing by the chief financial officer of the parent corporation that the corporation has filed a current FBAR that includes that account.[100]

Foreign Financial Accounts Must Exceed $10,000

The FBAR is required each calendar year during which the aggregate amounts in the accounts exceeded $10,000 valued in U.S. dollars at any time during the calendar year.[101] The revised FBAR requires filers to enter the exact maximum value of the foreign financial account, rather than a range of values which was checked on the old FBAR with the largest range being over $1 million.

Maximum Value in the Account

The maximum value of an account is the largest or highest amount (not the average amount) of currency and nonmonetary assets that appear on any quarterly or more frequent account statement issued for the applicable year.[102] For example, if the statement closing balance is $9,000 but at any time during the year a balance of $15,000 appears on a statement, the maximum value is $15,000.[103] If periodic statements are not issued, the maximum asset value is the largest amount of currency and nonmonetary assets in the account at any time during the year.[104] The conversion of foreign currency is done by using the official exchange in effect at the end of the year in question for converting the foreign currency into U.S. dollars.[105]

Determine Maximum Value Separately for Each Account

For purposes of determining whether an FBAR needs to be filed, the largest value during the year is determined separately for each account (including the accounts that did not exceed $10,000) and added together. For example, suppose a U.S. citizen has two foreign bank accounts with the following maximum account balances: $12,000 and $1,000. Both accounts have to be included in the FBAR.[106] If a family has separate foreign financial accounts in the name of the husband, wife and son and daughter the accounts are treated as separate accounts and are not consolidated for FBAR reporting purposes.

Valuing Nonmonetary Assets in the Account

The value of stock, other securities or other nonmonetary assets in an account reported on an FBAR is the fair market value at the end of the calendar year or, if withdrawn from the account earlier in the year, at the time of the withdrawal.[107] For purposes of determining the maximum amount in the account, if the filer has a financial interest in more than one account, each account is to be valued separately as discussed above.[108]

If a filer had a financial interest in one or more but fewer than 25 accounts and is unable to determine whether the maximum value of these accounts exceeded $10,000 at any time during the year, the Revised FBAR instructions state the filer is to complete Part II, *Information on Financial Account(s) Owned Separately,* Part III, *Information on Financial Account(s) Owned Jointly,* and Part V, *Information on Financial Account(s) Where Corporate Filer is Filing a Consolidated Report* for each of these accounts, and enter "value unknown" in Part II, Item 15 of the FBAR.[109]

FBAR Filing and Recordkeeping Rules

The determination to file the FBAR is made annually.[110] For example, the FBAR may be required to report the foreign bank account for one year but not subsequent years if the aggregate account balances in the subsequent years do not exceed $10,000.[111] The FBAR should not be filed with the filer's federal income tax return.[112]

When and Where to File the FBAR–General Rule

If the FBAR filing criteria otherwise is met for a calendar year, the FBAR must be filed on or before June 30 of the year following the calendar year.[113] The FBAR is filed by mailing the report to the Department of the Treasury, P.O. Box 32621, Detroit, Michigan 48232-0621 or by hand-carrying the FBAR to any local IRS office for forwarding to this address. Tax attaches are also located in the U.S. embassies in some countries for hand filing. Electronic filing is not permitted. If a U.S. person does not have all the available information to file the FBAR by June 30, the U.S. person should file as complete an FBAR as U.S. person can and file an amended FBAR when the additional or new information becomes available.[114] (*See* "Filing an Amended FBAR.") An FBAR is considered filed when it is received by the IRS, not when it is postmarked.[115]

Signatures

The FBAR must be signed by the person identified in Part I of the FBAR as the filer. If the FBAR is being filed on behalf of a partnership, corporation, fiduciary or other legal entity, it must be signed by an authorized individual. Consolidated reports should be signed by an authorized official of the parent corporation. In addition, the title of the individual signing for a legal entity, such as a corporation should be entered on the FBAR.[116] The IRS does not accept a fax signature on the FBAR. However, the IRS has indicated that if pressed for time the filer should file the FBAR with fax signature and follow up with an amended FBAR with an original signature later and an explanation of why the signature was obtained late.[117]

Combined FBAR Filing by Spouses

The revised FBAR instructions now permit a combined filing by spouses and request the identity information about the joint owner. If there is more than one joint owner, the revised FBAR instructions ask for the identity information about the principal joint owner. A spouse having a joint financial interest in a foreign financial account with the filing spouse should be included as a joint account owner in Part III of the FBAR. The filer should write "spouse" on Line 26 after the last name of the joint spousal owner. If the only reportable accounts of the filer's spouse are those reported accounts, the filer's spouse need not file a separate report. If the accounts are owned jointly by both spouses, the filer's spouse should also sign the report. If the filer's spouse has a financial interest in other accounts that are not jointly owned with the filer or has signature or other authority over other accounts, the filer's spouse should file a separate FBAR for all accounts including those owned jointly with the other spouse.[118]

Verification of FBAR Filings

Although clearly not required, filers may want to obtain verification from the IRS that the FBAR has been filed to avoid the incurrence of possible substantial FBAR penalties. (*See* "FBAR Penalties"). Filed FBARs are entered into the IRS Detroit Computing Center's Currency and Banking Retrieval System (CBRS) database and filing can be checked by calling personnel with CBRS passwords at this database at (800) 800-2877.[119] A CBRS printout of a FBAR can establish that the FBAR was actually filed.[120] Filers can request verification of the FBAR that they filed 60 days after the date of file and a request for verification must be in writing and should include the filer's name, taxpayer identification number and filing period and be mailed to the IRS Detroit Computing Center, P.O. Box 32063, Detroit, MI 48232, attn: Verification.[121]

FBAR Recordkeeping Requirements

If an FBAR is required to be filed, certain records must be retained by the filer.[122] Each person having a financial interest in or signature or other authority over any such account must keep the following records: (i) name in which the account is maintained; (ii) number or other designation of the account; (iii) name and address of the foreign bank or other person whom the account is maintained; (iv) type of account; and (v) maximum value of such account during the reporting period.[123] While retaining a copy of the FBAR is not required, a copy of the current FBAR contains most of the required information.[124] The records must be kept for five years and be available at all times for inspection as provided by law.[125] This requirement is in addition to the federal income tax recordkeeping requirements which generally require that the taxpayer retain such records until the period for limitations expires (generally six years) and for so long as they may be material to the administration of the tax law.[126] Records may need to be maintained for a longer period by persons who have been formally charged with a criminal tax violation.[127]

While the failure to maintain FBAR records potentially subjects U.S. persons to the same severe civil and criminal FBAR penalties (generally depending on "willfulness" (*see* "FBAR Penalties"), it is readily apparent that few taxpayers in the past knew about the requirements to maintain FBAR records for five years (or six years in order to satisfy the statute of limitations). At a recent tax conference attended by approximately 100 tax lawyers, the question was asked if the audience knew about the FBAR recordkeeping requirements. Less then a dozen hands went up in the audience to indicate they knew of these requirements. Suffice it to say, it is not only taxpayers and their advisors who may have inadequate knowledge of the FBAR requirements, but also banks, other financial intermediaries and third-party investment funds who until very recently may not have put resources toward, or focused on what is required in order to satisfy, the FBAR rules and requirements because they thought that these rules were not applicable to their companies.

FBAR Recordkeeping Requirements for Filers Having 25 or More Accounts

If the filer has a financial interest in 25 or more foreign financial accounts, the filer should check the "yes" box in Part I, Item 14 of the FBAR and indicate the total number of accounts and does not have to complete Part II (Continuation of Separate Accounts) or Part III (Joint Accounts) of the report.[128] Similarly, if the group of entities covered by a consolidated FBAR has a financial interest in 25 or more foreign financial accounts, the reporting parent corporation need only complete Part V (for consolidated reporting) Items 34 through 42, for the identity information of the account owners, but not complete the account information.[129] In both cases, however, detailed information about each account, including all information called for in the FBAR must be recorded and retained for five years from June 30 of the year following the calendar year reported.[130]

Filing an Amended FBAR and Amended Income Tax Returns

While the FBAR instructions for the July 2000 revision of the FBAR did not address filing amended FBARs, the revised FBAR instructions indicate that an amendment of a previously filed FBAR is accomplished by checking the "Amended" box in the upper right hand corner of the first page of the revised form, making the needed additions or corrections and then stapling it to a copy of the original form. The revised FBAR instructions also add a new requirement to include a statement explaining the changes or omissions to the originally filed FBAR which should be attached to the amended FBAR.[131] If the taxpayer (or his tax return preparer) has erroneously checked "No" on Schedule B on his originally filed income tax returns that he has no foreign financial accounts, the taxpayer should also file amended income tax returns and check the "Yes" box.

Filing a Delinquent FBAR

If a delinquent FBAR is filed the revised FBAR instructions now also require that the filer attach a statement explaining the reasons for late filing. In the case of delinquent or amended filing it makes good sense to draft the statements carefully explaining the reasons for late filing or changes or omissions in order to avoid sizeable civil penalties for failure to file. This may also forestall criminal prosecution in certain cases as a mitigation strategy. (*See* "FBAR Penalties.")

Delinquent FBARs–Extension to File FBAR until October 15, 2009, for 2008 and Earlier Years FBARs for Filers Who Have Paid Taxes on All Their Taxable Income for Prior Years Who Have Delinquent FBARs

On June 24, 2009, the IRS posted questions and answers (Q&As #43) on its public Web site[132] that provides relief to certain filers who only recently learned of their obligation to file an FBAR by setting forth conditions and procedures for filing the FBAR by September 23, 2009. On September 21, 2009, the IRS announced on its Web site under the heading, "Voluntary Disclosure: Questions and Answers," that delinquent FBAR filers who only recently learned of their obligation and who have no unreported income will have until October 15, 2009, to file their FBARs.

For filers who reported and paid tax on all their taxable income for prior years but did not know about the file FBARs, the current delinquent FBAR, including the preceding five years' FBAR filings that were not filed should be filed according to the revised FBAR instructions by attaching a statement why the reports are filed late and sending the FBARs to the Department of the Treasury, P.O. Box 32621, Detroit, MI 48232-0621. In addition, copies of the delinquent FBARs, together with copies of tax returns[133] for all relevant years by October 15, 2009, to the Philadelphia Offshore Identification Unit at Internal Revenue Service, 11501 Roosevelt Blvd., South Bldg., Room 2002, Philadelphia, PA 19154, Attn: Charlie Judge, Offshore Unit, DP S-611.[134] The IRS will not impose a penalty for the failure to file the FBARs.[135]

If a filer has been filing FBARs in earlier years (and presumably reporting the income on his or her or domestic entity tax returns), these filers have not been granted any extension and had until June 30, 2009, to filer the FBARs. No extension was provided because these filers already knew they had an obligation to file—and they should file as soon as possible with a separate statement explaining their delinquent FBAR filings with each FBAR report.

Filers who did not report the income from the foreign financial accounts on their individual, partnership, corporation or trust tax returns cannot get any extension and should ascertain if they are eligible to participate in the Voluntary Disclosure Program to extend the due date for filing the 2008 calendar year FBAR, as well as the earlier five open years until October 15, 2009. It can be expected that the FBAR and income tax civil penalties will be substantially worse for those U.S. persons who fail to comply with the requirements of the Voluntary Disclosure Program and may also face criminal penalties for tax evasion and fraud. For an expanded discussion of the voluntary disclosure program, *see* "Voluntary Disclosure Program," and for an expanded discussion of the potential penalties *see* "FBAR Penalties."

Delinquent FBARs–Extensions to File FBARs for 2009 and Future Years

Historically, the Treasury has not given filers any extension of time to file the FBAR and there is no statutory or regulatory provision specifically granting such extension for filing FBARs. Extensions of time to file the federal income tax returns does not extend the time for filing the FBARs.[136] If a delinquent FBAR is filed the revised FBAR instructions state that the filer should attach a statement explaining the reason for the late filing.

As discussed above, while the IRS eased the filing obligation for eligible filers of FBARs for 2008 and earlier calendar years who otherwise satisfy the conditions and procedures as provided in the IRS posted Q&As by granting what amounts to a three-and-a-half-month extension and again extended the filing deadline until June 30, 2010, for eligible filers with only signature authority and for filers with a financial interest in or signature authority over a foreign financial account in which the assets are held in a commingled fund for 2008 and earlier years, it would nonetheless be well advised for filers not to plan for other extensions for 2009 and succeeding calendar years.

Detailed Information Required by U.S. Persons on FBAR

The revisions to the FBAR may require both U.S. and foreign individuals and foreign entities who are in, and doing business in the United States to disclose and reveal sensitive financial and other information to the Treasury which may be shared with other federal, foreign and state and local governmental agencies for criminal, regulatory or tax purposes. For an expanded discussion, *see* "Purposes and Lack of Confidentiality of FBAR and Required Records." The revised FBAR requires a U.S. person to provide a foreign identification number, such as a foreign passport number or employer identification number and other identifying information. Similarly, if a nonresident alien or a foreign entity has signature authority over a foreign financial account, the person with the financial interest must also be identified. Under the old form, the filer could note that no U.S. person had an interest in the account. For example, now when a U.S. person holds a power of attorney over an account which is owned by a foreign family member, the relative must be identified and identifying information provided for that foreign person.

Transfer of FBAR Compliance and Enforcement to the IRS

In April 2003, the authority to enforce the foreign financial account reporting and recordkeeping provisions of the BSA[137] was re-delegated from FinCEN to the IRS by a Memorandum of Understanding (MOU) between FinCEN and the IRS because the IRS has greater resources available devote to FBAR compliance and enforcement, especially as it relates to individual filers.[138]

These duties include authority for the IRS to (i) investigate possible civil violations of these provisions; (ii) assess and collect civil FBAR penalties; (iii) employ the summons power; (iv) issue administrative rulings; and (v) take any other action reasonably necessary for the enforcement of these and related provisions, including the pursuit of injunctions.[139] When performing these functions, the IRS is not acting under Title 26 (Internal Revenue Code) of the U.S. Code, but instead is acting under the authority of Title 31 (Money and Finance) and the provisions of the Internal Revenue Code generally do not apply to FBARs.[140] The Small Business/Self-Employed Division (SB/SE) of the IRS has the responsibility for monitoring the overall FBAR compliance program. Criminal Investigation (CI) was delegated the authority to investigate possible criminal violations of the BSA.[141]

FBAR Penalties–In General

Whenever there is an FBAR violation, the IRS will issue either a FBAR warning letter, a Letter 3800 or determine a penalty[142] FBAR civil penalties have varying upper limits but no floor.[143] According to the IRS INTERNAL REVENUE MANUAL penalties should be asserted only to promote compliance with FBAR reporting and recordkeeping requirements and examiners when exercising their discretion, should consider whether the issuance of a warning letter and the securing of delinquent FBARs rather than the assertion of a penalty will achieve the desired result in the future.[144]

FBAR penalties are determined per account, not per unified FBAR for each person required to file an FBAR and penalties apply for each year of each violation.[145] There may be multiple FBAR civil penalty assessments arising from one account and FBAR civil penalties can apply to each person with a financial interest in or signature authority over the foreign financial account.[146] Thus, there may be multiple penalty assessments if there is more than one account owner or if a person other than the account owner has signature authority over the foreign account. Each person can be liable for the full amount of the penalty.[147]

Criminal vs. Civil FBAR Penalties

A civil penalty may be imposed for an FBAR violation even if a criminal penalty is imposed for the same violation. Typically, civil FBAR assessments and penalties are not assessed until the criminal aspects of an investigation have been formally closed. The criminal tax deficiency may differ from the civil tax deficiency in the civil process. Criminal violations are charged only against the tax deficiency that results from fraud. The civil tax deficiency is much broader and includes all tax due on a return, *i.e.,* the tax from the evaded income and the adjustments to the subject's itemized deductions.

Civil tax liability may differ from criminal tax liability for a number of reasons: (i) adjustments of a controversial or offsetting nature may not be included in a criminal tax computation to remove controversial issues from the criminal action; (ii) adjustments of a minor, technical, or a nonfraudulent nature may be considered solely for civil purposes; and (iii) evidence that may not meet the burden of proof necessary in a criminal investigation may be adequate for a civil case.[148]

FBAR Burden of Proof

The standard of proof for the enforcement FBAR civil penalties is different then for the enforcement of FBAR criminal penalties. In the case of FBAR criminal penalties, the government must establish "beyond a reasonable doubt" that the U.S person "willfully" or intentionally disregarded the law by (i) failing to file the FBAR; (ii) falsifying the FBAR; or (iii) failing to complete or maintain FBAR records or falsifying the FBAR records. In the case of the enforcement of FBAR civil penalties, the government standard of proof is reduced to a lower standard of only "clear and convincing evidence."

In an excellent paper entitled, *The Morning After… What You Need To Know About the FBAR and International Information Returns Including Defending Against and Litigating the Penalties,* Caroline D. Ciraolo, Esq. of Rosenberg, Martin, Greenberg, LLP discussed what is necessary to establish a willful violation for purposes of the FBAR penalties:

> To establish a willful violation for purposes of the civil FBAR penalty under 31 U.S.C. § 5321 or to sustain the heavy burden of proof to obtain a criminal conviction under 31 U.S.C. § 5322, the government must establish "a voluntary intentional violation of a known legal duty." Ratzlaf v. United States, 510 U.S. 135, 141 (1994); I.R.M. 4.26.16.4.5.3 (07-01-2008). The government must prove that the taxpayer was aware of the requirement to file the FBAR and intentionally failed to do so (or filed a false FBAR). IRS CCA 200603026, 2006 WL 148700 (January 20, 2006); United States v. Dollar Bank Money Market Account, 980 F.2d 233, 238 n. 2 (3d Cir. 1992). Short of a concession or a confession, the government will rely on circumstantial evidence and infer willfulness based on a course of conduct. See United States v. Sturman, 951 F.2d 1466, 1476 (6th Cir. 1991); see also Lerch v. Commissioner, T.C. Memo. 1987-295 (court characterized failure to disclose foreign bank account, failure to report income from foreign bank account, and failure to file accurate FBARs as clear and convincing evidence of fraud for purposes of IRC § 6653(b)).
>
> In Sturman, the defendant was convicted of willfully failing to maintain records and file FBARs. The Sixth Circuit affirmed the conviction, holding that the government proved willfulness through circumstantial evidence. Id. (citing Check v. United States, 498 U.S. 192 (1991); Spies v. United States, 317 U.S. 492, 499 (1943)). Specifically, Sturman "concealed his signature authority, his interests in various transactions, and his interest in corporations transferring cash to foreign banks." 951 F.2d at 1476. The court also noted that Sturman admitted knowledge of and failure to answer a question concerning signature authority at foreign banks on Schedule B of his income tax return. Id. at 1477. Since Schedule B made specific reference to a "booklet" that referenced the duty to file an FBAR, the court found:
>
> "that the defendant could have learned of the additional requirements quite easily. It is reasonable to assume that a person who has foreign bank accounts would read the information specified by the government in tax forms. Evidence of acts to conceal income and financial information, combined with the defendant's failure to pursue to knowledge of further reporting requirements as suggested on Schedule B, provide a sufficient basis to establish willfulness on the part of the defen-

Table 1

Violation	Civil Penalties	Criminal Penalties	Citation
Negligent Violation	Up to $500	N/A	31 USC §5321(a)(6)(A) 31 CFR 103.57(h)
Non-Willful Violation	Up to $10,000 for each negligent violation	N/A	31 USC §5321(a)(5)(B)
Pattern of Negligent Activity	In addition to penalty under §5321(a)(6)(A) with respect to any such violation, not more than $50,000	N/A	31 USC§5321(a)(6)(B)
Willful—Failure to File FBAR or retain records of account	Up to the greater of $100,000, or 50 percent of the amount in the account at the time of the violation	up to $250,000 or 5 years, or both	31 USC §5321(a)(5)(C) 31 USC §5322(a) and 31 CFR §103.59(b) for criminal. The penalty applies to all U.S. persons.
Willful—Failure to File FBAR or retain records of account while violating certain other laws	Up to the greater of $100,000, or 50 percent of the amount in the account at the time of the violation	up to $500,000 or 10 years, or both	31 USC §5322(b) and 31 CFR §103.59(c) for criminal.
Knowingly and Willfully Filing False FBAR	Up to the greater of $100,000, or 50 percent of the amount in the account at the time of the violation	up to $10,000 or 5 years, or both	18 USC §1001, and 31 CFR §103.59(d) for criminal.

Civil Tax Penalties and Criminal Tax Penalties may be imposed together. 31 USC §5321(d).

dant." Id.; see also United States v. Bank of New England, N.A., 821 F.2d 844, 855 (1st Cir. 1987) (finding willfulness can be inferred from a conscious effort to avoid learning about reporting requirements); I.R.M. § 4.26.16.4.5.3 (07-01-2008) (examples of willfulness)."

In considering whether to impose the civil penalty for willful violations, the Service will use the same criteria established for the civil fraud penalty under 26 U.S.C. § 6663, and bear the same burden of proving willfulness by clear and convincing evidence. IRS CCA 200603026, 2006 WL 148700 (January 20, 2006). To assist in their review, FBAR examiners may request a wide range of documents, from the tax returns to correspondence with investment managers and brokers. See I.R.M. 4.26.16.4.5.4 (07-01-2008) (list of documents helpful in establishing willfulness).

Unlike assessments of tax or civil tax penalties, there is no presumption of correctness in connection with the imposition of FBAR penalties. 18 U.S.C. Section 3282. Similarly, 26 U.S.C. § 7491(c), which imposes on the Service the burden of production with respect to all penalties and additions to tax asserted under Title 26, does not apply to the FBAR penalty.

