

IRS GUIDANCE ON FBAR PENALTIES

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On May 13, 2015, the IRS issued interim guidance to its examiners regarding penalties for failure to timely file the Report of Foreign Bank and Financial Accounts (FBAR). By no later than May 13, 2016, this interim guidance will be incorporated into the existing guidance in Internal Revenue Manual (IRM) sections 4.26.16 and 4.26.17. The guidance was effective upon issue, and it applies to all open cases; it is intended to procedurally improve the administration of the IRS's FBAR compliance program. The guidance has been welcomed by practitioners and apparently responds to concerns that FBAR penalties were excessive, in violation of the us constitution's eighth amendment.

Every US citizen and resident must file an FBAR annually if he or she has in aggregate more than \$10,000 in non-US bank and financial accounts. The IRS was delegated the authority to assess FBAR civil penalties and may impose wilfulness or non-wilfulness penalties for FBAR violations. A non-wilfulness penalty should not be imposed if the violations were due to reasonable cause and the person later filed a correct and complete FBAR. According to the IRM, an annual penalty is determined per unreported account, not per unfiled FBAR, and for each person who must file. The limitation period for the imposition of FBAR penalties ends six years from the report's due date (June 30 following the relevant year). The graduated structure of the wilfulness and non-wilfulness penalties depends on (1) the aggregate of the highest annual balances in all accounts and (2) the highest annual balance in each account. The per-account maximum wilfulness penalty set out in the IRM is the greater of \$100,000 and 50 percent of the account's closing balance on the last day for filing the FBAR; the maximum non-wilfulness penalty is \$10,000. An IRS examiner is expected to exercise discretion and take into account each case's unique facts and circumstances in determining the applicability and quantum of penalties. However, before the new guidance was issued, examiners apparently imposed the maximum wilfulness or non-wilfulness penalty annually on a per-account basis as a matter of course.

The new guidance provides that, in most cases, the total wilfulness penalty amount for all years under examination is limited to 50 percent of the annual highest aggregate balance of all unreported foreign financial accounts during those years. For example, the total wilfulness penalty is \$50,000 if in the six years under examination

Attorneys

James Bandoblu Jr.

Practices & Industries

Canada-U.S. Cross-Border

International Tax



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the highest aggregate balance in one year is \$100,000. On the basis of the facts, an examiner may recommend a penalty higher or lower than 50 percent of the annual highest aggregate account balance of all unreported foreign financial accounts, but the total penalty cannot exceed 100 percent of the annual highest aggregate balance of all those unreported accounts during the years under examination.

In contrast, in most multiple non-wilfulness violations, an examiner will recommend one penalty for each open year, regardless of the number of unreported accounts. The penalty for a year, which is determined first on the aggregate highest balance of all unreported accounts, is limited to \$10,000. However, the facts (including a consideration of the conduct of the would-be filer and his or her unreported accounts' aggregate balance) may indicate that a non-wilfulness penalty for each year is not warranted: in that case the examiner, with the group manager's approval and after consultation with an Operating Division FBAR coordinator, may assert one penalty of no more than \$10,000 and for one year only. Moreover, the facts may indicate that a separate non-wilfulness penalty is warranted for each account annually; the examiner may assert such a penalty on approval, but the total penalties for non-wilful violations cannot exceed 50 percent of the annual highest aggregate balance of all unreported accounts for the years under examination.

In summary, under the new guidance the wilfulness penalty is generally 50 percent of the annual highest aggregate balance of all unreported accounts during the years under examination, and the cap is 100 percent of that aggregate. The non-wilfulness penalty is generally a single penalty of \$10,000 annually for each year under examination, regardless of the number of accounts; the cap is 50 percent of the annual highest aggregate balance of all unreported accounts for the years under examination.

The guidance changes the analysis that practitioners and taxpayers must undertake to assess the penalty exposure when considering available options for rectifying FBAR noncompliance. Under the new guidance, an individual who previously may have considered the streamlined domestic offshore procedures or the offshore voluntary disclosure program (OVDP) may instead choose to proceed with the IRS's delinquent FBAR submission procedures, and current OVDP participants may choose to opt out of that program. Regardless of its practical impact, the guidance provides helpful insight into IRS procedures and tacitly acknowledges that the IRS generally is of the view that the FBAR penalty regime was too harsh.