FBAR Penalties

Table 1 is from the IRS Web site[149] and highlights the civil and criminal tax penalties that may be asserted for not complying with the FBAR reporting and recordkeeping requirements.[150] The table does not include penalties arising under the Internal Revenue Code, which are discussed in detail below, such as for the civil tax fraud,[151] which is generally 75 percent of the understatement of tax or the accuracy related penalty of 20 percent of the understatement of tax.[152] Under the penalty provisions found in 31 USC §5314(a)(5) it is possible to assert civil penalties for FBAR violations in amounts that exceed the balance in the foreign financial account.[153]

FBAR Negligence Penalties for Trades or Businesses Only for Failure to File FBAR or Retain Records of Account–Negligence Violation and Pattern of Negligent Activity Penalties (31 USC §5321(a)(6)(A),(B))

There are two negligence penalties which apply generally to all the BSA provisions.[154] A negligence penalty up to $500 may be assessed against a financial institution or nonfinancial trade or business for any negligent violation of the BSA, including an FBAR violation for failure to file an FBAR or satisfy the recordkeeping requirements.[155] An additional penalty up to $50,000 may be assessed against a financial institution or nonfinancial trade or business for a pattern of negligence FBAR violations.[156] The two negligence penalties generally only apply to financial institutions or trade or businesses and not to individuals.[157]

Actual knowledge of the FBAR reporting and recordkeeping requirement is not required to find negligence. If a financial institution or other business exercising ordinary business care and prudence for its particular business should have known about the FBAR filing and recordkeeping requirements, its failure to file or maintain records may be negligent. Thus, the standards of practice in a particular business are relevant in determining negligence. If the failure to file the FBAR or to keep or maintain records is due to reasonable cause and not due to negligence of the person who had the obligation to file, the negligence should not be asserted.[158] Examiners are directed to use general negligence principles in determining whether or not to apply the negligence penalty.[159]

FBAR Nonwillful Violation for Failure to File FBAR or Retain Records of Account—Civil Penalty Only (31 USC §5321(a)(5)(B))

If a person or a trade or business fails to file an FBAR or satisfy the recordkeeping requirements are subject to a civil penalty of not more than $10,000 for each negligent violation.[160] It is possible for a financial institution or trade or business to be subject to the negligence penalties, as well as the nonwillful violation penalty.

The nonwillful violation penalty will not be imposed if the person can establish that (i) the violation was due to reasonable cause, and (ii) the balance in the account at the time of the transaction was properly reported on an FBAR.[161] The Internal Revenue Manual provides that reasonable cause can be established if the taxpayer shows that the taxpayer was unaware of his obligations or shows ignorance of the law in conjunction with other facts and circumstances.[162]

In order to satisfy the second prong of the test, the examiner must receive the delinquent FBARs from the nonfiler in order to avoid application of the nonwillfulness penalty. Thus, the reasonable cause penalty may apply in appropriate situations in which the FBAR is not filed timely as well.[163] The ceiling on the penalty permits the examiner to have discretion in determining the amount of the penalty and mitigation guidelines have been developed by the IRS to assist examiners in asserting the appropriate nonwillfulness penalty amount.[164] (*See* "Civil Mitigation Guidelines and Threshold Conditions.")

A filing violation occurs on the June 30 of the year following the calendar year to be reported (that is the due date of the FBAR), unless the IRS has granted transitional relief and permitted an extension for eligible filers as noted above.[165] A recordkeeping violation occurs on the date when the records are requested by the IRS examiner if the records are not later provided.[166] Generally, criminal penalties will not be assessed in addition to the negligence and nonwillful FBAR civil penalties arising for the negligent or nonwillful failure to file an FBAR or for failure to satisfy the FBAR recordkeeping requirements for an account.[167]

FBAR Willfulness Penalties for Failure to File FBAR or Retain Records of Account—Civil and Criminal Penalties (31 USC §5321(a)(5)(C); 31 USC §5322(a))

A civil penalty may be imposed up to the greater of $100,000 or 50 percent of the amount in the account at the time of the violation by any U.S. person who willfully fails for file a timely FBAR or files an FBAR with a material omission or misstatement or fails to satisfy the recordkeeping requirements by not making or retain records.[168] The test for willfulness is whether there was a voluntary, intentional violation of a known legal duty.[169] A finding for willfulness under the BSA must be supported by evidence of willfulness and the burden of establishing willfulness is on the IRS.[170] 31 USC §5321(a)(5)(C)(ii) makes clear that there is no reasonable cause exception for willful violations.[171]

Willfulness is shown by the person's knowledge of the reporting requirements and the person's conscious choice not to comply with the requirements. In the case of the FBAR, the only thing that a person needs to know is that he or she has a reporting requirement. If a person has that knowledge, the only intent needed to constitute a willful violation of the requirement is a conscious choice not to file the FBAR.[172] Because the willfulness penalty has a substantial ceiling amount, the IRS has developed guidelines for the exercise of the examiner's discretion in arriving at the amount of a willfulness penalty.[173]

At a recent ABA Tax Section meeting held at the end of September 2009, Kevin M. Downing, a Senior Attorney in the Tax Division at the U.S. Department of Justice indicated that taxpayer's collateral behavior and circumstantial evidence will be looked at in determining "willfulness." For this purpose, the example used was of an 85-year-old grandmother who had inherited foreign financial accounts, but who was also the executor of the estate from which the foreign financial accounts were obtained, signed her individual tax returns and checked "No" in the box on Schedule B of the return that she did not own any foreign financial accounts. On these facts, Mr. Downing suggested that the DOJ may proceed with a criminal prosecution of the case for "willfulness." In rebuttal, the ABA Tax Section FBAR panel submitted that other facts in a given case could suggest lack of "willfulness," such as facts that establish that the return preparer's software program automatically checked "No" on the taxpayer's Schedule "B" or that the taxpayer was not the executor of the estate or could otherwise establish facts that the taxpayer did not have knowledge of the FBAR filing requirements.

It should be noted there that there may be both a reporting and a recordkeeping violation regarding each account. The amount of the penalty is calculated per account and per violation. There is no reduction in the amount due to multiple financial interests in the account. For example, the entire balance of an account owned by two persons is the amount used to calculate the amount of the penalty for each. The value of the account is not reduced by half because there are two owners.[174]

The date of a filing violation is June 30 of the year following the calendar year for which the accounts are being reported. This date is the last possible date (absent an extension for eligible filers by the IRS as noted above), so that the close of the day with no filed FBAR represents the first time a violation has occurred. The amount or balance in the account at the close of June 30 is the amount to use in calculating the filing violation.[175] The date that the examiner first requests records is the date of the violation for failure to keep records. The date of the violation should be tied to the date of the request and not a later date to avoid the filer manipulating the amount in the account after receiving a request for records. The balance in the account at the close of the day on which the records are first requested is the amount to use in calculating the recordkeeping penalty violation.[176]

A criminal penalty for the willful failure to file the FBAR or retain the records of the account can be imposed up to $250,000 or up to five years' imprisonment or both.[177]

FBAR Willfulness Penalty for Failure to File FBAR or Retain Records of Account While Violating Certain Other Laws—Civil and Criminal Penalties (31 USC §5322(b); 31 CFR §103.59(c))

A civil penalty may be imposed up to the greater of $100,000 or 50 percent of the amount in the account at the time of the violation if the violation by a U.S. person occurs while violating another law of the United States or as part of a pattern of illegal activity involving more than $100,000 in a 12-month period.[178] In addition, a criminal penalty can be imposed up to $500,000 or up to 10 years' imprisonment or both.[179]

FBAR Penalties for Knowingly and Willfully Filing False FBAR—Civil and Criminal Penalties (18 USC §1001; 31 CFR §103.59(d))

If a U.S. person knowingly and willfully falsifies or makes any materially false, fictitious or fraudulent statement or representation for an account in any FBAR, he can be subject to a civil penalty up to the greater of $100,000 or 50 percent of the amount in the account at the time of the violation or for criminal penalties of up to $10,000 or up to five years' imprisonment or both.[180] It should be noted the maximum five-year term of imprisonment under the FBAR criminal statute for the willful filing a false FBAR is more severe than the maximum three-year term of imprisonment for willfully making and subscribing any return, statement or other document that contains or is verified by a written declaration made under penalties of perjury, and that the taxpayer does not believe to be true and correct as to every material matter under Code Sec. 7206. (*See* "Code Sec. 7206 Criminal Fraud and Making False Statements.")

Civil and Criminal Penalties Under the Internal Revenue Code

Every U.S. person as part of filing the Form 1040, *U.S. Individual Income Tax Return,* Schedule B—Interest and Ordinary Dividends at Part III, Question 7a must answer either "Yes" or "No" in the appropriate box to the following declarative question: *At any time 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?* If the answer to the question is "Yes," the U.S. person is directed to the FBAR to report a financial interest in a foreign bank or brokerage account. For corporations, Form 1120, *U.S. Corporate Income Tax Return,* Schedule N, Foreign Operations of U.S. Corporations, Question 6a requires corporate files to answer the same question. Similarly, for partnerships, Form 1065, *U.S. Return of Partnership Income,* Schedule B, Other Information, Question 10 requires partnership filers and Form 1041, *U.S. Income Tax Return for Estates and Trusts, Other Information,* Question 3 requires trust filers to answer this question also. For tax-exempt filers who file the Form 990, *Return of Organizations Exempt from Tax,* the same question is asked at Part V, Statement Regarding Other Filings, Question 4a.

a. Code Sec. 7206 Criminal Fraud and Making False Statements—Perjury Penalty. If a U.S. person provides a false answer to the foreign bank account question, the U.S. person may be prosecuted for willfully making a false income tax return which he does not believe to be true and correct as to every material matter under penalties of perjury. Filing a false return is a felony and is subject to a fine of up to $100,000 ($500,000, in the case of a corporation) and a prison term of up to three years or both.[181] Thus, a person who knowingly answers "No" when the answer is in fact "Yes" may face possible criminal prosecution which from the point of view of a prosecutor will be a relatively simple case to prove when compared to trying to establish tax evasion in complex fact situations which are common in tax shelter schemes or other abusive transactions.

b. Code Secs. 6651(f) and 6663—Civil Fraud Penalties. A U.S. person's fraudulent failure to report to the IRS his worldwide income from one or more foreign financial accounts whether in the form of interest, dividends, capital gains or other income may result in civil fraud penalties equal to 75 percent of the underpayment of tax which is attributable to fraud. In the case of a joint return, the penalty does not apply with respect to a spouse unless some part of the underpayment is due to the fraud of that spouse. Acquittal in a criminal prosecution is not decisive of the civil fraud issue. However, a criminal conviction for income tax evasion does decide the fraud issue and the subject is collaterally estopped from raising it in the civil proceedings.[182]

When a U.S. person is required to file a tax return and fraudulently fails to do so on or before the due date of the return, Code Sec. 6651(f) imposes a penalty of 15 percent of the net tax amount required to be shown on the tax return for each month (or fraction of a month) that the return is late.[183] The maximum penalty is 75 percent.[184]

c. Code Sec. 7201 Criminal Attempt to Evade or Defeat Tax. Under Code Sec. 7201, if a U.S. person willfully attempts in any manner to defeat paying the U.S. tax on the income from a foreign financial account, a U.S. person may be guilty of a felony and may be fined up to $100,000 ($500,000 in the case of a corporation) or imprisoned for up to five years or both.[185]

d. Code Secs. 6651(a)(2) (Late Payment Penalty) and 6651(a)(3)—Civil Penalty for Failure to Pay Tax Penalties. When a U.S. person fails to timely pay the amount of tax shown on the return on or before the due date prescribed for payment, Code Sec. 6651(a)(2) imposes a late payment penalty equal to 0.5 percent of the amount of the underpayment for the first month, with an additional 0.5 percent for each additional month or fraction thereof during which such failure continues. The maximum amount of the penalty cannot exceed an aggregate 25 percent.[186] When a taxpayer fails to pay a tax that is required (but was not) shown on a return within 21 days from the date of the IRS notice and demand for that tax, Code Sec. 6651(a)(3) imposes a penalty of 0.5 percent for each month (or part thereof) that the assessment remains unpaid. The maximum penalty is 25 percent.[187]

e. Code Secs. 7203 and 6651(a)(1) (Delinquency Penalty) for Failure to File Return—Criminal and Civil Penalties. If the U.S. person fails to file his or her income tax return there may be a criminal penalty of up to $25,000 ($100,000 in the case of a corporation) or up to one year in prison or both.[188] A delinquency penalty of five percent a month may be imposed when a tax return is filed delinquently without reasonable cause, or when a taxpayer fails to file a return without fraudulent intent. The penalty is limited to 25 percent and is imposed on the net amount due.[189]

f. Code Sec. 6662 Civil Accuracy-Related (Negligence) Penalty. In general, Code Sec. 6662 imposes a 20-percent accuracy-related penalty on an underpayment of tax if the underpayment is attributable to among other items, negligence or disregard of the rules or regulations or a substantial understatement of income tax.[190] Negligence includes any failure to make a reasonable attempt to comply with the tax law and the term disregard includes any careless, reckless or intentional disregard.[191] There is a substantial understatement of income tax for any tax year if the amount of the understatement exceeds the greater of 10 percent of the tax required to be shown on the tax return for the tax year or $5,000.[192] In the case of a C corporation other than a personal holding company or an S corporation there is as substantial understatement if the amount of the understatement for the tax year exceeds the lesser of 10 percent of the tax required to be shown on the tax return for the tax year or $10 million.[193] The negligence penalty cannot be assessed against any portion of the understatement against which the fraud penalty is assessed.[194]

g. Code Sec. 6672 (100-Percent Penalty). A 100-percent penalty equal to the total amount of tax evaded may be imposed on any person who is required to collect, truthfully account for and pay over any tax; and willfully evades, fails to collect, account for and/or pay over such tax or willfully attempts in any manner to evade or defeat any such tax.[195]

h. Code Sec. 6694 Understatement of Taxpayer's Liability. It is likely that some tax return preparers, as well as the general public may not fully understand the FBAR rules and may have inadvertently checked the "No" box in answering question the FBAR question as to whether the U.S. person has a foreign financial account. This raises the possibility that the tax return preparer penalty of Code Sec. 6694 may be applied by the IRS.

Under Code Sec. 6694 any tax return preparer who prepares a tax return or claim for refund with respect to which any part of the understatement of liability is due to a "unreasonable position" may have pay a penalty equal to the greater of $1,000 or 50 percent of the income derived by the tax return preparer.[196] No penalty will be imposed if it shown that there is reasonable cause for the understatement and the tax return preparer acted in good faith.[197]

A position is treated as an unreasonable position unless (i) there is or was substantial authority for the position; or (ii) the position was properly disclosed and had a reasonable basis.[198] There is substantial authority for a position if the taxpayer is subject of a "written determination" as provided in Reg. §1.6662-4(d)(3)(iv)(A).[199]

If a preparer of a tax return wants to take a position that a U.S. person did not 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 and not disclose the position on the return, the preparer must have "substantial authority" to avoid the Code Sec. 6694 penalty. If the preparer discloses the issue on the return, the preparer must also have a reasonable basis for this position on the return to avoid the penalty.

FBAR Audit Examination, Discovery and Assessment Procedures–An Overview

It should be emphasized that FBAR examinations by the IRS require very different audit procedures for examination and discovery then from Title 26 tax cases (and other BSA cases), although FBAR cases are often found in these other cases as well.[200] At the onset, a separate FBAR file must always be set up if there appears to be an FBAR violation, regardless of whether a penalty is ultimately asserted.[201] If the examiner notes that an FBAR should have been filed during the tax, BSA or Form 8300 compliance examination (*e.g.,* Currency Transaction Report)[202] the examiner should determine (i) whether the FBAR was required, (ii) whether the FBAR was filed, and (iii) whether the records required by the FBAR instructions and 31 CFR §103.32 were properly retained.[203]

This article goes into detail into each step of the audit, discovery and closing procedure process in an effort to enlighten advisors and U.S. persons on the FBAR examination process so that taxpayers and their counsel can consider appropriate and timely opportunities to raise procedural and substantive FBAR issues with the examiner, the Group Manager Area Counsel and senior management in the IRS. To this end, it is strongly recommended advisors work through the IRS chain-of-command rather than skipping levels to encourage positive communication in resolving FBAR issues with the IRS.

In addition, at the first meeting or conference with the examining agent and the tax advisor, it is recommended that the parties agree, if possible, at the onset to have a set of operating rules to govern the scope of the audit examination and discovery process to avoid a fishing expedition, as well as agree to a procedure that when issues have been agreed to by the parties, such agreement will be documented in a form amenable to both parties so that the FBAR issues are not again raised at a subsequent meeting or conference.

FBAR Summons

During the course of the FBAR examination, it may be necessary to summons books, records or testimony.[204] Every effort should be made to obtain the information needed for the FBAR examination without resorting to a summons.[205] If it becomes necessary, the examiner should use the BSA summons, the TDF 90-22.31, and not the Title 26 summons[206] in FBAR examinations that do not have a concurrent Title 26 examination.[207]

The summons is used to summon and require to appear and give testimony or produce books, papers and other data identified as essential to the enforce the requirements of the among other laws the BSA.[208] A Title 31 summons may be used for the examination of books and records and for witnesses in connection with the FBAR examination of (i) a financial institution,[209] (ii) an officer or employee of a financial institution including a former officer or employee, or (iii) any person having possession, custody or care of any other records and reports required under the BSA.[210] Service of a Title 31 summons may be made on any person by registered mail, or on any natural person by personal delivery or upon any other person by delivery to an officer, managing or general agent or any other agent authorized to receive process of service.[211]

The examiner should report immediately to the examiner's manager, the Territory Manager and the SB/SE Division Local Counsel any refusal to comply or any proceeding brought by the summoned party to quash a summons.[212] The INTERNAL REVENUE MANUAL directs that no officer or employee of the Treasury shall publicly name any person to whom a summons has been issued or the issuance of a summons prior to the time and date set for the appearance or production of documents.[213] Similarly, they are precluded from disclosing any testimony taken or material summoned, including the name and address of the witness to anyone other than an officer or employee of the Treasury.[214]

Power of Attorney

During the course of the FBAR examination, the person under examination may request representation and may ask to submit to the IRS the Form 2848, *Power of Attorney and Declaration of Representative,* for the authority to represent the person. Form 2848 was developed to meet the requirements relating to tax and is generally inappropriate for an FBAR examination, unless there is also a concurrent tax examination.[215] The FBAR examiner should accept a general power of attorney valid under state law and in cases where there is a related statute determination (*e.g.,* Title 26) may accept a Form 2848.[216] If the Form 2848 is used in a concurrent examination, for clarity the filer may add "FBAR Examination" on Line 3 of the Form 2848.[217] The general power of attorney should state that it is for the limited purpose of representation of the person during the FBAR examination.[218]

Statutes of Limitations

It should be noted that Title 26 statutes of limitation do not apply to FBAR cases. The statute of limitations on assessment of civil FBAR penalties is six years from the date of the violation.[219] The statute of limitations on bringing suit to collect the assessment of civil penalties is two years from the date of assessment or the date any judgment becomes final in any criminal action under 31 USC §5322.[220]

The IRS may commence a civil action to recover a civil penalty assessed under 31 USC §5321(a) at any time before the end of the two-year period beginning on the later of (i) the date the penalty was assessed, or (ii) the date any judgment becomes final in any criminal action under 31 USC §5322 in connection with the same transaction with respect to which the penalty is assessed.[221] FBAR civil statutes of limitation on assessment and collection may be waived.[222] The IRS currently does not have any special procedures for soliciting these waivers and a person may voluntarily waive the statute of limitation for assessing FBAR penalties.[223]

The period of limitation for FBAR criminal penalties is the general statute of limitation found in 18 USC §3282, which provides that except as otherwise provided by law, no person shall be prosecuted, tried or punished for any noncapital offense unless the indictment is found or the information is instituted within the five years next after such offense shall have been committed.[224]

Privacy Issues Prior to Working the FBAR Case–Related Statute Memorandum

If the source of the FBAR information is a Title 26 examination or a Form 8300 examination, the information obtained is return information protected by Code Sec. 6103.[225] The examiner must obtain a related statute determination signed by a Territory Manager before using the return information in an FBAR case.[226] A related statute determination is a good-faith determination with respect to the present case that the apparent FBAR violation was in furtherance of an apparent Title 26 violation and is necessary to allow the examiner to use the information obtained from a Title 26 examination in the FBAR examination.[227] The examiner should also not ask interview questions or request documents that are relevant to the FBAR examination without first obtaining a related statute memorandum by the examiner's Territory Manager.[228]

Similarly, neither interviews nor Information Document Requests (IDRs) in a Title 26 case should request documents only needed for the FBAR examination, such as the FBAR itself prior to getting a related statute memorandum signed by the examiner's Territory Manager.[229] Without a related statute determination, Title 26 information cannot be used in the Title 31 FBAR examination. Any such use could subject the persons making the disclosure to civil and criminal penalties for violating the disclosure provisions protecting Title 26 return information.[230]

FBAR Assessments

The IRS FBAR assessment authority emanates from Title 31 rather than Title 26, which derives its assessment authority for income tax determinations under Code Sec. 6201 for all taxes and income tax penalties. Under 31 USC §5321(a)(5), the Treasury may impose a civil penalty on any person who violates or causes any violations of the FBAR rules and allows an assessment within a specified time. (*See* "Statutes of Limitations.")

Working the FBAR Case

The examiner conducting the FBAR examination will set up work papers on the FBAR issues in the FBAR file. The examiner should consider whether the FBAR requirements have been met and whether the required records were kept. (*See* "FBAR Filing Criteria.") The examiner should determine whether the FBAR was properly completed and timely filed and whether the required FBAR records were retained by the filer. Appropriate audit techniques include reviewing the taxpayer's income tax return to determine whether the taxpayer acknowledged the existence of a foreign account (*e.g.,* did the taxpayer answer "Yes" or "No" on the Form 1120, Schedule N, question 6(a)),[231] and, if "Yes," did the taxpayer file the required FBARs for the open tax years under the statute of limitations? (*See* "Statutes of Limitations.")

It is recommended that examiners identify the corporate executives or partners and others associated with the taxpayer entities that have an interest in or signature authority over foreign accounts and trace any income that should be reported on the executive returns.[232] The examiner should review the FBAR issues with the taxpayer/BSA entity along with other examination issues and a make a decision concerning violations and penalties.[233]

Information relevant to a Title 26 case that is also relevant to an FBAR case may be obtained during a tax or Form 8300 examination.[234] For example, bank account information is a necessary part of an income probe and may reveal the existence of a foreign account requiring the filing of an FBAR.[235]

Closing the FBAR Case

Closing procedures vary depending on the results of the FBAR case. The examiner will support the determination with a separate FBAR case file that may include (i) a FBAR lead sheet; (ii) work papers; (iii) a summary memorandum explaining the FBAR violations, if any; (iv) a copy of the delinquent FBARs annotated in red on the top, "Secured by Examination," if available; and (v) a related statute determination, if appropriate and an agent activity record.[236]

In all cases the examiner will support the determination in a summary memorandum with references to the work papers. The summary memorandum should show all years opened and the determination reached in each year. If several years are opened, but a penalty is asserted only with respect to one year, the summary memorandum should provide an explanation.[237] In all cases, the examiner will complete an FBAR Monitoring Document (FMD) Form 13536 for each year.[238]

There are different closing procedures depending on whether there is (i) no FBAR violation; (ii) an FBAR violation without penalty—FBAR Warning Letter 3800; (iii) negligence or nonwillful FBAR violations; (iv) a willful FBAR violation; or (v) a referral to Criminal Investigation.[239]

No FBAR Violation

If there is no FBAR violation found as a result of the FBAR examination, the examiner will close the case by completing the summary memorandum and the FMD and close the case with the group manager. The group manager will review the case for both technical and procedural issues and note this on the activity record.[240]

The Detroit Computing Center (DCC) will enter the information from the FMD into the FBAR account database, note on the database in the comments field when and if a follow-up FBAR examination is needed, and place the case file in the FBAR historic files.[241]

FBAR Violation Without Penalty– FBAR Warning Letter 3800

The examiner may, after a discussion with the group manager, decide to issue a FBAR Warning Letter 3800 ("Warning Letter") if there is violation of the

FBAR requirements but no penalty is being asserted. A Warning Letter may be issued if there is a FBAR violation, but the penalties are not warranted in view of the facts and circumstances of the case.[242] If the Warning Letter is issued, the examiner will issue and deliver a copy of the Warning Letter to the person apparently in violation of the FBAR requirements and retain a copy in the file. The person will return any delinquent or corrected FBARs and a copy of the warning letter to the examiner, and the examiner will complete a summary memorandum and FBAR FMD and close the case to the group manager.[243] The group manager will review the FBAR case file for both technical and procedural issues and note this activity on the activity record, indicate on the FMD the date closed form the group and forward a copy to the DCC.[244] The DCC will enter the information from the FMD into the FBAR database, note on the FBAR data base when a follow-up examination is needed, remove the original FBARs for entry on CBRS and retention in the Federal Records System and place the case file in the FBAR historic records.[245]

FBAR Violation with Penalties

If the examiner after a discussion with the group manager determines it is appropriate to assert an FBAR penalty and that a referral to Criminal Investigation is not appropriate or has been declined, the examiner should assert penalties in accordance with the FBAR penalty guidelines.[246] Once the penalties have been determined and just before the examiner is ready to issue Letter 3709, the FBAR 30-day letter, and Form 13449, *FBAR Agreement to Assessment and Collection,* the examiner will submit the FBAR case file to an SB/SE Counsel Area FBAR Coordinator for review.[247] Counsel will render its advice within 45 days and prepare a written memorandum of the review of the FBAR case.[248]

If Counsel recommends issuance of Letter 3709, the FBAR 30-day letter, the review will be designed to assist Appeals in the event the case is appealed. If Counsel does not recommend issuance of Letter 3709, the review will state the reasons for the disagreement. If the disagreement is based upon inadequate factual development, the review should recommend areas for further examination.[249]

After the Counsel review has been received and agreed that penalties are appropriate, the examiner will (i) issue Letter 3709, the FBAR 30-day letter;[250] (ii) transmit with Letter 3709 the Form 13449, *FBAR Agreement to Assessment and Collection;*[251] (iii) provide the customer Notice 1330, *Information on Making FBAR Penalty Payment by Check,* and retain a copy in the file;[252] and (iv) discuss payment.[253]

It has been recommended by one pair of tax commentators[254] that:

> Taxpayer's counsel [should] carefully monitor the case and be actively engaged if it is determined the examiner is considering asserting penalties. This includes making appropriate submissions on whether there is a violation and, if so, whether there was reasonable cause for and lack of willfulness[255] regarding the violation. These submissions may not only convince the examiner, but could be influential with the examining agent's Group Manager and Area Counsel as to whether the penalty is warranted an if warranted, the appropriate amount of the penalty. Meetings with the Group Manager or Area Counsel should also be requested in appropriate circumstances—even if they might be resisted by the IRS. The penalty for willful failures carries a high burden of proof which the government must meet to sustain the penalty[256] and the amount of the penalty may depend on the taxpayer's culpability under the IRS penalty mitigation guidelines. There is substantial opportunity at the examination stage for counsel to influence a more favorable outcome of the examination.[257]

Closing the FBAR Case with Agreed Penalties

If the person allegedly violating the FBAR requirements agrees to assessment of the penalties, the person returns to the examiner delinquent FBARs, a signed and dated, Form 13449, *FBAR Agreement to Assessment and Collection,* and partial or full payment.[258]

The examiner will (i) place the signed Form 13449 in the FBAR case file; (ii) process the delinquent forms in accordance with instructions in this chapter;[259] (iii) complete a summary memorandum and FMD; and (iv) forward the FBAR case for closure to the group manager.[260] The group manager will review the FBAR case file for both technical and procedural issues and note this on the activity record, indicate the date the case was closed from the group and forward to the DCC.[261]

DCC will (i) enter the information from the FMD to the FBAR database; and (ii) forward the penalty assessment information to the Field Director, Compliance Services, Cincinnati, Small Business/Self-Employed or her designee. This designated official completes the assessment using Form 13448, *Penalty Assessments Certification Summary*.[262]

If the penalty has been paid in full, place the case file in the FBAR historic files.[263] If the penalty is not paid in full, issue Letter 3708. Letter 3708 should be sent certified mail with a return receipt requested.[264] A copy of Letter 3708 is sent to the Power Of Attorney (POA) as appropriate. DCC should check the FMD to determine if there is a POA. A copy of the dated Letter 3708 should be placed in the case file. Forward the collection information to FMS and place the case file in the FBAR historic files.[265]

Closing the FBAR Case–Payment

The examining agent should secure payment by (i) photocopying the check or money order; (ii) photocopying Form 13449 and clipping Form (front and back) to the check or money order; (iii) completing Form 3210 describing the documents; and (iv) forward by certified mail to payment and the forms to the IRS, P.O. Box 33115, Detroit, MI 48232-115. This is not the same post office box used for forwarding the file. If any payment is made, the examiner will not execute a *Payment Posting Voucher,* Form 3244 for any payments received. If Form 3244 is inadvertently executed, the examiner will be responsible for tracing the payment to ensure that it is refunded from the tax module. The examiner will then need to obtain another payment which will be sent to DCC for posting to the FBAR database.[266]

Closing the FBAR Case– No Agreement on Penalties

If an FBAR penalty is proposed but not agreed to, the examiner will wait 45 days to see if the person will appeal as provided in Letter 3709.[267] In order to appeal, the person against whom an FBAR penalty is proposed must mail a written protest in duplicate to the examiner that is postmarked before the designated response date, which is listed in the Letter 3709. The protest must contain all the information required in Letter 3709. An appeal requires 180 days remaining on the assessment statute of limitations.[268]

If there is no response from the person against whom an FBAR penalty is proposed, the penalty is assessed and the collection process begins.[269] The examiner will complete a summary memorandum and FBAR Monitoring Document and forward the FBAR case for closure to the group manager. The group manager will review the FBAR case file for both technical and procedural issues and note this on the activity record. DCC will enter the information from the FMD to the FBAR database, note on the FBAR database that a follow-up FBAR civil examination is needed, and forward the penalty assessment information to the Field Director, Compliance Services, Cincinnati, Small Business/Self-Employed. This designated official completes the assessment using Form 13448, *Penalty Assessments Certification Summary.*[270]

If the penalty has been paid in full, the case file can now be placed in the FBAR historic files. If the penalty has not been paid in full, DCC will issue Letter 3708, *Notice and Demand for Payment.* Letter 3708 should be sent by certified mail, return receipt requested. A copy should be placed in the case file. DCC enters the interest rate on Letter 3708 according to the interest rate currently published by the Financial Management Service (FMS) at *http://fms.treas.gov/cvfr/index.html.* DCC then places the case file in the FBAR historic files and forwards the collection information to the FMS.[271]

Administrative Appeal Rights and Closing the FBAR Case

If the person allegedly violating the FBAR requirements appeals, and there is no related Title 26 case or the related Title 26 case is agreed, the following procedures apply. The examiner will ensure that any documents needed in any related cases or in the FBAR case are copied so that there is a fully documented case file for each and note on the Transmittal Letter that the case is an FBAR category case, UIL 9999.99-01, in the Appeals Coordinated Issue (ACI) Program. The Appeals Officer must contact the Appeals FBAR Coordinator prior to scheduling the initial conference and forward through the group manager, an FMD to DCC so that the appeal can be entered on the FBAR database. The group manager will review the FBAR case file for both technical and procedural issues and note this on the activity record. Indicate the date the case is closed from group, complete and forward the FMD to the DCC and forward the case to Appeals following regular case processing procedures.[272]

DCC will record the appeal on the FBAR database and continue to monitor the statute of limitations. DCC will contact Appeals when the statute of limitations has less than a year to expire and thereafter on a regular basis. Appeals Officers will follow procedures outlined in "Foreign Bank and Financial Accounts Requirements Guidance for Appeal Officers" available on the Appeals Web site. Appeals will close the FBAR case through DCC following the closing procedures for examiners found in this section. In addition to the above procedures which are to be used in all appealed cases, where there is a related Title 26 case, the examiner, the group manager and Appeals will discuss whether the examiner should hold the FBAR case until the Title 26 case is closed or forwarded to Appeals. The different statutes of limitation are important in this discussion.[273]

Discovery Requests– Freedom of Information Act

Taxpayer's counsel may make want to make a Freedom of Information Act (FOIA) request either during the FBAR audit or upon its completion. Under this FOIA request, taxpayer's counsel may request the following materials arising from the FBAR audit: (i) agent activity record—FBAR activity code 545; (ii) related statute determination, if appropriate; (iii) FBAR lead sheet and all related work papers; (iv) a summary memorandum explaining any FBAR violation(s); (v) copy of any delinquent or filed FBARs; (vi) FBAR monitoring documents (FMDs) providing closing information for the FBAR database; (vii) Letter 3800, warning letter for apparent foreign bank and financial accounts report violations; (viii) Letter 3709, FBAR 30-day letter (transmitting agreement for assessment and collection, F-13449); (ix) Form 13449, agreement to assessment and collection of penalties under 31 USC §§5321(a)(5) and 5321(a)(6); (x) Notice 1330, information on making FBAR penalty payment by check; (xi) power of attorney (Form 2848) or general power of attorney; (xii) Form 13448, penalty assessments certification summary; (xiii) Letter 3708, notice and demand for payment of FBAR penalty; (xiv) Notice 1330, information on making FBAR penalty payment by check; and (xv) any other relevant information related to the FBAR audit. For an excellent review of the issue, *see* Caroline D. Ciraolo of Rosenberg Martin Greenberg, LLP in a paper entitled, *The Morning After….What You Need To Know About the FBAR and International Information Returns Including Defending Against and Litigating the Penalties,* as part of her presentation for the ABA Tax Section Civil and Criminal Tax Penalties Panel entitled, "Defending and Litigating FBAR and Related Information Return Penalties," on September 26, 2009, in Chicago, Illinois.

FBAR Criminal Referrals

The IRS CI has authority to examine criminal FBAR violations. The acceptance by CI of an FBAR referral for criminal investigation depends on the evidence establishing willfulness and sometimes other criteria. Willfulness is a question of intent. Willfulness involves the intentional, voluntary violation of a known legal duty.[274]

A Fraud Technical Advisor (FTA) can assist the examiner in determining whether or not there was a willful violation and provide the examiner with information concerning referrals to Criminal Investigation. If the examiner considers that the case warrants referral for possible criminal investigation, the examiner, with the approval of the group manager, will involve an FTA as soon as possible.

If the decision to involve the FTA is made, the examiner will fill out the *Fraudulent Intent Referral Memorandum* (FIRM), Form 13639. The FIRM documents the involvement of the FTA, the plan for developing the case further and the referral recommendations of the FTA. Any related income tax case submitted for fraud development should follow regular fraud development procedures including completion of Form 11661.[275]

If the FTA considers that additional development is warranted, the FTA will provide a written plan of action. If the FTA considers that criminal investigation is not appropriate, the FTA will so advise the examiner and provide a written explanation of the reason that criminal referral is not appropriate and recommendations respecting civil penalties. The examiner may then proceed with the FBAR case under FBAR civil procedures.[276]

If there are firm indications of willful FBAR violations that warrant referral to Criminal Investigation, the FTA will advise the examiner and the examiner's manager of this determination. The examiner will prepare Form 2797, *Referral Report of Potential Criminal Fraud Cases,* with a detailed explanation of the FBAR violations. The FTA will assist in the preparation of Form 2797 if requested by the examiner.[277]

Civil Mitigation Guidelines and Threshold Conditions

Before the enactment of the American Jobs Creation Act of 2004, the IRS had issued internal guidelines for the calculation of the FBAR civil penalty for willful violations. In most civil FBAR cases, if a U.S. person met the four threshold conditions, then the U.S person may have been subject to less than the maximum FBAR penalty depending on the amount in the person's accounts.[278]

These four threshold conditions vary slightly depending on the date of the violation. For violations that occur prior to October 23, 2004, the four threshold conditions are as follows: (i) the person has no history of past FBAR penalty assessments and no history of criminal tax or BSA convictions for the preceding 10 years; (ii) no money passing through any of the foreign accounts associated with the person was from an illegal source or used to further a criminal purpose; (iii) the person cooperated during the examination (*i.e.,* the IRS did not have to resort to a summons to obtain nonprivileged information, and the taxpayer responded to reasonable requests for documents, meetings and interviews or otherwise back-filed correct reports; and (iv) the IRS did not sustain a civil fraud penalty against the person for an underpayment for the year in question due to the failure to report income related to any amount in a foreign account.[279] For violations occurring after October 22, 2004, the first condition was expanded to include no history of criminal tax or BSA convictions for the preceding 10 years as well as no history of past FBAR penalty assessments. Otherwise, the four conditions are the same.

The examiner must document in his work papers the circumstances that make mitigation of the penalty under the guidelines appropriate and obtain the written approval of the examiner's manager. The maximum penalty was the amount in the foreign account at the time of the violation up to $100,000, unless the maximum amount in the account at the time of the violations was less than $25,000 (in which case the maximum penalty was $25,000).[280]

The mitigation guidelines for willful violations occurring prior to October 23, 2004 provide for four levels of mitigation (*see* Exhibit 4.26.16-1):

- **Level I Willful Violations.** A Level I penalty applies if the maximum aggregate balance for all required but unreported foreign accounts does not exceed $20,000. For Level I cases, the penalty will be five percent of the maximum balance during the calendar year for each of the unreported foreign accounts that should have been reported.
- **Level II Willful Violations.** A Level II penalty applies if the Level I penalty does not apply and the maximum balance during the year for a required but unreported foreign account is not more than $250,000. The balance in each account is analyzed separately to determine the applicable penalty for that account. For an account that falls within Level II, the penalty will be 10 percent of the maximum balance during the year for each of the unreported foreign accounts that should have been reported. Thus, the maximum Level II penalty is $25,000 per account.
- **Level III Willful Violations Occurring.** A Level III penalty applies if the maximum balance during the year for an unreported foreign account that should have been reported is greater than $250,000 but not more than $1 million. The balance in each account is analyzed separately to determine the applicable penalty for that account. For an account that falls within Level III, the penalty will be the lesser of (i) 10 percent of the maximum amount of the foreign account that should have been reported, or (ii) the amount in the account as of the last day for filing the FBAR, unless this amount is less than $25,000, in which case the penalty is $25,000.
- **Level IV Willful Violations Occurring.** A Level IV penalty applies if the maximum balance during the year for an unreported foreign account that should have been reported was greater than $1 million. The balance in each account is analyzed separately to determine the applicable penalty for that account. For Level IV, the penalty will be the lesser of (i) $100,000 or (ii) the amount in the account as of the last day for filing the FBAR, unless this amount is less than $25,000, in which case the penalty is $25,000.

Similarly, the mitigation guidelines for willfulness penalties occurring after October 22, 2004, provide for four separate levels of mitigation as follows:

- **Level I Willful Violations.** If the maximum aggregate balance for all accounts to which the violations relate did not exceed $50,000, Level I applies to all accounts. Determine the maximum balance during the calendar year for each account. Add the various maximums to find the maximum aggregate balance. The Level I penalty is the greater of $1,000 per violation or five percent of the maximum account balance during the calendar year for each Level I account.
- **Level II Willful Violations.** If Level I does not apply and if the maximum account balance to which the violations relate at any time during the calendar year did not exceed $250,000, Level II applies to that account. The Level II penalty assessed for each account is the greater of $5,000 per violation or 10 percent of the maximum account balance during the calendar year for each Level II account.
- **Level III Willful Violations.** If the maximum account balance to which the violations relate

at any time during the calendar year exceeded $250,000 but did not exceed $1 million, Level III applies to that account. The Level III penalty assessed for each account is the greater of 10 percent of the maximum account balance during the calendar year for each Level III account or 50 percent of the closing balance in the account as of the last day for filing the FBAR.

- **Level IV Willful Violations.** If the maximum account balance to which the violations relate at any time during the calendar year exceeded $1 million, Level IV, the statutory maximum, applies to that account. The Level IV penalty is the statutory maximum applied to each account. It is the greater of $100,000 or 50 percent of the closing balance in the account as of the last day for filing the FBAR.

The Bank Secrecy Act (BSA) permits the Treasury some discretion in determining the amount of penalties for violations of the FBAR reporting and recordkeeping requirements. There is a penalty ceiling but no minimum amount. This discretion has

Table 2. Normal FBAR Penalty Mitigation Guidelines for Violations Occurring After October 22, 2004–Per Person Per Year

Nonwillful (NW) Penalties	
To Qualify for Level I-NW—Determine Aggregate Balances	If the maximum aggregate balance for all accounts to which the violations relate did not exceed $50,000 at any time during the year, Level I-NW applies to all violations. Determine the maximum balance at any time during the calendar year for each account. Add the individual maximum balances to find the maximum aggregate balance.
Level I-NW Penalty is	$500 for each violation, not to exceed an aggregate penalty of $5,000 for all violations.
To Qualify for Level II-NW—Determine Account Balance	If Level I-NW does not apply and if the maximum balance of the account to which the violations relate at any time during the calendar year did not exceed $250,000, Level II-NW applies to that account.
Level II-NW Penalty is	$5,000 for each Level II-NW account violation, not to exceed 10% of the maximum balance in the account during the year
To Qualify for Level III-NW	If Level I-NW does not apply and if the maximum balance of the account to which the violations relate at any time during the calendar year was more than $250,000, Level III-NW applies to that account.
Level III-NW is	$10,000 for each Level III-NW account violation, the statutory maximum for nonwillful violations.
Willfulness Penalties	
To Qualify for Level I—Determine Aggregate Balances	If the maximum aggregate balance for all accounts to which the violations relate did not exceed $50,000, Level I applies to all accounts. Determine the maximum balance at any time during the calendar year for each account. Add the individual maximum balances to find the maximum aggregate balance.
Level I Penalty is	The greater of $1,000 per violation or 5% of the maximum balance during the year of the account to which the violations relate for each violation.
To Qualify for Level II—Determine Account Balance	If Level I does not apply and if the maximum balance of the account to which the violations relate at any time during the calendar year did not exceed $250,000, Level II applies to that account.
Level II Penalty is per account	The greater of $5,000 per violation or 10% of the maximum balance during the calendar year for each Level II account.
To Qualify for Level III	If the maximum balance of the account to which the violations relate at any time during the calendar year exceeded $250,000 but did not exceed $1,000,000, Level III applies to that account.
Level III Penalty is per account	The greater of (a) or (b): (a) 10% of the maximum balance during the calendar year for each Level III account, or (b) 50% of the closing balance in the account as of the last day for filing the FBAR .
To Qualify for Level IV	If the maximum balance of the account to which the violations relate at any time during the calendar year exceeded $1 million, Level IV, the statutory maximum, applies to that account.
Level IV Penalty is per account the statutory maximum	The greater of (a) or (b): (a) $100,000, or (b) 50% of the closing balance in the account as of the last day for filing the FBAR

been delegated to the FBAR examiner. The examiner may determine that the facts and circumstances of a particular case do not justify a penalty. If there was an FBAR violation but no penalty is appropriate, the examiner should issue the FBAR warning letter, Letter 3800. When a penalty is appropriate, IRS has established penalty mitigation guidelines so that the penalties determined through the examiner's discretion are uniform. The examiner may determine that a penalty under these guidelines is not appropriate, or a lesser amount than the guidelines would otherwise provide is appropriate.

The examiner must make this determination with the written approval of the examiner's manager. The examiner's work papers must document the circumstances that make mitigation of the penalty under these guidelines appropriate. To qualify for mitigation, the person must meet four criteria: (i) The person has no history of criminal tax or BSA convictions for the preceding 10 years and has no history of prior FBAR penalty assessments; (ii) no money passing through any of the foreign accounts associated with the person was from an illegal source or used to further a criminal purpose; (iii) the person cooperated during the examination; and (iv) the IRS did not determine a fraud penalty against the person for an underpayment of income tax for the year in question due to the failure to report income related to any amount in a foreign account. *See* Exhibit 4.26.16-2 (July 1, 2008).

FBAR Collection Rules

The authority to collect FBAR penalties comes from Title 31 rather than Title 26. According to at least one commentator,[281] the FBAR penalty assessment is not subject to the administrative collection remedies normally available for a tax or penalty under the Internal Revenue Code's broad collection provisions[282] with respect to notice and demand,[283] liens[284] and levies.[285] The remedies available to collect the civil penalty are limited to collection through the Financial Management System (FMS) which collect nontax debts *via* a civil penalty in U.S. district court to recover a civil penalty.[286] Presumably, these collection efforts include the use of the DOJ and the U.S. Marshal to enforce judgments for FBAR penalties by taking possession of the debtor's assets and selling them to satisfy the judgment or the garnishment of his wages, rather than the Revenue Agent's lien and levy powers under the Internal Revenue Code.

Taxpayers who want to challenge the FBAR penalties cannot do so in Tax Court where they don't have to pay taxes, interest and penalties up front, but must pay the liability, which may be huge, and sue for a refund in U.S. District Court or wait until the government files suit in District Court to collect the FBAR penalty and challenge the assessment.[287] It was suggested at a recent ABA Tax Section meeting that litigants should have a right to a jury trial in an FBAR proceeding. The opponent may be either the U.S. Department of Justice or the IRS in a civil FBAR proceeding. The IRS Tax Division may have ceded authority for FBAR criminal violations to the DOJ, although this is not presently clear. It should be noted the FBAR penalty will not fall within the exception to discharge in bankruptcy under the Bankruptcy Code.[288]

The issue of what the IRS meant by its reference to "miscellaneous penalty" in a recent FBAR closing agreement for a taxpayer was first raised by Steven Toscher, Esq. of Hochman, Salkin, Rettig, Toscher & Perez, P.C. at an ABA Civil & Criminal Penalties luncheon sponsored by Kostelanetz & Fink LLP held in late September 2009 and again by Cono Namorato, Esq. from Caplin & Drysdale Chartered and other private practitioners on an ABA Tax Section FBAR panel at the Fall ABA Tax Section meeting ("ABA Tax Section FBAR Panel"). The closing agreement generally provided that "in lieu" of any FBAR and Title 26 information reporting penalties, the taxpayer will be assessed a "miscellaneous penalty" as an "offshore penalty." No definition was provided as to the meaning of "offshore penalty," and the closing agreement apparently gave no cite as to where the exact authority for this penalty arose if it was not an FBAR penalty or a Title 26 information reporting penalty. Steven Toscher, Esq. and the ABA Tax Section FBAR Panel raised the issue that the determination of the type of penalty is important to a taxpayer. If the penalty arose under Title 26, the taxpayer has due process safeguards built into the IRS collection procedure. However, if the penalty arose under Title 31, much more limited due process safeguards are present as the government enforces its rights to collect this debt.

Criminal Sentencing in FBAR Cases

Criminal sentencing in FBAR cases depends on the Federal Sentencing Guidelines. Federal Sentencing Guidelines for money laundering cases including criminal FBAR reporting or recordkeeping violations appear in the U.S. Sentencing Guidelines, §2S1.3. The relevant statutes require monetary reporting without regard to whether the funds were lawfully or unlawfully obtained.[289]

Section 2S1.3 governs sentencing for criminal FBAR violations and generally provides for a base level offense of six plus the number of offense levels from the table in §2B1.1 corresponding to the value of the funds.[290] The U.S. Sentencing Guidelines indicate if the defendant knew or believed the funds were proceeds of an unlawful activity or intended to promote unlawful activity and committed the offense as part of a pattern of unlawful activity involving more than $100,000 in a 12-month period, the offense level can be increased by two levels and can be decreased if the defendant did not act with reckless disregard of the source of the funds and the funds were the proceeds from lawful activity and used for a lawful purpose.[291]

At a recent ABA Tax Section meeting held at the end of September 2009, Kevin M. Downing, a Senior Attorney in the Tax Division at the U.S. Department of Justice, indicated that taxpayers as part of their guilty pleas are generally given the choice whether to be found guilty under the FBAR criminal violation statute for failure to file the FBAR or under Code Sec. 7206 for filing a fraudulent tax return. As pointed out, the latter FBAR criminal statute has a five-year imprisonment cap while the fraudulent tax return criminal statute has a three-year cap.

Mr. Downing also pointed out that generally the U.S. Department of Justice has insisted upon a one-year monetary penalty equal to 50 percent of the highest balance in the account over the open statute of limitations period. This should be contrasted to the 20-percent penalty based on the highest account balance over the open statute of limitations period for U.S persons who have decided to participate in the IRS voluntary disclosure program before October 15, 2009. (*See* "Voluntary Disclosure Program.")

U.S Department of Justice Criminal Plea Agreements for FBAR Violations

DOJ Plea Agreements

If a taxpayer agrees to a DOJ plea agreement in an FBAR case, typically the taxpayer/defendant agrees to plead guilty to a felony in violation of 31 USC §§5314 and 5322(a), which has a maximum prison sentence of five years and is relieved of other tax crimes related to his offshore accounts. The Tax Division of the DOJ must approve the plea agreement, and the DOJ (and the U.S. Attorneys Offices (USAOs) and the taxpayer are bound by the plea agreement as parties, but the plea agreement generally provides that it limited only to the DOJ and USAO handling the case and does not bind other federal, state or local authorities. The government will, however, bring the plea agreement to other prosecuting offices if requested to do so. The plea agreement in many cases funnels the sentence into the tax guidelines. In many cases, if the taxpayer agrees to accept the stipulation under the FBAR criminal statute, he may get sentenced to the same sentence as if he had entered into a plea for tax perjury under Code Sec. 7206, except that the potential sentence is five years rather than three years. However, one commentator has suggested that if one just focuses on the U.S. Sentencing Guidelines ("Guidelines") (*i.e.,* USSG §§2S1.3(c)(1), 2T1.1 and 2T4.1), the taxpayer's extra exposure may be low enough that the risk involved in the extra exposure is not that great. As an integral part of the plea agreement the taxpayer must agree to cooperate fully with the government on any future criminal investigations.[292]

Criminal Sentencing Factors

The District Court Judge may order restitution even though the plea is under Title 31 and not a tax crime under Code Sec. 7206 for filing fraudulent income tax returns unless contractually agreed to by the taxpayer in the plea agreement or imposed as a condition to sentencing. The other parts of the plea agreement may suggest that the "victim" is the United States, which must be paid before sentencing, so restitution may not be an issue. The government normally reserves the right to bring appropriate sentencing factors to the sentencing court.[293]

Taxpayer Criminal Sentencing Mitigants

Taxpayer's counsel would be wise to reserve the right to raise his own sentencing factors to the sentencing court to mitigate or reduce the taxpayer's sentence or penalties, including, for this purpose, letters and other circumstantial evidence of (i) the taxpayer's good character (*e.g.,* testimonials from the defendant's clergy, business associates or friends in the community); (ii) the taxpayer's personal history (*e.g.,* evidence to show the defendant has had no prior history or convictions for fraud or other crimes; (iii) community service by the taxpayer; (v) how employees and others may be harmed by the taxpayer's incarceration; and (vi) the lack of a substantial tax loss to the government. In addition, taxpayer's counsel should be prepared at sentencing to offer alternatives to the taxpayer's incarceration for the judge to consider at the sentencing hearing, such as community service (*e.g.,* volunteer and charitable work in the taxpayer's community for a fixed period of time, restrictions requiring the taxpayer to stay at his residence when not at work for a fixed period of time, agreed-upon time spent at a half-way house or other rehabilitation facility and professional counseling. If possible, taxpayer's counsel should try to get the Judge in rendering the sentence to read into the judgment any of the above mitigants to a harsh sentence. This language may be quite useful latter if taxpayer's counsel later attempts to get a reduction of the sentence through the U.S. Department of Prisons, which is generally a difficult task.

Taxpayer Alcohol and Drug Rehabilitation As a Sentence Reduction Strategy with the U.S. Bureau of Prisons

The DOJ and the taxpayer can stipulate to the agreed-upon sentencing factors, but the government will typically reserve the right to avoid any stipulation that it subsequently determines is untrue (*e.g.,* taxpayer alleges that he has a alcohol or drug problem which is later found to be untrue—in some cases the taxpayer can get a reduction in his sentence from the U.S. Bureau of the Prisons of six to nine months on the completion of a drug or alcohol rehabilitation program). Taxpayer's counsel now will have to obtain a report certified by one or more medical doctors to proof that the taxpayer has a alcohol or drug problem in order to qualify for this treatment.

Settlement of FBAR Civil Penalties

The civil income tax aspects of an FBAR case are typically not resolved in the DOJ plea agreement and any assessments or settlements with the IRS must wait until the criminal proceedings have closed, unless they are made a part of the agreement between the government and the taxpayer. However, the civil liability for the FBAR penalty is resolved by an agreement by the taxpayer to pay "for one year" a penalty equal to 50 percent of the highest aggregate balance of the undisclosed foreign accounts over the last six years in lieu of other FBAR civil penalties that might otherwise apply. Since the FBAR civil penalty generally is 50 percent of the highest aggregate balance of the undisclosed accounts for each year open under the statute, the convicted taxpayer should be advised that he is getting a good bargain for the civil settlement of the FBAR portion of case.

Continuing Civil Federal, State and Local Income Tax, Penalties and Interest Exposure

For civil income tax purposes, the taxpayer will likely continue to be liable after the criminal proceeding closes for the federal, state and local income taxes on the undisclosed income and any correlative adjustments such as to the taxpayer's itemized deductions, the accuracy-related penalty equal to currently 20 percent (which may go up to 40 percent under the Treasury Proposals—*see* "Recent Legislative Proposals") of the tax due and interest due on the tax and accuracy-related penalty, in addition to other penalties, which may be imposed by the federal, state or local taxing authorities (*e.g.,* if the taxpayer had not filed income tax returns he would be subject to a 25-percent delinquency penalty as well).

Tax Loss

In the stipulation, the taxpayer normally agrees to a tax loss for sentencing purposes of $400,000 to $1 million. That tax loss under the Guidelines produces a Base Offense Level of 20. The specific foreign financial accounts of the taxpayer may be referred to in the stipulation. A question was raised by Jack Townsend in his recent blog discussing a UBS settlement whether the taxpayer had other accounts which should also be disclosed to the government and to the Probation Office and be considered by the sentencing court in determining the tax loss. (*See* Townsend Blog.)

Departure or "Variance" from Criminal Sentencing Guidelines

The plea agreement as part of the stipulation as to certain sentencing factors will normally address whether the parties will seek or argue for a "departure" or "variance" from the Guidelines, even though the Guidelines to impose a sentence within the Guidelines range (absent circumstances justifying a departure) are no longer mandatory for purposes of determining sentencing under *Booker v. U.S.*[294] However, a District Court judge can still rely upon the probation officer's presentencing report for relevant factual information uncovered after the trial and can take account of the Guidelines together with the sentencing goals to assist in his determination of the taxpayer's sentence. The parties usually stipulate a sentencing history unless the parties cannot the resolve the issue. In such case, the parties may reserve any right they may have under 18 USC §3472 to appeal the sentencing court's determination of the criminal history category.

Recent Legislative Proposals

Recently, there have been several legislative proposals that have targeted tax havens and concealed offshore accounts owned by U.S. taxpayers. On March 2, 2009, Senator Carl Levin introduced the Stop Tax Haven Abuse Act (S. 506), and the next day Congressman Lloyd Doggett introduced an identical bill in the House (H.R.1265), both of which are focused on tax havens and, among other proposals, increased disclosure of offshore accounts owned by taxpayers by U.S. banks and financial institutions and intermediaries.[295] It can be expected that the existing FBAR reporting and record retention rules of Title 31 will likely be used as a starting point for this new legislation rather than using an entirely new body of law. President Barack Obama previously supported an earlier version of Senator Carl Levin's Stop Tax Haven Abuse Act. This means that whatever bill is ultimately passed by the House and Senate may have a better than average chance of becoming law when it goes to President Obama for his signature.

Treasury Green Book Proposal Requires Disclosure of FBAR Accounts to Be Filed with Tax Return

On May 11, 2009, the Treasury released the so-called Green Book, more formally entitled, *General Explanations of the Administration's Fiscal Year 2010 Revenue Proposals*[296] (hereinafter, "Treasury Proposal"), which cracks down on the abuse of tax havens by U.S. individuals illegally hiding income (and assets) offshore.

New Requirement for FBAR Information to Be Reported on Income Tax Returns

Under the Treasury Proposal, taxpayers who are required to file an FBAR will now have to provide more information about the foreign account on their income tax returns in addition to the regularly required FBAR filings. In a separate schedule, which would become part of the income tax return, the taxpayer would provide the account number, financial institution and maximum value during the year and would be required to be prepared when the income tax return is due, even if the FBAR would be filed on a later date. This proposal raises the following question: If all the FBAR information is integrated into Title 26 and income tax returns, is there still a need for separate FBAR filings and does such integration provide better "due process" protections for taxpayers? Also, if this proposal becomes law, would it be better to integrate the FBAR examination and penalties into the Title 26 audit and penalty regime?

Extends the Statute of Limitations to Six Years

The Treasury Proposal would also extend the statute of limitations from three to six years after the taxpayer furnishes the information required to be reported to the IRS as now broadened to include the proposed tax return disclosure of FBAR information.

Increase Accuracy-Related Penalty to 40 Percent for Failure to Provide FBAR Related Information as Part of Income Tax Return

The FBAR penalties would continue to apply to FBAR filing and recordkeeping failures, as well as the penalties under the Internal Revenue Code. (*See* "FBAR Penalties.") The 20-percent accuracy related penalty would be increased to 40 percent when the understatement is due to the failure to disclose FBAR related information on separate schedules as part of their income tax returns and the reasonable cause exception would not apply.

Create Rebuttable Presumptions to Require FBAR Reporting for Taxpayers and Non-QIs

The Treasury Proposal creates a rebuttable presumption if a taxpayer has any foreign financial account or signature or other authority over such account, that the account contains enough funds to require an FBAR to be filed. In addition, the Treasury Proposal would treat the failure to file an FBAR with respect to any foreign financial account held with a nonqualified intermediary as "willful" if the account has a balance of more than $200,000 at any point during the year. The proposal would exempt an officer or employee of a corporation who has signature or other authority over the account from the presumption provided such officer or employee has "no more than a de minimis financial interest in that corporation." If regulations are drafted by the Treasury to explain this exemption (and possibly other exemptions), it is hopeful that the *de minimis* financial interest will be defined to give such corporations and their U.S. officers and employees bright lines rules to assess their risk of joint and several penalties for failure to file FBARs, which may now be heightened significantly under the "willful" category of noncompliance.

Senator Levin's Stop Tax Haven Abuse Act

On March 2, 2009, Senator Carl Levin introduced legislation entitled the Stop Tax Haven Abuse Act ("the Bill").[297] The Bill goes well beyond the current FBAR reporting requirements imposed on taxpayers and puts the reporting burden on banks and other financial institutions and intermediaries by expressly requiring a bank or broker that knows that a U.S. person is the beneficial owner of a foreign entity that opened an account to disclose that account to the IRS by filing a 1099 or equivalent form reporting the account income. The Bill would require any U.S. financial institution that directly or indirectly opens a foreign account or establishes a foreign corporation or other entity for a U.S. customer to report that action to the IRS and authorizes the regulators of banks and securities firms as well as the IRS to enforce this filing requirement. The Bill also seeks to increase reporting requirements and penalties for owners of offshore accounts and among other proposals would extend the civil statute of limitation and creates presumptions adverse to U.S. persons who hold these accounts. The Bill clarifies the authority of IRS agents investigating FBAR violations to use tax information in those investigations and simplifies the calculation of FBAR penalties by tying the penalty to the highest balance in the account during the reporting period.

Voluntary Disclosure Program

On March 23, 2009, the IRS announced a voluntary disclosure program (VDP) to enable taxpayers with undisclosed foreign accounts or entities to "become compliant, avoid substantial civil penalties and generally eliminate the risk of criminal prosecution" by making a voluntary disclosure" and "… also provides the opportunity to calculate with reasonable degree of certainty the total cost of resolving all offshore tax issues."[298] Because of the aggressive enforcement policy by both the Treasury and the U.S. Department of Justice, taxpayers with offshore undisclosed accounts seem to have fewer options with each passing day. It should be noted the VDP will expire on October 15, 2009. While full disclosure under the program does not need to be completed by this date, the key is to notify the IRS of the taxpayer's intent to make a voluntary disclosure by October 15, 2009.[299] The VDP is an option for taxpayers who have undisclosed accounts to seriously consider before this deadline passes. Corporations, partnerships and trusts as well as individuals are eligible to make voluntary disclosures.[300]

Taxpayer Failed to File FBARs, but Reported All Taxable Income

The purpose for the VDP is to provide a way for a taxpayer who did not report taxable income in the past to come forward and resolve the tax matters. The IRS in FAQ #9[301] advises that if a taxpayer reported and paid tax on all taxable income, but did not file FBARs, the taxpayer should not use the VDP.[302] Rather, these taxpayers should file the delinquent FBAR reports and attach a statement explaining why the reports are filed late. (*See* "Filing a Delinquent FBAR.") The IRS then states that it "will not impose a penalty for the failure to file the FBARs." Notwithstanding this prophylactic language from the IRS, a taxpayer would be well advised to draft a statement very carefully so that he can support the argument that the taxpayer's failure to file the FBAR was due to "reasonable cause." (*See* "FBAR Penalties.")

If a taxpayer has paid all his taxes and mistakenly used the VDP to file delinquent FBARs, the taxpayer may be subject to unnecessary penalties that will *automatically* be applied, including a 20-percent penalty on the highest account balance in the account over the last six years for the failure to file the FBAR. (The penalty may be reduced to five percent if the taxpayer did create the account, have any activity in the account and did not owe any U.S. tax.)[303] Thus, the taxpayer who reported all the taxable income but nonwillfully failed to file FBARs should not use the VDP to avoid FBAR penalties. However, rather than risk significant civil FBAR penalties, the taxpayer should file up to six years of FBARs (back to 2003) and provide a reasonable cause statement why these reports are filed late as soon as possible.

Taxpayer Failed to File FBARS and Failed to Report All Taxable Income

In some cases, taxpayers may have attempted a "quiet" disclosure by filing amended income tax returns and delinquent FBARs and paying any related tax and interest for the previously unreported offshore income without otherwise notifying the IRS. The IRS in FAQ #10[304] points out that taxpayers who have already made "quiet" disclosures may take advantage of the penalty framework applicable to the VDP by sending previously submitted documents to their local CI office by October 15, 2009.

Those taxpayers making "quiet" disclosures should be aware of the risk of being examined and potentially criminally prosecuted for all applicable years. The IRS has pointed out that it will continue to identify amended tax returns reporting increased income and will be closely reviewing these returns to determine whether enforcement action is appropriate. Taxpayers who have yet to make any decision as to what to do if they or their advisors have set up a foreign bank account on their behalf, failed to report the taxable income attributable to such account and failed to file FBARs would likely be well advised to notify the IRS now that they want to participate in the VDP.

The ABA Tax Section FBAR Panel suggested that the government should distinguish between pre–October 2008 FBAR filing and post–October 2008 FBAR filings on the basis that this was the date that the FBAR was significantly revised and the date that the IRS ramped up its efforts to publicize the requirement of U.S persons to filer FBARs. After the panel discussion in a follow-up question to Kevin M. Downing, a Senior Attorney in the Tax Division at the U.S. Department of Justice, he cautioned that no inferences should be made that the U.S. Department of Justice will draw a line in the sand on this date and be more lenient for FBAR criminal prosecutions for pre–October 2008 FBAR filers.

How Does the VDP Penalty Framework Work?

If the taxpayer decides to participate in the VDP, comes forward and reports his taxable income, the program will eliminate the risk of criminal prosecution and substantial civil penalties. However, the VDP will be very expensive for the taxpayer. The IRS in FAQ #12[305] assumes a taxpayer deposited $1million in an offshore account in 2003 and earned $50,000 per year for the next six years and is in the 35-percent tax bracket. The taxpayer files an income tax return but does not include the foreign account or the interest income in the return (and does not file any FBARs for the preceding six years). If the taxpayer comes forward and participates in the VDP, he would pay $386,000 plus interest. This includes a tax of $105,000 (six years at $17,500) plus interest, an accuracy-related penalty of $21,000 (*i.e.,* $105,000 x 20%) and an additional penalty in lieu of FBAR and other potential penalties that may apply of $260,000 (*i.e.,* $1,300,000 x 20%). (If the taxpayer had not filed income tax returns he would have been subject to a 25-percent delinquency penalty on the net tax required to be shown on the return in lieu of the 20-percent accuracy-related penalty.)

Tax advisors should also include in this calculation the cost of the additional state and local taxes, interest and penalties for their clients. However, some states have implemented amnesty programs. Tax advisors should also apprise their clients that fixing the problem so that they can repatriate the funds may be costly in professional fees to resolve whether or not they decide to participate in the VDP.

If the taxpayer didn't come forward and the IRS later discovered the offshore activities, the taxpayer can face up to $2,306,000 in tax, accuracy-related penalty and FBAR penalty, and would also be liable for interest and possibly additional penalties and an examination could lead to criminal prosecution.

Procedural VDP Issues

The IRS in FAQ #5 tells taxpayers that a voluntary disclosure is made by following the procedures in the INTERNAL REVENUE MANUAL §9.5.11.9.[306] This section indicates that a voluntary disclosure will not guarantee a taxpayer from immunity from prosecution, but may result in a prosecution not being recommended.[307] The VDP program does not apply to illegal source income.[308] In order to start the program, the taxpayer must (i) include a statement that the taxpayer is willing to cooperate and does in fact cooperate with the IRS in determining his correct tax liability; and (ii) makes good-faith arrangements with the IRS to pay the IRS in full the tax, interest and any penalties.[309] The disclosure must be truthful, timely and complete and for this purpose will likely include all open tax years—in this case going back to 2003. However, FAQ # 27 indicates that it may be possible for the taxpayer who is unable to pay (and is able to prove this fact to the IRS) to make other financial arrangements acceptable to the IRS to resolve all outstanding liabilities.[310]

Timely Disclosure

A disclosure will be timely if it is received before (i) the IRS has initiated a civil examination or criminal investigation of the taxpayer or has notified the taxpayer that it intends to commence such examination or investigation; (ii) the IRS has received information from a third party alerting the IRS to the specific taxpayer's noncompliance; (iii) the IRS has initiated a civil or criminal examination that is directly related to the specific liability of the taxpayer; and (iv) the IRS has acquired information directly related to the specific liability of the taxpayer from a criminal enforcement action (*e.g.,* search warrant, grand jury subpoena).[311] The IRS pointed out in FAQ #17[312] that the IRS has stepped up its enforcement efforts, including the use of John Doe summonses to identify taxpayers using offshore accounts and entities to avoid tax. In addition, the IRS continues to receive information from whistleblowers and other taxpayers making voluntary disclosures. If the IRS receives specific information about a taxpayer's noncompliance before the taxpayer attempt to make a voluntary disclosure, the disclosure will not be timely and the taxpayer will not be eligible for the criminal and civil penalty relief available under the VDP.

According to ABA Tax Section FBAR Panel, if a taxpayer decides to use the VDP program, but is rejected by the IRS from participation in the VDP for any of the above reasons, the taxpayer should bear in mind that every disclosure made by the taxpayer as part of his application to the VDP submission is evidence and anything said can be used as a confession to be read into the record.

Required Forms and Filings for Voluntary Disclosure

FAQ #25[313] indicates that the IRS wants among other items the following forms and returns in connection with a voluntary disclosure: (i) copies of the original and amended federal income tax returns for tax periods covered by the voluntary disclosure; (ii) complete and accurate amended federal income tax returns or original returns if not previously filed for the taxpayer for all tax years covered by the voluntary disclosure; (iii) an explanation of previously reported or underreported income or incorrectly claimed deductions or credits related to the undisclosed foreign accounts or undisclosed foreign entities, including the reason for the omission; (iv) completed Forms 3520, 3520-A, 5471, 5472, 926 and 8865 for all tax years covered by the voluntary disclosure; and (v) completed and accurate FBARs for foreign accounts maintained during the calendar years covered by the voluntary disclosure.

List of Questions Taxpayers Are Expected to Answer As Part of Voluntary Disclosure

FAQ #21 and #22[314] indicate that the IRS has no specific questionnaire or other standard list of questions taxpayers are expected to answer as part of the VDP. However, Laura Saunders, in a recent WALL STREET JOURNAL article, suggested that taxpayers are being asked the following list of 30 questions if the participate in the VDP:

- Is it your statement that the taxpayers are willing to comply with the IRS and make a good faith arrangement to pay all taxes, penalties, fees and interest?
- Where are the funds held regarding the disclosure?
- Do you have any records? If not, whom are you working with at the bank? (Note: If the taxpayer is a UBS client and if they don't have the records, IRS will attempt to assist them in record retrieval.)
- When was the account opened?
- How was the account opened?
- Who assisted you with the account opening?
- Who told you about the bank and how to initiate opening of the account?
- Do you have a trust set up relating to the account or the funds?
- How did you deposit money into the account?
- How did you withdraw money from the account?
- Did you have any credit or debit cards associated with the account?
- How did you correspond with the bank? Do you have records relating to the correspondence?
- Who is your current point of contact at the bank?
- Did you ever meet face to face with anyone from the bank? If so, where? When?
- Did you travel outside of the United States to conduct business relating to your account and or tax activities?
- Where was your bank statements sent?
- Who has ownership of the account? Is it a joint account?
- What is the source of the funds?
- Do you have tax returns? Have you prepared amended tax returns? If so, have you submitted them to the IRS?
- Who prepared your returns?
- When were your returns prepared?
- Did they know about the issues discussed today?
- Did you file FBARS? If not, why not?
- For those who inherited the account, when did you take control of this account?

And, all the related questions a "yes" answer makes us ask:

- Did you trade U.S. and/or foreign securities with this account? If yes, describe the mechanism for doing that (buy/sell orders, *etc.*)?

- Did you file returns?
- Have you directly or indirectly controlled any foreign entities?
- Did you file the required returns for them?
- For UBS clients in particular—Have you been notified that the US requested information relating to your accounts?
- What countries do you have accounts in?

Since the taxpayers who participate in the VDP are expected to cooperate fully and act in good faith, it can be expected that the IRS will want full and robust answers to these questions, especially as to who may have assisted and facilitated taxpayers with their offshore accounts and foreign entities.

Objectives of VDP

In addition to bringing taxpayers that have undisclosed foreign accounts and undisclosed foreign entities into compliance with U.S. tax laws, FAQ #2 states that the information gathered from taxpayers in the VDP will be used to further the IRS's understanding of how foreign accounts and foreign entities are promoted to U.S. taxpayers as ways to avoid or evade tax. The data gathered will be used in developing strategies to inhibit promoters and facilitators from soliciting new clients.[315]

Conclusion–What Next?

According to IRS Commissioner Douglas Shulman, in a telephone interview on August 19, 2009, the government decided to pursue international tax enforcement as a policy matter on the basis that it is unfair for teachers and fireman to have to pay their full share of U.S. tax, while wealthy Americans conceal their assets in offshore foreign bank accounts and don't pay taxes on the income from these assets. The approach the IRS has adopted is a "carrot and stick" approach.

- **The Carrot**. This is to permit taxpayers to use the voluntary disclosure program or VDP to disclose their offshore accounts and foreign entities by filing delinquent FBARs and amended tax returns and paying all their taxes and interest. According to Commissioner Shulman this program is not an amnesty program because participants will have to pay substantial penalties. He also pointed out the government as part of this program is learning about other taxpayers who have undisclosed bank accounts, as well as if their lawyers, consultants and other professional advisors helped set up the structure to facilitate their tax evasion and FBAR violations.
- **The Stick.** In this case, this is the threat of civil and criminal prosecution and substantial penalties for tax evasion and fraud and failure to file complete income tax returns under the Internal Revenue Code or failure to file FBARS and keeping required records arising under Title 31.

It should be noted that the approach the IRS is using to resolve the problem for concealed offshore bank accounts and foreign entities dovetails with the strategy it employed so successfully in its recent abusive tax shelter initiative. While the government is using all of its compliance and enforcement tools, it is choosing to use these scare resources carefully based upon a cost/benefit analysis.[316]

Mapping the Offshore Structure and Identification of Promoters, Advisors and Facilitators

The first prong of this initiative is very similar to the taxpayer reporting and IRS tracking and mapping effort for listed or abusive transactions which taxpayers are required to report to the IRS. According to a recent New York Times article,[317] the IRS is using the *UBS* case (and presumably its progeny) as a road map as it tries to clamp down on tax evasion by Americans who use offshore accounts. The IRS has a unit called the Offshore Identification Unit, which is helping to build a map of this world. It has begun tracking all disclosures of wealthy Americans who have come forward to declare their assets and account details, often naming the private banks and intermediaries they used.

It can be expected that the answers the IRS gets to the 30-question list identified above in, List *of Questions Taxpayers Are Expected to Answer as Part of Voluntary Disclosure* (which is an unofficial part of the VDP) will be part of the data base the IRS is compiling, together with the information the IRS gets from whistleblowers, as well its recent civil investigations of amended return and FBAR filings. It can also be expected that the IRS will also be able to obtain much information from criminal investigations of the undisclosed accounts and sham entities in its own shop from CI, as well as from the DOJ. Lastly, if FBAR and tax haven legislation is enacted, taxpayer disclosures of their offshore accounts and foreign entities will likely be significantly increased—this information will no doubt go into the IRS mapping effort.

Civil and Criminal Enforcement Against Promoters, Advisors and Facilitators

In the case of the IRS strategy for abusive tax shelters, the government identified the promoters, advisors and facilitators who developed and marketed these abusive shelters to taxpayers and then strategically decided to litigate those cases which had the highest probability of success on the merits for sustaining the government's policies and positions. Aggressive criminal and civil prosecution with little or no appetite for settlement was then pursued for these cases to establish favorable judicial precedent which would have a chilling effect on taxpayers and their promoters, advisors and other facilitators of such abusive shelters.

It is likely the government, with many of the same lawyers at the IRS and DOJ who were involved in the recent abusive tax shelter initiative will now employ the same strategy for the international tax enforcement initiative related to undisclosed offshore accounts (and foreign entities) with the idea that promoters, advisors and facilitators will think twice before promoting offshore accounts and structures through the use of sham corporations and risking criminal or civil prosecution.

At a recent ABA Tax Section meeting held at the end of September 2009, Mr. Downing confirmed that the recent UBS prosecution by the DOJ was not an anomaly and the DOJ would continue to prosecute vigorously financial institutions and their clients, as well as find other FBAR violators and tax evaders by coercing these defendants to disclose their relationships to promoters and other facilitors of such offshore accounts and structures. Mr. Downing pointed out the "tax loss" to the government is an important policy incentive to the DOJ aggressively prosecuting these cases.

Banks and Other Financial Intermediaries As Guardians of the Fisc

In addition, the government will want to use the banks and other financial intermediaries as guardians of the fisc and protector of U.S. tax and FBAR laws on behalf of the government by establishing more robust (i) FBAR compliance and recordkeeping programs, (ii) investor documentation and information reporting processes, and (iii) more tightly drafted qualified intermediary agreements. To that end, the government will likely promulgate more robust laws and regulations, as well as enforcement and audit tools to cement this relationship in these areas.

Foreign Bank Account Exposures: Prophylactic FBAR Planning, Corporate Governance and Compliance to Manage Foreign Bank Account Risk

Banks and other financial service companies as well as financial intermediaries may want to affirmatively plan to have their FBAR corporate governance and compliance shops in order before the government comes knocking on the door asking about its or its customers foreign bank accounts or other accounts over that it has signature or other authority. What can banks and other financial service companies do now?

Conduct Thorough Due Diligence and Proactively Manage the Foreign Bank Account Risk

It is unlikely that the UBS legal, compliance or tax groups knew about the cross-border private banking initiative to solicit American clients and set them up in offshore accounts to conceal their assets and income from the U.S. government. However, the behavior of one or more business groups can be imputed to the bank and to its directors and senior officers at the bank with the potential for both civil and criminal prosecution if the bank does not have robust compliance programs in place to avoid misconduct.[318] It would be prudent for banks and financial service companies to undertake their own compliance initiatives in 2009 to make sure that these programs pass muster.

The legal, compliance or tax groups who make the "key" compliance decisions for FBAR reporting, compliance and recordkeeping and investor documentation and information reporting should be assigned the task to do "scorched earth" diligence around (i) FBAR reporting, compliance and recordkeeping on a foreign account and legal entity basis for both on balance sheet and off-balance sheet supported assets and funds and other investor accounts and vehicles; (ii) the efficacy of the qualified intermediary and investor documentation and information reporting process (*e.g.,* does the bank know-its-customers under best practice "KYC" principles, and has the bank made reasonable inquiries to verify its clients' documentation (*e.g.,* Forms W-8s, W-8BENs,W-8IMYs or W-9s)?);[319] and (iii) legal entity rationalization—has the bank performed a recent legal entity rationalization for each of the business (and fund) groups for the open tax years—2003 to date?

As part of this project, it may be a good idea to also get an independent internal or external third-party view and comments regarding the diligence reports and fact findings as an additional check.

Two questions should be posited—if there were to be an audit by an external monitor akin to what UBS was required to recently undertake, would the bank have the processes and documentation in place to support a favorable review? Second, will the bank be able to support the conclusion that the business groups both on- and off-balance sheet, including the private equity, alternative funds and structured product businesses are not setting up foreign accounts or structures which need to have Fin 48 or FAS 5 reserve exposures or which would require footnote disclosure on the audited financial statements or other SEC filings if all the facts are known with 20/20 hindsight?

The results of this due diligence and recommendations as to "best practices" related to "foreign financial accounts" and "accounts with signature or other authority," investor documentation and information reporting and related anti–money laundering "know-your-customer" processes should be reviewed by the internal audit committee of the Firm and recommendations should be made to senior management and to the Board of Directors as to how to fill and remedy any internal control gaps as quickly as possible.

A decision needs to be reached at as early as stage as possible about what outside regulators should be told and when. It can be expected that early disclosure to bank and other regulators including a discussion about the mitigation plans for the regulators to review and approve will be viewed in a much better light then if the bank tries simply tried "plug the leak" without fully apprising the governmental regulators.

a. Fixing the Foreign Bank Account Problem—Consider Voluntary Disclosure If a serious problem is identified such as the bank failure to file FBARs and report taxable income attributable to such accounts on the bank's tax return (or provide such information for the clients' returns), serious consideration should be given to either (i) filing amended returns and delinquent FBARs and paying any underpayment of tax; or (ii) participating in the voluntary disclosure program with the IRS. If the first alternative is chosen, the bank's tax advisors should give serious thought to the "reasonable cause" explanation for such failures. If the bank opts for a voluntary disclosure, it should actively cooperate by responding to IDRs, document production requests and submitting to interviews by the "key" decision makers around FBAR compliance, investor documentation and information reporting and AML compliance at the firm. In addition, the bank should make every effort to file as complete a voluntary disclosure as possible for the open years by providing all the delinquent FBARs and amended returns for the current year and preceding five years to avoid ambiguous or misleading statements that may derail the voluntary disclosure process at the onset, but will not create a fishing expedition by the IRS on unrelated tax issues.

Future FBAR Reporting and Enforcement Activity by the U.S. Government

Both FBAR reporting and recordkeeping requirements are likely to be expanded as the government moves forward in its initiatives to close the perceived tax gap as part of its international tax enforcement and anti–money laundering efforts.

a. Expand FBAR Reporting to Nonliquid Offshore Assets Owned or Controlled by "U.S. Persons." While the U.S. government has not undertaken an initiative yet for other types of offshore assets owned or controlled by U.S. persons, it is possible the FBAR or FBAR-related laws may be revised in the not-too-distant future to reflect a focus not only on liquid assets in foreign financial accounts, but also on other offshore assets owned or "controlled" by U.S. persons such as real estate, bonds and personalty, including collectibles, art work and luxury yachts. It is noteworthy that some of the G-20 countries are already aggressively pursuing the disclosure of hidden offshore assets and income in tax havens and are requesting full disclosure over a much longer time period than six years under the current FBAR statute.

b. Revise FBAR to Find out the "Source" of the Offshore Assets. Mark E. Matthews, Esq. of Morgan Lewis & Bockius LLP, a panelist at the recent ABA Tax Section meeting, indicated he had recently made inquiries to FinCEN and the U.S. Treasury regarding the usefulness of the FBAR for purposes of its enforcement of its money laundering provisions. Mr. Matthews found that the government generally has not used the FBAR to enforce these provisions which was originally contemplated by the Bank Secrecy Act legislation.

It is possible that government will reanalyze its authority to use the FBAR as a tool to better enforce money laundering, as well as to combat tax fraud and evasion by U.S. persons, and may revise the FBAR in the near future to request filers to identify the "source" of their offshore funds and other assets owned or controlled in foreign financial account assets. Based on the existing FBAR legislation, the request for this information by the government seems at first blush to fall well within the scope of the government's BSA/Patriot Act legislative authority.

c. Expand Recordkeeping Requirements by FBAR Filers and Financial Intermediaries. If the government finds as part of its current wave of FBAR prosecutions that banks and other intermediaries with signature or other authority over foreign financial accounts have failed to adequately keep and retain FBAR records for the required five-year period, it is also very possible new regulations may be implemented to impose expanded recordkeeping requirements on these intermediaries as a mechanism to better enforce the FBAR filing requirements by the owners of these accounts.

d. Beef up Foreign Financial Account Disclosures on Taxpayer Income Tax Returns. According to Mr. Matthews, the IRS has been using the foreign financial account question on the Schedule B of taxpayers' individual tax returns primarily as an enforcement and prosecution tool to establish tax fraud and evasion, even though there is at present no data collection mechanism that collates the taxpayers' FBAR filings to income tax returns. At a minimum, the IRS will likely soon collate this information since the taxpayer identification number is now requested on the revised FBAR. It is also possible that the FBAR could be made a part of the income tax return filing if the IRS sees advantages to having this information directly reported on the taxpayers' income tax returns. If this were effectuated, it remains to be seen what would happen to the FBAR penalty regime.

e. Increased Enforcement Activity by State and Local Governments. State and local governments are also implementing their own initiatives for their residents to get them to disclose their offshore accounts and pay overdue taxes. Many states have disclosure or amnesty programs that offshore account owners should consider either as part of their participation in the VDP program or otherwise to become state compliant and forego criminal penalties.

In a very recent article by Kevin McCoy in USA TODAY entitled, *States offer tax evaders with offshore accounts a deal,* it was suggested that the decision by a taxpayer not to participate in these state programs now comes with a risk; McCoy quoted Richard Nicholson, Head of Connecticut's Department of Revenue Services, who stated, "Taxpayers that do not come forward … will face the possibility of criminal prosecution, in addition to civil penalties and interest on the original tax amount." While states have not directly linked their programs to the VDP program, the article quotes William Comiskey, New York's Deputy Commissioner for Tax Enforcement, who tersely warned, "The message from me to all of them is: When you apply to the feds you should apply here."

Presumably, taxpayers must file amended state and local tax returns for all open tax years and be ready to fully cooperate with the states at the same time. The federal VDP program has been explained to taxpayers through the FAQs on its Web site so that taxpayers can make a decision whether they are eligible and want to participate in the VDP program (*e.g.,* the IRS does not already have information from a third party about the undisclosed income or tax liability or is not conducting an audit or other enforcement action relating to the tax liability against the taxpayer) to protect themselves from criminal liability.

Most states, on the other hand, have not clearly articulated similar protections for taxpayers who have undisclosed income in offshore accounts and decide to come forward voluntarily, in addition to the VDP disclosure. It can be expected that states will obtain the federal income tax adjustments in any event as taxpayers file their amended returns through a "quiet disclosure," as part of the information sharing programs that already exist. However, if the states get the information about their residents' undisclosed income in offshore accounts through these information-sharing programs, rather than through participation in a state amnesty or disclosure program, it can be expected that no promises will be made as to the extent of the taxpayer's civil or criminal liabilities.

ENDNOTES

[*] I want to personally thank David Miller, Shlomo Boehm, Ray Banoun, David Mulcahy and Shelly Goldklang of Cadwalader, Wickersham & Taft LLP in New York, New York for their permission to use their examples illustrating the potential breath of the FBAR reporting for investment funds; Steven Toscher and Michel R. Stein of Hochman, Salkin, Rettig, Toscher & Perez, P.C. in Beverly Hills, California for their original and insightful articles addressing both FBAR substantive and procedural issues; and David R. Sicular of Paul Weiss Rifkind Wharton & Garrison LLP in New York, New York, Michael Farber of Davis Polk & Wardwell in New York, New York and Erika W. Nijenhuis of Cleary Gottlieb Steen and Hamilton LLP in New York and many other New York State Bar Association Tax Section members who contributed to the New York State Bar Association Tax Section, Request for Formal Guidance on FBAR Reporting Obligations letter dated July 17, 2009. Finally, I would like to thank Cono Namorato of Caplin & Drysdale Chartered in Washington, D.C., Paula M Junghans of Zuckerman Spaeder LLP in Washington, D.C., Caroline Ciraolo of Rosenberg Martin Greenberg LLP in Baltimore, Maryland and Mark E. Matthews of Morgan Lewis & Bockius, LLP in Washington, D.C. for their enlightening ABA Tax Section Panel FBAR discussion; and last but certainly not least, Kevin M. Downing, Attorney, Tax Division, U.S. Department of Justice in Washington, D.C. I am indebted to you all for letting me stand on the shoulders of giants.

[1] Titles I and II of P.L. 91-508, as amended, codified at 12 USC §1829b, 12 USC §§1951–59, and 31 USC §§5311–30. Regulations implementing Title II of the Bank Secrecy Act (BSA) were codified at 31 USC §§5311–30 and 31 CFR §103.

[2] IRS News Release, IR-2008-79 (June 17, 2008).

[3] *Id.*

[4] *See* U.S. Senate, Permanent Subcommittee on Investigations, Committee on Homeland Security and Governmental Affairs, *Tax Haven Banks and U.S. Tax Compliance*, Staff Report (July 17, 2008) ("the Report"). The Report cites several studies by tax experts to support the $100 billion tax gap.

[5] For example, *see Tax Officials Probe Estate of Gianni Agnelli*, FINANCIAL TIMES, Aug. 14, 2009, where it was suggested by Attilio Befera, director of Italy's tax collection agency, that "the agency was also pursuing up to 170,000 other wealthy Italians suspected of hoarding billions of Euros abroad … ." Similarly in an news article entitled, *HRMC wins court order for access to offshore accounts* in *Telegraph.co.uk* on August 12, 2009, Paul Farrow reported that HM Revenue & Customs, England's taxing authority, won permission to force more than 300 banks to hand over details of customers' accounts with offshore accounts. The article points out that the order comes just 48 hours after the United Kingdom reached a deal with the Liechtenstein authorities to recoup unpaid tax from 5,000 British investors who have an estimated £3 billion held in offshore accounts in the tiny principality. The article also noted that in May 2007 the HMRC won permission to force several banks, understood to have included Barclays, HSBC, Lloyds and the Royal Bank of Scotland, to hand over information on customers with offshore accounts.

[6] Internal Memorandum from Robert L. Trujillo, Director, Planning, Quality, Analysis and Support, dated October 31, 2008, entitled, *Report of Foreign Bank and Financial Accounts (FBAR) Job Aid and Counsel Review of Penalty Cases,* hereinafter referred to as "Trujillo Memorandum"; *see also* IRS News Release, IR-2008-79 (June 17, 2008).

[7] U.S. Treasury Department, Report to Congress in Accordance with 361(b) of the USA Patriot Act Pub. L. No. 107-56 (April 26, 2001) (the "Report"). The Report states, "It is difficult to determine with any accuracy how many taxpayers are failing to file required FBARs in any calendar year. Extrapolating from the limited information available concerning the number of foreign bank and credit card accounts held by United States citizens, the IRS estimates that there may be as many as 1 million U.S. taxpayers who have signature authority or control over a foreign bank account and may be required to file FBARs. Thus, the approximate rate of compliance with the FBAR filing requirements based on this information could be less than 20 percent."

[8] Internal Memorandum from Faris R. Fink, Deputy Director, Small Business and Mid-Sized Business Division, dated March 23, 2009, entitled, *Emphasis on Proper Development of Offshore Examination Cases, Managerial Review and Revocation of Last Chance Compliance Initiative.*

[9] Lynnley Browning, *Deal on Names Cracks At Swiss Banks*, N.Y. TIMES, Aug. 20, 2009, at 1.

[10] On August 15, 2009, it was reported in *Bloomberg.com* by David Voreacos and Carlyn Kolker that John McCarthy, a California client of UBS, agreed to plead guilty in U.S. District Court (Central District of California (Los Angeles) to a charge of failing to file an FBAR and pay a penalty equal to 50 percent of the highest balance of his COGS account since 2003. *See U.S. v. John McCarthy,* CR # 09-00784, U.S. District Court, District of California (Los Angeles). "The case against Mr. McCarthy is the latest victory in the Justice Department's crackdown on offshore tax evasion," said John DiCicco, acting Assistant Attorney General for the Justice Department Tax Division in a statement. McCarthy opened a Swiss account in 2003 in the name of COGS Enterprise Ltd, a Hong Kong entity, and failed to file FBARs. McCarthy skimmed money from his U.S. business into a domestic bank account in 2003 and with the help of UBS representatives and his Swiss lawyers transferred that money into his COGS account in Switzerland. McCarthy, a resident of Malibu, California met with UBS bankers and his Swiss lawyers over the next five years to discuss UBS accounts. His Swiss lawyer advised him to set up a Liechtenstein foundation or a Panamanian or Hong Kong corporation to "create an extra layer of privacy" and help hide his identity according to the plea agreement. It was also reported August 22, 2009, that another ex-UBS banker, Bradley Birkenfeld, who assisted governmental investigations probing the UBS offshore accounts was sentenced to more than three years in prison for helping wealthy Americans evade tax. *See* Erik Larson and Carlyn Kolker, *UBS Tax Fraud Case Whistleblower Gets 40-Month Prison Sentence*, *Bloomberg.com,* Aug. 22, 2009.

[11] *See* Peter D. Hardy and Thomas E. Zehnle, *Deferred Prosecution Agreement Struck With Swiss Bank UBS As Government Tightens Enforcement Net Around Foreign Accounts*, www.abanet.org/crimjust/wcc/newsletter309.htm. According to the article, the deferred prosecution agreement is supported by a detailed statement of facts that "alleges that private bankers and managers working for UBS in its U.S. cross-border business participated in scheme to defraud the IRS by facilitating for U.S. taxpayers the creation of accounts in the names of offshore accounts in the names of offshore entities, thereby allowing the U.S. taxpayers to evade their reporting requirements. Some of the alleged misconduct involved the manipulation and falsification of forms required under a 'Qualified Intermediary Agreement' that UBS had entered into with the IRS, in which the bank agreed to identify U.S. clients who held U.S. investments or received U.S. source income in their foreign accounts. The statement of facts also alleges that UBS private bankers routinely traveled to the United States to meet with clients and received training on how to avoid detection by U.S. authorities. It further describes inadequate compli-

ance systems at UBS." *See also* Stephanie Meltzer, Patrick Pericak and Shelly Goldklang, *IRS Offers to Ease Penalties for Taxpayers Who Disclose Their Overseas Accounts in the Wake of the Department of Justice's Continuing Crackdown on the Use of Tax Havens*, Cadwalader Clients & Friends Memo, Apr. 14, 2009. The Qualified Intermediary or QI program was intended to put the burden of information reporting and withholding tax returns on the foreign financial institutions who were presumably closer to their customers under "know your customer" or KYC principles. The theory being that the foreign financial institutions would not only be in the best position to collect the required documentation (*e.g.,* Forms W-8s, W-8BENs, W-8IMYs or W-9s), but would also be able to verify that such information about their clients was correct. Reg. §1.1441-1(e)(5). At the time the QI program was adopted, the IRS explained its scope and purpose in Announcement 2000-48, 2000-1 CB 1243. A Form W-9 discloses the taxpayer's name, address and taxpayer identification number and notifies recipients such as UBS that they are generally required to withhold from such taxpayers at a rate of 28 percent if such information is not disclosed and a taxpayer certification obtained.

[12] U.S. Department of Justice Press Release 09-825 (Aug. 20, 2009). Under 18 USC §371, if more than one individual is involved in committing a tax or other crime, they can be charged with conspiring to defraud the United States. Each member of the conspiracy can be fined or imprisoned for up to five years or both. If, however, the offense that is the object of the conspiracy is a misdemeanor only, the punishment for such conspiracy shall not exceed the maximum punishment provided for such misdemeanor. Under 18 USC §3571, if the defendants are found guilty of the offense, the maximum fine is not more than $250,000 for individuals and $500,000 for corporations.

[13] *Clines,* CA-4, 958 F2d 578, 581, *cert. denied,* 505 US 1205 (1992).

[14] 31 CFR §103.24(a); Internal Revenue Manual (hereinafter referred to as "IRM"), §4.26.16.2.2.

[15] Uniting and Strengthening America By Providing Appropriate Tools Required to Intercept and Obstruct Terrorism of 2001 (P.L. 103-56) (2001) (hereinafter referred to as "USA Patriot Act").

[16] Act Sec. 361(b) of the USA Patriot Act provides in part: "COMPLIANCE WITH REPORTING REQUIREMENTS—The Secretary of the Treasury shall study methods for improving compliance with the reporting requirements established in section 5314 of title 31, United States Code, and shall submit a report …"

[17] U.S. Treasury Department, Report to Congress in Accordance with 361(b) of the USA Patriot Act (P.L. 107-56) (Apr. 26, 2001) ("the Report").

[18] *See* page 12 of the Report; Instructions to FBAR (July 2000).

[19] *Id.*

[20] The information collected in the FBAR, which is authorized under Title 31 (Money and Finance), is not subject to the taxpayer confidentiality provisions of Code Sec. 6103, which generally protects taxpayer returns and return information under the Internal Revenue Code.

[21] Report of Foreign Bank and Financial Account, TD F 90-22.1 (Rev. Oct. 2008).

[22] IRS Frequently Asked Questions #26 (revised June 24, 2009); IRS News Release IR-2009-56 (June 5, 2009), Announcement 2009-51, IRB 2009-28, 128, and FAQs Regarding Report of Foreign Bank and Financial Accounts (FBAR)—Filing Requirements, Q&A #17. Last Revised June 29, 2009.

[23] Hereinafter referred to as "Revised instructions to FBAR" (Rev. 10-2008), under the heading "Who Must File this Report"; 31 CFR §103.24(a).

[24] *See* FAQ Regarding Report of Foreign Bank and Financial Accounts (FBAR) Q&A#5 (last revised June 29, 2009).

[25] IRM §4.26.16.3.2(1)(A–D).

[26] IRM §4.26.16.1.1(1) states, "A citizen of the United States has a U.S. birth certificate or naturalization papers …" It goes on to indicate these documents would not normally be needed to substantiate citizenship and would not normally be requested as part of an IRS FBAR examination.

[27] IRM §4.26.16.3.1.1(2) defines a "resident" by stating that a "resident" of the United States is a permanent resident. The definition of "resident alien" in Code Sec. 7701(b) is not applicable for FBAR purposes. The plain meaning of the term "resident" (in this context, someone who is living in the United States and not planning to permanently leave the United States) should be used for examination purposes. Although Code Sec. 7701(b) is not applicable, an individual can establish that he is not a resident for FBAR purposes if he can show that *none* of the following three criteria apply: (1) The green card test—individuals who at any time during the calendar year have been lawfully granted the privilege of residing permanently in the United States under the immigration laws automatically meet the definition of resident alien under the green-card test; (2) individuals who are not lawful permanent residents are defined as resident aliens under the substantial presence test if they are physically present in the United States for at least 183 days during the calendar year, or they are physically present in the United States for at least 31 days during the current year and the specifications contained in Code Sec. 7701(b)(3); or (3) the person files a first-year election on his income tax return to be treated as a resident alien under Code Sec. 7701(b)(4). Revised Instructions to FBAR under the heading "General Definitions—United States Person."

[28] FAQs Regarding Report of Foreign Bank and Financial Accounts (FBAR)—United States Person, Q&A #2 (last revised June 29, 2009), which states, "Whether a person is considered for FBAR purposes to be in, and doing business in the United States is determined based on an analysis of the facts and circumstances of each case. Generally, a person is not considered to be in, and doing business in the United States unless that person is conducting business within the United States on a regular and continuous basis. Persons who are merely visiting the United States or who sporadically conduct business in the United States are not in and doing business in the United States for FBAR reporting purposes. For example, a person who is not a citizen or resident of the United States and who is engaged in a business but who only occasionally visits the United States to meet customers or business associates would not be in and doing business in the United States for FBAR reporting purposes. A person is a nonresident and who visits the United States to manage his personal interests, such as rental property and conducts no other business is not considered to be in and doing business in the United States for FBAR reporting purposes. *See* Q&A #4. Artists, athletes and entertainers who are not citizens or residents of the United States and who only occasionally come to the United States to participate in exhibits, sporting events, or performances do not have to file FBARs. *See* Q&A #3. A nonresident alien who doesn't meet the 183 test is a partner in a U.S. partnership where the U.S. partnership deals with rentals. Must he file an FBAR? Whether a person is a nonresident alien for tax purposes has no bearing on the persons FBAR reporting obligation. The domestic partnership may have to file FBARs if it has a financial interest in or signature authority (or other authority that is comparable to signature authority) over a financial account that is located in a foreign country. Whether a person is considered to be in and doing business in the United States is determined based on an analysis of the facts and circumstances of each case. Generally, a nonresident is not considered to be in and doing business in the United States for FBAR reporting purposes if he

only holds a partnership interest in a domestic partnership. Q&A#5."

See also WHITE & CASE CLIENT ALERT, Jan. 2009 (J. William Dantzler, Partner and John T.Lillis, Partner), which provides, in part, "Under the revised FBAR, a 'United States person' continues to include a citizen or resident of the United States, but now also includes a 'person in and doing business in the United States.' The expansion of the scope of individuals and entities required to file the FBAR contains a two-fold test. One must be both 'in' and 'doing business' in the United States." The word "in," although not defined in the revised FBAR, suggests a requirement of some physical presence in the United States. For penalties that conduct business through a branch in the United States, the personnel and assets associated with the branch would seem to constitute a sufficient nexus to be considered "in" the United States for FBAR purposes. For individuals, it is unclear whether there is a requirement that the individual be physically present in the United States or if U.S.-based business interests held by the individual would be sufficient to constitute being "in" the United States for FBAR purposes. In the absence of guidance to the contrary, individuals who hold U.S.-based business interests through fiscally transparent entities should anticipate that the Treasury may assert (based on analogy to income tax principles) that the requirement of physical presence in the United States is satisfied by the presence of the U.S.-based business operations. The term "doing business" is not defined in either the revised FBAR or in the regulations. It is unclear if foreign persons should look to principles of state law, tax law, or some other source of law for the meaning of the term. However, "doing business" would seem to include persons engaged in a trade or business within the United States and persons treated as engaged in a trade or business as a result of holding an equity interest in a fiscally transparent entity (such as a partnership or LLC) that is engaged in business in the United States. Because the FBAR reporting requirements do not define "in and doing business in the United States," there is uncertainty as to who is required to file a FBAR. Without further guidance from the Treasury, foreign persons should have a reasonable basis to rely on the definition of a "trade or business within the United States," as defined in the Internal Revenue Code of 1986, as amended (hereinafter, "U.S. trade or business"), when making the factual determination as to whether they qualify as "persons in and doing business in" the United States for FBAR purposes.

Based on this interpretation, if foreign individuals or entities engage in activities that constitute a U.S. trade or business, they could be "United States persons" and therefore required to file a FBAR. This would include foreign persons treated as engaged in the conduct of a U.S. trade or business as a result of either holding an interest in a fiscally transparent entity that is so engaged in a U.S. trade or business, or holding an interest in U.S. real property. As "United States persons," foreign individuals or entities that are either engaged in a U.S. trade or business or hold a U.S. real property interest would be required to report any financial interest in, or signature or other authority over, any foreign financial accounts, including bank, securities or other types of financial accounts, if the aggregate value of these financial accounts exceeds US$10,000 at any time during the calendar year. These accounts would be required to be disclosed even if they are unrelated to any U.S. trade or business.

[29] IRM §26.16.3.1.1(3)(A). In October 2008, the IRS in the revised FBAR instructions added, "person in or doing business in the U.S." to match the definition in 31 USC §5314. IRS examiners should use the definition of "U.S. person" found in the FBAR instructions when determining whether a person has an obligation to file an FBAR. *See* IRM §4.26.16.3.1(E). This FBAR instruction cites to 31 CFR §103.11(z) for a definition of "Person" to include an individual; a corporation; trust or estate; a joint stock company; an association; a syndicate, joint venture or other unincorporated organization or group; an Indian tribe (as that term is defined in the Indian Gaming Regulatory Act); and all entities cognizable as legal personalities. A certificate of incorporation from a state of the United States establishes that the corporation is a U.S. person under IRM §4. The use of the phrase "all entities cognizable as legal personalities" is a catch-all that may be read very broadly to capture foreign entities in jurisdictions that have their own definitions and nomenclature for different types of entities who may be "doing business in the U.S." The revised FBAR instructions provide that "[a] branch of a foreign entity that is doing business in the United States is required to file this report even if not separately incorporated under U.S. law." Presumably, the FBAR reporting would be applicable to a branch of a foreign corporation, partnership or trust that is otherwise doing business in the United States and the foreign entity would be required to file the FBAR under this expanded definition. National Phone Forum Q&A, at 48, under the heading "Expansion of the Large Corp Exception to Include Universities," suggests that tax-exempt organizations such as large universities will be subject to FBAR reporting.

[30] *See also* FAQs Regarding Report of Foreign Bank and Financial Accounts (FBAR)—United States Person, Q&A #8 (last revised June 29, 2009); National Phone Forum Q&A, at 51, under the heading "LLC."

[31] 31 CFR §103.24; IRM §4.26.16.3.1.1(3)(B).

[32] *Id.*

[33] Revised instructions to FBAR under the heading "General Definitions—United States Person."

[34] Revised instructions to FBAR under the heading "General Definitions—United States Person." *Id. See also* the definition at 31 CFR §103.11(nn) that expands the definition of "United States" to include "the States of the United States, the District of Columbia, the Indian lands (as that termed is defined in the Indian Gaming Territories Act) and the territories and insular possessions of the United States." For this purpose, the insular possessions include the Northern Mariana Islands, American Samoa, Guam, Puerto Rico, U.S. Virgin Islands and Trust Territories of the Pacific Islands.

[35] IRM §4.26.16.3.1.1(4).

[36] Revised instructions to FBAR under the heading "General Definitions—United States Person."

[37] Announcement 2009-51, IRB 2009-25, 1105.

[38] Report of Foreign Bank and Financial Account, TD F 90-22.1 (revised July 2000). The term "United States person" means (1) citizen or resident of the United States, (2) a domestic partnership, (3) a domestic corporation, or (4) a domestic estate or trust under the prior FBAR instructions.

[39] Announcement 2009-51, IRB 2009-25, 1105.

[40] Instructions to FBAR under the heading "General Definitions—Financial Account"; *see also* IRM §4.26.16.3.2. The operative language of 31 CFR §103.24 does not include the term "financial institution"; the instructions to the FBAR (*see* note 19 below) use this term. BSA Regulation at 31 CFR §103.11(n) defines a "financial institution" very broadly as each agent, agency, branch or office within the United States of any person doing business, whether or not on a regular basis or as an organized business concern, in one or more capacities listed below: (1) bank (except bank credit card systems); (2) a broker or dealer in securities; (3) a money service business as defined in paragraph (uu) of this section; (4) a telegraph company; and (5) certain casinos. Under 31 CFR §103.11(c), a "bank" is also defined very broadly to include each agent, agency, branch or office within the United States of any person doing business in one or more of the capacities listed below: (1) a commercial bank or trust company organized under the laws of any State or of the United States; (2) a private bank; (3) a savings and loan association or a building and loan association organized under the laws of any State or of the United States; (4) an insured institution as defined in section 401 of the

National Housing Act (5) a savings bank, industrial bank or other thrift institution; (6) a credit union organized under the law of any state or of the United States; (7) any organization (except a money services business) chartered under the banking laws of any state and subject to the supervision of the bank supervisory authorities of a state; (8) a bank organized under foreign law; (9) any national banking association or corporation acting under the provisions of Section 25(a) of the Act of Dec. 23, 1913, as added by the Act of Dec. 24, 1919, ch. 18, 41 stat. 378, as amended (12 USC §611-32). Lastly, a "broker or dealer" is defined by 31 CFR §103.11(f) as a broker or dealer in securities, registered or required to be registered with the SEC under the Securities Exchange Act of 1934, except persons who register pursuant to Act Sec. 15(b)(11) of the Securities Exchange Act of 1934.

[41] *See* Steven Toscher and Michel R. Stein, *FBAR Enforcement—Five Years Later*, J. Tax Practice & Procedure, June–July 2008, at 37–58; *see* Exhibit 1, FBAR Q&A, which includes the full text of the Q&As that the authors state was released by the IRS on October 22, 2007, following a National Phone Forum on FBAR compliance, and was deemed reliable as of that date (hereinafter referred to as National Phone Forum Q&A). *See* National Phone Forum Q&A, at 47, under the heading "Domestic company making legitimate loan to foreign company/individual," and Q&A, at 56, under the heading "Stock"; *see also* FAQs Regarding Report of Foreign bank and Financial Accounts (FBAR)—Financial Accounts, Q&A #5, and FAQ s Regarding Report of Foreign Bank and Financial Accounts (FBAR)—Financial Accounts, Q&A #1 (last revised June 29, 2009).

[42] National Phone Forum Q&A, at 49, under the heading "Foreign Life Insurance."

[43] National Phone Forum Q&A, at 55, under the heading "Pension Issues."

[44] *See* National Phone Forum Q&A, at 48, under the heading "Financial Interest"; IRS FAQs Regarding Report of Foreign Bank and Financial Accounts (FBAR)—Financial Accounts, Q&A #6 (last revised June 29, 2009); National Phone Forum Q&A, at 48, under the heading "Financial Interest;" National Phone Forum Q&A, at 50, under the heading "Gold Bullion."

[45] For an expanded discussion of possible FBAR reporting for the indirect ownership of Mexican real estate by a U.S. citizen held through a trust, *see* National Phone Forum Q&A under the heading "Mexico Real Estate."

[46] *See* revised instructions to the FBAR under the heading "Financial Account." According to the revised Instructions to the FBAR, the term "financial account" encompasses any account in which the assets are held in a commingled fund, and the account owner holds an equity interest in the fund (including mutual funds). The parenthetical "including mutual funds" was added by the revised FBAR instructions.

[47] National Phone Forum Q&A, at 50–51, under the heading "Interest-bearing Securities Issued by Foreign Country."

[48] New York State Bar Association Tax Section FBAR Letter to the IRS dated July 17, 2009, at 17–18. Footnote 38 of the Letter provides, "Note, however, that a proposed amendment to the BSA would define 'mutual fund' as an 'investment company' (as the term is defined in section 3 of the Investment Company Act (15 USC 80a-3)) that is an 'open-ended company' (as that term is defined in section 5 of the Investment Company Act (15 USC 80a-5)) registered or required to register with the SEC under section 8 of the Investment Company Act (15 USC 80a-8)." *See* Proposed Amendment to 31 CFR §103.11, 74 FR 27,000 (June 5, 2009).

[49] National Phone Forum Q&A, at 51, under the heading "IRA Accounts."

[50] The panelists were Samuel Berman, Special Counsel, IRS SB/SE Division Counsel; Rod Lundquist, IRS SB/SE BSA Policy Liaison to FinCEN; and John C. McDougal, IRS Counsel (SB/SE). *See* James I Black III, Andrew S Mason, Janna Freed and Donald L. Korb, *Reporting Requirements for Foreign Financial Accounts Including Foreign Hedge Funds and Private Equity Funds*, Sullivan & Cromwell LLP (June 16, 2009).

[51] *Id.*

[52] Kristen A. Parillo, *Hedge Fund, Private Equity Investors Must File FBAR, IRS Confirms*, Tax Analysts Highlights and Documents 3944 (June 29, 2009).

[53] Notice 2009-62, IRB 2009-35, 260.

[54] David Miller, Shlomo Boehm, Ray Banoun, David Mulcahy and Shelly Goldklang, *FBAR Filing Requirements for Owners of Foreign Accounts, Hedge Fund Investors, Hedge Fund Managers, and Financial Institutions, June 30, 2009 Filing Deadline Extended Until September 23, 2009 For Certain Filers,* Cadwalader, Wickersham & Taft LLP Clients & Friends Memo, June 29, 2009, hereinafter referred to as "Cadwalader Memo." *See also* Jeffrey T Skinner, Sarah N Lowe, John P MacMaster, Matthew S Chambers and R. Sterling Perkinson, *Recently Announced FBAR Reporting Requirements for Hedge Fund and Similar Investments—Due June 30, 2009—Update: IRS Modifies FBAR Reporting Requirements for Hedge Fund and Similar,* Kilpatrick Stockton LLP, June 25, 2009.

[55] Cadwalader Memo, at 3–4.

[56] For this purpose, the revised instructions to FBAR under the heading "General Definitions-Account in a Foreign Country" makes reference to the definition of "United States Person" in the instructions to the FBAR and to 31 CFR §103.11(nn), which provides that "United States" includes "the States of the United States, the District of Columbia, the Indian lands (as that termed is defined in the Indian Gaming Territories Act) and the territories and insular possessions of the United States." *See also* IRM §4.26.16.3.3(1).

[57] Revised instructions to FBAR under the heading "General Definitions-Account in a Foreign Country"; *see also* IRM §4.26.16.3.3(2).

[58] Revised instructions to FBAR under the heading "General Definitions-Military Banking Facility"; *see also* IRM §4.26.16.3.3(2)(C).

[59] *See* note 57, *supra,* and National Phone Forum Q&A, at 49, under the heading "Form 1099-INT."

[60] As part of the FBAR reporting requirement, U.S. persons filing a Form 1040 are questioned on their Form 1040, Schedule B, Part III whether the individual has an interest in a financial account in a foreign country by checking "Yes" or "No" in the appropriate box. If the taxpayer checks "Yes," he or she is directed to the FBAR to report a financial interest in a foreign bank or brokerage account.

[61] IRM §4.26.16.3.3(3)(A)–(D). The IRM adds a cautionary note that these businesses may or may not have a financial interest in or authority over a financial account located in a foreign country even though they transmit funds to an account overseas.

[62] Revised instructions to FBAR under the heading "Financial Interest—Item #1"; IRM §4.26.16.3.4(1).

[63] IRM §4.26.16.3.4(1).

[64] *Id.*

[65] Revised instructions to FBAR under the heading "Financial Interest—Item #3 in the flush language"; *see also* IRM §4.26.16.3.4(3).

[66] Revised instructions to FBAR under the heading "Financial Interest—Item #2"; IRM §4.26.16.3.4(2)(A).

[67] National Phone Forum Q&A, at 54, under the heading "Ownership Attribution," provides the attribution rules in the Internal Revenue Code are not applicable with respect to FBARs. It is presently unclear whether the IRS will rethink this conclusion and use constructive ownership principles for purposes of determining whether the U.S. person has an "indirect" ownership in the shares or voting power. Presumably, the Treasury will use an expansive definition and may choose follow definitions under Code Sec. 318 or 267 or choose a securities law definition under common control principles since the FBAR is not under the Internal Revenue Code, but instead the Money and Banking under Title 31.

[68] Revised instructions to FBAR under the heading "Financial Interest—Item #2"; IRM §4.26.16.3.4(2)(B) (last revised July 1, 2008) does yet incorporate a financial interest if a U.S. person owns more than 50 percent

of the "voting power," of all shares of stock which is now found in the revised instructions to the FBAR.

69 Revised instructions to FBAR under the heading "Financial Interest—Item #2"; *see also* IRM §4.26.16.3.4(2)(C).

70 Revised instructions to FBAR under the heading "Financial Interest—Item #2."

71 Revised instructions to FBAR under the heading "Financial Interest—Item #2"; *see also* IRM §4.26.16.3.4(2)(C).

72 Revised instructions to FBAR under the heading "Financial Interest—Item #2"; *see also* IRM §4.26.16.3.4(2)(D). It is unclear whether the IRS intended by using the term "current income" to use concepts related to distributable net income under Code Sec. 643 for this purpose or if another definition of current income was intended. Also, the use of the word "present" beneficial interest either in assets or current income may suggest that a beneficial interest in a trust that has springing interest in the income or assets that exceeds 50 percent after the end of the calendar year for filing the FBAR may not trigger a filing requirement in the current year. It is also unclear whether the IRS will apply constructive ownership principles for purposes of determining whether the U.S. person has an "indirect" interest in the assets or current income. Presumably, the Treasury will use an expansive definition and may choose to follow definitions under Code Sec. 318 or 267 or choose a securities law definition under common control principles.

73 Revised instructions to FBAR under the heading "Financial Interest—Item #2"; *see also* IRM §4.26.16.3.4(2)(D).

74 Revised instructions to FBAR under the heading "Financial Interest—Item #3."

75 *Id.*

76 National Phone Forum Q&A, at 50, under the heading "Foreign Trust."

77 IRM §4.26.16.3.5(1).

78 Revised instructions to FBAR under the heading "Signature or Other Authority over an Account"; *see also* IRM §4.26.16.3.5(2).

79 IRM §4.26.16.3.5(2).

80 Revised instructions to FBAR under the heading "Signature or Other Authority over an Account."

81 *See* FAQs Regarding Report of Foreign Bank and Financial Accounts (FBAR)—Financial Accounts, Q&A #7 (last revised June 29, 2009).

82 *Id.*

83 *See* FAQs Regarding Report of Foreign Bank and Financial Accounts (FBAR)—United States Person, Q&A #6 (last revised June 29, 2009).

84 *See* FAQs Regarding Report of Foreign Bank and Financial Accounts (FBAR)—Filing Requirements, Q&A #5 (last revised June 29, 2009); FAQs Regarding Report of Foreign Bank and Financial Accounts (FBAR)—United States Person, Q&A #7 (last revised June 29,2009).

85 National Phone Forum Q&A, at 45, under the heading "Corporations" and, at 47, under the heading "Corporate Foreign Account."

86 Notice 2009-62, IRB 2009-35, 260.

87 *See* "The Filer Must Have a 'Financial Interest' in the Account or Signature Authority Over an Account—Signature or Other Authority Over an Account."

88 *See* "The Account Must Be a Financial Account."

89 *See* "The Filer Must Have a 'Financial Interest' in the Account or Signature Authority Over an Account—Signature or Other Authority Over an Account."

90 *See* "Exceptions to FBAR Reporting."

91 *Id.*

92 Code Sec. 1297 provides the definition of a foreign passive investment company by stating it "… means any foreign corporation if—(1) 75 percent or more of the gross income of such corporation for the taxable year is passive income, or (2) the average percentage of assets (as determined in accordance with subsection (e)) held by such corporation during the taxable year which produce passive income or which are held for the production of passive income is at least 50 percent." Code Sec. 1297(b)(1) provides the general definition of passive income and Code Sec. 1297(b)(2) provides exceptions to the general rule. Code Sec. 1297(b)(1) provides, "Except as provided in paragraph (2), the term 'passive income' means any income which is of a kind which would be foreign personal holding company income as defined in section 954(c), which includes among other categories of income dividends, interest, royalties, rents and annuities." *See* Code Sec. 954(c)(1)(A).

93 Code Sec. 1298(b) provides special rules for purposes of the applicability of the foreign passive investment company rules such as time for determination, the treatment of certain corporations during the start-up year, certain corporations changing businesses, separate interests treated as separate corporations, application where stock is held by other entity, dispositions, treatment of certain foreign corporations owning stock in 25-percent owned domestic corporation and the treatment of certain Subpart F inclusions.

94 *See* notes 92 and 93, *supra.*

95 *See* "The Account Must Be a Financial Account."

96 Revised Instructions to FBAR under the heading "Exceptions"; IRM §4.26.16.3.5(3)(A). For this purpose, a bank regulator includes a bank that is subject to the supervision of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Office of Thrift Supervision or the Federal Deposit Insurance Corporation.

97 National Phone Forum Q&A, at 43, under the heading "Bank Subsidiary."

98 Revised instructions to FBAR under the heading "Exceptions"; *see also* IRM §4.26.16.3.5(3)(B).

99 Revised instructions to FBAR under the heading "Exceptions"; *see also* IRM §4.26.16.3.5(3)(C).

100 Revised instructions to FBAR under the heading "Exceptions"; *see also* IRM §4.26.16.3.5(3)(D).

101 31 CFR §103.27(c); revised instructions to FBAR under the heading "Who Must File this Report"; *see also* IRM §4.26.16.3.6.

102 Revised instructions to FBAR under the heading "Part II—Item 15"; *see also* IRM §4.26.16.3.6(1).

103 *Id.*

104 Revised instructions to FBAR under the heading "Part II—Item 15"; *see also* IRM §4.26.16.3.6(2).

105 Revised instructions to FBAR under the heading "Part II—Item 15"; *see also* IRM §4.26.16.3.6(3). When valuing currency of a country that uses multiple exchange rates, use the rate that would apply if the currency in the account were converted into U.S. dollars at the close of the calendar year. The official Treasury Reporting Rates of Exchange for the previous quarter year can be obtained at *http://fms.treas.gov/inm.hlm#rates* or by calling the Department of the Treasury, Financial Management Service International Funds Team, at (202) 874-7994. As these rates are published quarterly, the rates should be accessed during the first quarter of the following year to obtain the previous December 31 valuation. The rates posted on the FMS Web site are the current exchange rates. Historical exchange rates will be needed to determine the value in a foreign account in prior years. For historical exchange rates, call FMS at (202) 874-8001 or (202) 874-8004 or check the FMS Web site at *www.fms.treas.gov* for the most current information.

106 National Phone Forum Q&A, at 42, under the heading "Aggregate."

107 Revised instructions to FBAR under the heading "Part II—Item 15"; *see also* IRM §4.26.16.3.6(4).

108 Revised instructions to FBAR under the heading "Part II—Item 15"; *see also* IRM §4.26.16.3.6(5).

109 Revised instructions to FBAR under the heading "Part II—Item 15"; *see also* IRM §4.26.16.3.6(6).

110 Revised instructions to FBAR under the heading "Filing Information"; *see also* IRM §4.26.16.3.7(1).

111 *Id.*

112 Revised instructions to FBAR under the

heading "When and Where to File"; *see also* IRM §4.26.16.3.7(5).

[113] Revised instructions to FBAR under the heading "Filing Information"; *see also* IRM §4.26.16.3.7(3).

[114] Revised instructions to FBAR under the heading "Filing Information"; *see* FAQs Regarding Report of Foreign Bank and Financial Accounts (FBAR)—Filing Requirements Q&A #8 (last revised June 29, 2009).

[115] IRM §4.26.16.3.7(6). This is in contrast to the rule for income tax returns, claims, statements or other documents required to be filed or any payments required to be made, which treats the postmark date as the date the return was filed or to which the payment was made. *See* Code Sec. 7502(a).

[116] Revised instructions to FBAR under the heading "Signatures."

[117] National Phone Forum Q&A, at 48, under the heading "Fax Signatures."

[118] Revised instructions to FBAR under the heading "Part III, Items 25-33."

[119] Revised instructions to FBAR under the heading "When and Where to File"; IRM §4.26.16.3.7.3(1).

[120] IRM §4.26.16.3.7.3(2).

[121] IRM §4.26.16.3.7.3(3).

[122] Revised instructions to FBAR under the heading "Filing Information—Recordkeeping Requirements"; IRM §4.26.16.3.8(1).

[123] Revised instructions to FBAR under the heading "Filing Information—Recordkeeping Requirements"; IRM §4.26.16.3.8(1) (A-E); 31 CFR §103.32.

[124] IRM §4.26.16.3.8(2).

[125] Revised instructions to FBAR under the heading "*Recordkeeping Requirements*"; *see also* IRM §4.26.16.3.8(3). For purposes of computing the five-year period, disregard any period beginning with a date on which the taxpayer is indicted or information filed on account of the filing of a false or fraudulent federal income tax return or failing to file a federal income tax return and ending with the date on which final disposition is made of the criminal proceeding. *See* 31 CFR §103.32.

[126] *See* IRS Publication 552, *Recordkeeping for Individuals,* Dec. 2008, at 6.

[127] IRM §4.26.16.2.2(3); 31 CFR §103.27(c).

[128] Revised instructions to FBAR under the heading "Explanations for Specific Items—Part II, Item 14"; 31 CFR §103.32.

[129] Revised instructions to FBAR under the heading "Explanations for Specific Items—Part II, Item 14"; *see also* IRM §4.26.16.3.9; 31 CFR §103.32.

[130] 31 CFR §103.32.

[131] Revised instructions to FBAR under the heading "Filing Information—When and Where to File"; *see also* IRM §4.26.16.3.7.2(1).

[132] *See www.irs.gov/newsroom/article* under the search, "Delinquent FBARs," and *see* Q&A #43.

[133] For 2008 tax returns due after September 23, 2009, the tax return does not need to accompany the 2008 FBAR. *See* Q&A #43.

[134] *See* note 132, *supra.*

[135] *Id.*

[136] Revised instructions to FBAR under the heading "Filing Information—When and Where to File"; and IRM §4.26.16.3.7.1(1). Code Sec. 7506 generally provides time for performing certain acts by reason of service in a combat zone or contingency operation but does not grant U.S. persons that are U.S. Armed Forces members any extension of time to file the FBAR. *See* IRM §4.26.16.3.7.1(2).

[137] 31 USC §5314 and 31 CFR §103.24. The regulatory authority for the FBAR is 31 CFR §§103.24 and 103.27. Section 103.32 provides for FBAR records and §103.56 tasks the IRS with enforcement. *See also* IRM §4.26.16.2.2(1).

[138] The MOU is referenced in 31 CFR §103.56(g).

[139] IRM §4.26.16.2.2(4)(A)–(E).

[140] IRM §4.26.16.4.1(2).

[141] IRM §4.26.16.4.1(3). CI has had the authority to examine criminal FBAR examinations since 1992. It also has expanded authority to investigate money laundering offenses under 18 USC §§1956 and 1957 where the underlying conduct is subject to investigation under Title 26 or under the Bank Secrecy Act. *See* 31 CFR §103.56(c)(2); IRM §§4.26.16.4.1 and 4.26.17.5.4.

[142] IRM §4.26.16.4(3).

[143] IRM §4.26.16.4(5). The examiner has discretion in determining the amount of the penalty.

[144] IRM §4.26.16.4(4).

[145] IRM §4.26.16.4(7).

[146] IRM §4.26.16.4(8).

[147] *Id.*

[148] IRM §4.26.16.4.1(3); IRM §9.5.13.2(1); 31 CFR §103.56(c)(2).

[149] Workbook on the Report of Foreign Bank and Financial Accounts, under the heading "Penalties," Feb. 19, 2009, at *www.irs.gov/businesses/small/article/0,id=159757,00.html.*

[150] *Id.* The citations are to the BSA and the Code of Federal Regulations and not the Internal Revenue Code.

[151] Code Sec. 6651(f) or 6663.

[152] Code Sec. 6662.

[153] *See* FAQs Regarding Report of Foreign Bank and Financial Accounts (FBAR)—Filing Requirements, Q&A #14 (last revised June 29, 2009).

[154] IRM §4.26.16.4.3; 31 USC §5521(a)(6).

[155] IRM §4.26.16.4.3(1)(A); 31 USC §5321(a)(6); IRM §9.5.13.3.2(3)(F); 31 CFR §103.57(h).

[156] IRM §4.26.16.3(1)(B); 31 USC §5321(a)(6)(B); IRM §9.5.13.3.2(3)(F).

[157] IRM §4.26.16.4.3(2).

[158] IRM §4.26.16.4.3.1(1).

[159] IRM §4.26.16.4.3.1(3), Reg. §1.6664-4, reasonable cause and good faith exception to Code Sec. 6662 penalties may serve as useful guidance in determining the factors to consider. Although the tax regulation does not apply to FBARs, the information it contains may still be helpful in determining whether the FBAR violation was due to reasonable cause and not due to negligence.

[160] IRM §4.26.16.4.4(1); 31 USC 5321(a)(5)(B).

[161] 31 USC §5321(a)(5)(B)(ii). IRM §20.1.1.3.1.2.1(1), (2). *See also* IRS FAQ, Q&A #18 (Mar. 13, 2009).

[162] *See also* Hale E. Sheppard, *Evolution of the FBAR: Where We Were, Where We Are, and Why It Matters*, HOUSTON BUS. & TAX J., 2006, at 31–37. Although generally intended to provide guidance for purpose of determining the meaning of "reasonable cause" for purposes of the exception for certain Title 26 penalties, IRM §20.1.1.3.1 may be useful in giving FBAR filers some guidance on the "reasonable cause" exception for civil Title 31 FBAR penalties that are found in 31 USC §5321(a)(5(B)(ii) for nonwillful violations. It provides that reasonable cause is based on all the facts and circumstances in each situation and allows the IRS to provide relief from a penalty that would otherwise be assessed. Reasonable cause relief is generally granted when the taxpayer exercises ordinary business care and prudence in determining their tax obligations but nevertheless is unable to comply with those obligations. In the interest of equitable treatment of the taxpayer and effective tax administration, the nonassertion or abatement of civil penalties based on reasonable cause or other relief provisions provided in this IRM must be made in a consistent manner and should conform with the considerations specified in the Internal Revenue Code, regulations, policy statements and IRM Part 20.1. Reasonable cause relief is not available for all penalties; however, other exceptions may apply. For those penalties where reasonable cause can be considered, any reason that establishes that the taxpayer exercised ordinary business care and prudence, but nevertheless was unable to comply with a prescribed duty within the prescribed time, will be considered. If a reasonable cause provision applies only to a specific Code Sec., that reasonable cause provision will be discussed in the IRM Part 20.1 relating to that Code section. *See* Exhibit 20.1.1-2., Penalty Relief-Application Chart. When considering the information provided in the following pages, remember that an acceptable explanation is not limited to those given in IRM Part 20.1, Penalty Handbook. Penalty relief granted because the taxpayer provided an "other acceptable explanation" is identified by use of PRC 030 (Penalty Rea-

son Code) on either the closing or adjustment document, or on the Master File with a TC 290.00 (with the related penalty TC for .00, such as TC 180 .00), and RC 062. The wording used to describe reasonable cause provisions varies. Some Code penalty sections also require evidence that the taxpayer acted in good faith or that the taxpayer's failure to comply with the law was not due to willful neglect. *See* specific IRM sections for the rules that apply to a specific IRC section. Taxpayers have reasonable cause when their conduct justifies the nonassertion or abatement of a penalty. Each case must be judged individually based on the facts and circumstances at hand. Consider the following in conjunction with specific criteria identified in the remainder of this section. *See* IRM 20.1.1.3. What happened and when did it happen? During the period of time the taxpayer was noncompliant, what facts and circumstances prevented the taxpayer from filing a return, paying a tax, and/or otherwise complying with the law? How did the facts and circumstances prevent the taxpayer from complying? How did the taxpayer handle the remainder of their affairs during this time? Once the facts and circumstances changed, what attempt did the taxpayer make to comply? Reasonable cause does not exist if, after the facts and circumstances that explain the taxpayer's noncompliant behavior cease to exist, the taxpayer fails to comply with the tax obligation within a reasonable period of time.

[163] IRM §4.26.16.4.4(2); 31 USC 5321(a)(5)(B)(ii).

[164] *See* Exhibit 4.26.16-1-4 for the mitigation guidelines, as well as the discussion in IRM §4.26.16.4.4(3).

[165] IRM §4.26.16.4.4(4).

[166] IRM §4.26.16.4.4(5).

[167] Workbook on the Report of Foreign Bank and Financial Accounts, under the heading "Penalties," Feb.19, 2009, at *www.irs.gov/businesses/small/article/0,id=159757,00.html.*

[168] IRM §4.26.16.4.5.1(3); IRM §9.5.13.3.2(3)(E); 31 USC §5321(a)(5)(C); 31 USC §5322(a). The penalty applies to all U.S. persons. Workbook on the Report of Foreign Bank and Financial Accounts, under the heading "Penalties," Feb. 19, 2009.

[169] IRM §4.26.16.4.5.3(1). Willfulness can rarely be proven by direct evidence, since it is a state of mind. It is usually established by drawing a reasonable inference from the available facts. The government may base a determination of willfulness in the failure to file the FBAR on inference from conduct meant to conceal sources of income or other financial information. For FBAR purposes, this could include concealing signature authority, interests in various transactions or interests in entities transferring cash to foreign banks. IRM §4.26.16.4.5.3(7). The following examples in IRM §4.26.16.4.5.3(8)(A)–(D) illustrate situations in which willfulness may be present: (1) A person admits knowledge of and fails to answer a question concerning signature authority over foreign bank accounts on Schedule B of the income tax return. When asked, the person does not provide a reasonable explanation for failing to answer the Schedule B question and for failing to file the FBAR. A determination that the violation was willful likely would be appropriate in this case. (2) A person files the FBAR, but omits one of three foreign bank accounts. The person had closed the omitted account at the time of filing the FBAR. The person explains the omission was due to unintentional oversight. During the examination the person provides all information requested with respect to the omitted account. The information provided does not disclose anything suspicious about the account and the person reported all income associated with the account on his tax return. The willfulness penalty should not apply absent other evidence that may indicate willfulness. (3) A person filed the FBAR in earlier years but failed to file the FBAR in subsequent years when required to do so. When asked, the person does not provide a reasonable explanation for failing to file the FBAR. In addition, the person may have failed to report income associated with foreign bank accounts for the years that FBARs were not filed. As with example A, a determination that the violation was willful likely would be appropriate in this case. (4) A person received a warning letter informing him of the FBAR filing requirement, but the person continues to fail to file the FBAR in subsequent years. When asked, the person does not provide a reasonable explanation for failing to file the FBAR. In addition, the person may have failed to report income associated with the foreign bank accounts. As with examples A and C above, a determination that the violation was willful likely would be appropriate in this case.

[170] IRM §4.26.16.4.5.3(2) and (3).

[171] IRM §4.26.16.4.5.3(4). However, *see* 31 USC §5321(a)(5)(C)(ii), which states that subparagraph (B)(ii)—the reasonable cause exception in Code Sec. 5321(a)(5) shall not apply.

[172] IRM §4.26.16.4.5.3(5). Under the concept of "willful blindness," willfulness may be attributed to a person who has made a conscious effort to avoid learning about the FBAR reporting and recordkeeping requirements. An example that might involve willful blindness would be a person who admits knowledge of and fails to answer a question concerning signature at foreign banks on Schedule B of his income tax return. This section of the return refers taxpayers to the instructions for Schedule B that provide further guidance on their responsibilities for reporting foreign bank accounts and discusses the duty to file Form 90-22.1. These resources indicate that the person could have learned of the filing and recordkeeping requirements quite easily. It is reasonable to assume that a person who has foreign banks accounts should read the information specified by government in tax forms. The failure to follow-up on the knowledge and learn of the further reporting requirement as suggested on Schedule B may provide some evidence of willful blindness on the part of the person. For example, the failure to learn of the filing requirements coupled with other factors, such as the efforts taken to conceal the existence of the accounts and the amounts involved may lead to a conclusion that the violation was due to willful blindness. The mere fact that the person checked the wrong box or no box on a Schedule B is not sufficient by itself to establish that the FBAR violation was attributable to willful blindness. *See* IRM §4.26.16.4.5.3(6).

[173] IRM §4.26.16.4.5(2).

[174] IRM §4.26.16.4.5.5(3).

[175] IRM §4.26.16.4.5.5(4).

[176] IRM §4.26.16.4.5.5(5).

[177] 31 USC §5322(a); 31 CFR §103.59(b).

[178] 31 USC §5322(b).

[179] 31 USC §5322(b) and 31 CFR §103.59(c).

[180] 18 USC §1001; 31 CFR §103.59(d).

[181] Code Sec. 7206(1).

[182] Code Sec. 6663(a). Code Sec. 6663(b) provides that if the IRS establishes that any portion of the underpayment is attributable to fraud, the entire underpayment of tax shall be treated as attributable to fraud, except for the portion of the underpayment that the taxpayer establishes by a preponderance of the evidence is not attributable to fraud. IRM §9.5.13.2.2.1(1) and (2).

[183] Code Sec. 6651(f).

[184] *Id.*

[185] Code Sec. 7201. In addition, the defendant may have to pay the costs of prosecution.

[186] Code Sec. 6651(a)(2); IRM §9.5.13.2.2.4(1).

[187] Code Sec. 6651(a)(3).

[188] Code Sec. 7203.

[189] Code Sec. 6651(a)(1); IRM §9.5.13.2.2.3(1).

[190] Code Sec. 6662(a) and (b).

[191] Code Sec. 6662(c); IRM §9.5.13.2.2.2(2).

[192] Code Sec. 6662(d)(1)(A).

[193] Code Sec. 6662(d)(1)(B).

[194] IRM §9.5.13.2.2.2(1).

[195] Code Sec. 6672; IRM §9.13.2.2.5(1).

[196] Code Sec. 6694(a)(1); Notice 2009-5, IRB 2009-3, 309.

[197] Code Sec. 6694(a)(3).

[198] Code Sec. 6694(a)(2).

[199] Notice 2009-5, *supra* note 196. In the case of a tax return preparer, however, a written

determination with a misstatement or omission of material fact is substantial authority unless the tax return preparer knew or should have known of the misstatement or omission of material fact when the return or claim for refund was filed. The applicability of court cases to the taxpayer's situation by reason of the taxpayer's residence in a particular jurisdiction is not taken into account in determining whether there is substantial authority for a position in accordance with Reg. §1.6662-4(d)(3)(iv)(B). Notwithstanding the preceding sentence, there is substantial authority for a position if the position is supported by controlling precedent of a U.S. Court of Appeals to which the taxpayer has a right of appeal with respect to the position. Finally, there is substantial authority for a position only if there is substantial authority on the date the return or claim for refund is deemed prepared, as prescribed by Reg. §1.6694-1(a)(2), or there was substantial authority on the last day of the tax year to which the return relates. Conclusions reached in treatises, legal periodicals, legal opinions or opinions rendered by tax professionals (including tax return preparers) are not authority. The authorities underlying such expressions of opinion, if applicable to the facts of a particular case, however, may give rise to substantial authority for the position. Solely for purposes of Code Sec. 6694(a), a tax return preparer nevertheless will be considered to have met the standard in Code Sec. 6694(a)(2)(A) if the tax return preparer relies in good faith and without verification on the advice of another advisor, another tax return preparer or other party. Factors used in evaluating a tax return preparer's good faith reliance on the advice of another are found in Reg. §1.6694-2(e)(5).

[200] IRM §4.26.17.1(1).

[201] IRM §4.26.17.1(2).

[202] IRM §4.26.12.1; Form, 8300, *Report of $10,000 Received in a Trade or Business.*

[203] IRM §4.26.17.1(3)(A)–(C).

[204] IRM §4.26.8.3(1).

[205] IRM §4.26.8.3(2).

[206] IRM §4.26.8.3(1); Code Sec. 7602(a). The income tax summons, IRS Form 2039, is not used in a BSA or FBAR examination.

[207] IRM §4.26.17.5.3(1).

[208] IRM §4.26.17.5.3(1). *See* Titles I and II of P.L. 91-508, as amended, codified at 12 USC §1829b, 12 USC §§1951–59, and 31 USC §§5311–30.

[209] For this purpose, a "financial institution" as defined in 31 CFR §103.11(n).

[210] IRM §4.26.8.3(4).

[211] IRM §4.26.8.3.3(2).

[212] IRM §4.26.17.5.3.2(1).

[213] IRM §4.26.8.3.7(1)(A).

[214] IRM §4.26.8.3.7(1)(B).

[215] IRM §4.26.17.5.2(2), (3).

[216] IRM §§4.26.17.5.2(4) and 4.26.17.5.2.1(1).

[217] IRM §4.26.17.5.2.1(2).

[218] IRM §4.26.17.5.2.2(2).

[219] IRM §4.26.17.5.5(1), (2); *See also* 31 USC §5321(b)(1). The date of the transaction for report filing violations is June 30 of the year following the calendar year for which the foreign financial account should be reported. The date of the transaction for recordkeeping purposes is the date the examiner first requests the records required to be maintained under 31 CFR §103.32. Note that Section 103.32 generally only requires that records be maintained for five years. The date the FBAR civil penalty is assessed is the date the IRS designated official delegate stamps the assessment form. The assessment certification form is IRS Form 13448.

[220] IRM §4.26.17.5.5(3). *See also* 31 USC §5321(b)(2).

[221] IRM §4.26.17.5.5.2(1), (2). The date the FBAR penalty is assessed is the date the IRS designated agent official stamps IRS Form 13448.

[222] IRM §4.26.17.5.5.3(1), (2) and (3).

[223] *Id.*

[224] IRM §4.26.17.5.5.4(1); 18 USC §3282.

[225] IRM §4.26.17.2(1)(D); Code Sec. 6103. Note, there is no reference to confidentiality or a separate privacy right arising under this section for a FBAR examination.

[226] *Id.*

[227] IRM §4.26.17.2(1)(E) and (F).

[228] IRM §4.26.17.2(1)(B).

[229] IRM §4.26.17.2(1)(C).

[230] IRM §4.26.17.2(1)(G). Code Sec. 6103.

[231] Trujillo Memorandum—Attachment, at 4.

[232] Trujillo Memorandum, at 2.

[233] IRM §4.26.17.3.1(1)(B).

[234] IRM §4.26.17.2(1).

[235] IRM §4.26.17.2(1)(A).

[236] IRM §4.26.17.3(1)(A), (B), (C), (D) and (E).

[237] IRM §4.26.17.4(1) and (2).

[238] IRM §4.26.17.4(3).

[239] IRM §4.26.17.4(4).

[240] IRM §4.26.17.4.1(1), (2).

[241] IRM §4.26.17.4.1(3).

[242] IRM §4.26.17.4.2(1)(A).

[243] IRM §4.26.17.4.2(2).

[244] IRM §4.26.17.4.2(3).

[245] IRM §4.26.17.4.2(4).

[246] IRM §4.26.17.4.3(1); *see* IRM 4.26.16 for the FBAR penalty computation rules and penalty mitigation.

[247] IRM §4.26.17.4.3(2).

[248] IRM §4.26.17.4.3(5)(A).

[249] *Id.*

[250] IRM §4.26.17.4.3(6)(A).

[251] IRM §4.26.17.4.3(6)(B). Although Form 13449 is shown as an Agreement, it also functions as the examiner's report of FBAR violations. It is the basis for the FBAR penalty assessment.

[252] IRM §4.26.17.4.3(6)(C). This notice advises that the payment will be recorded electronically and that the person submitting payment will not receive a copy of the cancelled check.

[253] IRM §4.26.17.4.3(6)(D). Payment on the FBAR penalty must be evidenced by a separate check or money order made out to the U.S. Treasury showing the FBAR account number and year. Separate checks or money orders should be written for FBAR and tax payments. When a receipt is desired, payment should be made by money order or cashier's check. The examiner should not issue a tax receipt form, such as Form 809. No interest accrues on FBAR penalties prior to assessment; therefore, only the penalty amount would be owed if full payment is made in a preassessment case or if payment is made within 30 days after the date a notice of the penalty amount due is first mailed to the filer. Under 31 USC §3717(b), interest begins to accrue on the date the FBAR notice of penalty assessment is mailed but no interest is owed on payments received within 30 days from the date a notice of the penalty amount due is first mailed to the filer. In addition to interest, a six-percent delinquency penalty applies to amounts remaining unpaid ninety days from the date a notice of the penalty amount due is first mailed to the filer. The applicable interest rate is found at *http://fms.treas.gov/cvfr/index.html.* This rate is updated at least annually but may be updated quarterly if certain criteria, identified in Code Sec. 3717(a)(2), are met.

[254] *See* Toscher & Stein, *supra* note 41.

[255] *See* IRM §4.26.16.4.5.4(1), which identifies documents that may be helpful in establishing willfulness include the following: (1) Copies of documents from the administrative case file (including the Revenue Agent Report) for the income tax examination that show income related to funds in a foreign bank account was not reported. A copy of the signed income tax return with Schedule B attached (showing whether or not the box pertaining to foreign accounts is checked or unchecked). (2) Copies of statements for the foreign bank account. Notes of the examiner's interview with the foreign account holder/taxpayer about the foreign account. Any documents that would support fraud (*see* IRM 4.10.6.2.2 for a list of items to consider in asserting the fraud penalty). (3) Correspondence with the account holder's tax preparer that may address the FBAR filing requirement. Documents showing criminal activity related to the nonfiling of the FBAR (or noncompliance with other BSA provisions). Promotional material (from the promoter or offshore bank). (4) Statements for debit or credit cards from the offshore bank (which could show if the account holder was using funds from the offshore account to cover everyday living expenses in a manner that would conceal the source of the funds). (5) Printouts from CBRS

that show that the FBAR was not filed. (6) Copies of any FBARs (or CBRS printouts of FBARs) that were previously filed by the account holder. (7) Copies of tax returns (or RTVUEs/BRTVUs) for at least three years prior to the opening of the offshore account and for all years after the account was opened. (To show any significant drop in reportable income after the account was opened, three years prior to the opening of the account would be requested in order to give the examiner a better idea of what the account holder typically would have reported as income prior to opening the foreign account.) (8) Copies of Information Document Requests with items that were not provided by the account holder highlighted and explanations given as to why the requested information was not provided. (9) Copies of debit or credit card agreements and fee schedules with the foreign bank (which may show a significantly higher cost than typically associated with cards from domestic banks). (10) Copies of debit and credit card statements prior to the opening of the foreign account (to show that the account holder did or did not routinely use such cards for everyday living expenses, keeping in mind these statements may be difficult to obtain if the foreign account was opened many years ago). (11) Copies of any investment management or broker's agreement and fee schedules with the foreign bank (which may show significantly higher costs than costs associated with domestic investment management firms or brokers). The account holder's written explanation of why the FBAR was not filed (if the account holder wishes to provide such a statement). Otherwise, note in the work papers whether the account holder was given an opportunity to provide such a statement. Copies of any previous warning letters issued to the account holder. (12) Copies of any prior Revenue Agent Reports that may show a history of noncompliance. An explanation, in the work papers, as to why the examiner believes that the account holder's failure to file the FBAR was willful. Two sets of cash Ts (a reconciliation of the taxpayer's sources and uses of funds) with one set showing any unreported income in foreign accounts that was identified during the examination and the second set excluding the unreported income in foreign accounts.

[256] *See* Toscher & Stein, *supra* note 41, at 5. Footnote 55 states, "The IRS must prove willfulness by 'clear and convincing' evidence and a general presumption of correctness afforded to tax assessments does not apply. *See* CCA 200603026 (September 1, 2005)."

[257] *See* Toscher & Stein, *supra* note 41, at 41–42.

[258] IRM §4.26.17.4.4(1).

[259] Note on the FBAR database that a follow-up FBAR civil examination referral is needed.

[260] IRM §4.26.17.4.4(2).

[261] IRM §4.26.17.4.4(3).

[262] IRM §4.26.17.4.4(4). Form 13448 is for internal use only. It validates the assessment; *i.e.,* it documents the IRS's determination that the penalty assessed is legally due and payable. It functions in the same way as Form 23C in the Campuses. A copy of Form 13448 is placed in the case file.

[263] IRM §4.26.17.4.4(4)(D).

[264] Enter the interest rate on Letter 3708 according to the interest rate currently published by the Financial Management Service at *http://fms.treas.gov/cvfr/index/html.*

[265] IRM §4.26.17.4.4(4)(E), (F).

[266] IRM §4.26.17.4.5.

[267] IRM §4.26.17.4.6(1).

[268] IRM §4.26.17.4.6(2). The statute of limitations on assessment of a failure to file penalty is six years from the date when the FBAR should have been filed (which is June 30 of the year following the year for which the foreign financial account is being reported).

[269] IRM §4.26.17.4.6(3).

[270] IRM §4.26.17.4.6(4), (5), (6).

[271] IRM §4.26.17.4.6(6)(E), (F).

[272] IRM §4.26.17.4.7(1), (2) and (3).

[273] IRM §4.26.17.4.7(4), (5) and (6).

[274] IRM §4.26.17.5.4(1)(A), (B), (2) and (3). Treasury Directive 15-41 (Dec. 1, 1992) delegates to the IRS the authority to initiate investigations of any person, including banks and brokers or dealers in securities, for possible criminal violations of 31 CFR §part 103 (except violations of §103.23). Treasury Directive 15-42 (Jan. 21, 2002) further delegates to the IRS investigatory authority over violations of 18 USC §§1956 and 1957 where the underlying conduct is subject to investigation under Title 26 or under the Bank Secrecy Act, or 31 USC §§5311–32 (other than violations of 31 USC §5316). Criminal FBAR penalties appear at 31 USC 5322 and 31 CFR §103.59.

[275] IRM §4.26.17.5.4.1(1), (2), (3) and (4).

[276] IRM §4.26.17.5.4.1(5), (6).

[277] IRM §4.26.17.5.4.1(7), (8) and (9). When preparing Form 2797 for an FBAR referral, the examiner will follow the instructions attached to the form and note that "filer" means the person required to file the FBAR regardless of whether or not the person filed. Insert FBAR Violation in Item 2f. Note that Item 3d of the Form 2797 must show that CBRS was checked for FBAR filings if an FBAR referral to Criminal Investigation is being made. Document on the Form 2797 referral to CI and in the workpapers the date that the entity was educated about filing and the filing compliance status at the date of the referral. Omit items 4, 8, and 9.If there is a related tax case, the examiner will prepare a separate Form 2797 for any related tax case, if warranted. Submit related tax and FBAR referrals to CI at the same time if possible. Follow procedures established for criminal referrals in IRM §25.1.3. If a related statute determination is made, a copy of the related statute determination memorandum must be attached to Form 2797.

[278] IRM §4.26.16.4.6.1(1).

[279] IRM §4.26.16.4.6.1(2).

[280] *See* IRM §4.26.16-1 (Pre–October 23, 2004 Normal FBAR Civil Penalty Mitigation Guidelines) (July 1, 2008); *see also* Steven Toscher and Michel R. Stein, *FBAR Enforcement is Coming!* J. TAX PRACTICE & PROCEDURE, Dec. 2003–Jan. 2004; and Caroline D. Caraolo, *The Morning After … . What You Need To Know About the FBAR and International Information Returns Including Defending Against and Litigating the Penalties*, submitted as part of her presentation for the ABA Tax Section Civil and Criminal Tax Penalties Panel entitled, "Defending and Litigating FBAR and Related Information Return Penalties," on September 26, 2009, in Chicago, Illinois.

[281] *See* Toscher & Stein, *supra* note 41, at 42.

[282] Code Sec. 6301.

[283] Code Sec. 6303.

[284] Code Sec. 6321.

[285] Code Sec. 6331.

[286] 18 USC §5321(b)(2).

[287] Sandra R. Brown, *IRS & The FBAR International Tax Focus for U.S. Tax Compliance,* Nov. 20, 2008, *www.abanet.org/crimjust/wcc/march09sandra.doc;* 31 USC §5321(b)(1); 31 CFR §103.56(g); *Williams,* 131 TC 6, Dec. 57,547 (2008).

[288] *Id. See* 11 USC §523(a)(7); *Simonelli,* Slip Copy, 2008 SL 4479265 (D. Conn. Sept. 30, 2008).

[289] IRM §4.26.17.5.4(3).

[290] U.S. FEDERAL SENTENCING GUIDELINES MANUAL §2s1.3(a) (2008).

[291] U.S. FEDERAL SENTENCING GUIDES MANUAL, §2s1.3(b)(1),(2) and (3) (2008).

[292] *See* Jack Townsend, *Federal Tax Crimes* blog, at *http://federaltaxrimes.blogspot.com/2009/09/,* for an excellent review of DOJ FBAR plea agreements (hereinafter referred to as "Townsend Blog").

[293] *See* Townsend Blog.

[294] *Booker v. U.S.,* 543 US 220 (2005).

[295] Stop Tax Haven Abuse Act, S. 681, 110th Congress, 1st Sess. (Feb. 17, 2007).

[296] U.S. Department of the Treasury, General Explanations of the Administration Fiscal Year 2010 Revenue Proposals (May 2009), available at *www.treas.gov/offices/tax-policy/library/grnbk09.pdf.*

[297] *Supra* note 291.

[298] IRS Frequently Asked Questions #3 (June 24, 2009).

[299] IRS Frequently Asked Questions #18 (June 24, 2009).

[300] IRS Frequently Asked Questions #19 (June 24, 2009).

[301] IRS Frequently Asked Questions #9 (June 24, 2009).

[302] It is not presently clear whether a taxpayer who willfully failed to file FBARs should consider using the VDP to avoid possible penalties,

notwithstanding the flush language at the bottom of the answer to Question #9 that the IRS will not impose a penalty for failure to file the FBARs.

[303] *See* Linda E. Stiff, *Memorandum Authorizing Application of Penalty Framework,* Mar. 23, 2009, at 2, which provides, "If, (a) the taxpayer (i) did not open or cause any accounts to be opened or entities formed (b) there has been no activity in any account or entity (no deposits, withdrawals, etc.) during the period the account/entity was controlled by the taxpayer and (c) all applicable taxes have been paid on the funds in the accounts/entities (where only account/earnings have escaped U.S. taxation), then the penalty in (3) is reduced to 5 percent."

[304] IRS Frequently Asked Questions #10 (June 24, 2009).

[305] IRS Frequently Asked Questions #12 (June 24, 2009).

[306] IRS Frequently Asked Questions # 5 (June 24, 2009).

[307] IRM §9.5.11.9(2).

[308] *Id.*

[309] IRM §9.5.11.9(3).

[310] IRS Frequently Asked Questions #27 (June 24, 2009).

[311] IRM §9.5.11.9(4).

[312] IRS Frequently Asked Questions #17 (June 24, 2009).

[313] IRS Frequently Asked Questions #25 (June 24, 2009).

[314] IRS Frequently Asked Questions ##21, 22 (June 24, 2009); Laura Saunders, *IRS Gets Tougher on Offshore Tax Evaders,* Wall St. J., July 20, 2009. Source of list: George Clarke of Miller & Chevalier.

[315] IRS Frequently Asked Questions #2 (June 24, 2009).

[316] *See* Tax Analysts, Trac Reports. The total number of prosecutions brought by the IRS nationally in fiscal 2008 was 1,368, an increase of 8.7 percent over the 1,259 such prosecutions reported for fiscal 2001 (2009) *www.taxanalysts.com/www/tracreports.nsf/Lookup/.*

[317] Lynnley Browning, *Deal on Names Cracks At Swiss Banks,* N.Y. Times, Aug. 20, 2009, at 1.

[318] Corporations and other organizations can be held liable for the criminal acts of their directors, employees or agents. In June 1999, the U.S. Department of Justice created an additional incentive for corporations to implement robust compliance programs when it instructed federal prosecutors to consider the existence of an organization's compliance programs in determining to charge an organization for the misconduct of its employees or agents. *See* U.S. Attorney's Manual, *Principles of Federal Prosecution of Business Organizations,* §9-28.800 (2008). The Sentencing Commission in response to a directive in the Sarbanes-Oxley Act undertook a major revision to the definition of an effective compliance program and how it would impact a corporation's sentence under the Sentencing Guidelines. These revisions reflected the public's reaction to the corporate frauds that had dominated the news and now require a corporation's board of directors to be knowledgeable about the content and operations of any compliance and ethics program and to maintain reasonable oversight with respect to the implementation and effectiveness of the program. In addition, the person assigned day-to-day operations of a compliance and ethics program was required to report directly to the board or an appropriate subcommittee of the board. In order for a compliance program to qualify for a sentence reduction, there must be an effective program to prevent and detect violations. According to the Sentencing Guidelines, an effective compliance program "shall be reasonably designed, implemented and enforced so that the program is generally effective in preventing and detecting criminal conduct." *See* USSG §8B2.1(a)(2). *See also* Jeffery M. Cross and Marc H. Kallish, *The Definition of an Effective Compliance Program Under the Sentencing Guidelines: A Template for Use Beyond the Guidelines,* Corporate Compliance and Ethics Institute 2009, Practising Law Institute Course Handbook Series Number B-1731 (2009); and Rebecca Walker, *The Evolution of the Law of Corporate Compliance in the United States: A Brief Overview,* Corporate Compliance and Ethics Institute 2009, Practising Law Institute Course Handbook Series Number B-1731 (2009); and Corporate Compliance and Ethics Institute 2009, Practising Law Institute.

[319] The Qualified Intermediary, or QI, program was intended to put the burden of information reporting and withholding tax returns on the foreign financial institutions who were presumably closer to their customers under KYC principles. The theory being that the foreign financial institutions would not only be in the best position to collect the required documentation (*e.g.,* Forms W-8s, W-8BENs, W-8IMYs or W-9s), but would also be able to verify that such information about their clients was correct. The QI would agree to assume responsibility for obtaining documentation from its customers covered by the QI agreement with the IRS and to substantiate the status of its customers as the beneficial owners of such income. However, in a telling exception, the QI rules under current law continue to treat a foreign corporation as such for U.S. tax purposes, even though it was beneficially owned by U.S. persons (absent actual knowledge that the beneficial owners were U.S. persons). This would hold true even though the foreign corporation was located in a tax haven. Under the QI regulations, the foreign financial institution or clearing house (or foreign branch or office of a U.S. financial institution or clearing house) would enter into a contract with the IRS, agree to verify the identities and beneficial ownership of its customers (and generally not look beyond the customers' foreign entities in which they had an ownership interest) and be subject to an annual audit by an external auditor. Unless the QI had agreed to assume the U.S. withholding responsibilities, which was atypical, it would certify to the U.S. withholding agent or payor as to the amount of withholding (or reduced treaty rate) by providing withholding rate pool information as to the portion of each payment that qualifies for exemption or a reduced rate of withholding. Thus, identifying customer information was effectively shielded from both the IRS, as well as the U.S. withholding agent with respect to foreign persons, although the QI was generally required to provide Form W-9s to the withholding agent so that it could provide 1099s to its U.S. customers. *See* Reg. §1.1441-1(e)(5); Announcement 2000-48, 2000-1 CB 1243; Reg. §1.1441-1(e)(5)(ii); Rev. Proc, 2000-12, 2000-1 CB 387, *supplemented by* Announcement 2000-50, 2000-1 CB 998, and *modified by* Rev. Proc. 2003-64, 2003-2 CB 306; Rev. Proc. 2005-77, 2005-2 CB 1176; Rev. Proc. 2002-55, IRB 2002-35, 435; Rev. Proc. 2000-55, IRB 2002-36, 481; Rev. Proc. 2002-35, IRB 2002-2, 1187. T.D. 8881 (May 16, 2000).