

FBAR vs. Form 8938

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Summary

Do we really have to file both the FBAR and Form 8938?! The consequences of noncompliance can be severe. This session breaks down the filing requirements for each, distinguishes between foreign accounts and foreign assets, and reviews the reporting thresholds. You'll learn what you must do to ensure that your clients satisfy their foreign reporting obligations and what to do if they don't.

The information contained herein is for educational use only and should not be construed as tax, financial, or legal advice. Each individual's situation is unique and may require specialized treatment. It is, therefore, imperative that you consult with tax and legal professionals prior to implementation of any strategies discussed.

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I. Introduction

No more “secret” Swiss bank accounts! In January 2016, HSZH Verwaltungs AG became the 78th bank to join the US Department of Justice’s Swiss Bank Program which allows banks to avoid criminal prosecution in exchange for providing complete disclosure of all cross-border activities, detailed account information for accounts in which US taxpayers have an interest, as well as information about other banks which transferred or accepted funds when secret accounts were closed.¹

Gone are the days of hiding money abroad. Whether by corporate decision to cooperate with US tax prosecutors or by multi-national agreement between governments, the time has come for US taxpayers to come clean. As of May 2016, 101 countries have signed the Convention on Mutual Administrative Assistance in Tax Matters, thereby committing to information sharing to combat tax avoidance and evasion.²

“International laws, whistleblower bounties and embarrassing data breaches such as the one being dubbed the Panama Papers³ have made the lives of would-be US tax cheats increasingly perilous.”⁴ To date, more than 54,000 taxpayers have voluntarily disclosed previously hidden offshore accounts and paid over \$8 billion in back taxes, interest and penalties.⁵ Those who have not (yet) disclosed foreign accounts and assets face stiff penalties and potential criminal prosecution. That means that time is up!

II. Reporting Requirements for Foreign Accounts and Assets

A. Foreign Accounts

Mandated by the Bank Secrecy Act of 1970,⁶ a US person must file a report (**FinCEN 114**) with the US Treasury if, at any time during the calendar year, he had a financial interest in or signatory authority over one or more foreign financial accounts with an aggregate value of \$10,000 or more.

B. Foreign Assets

In addition to foreign account reporting, certain taxpayers may be required to file supplemental forms. Indeed, some reporting requirements may seem annoyingly duplicative but are nevertheless required based on differing legislative mandates and regulatory oversights. As an example, **FinCEN 114** must be filed with the US Department of Treasury while **Form 8938 Statement of Specified Foreign Financial**

¹ The US Department of Justice, *Swiss Bank Program* [available at <https://www.justice.gov/tax/swiss-bank-program>, last accessed May 17, 2016].

² Byrnes, *Bahrain, Lebanon, Nauru, Panama and Vanuatu Have Now Committed to the International Standard of Automatic Exchange of Financial Account Information to Tackle Tax Evasion and Avoidance* (May 14, 2016).

³ A trove of 11.5 million files leaked from the world’s fourth largest offshore law firm, Mossack Fonseca, identifying international politicians, business leaders and celebrities involved in suspicious financial transactions.

⁴ Higham, *For US Tax Cheats, Panama Papers Reveal a Perilous New World*, The Washington Post (April 8, 2016).

⁵ IR-2015-116.

⁶ Codified as Title 31 of US Code.

Assets must be submitted to the IRS along with the taxpayer's income tax return;⁷ yet both forms report almost identical information to the regulatory authorities.

III. Foreign Bank Account Report (FBAR)

A. FinCEN114⁸

This form has replaced **Form TD F 90-22.1 Report of Foreign Bank and Financial Accounts** (FBAR) effective April 2013. It must be *electronically* filed.

B. Definitions

A US person is defined as a US citizen or resident⁹ or any entity created (organized) under US law.¹⁰ The actual tax status of the "person" is disregarded for purposes of foreign account reporting compliance.

Signature authority allows an individual to control the disposition of assets by written or oral communication. Authority may be exercised alone or in conjunction with others. Accounts may have multiple signatories and all will be required to comply with foreign account reporting requirements. **NOTE:** If the US person cannot directly access the foreign account but must, instead, communicate through a US entity or branch, no FBAR filing is required.

Financial interest means that the US person holds title to the account directly, is the beneficial owner of an account held by a third party, or holds title indirectly (e.g. through majority ownership of an entity that holds title to the account).

A foreign account is any account held outside of the US. **EXCEPTION:** An account in an institution known as a US "military banking facility" is not considered to be an account in a foreign country, regardless of its geographic location.

Financial accounts may include monetary and non-monetary assets (e.g. banks, brokerage accounts, insurance cash values, annuities, mutual funds, online gambling accounts,¹¹ amongst others). Real and personal property is generally not included.¹²

⁷ IRC §6038D.

⁸ FinCEN = Financial Crimes Enforcement Network.

⁹ For purposes of determining residency, the US includes the 50 states, the District of Columbia, Indian lands as defined by the Indian Gaming Regulatory Act of 1988, as well as all US territories (American Samoa, Northern Mariana Islands, Puerto Rico, Guam and the US Virgin Islands) and US possessions [IRC §7701(b)].

¹⁰ Entities include, but are not limited to corporations, partnerships, limited liability companies, trusts and estates. **NOTE:** An entity disregarded for income tax purposes is nevertheless subject to the foreign account reporting mandate.

¹¹ *US v Hom*, US District Court, N.D. California, Case No. 3:13-cv-03721 (June 4, 2014).

¹² In response to an inquiry from *Forbes*, the IRS issued this statement: "The Financial Crimes Enforcement Network, which issues regulatory guidance pertaining to reports of Foreign Bank and Financial Accounts (FBARs), is not requiring that digital (or virtual) currency accounts be reported on an FBAR at this time but may consider requiring such accounts to be reported in the future." [Erb, *IRS Says Bitcoin Not Reportable on FBAR* (June 30, 2014)].

C. Rules

Valuation

Each account must be valued separately at its highest value as reported to the account holder on periodic statements, regardless of when the valuation was achieved during the calendar year. The value must then be converted to US currency using the applicable exchange rate on December 31.¹³ After each separate account has been valued and converted, all account values are aggregated to determine whether the foreign account reporting threshold (\$10,000) has been met for the reporting period.

Joint and Consolidated Reporting

Spouses may file a single, combined FBAR to report jointly-held accounts if all foreign accounts are in fact held jointly. However, if either spouse also holds one or more separately-held accounts, each spouse must file a separate FBAR which then includes the *entire* value of each jointly-held account.

Entities of all types may file consolidated reports. Truncated filing is permitted for more than 25 foreign accounts.

Exceptions

The following persons are not required to file an FBAR:

- Participants and beneficiaries of tax-qualified retirement plans.
- A trust beneficiary with a greater than 50% interest in a US trust's assets if the trust has filed an FBAR.
- A US entity that is named in a consolidated FBAR filed by a greater than 50% owner.
- Individuals who have signature authority but no financial interest in a foreign account if the individual is an officer or employee of a regulated bank, an SEC-regulated financial institution or a listed stock exchange and the account is owned or maintained by the bank, financial institution or exchange.

Recordkeeping

Records of accounts required to be reported on an FBAR must be kept for five years from the due date of the report and must include the account owner's name, the account number, the name and address of the financial institution at which the account is held, the type of account, and its maximum value during the calendar year. **NOTE:** Maintaining a copy of the submitted FBAR satisfies this recordkeeping requirement.

D. How to File

Due Date

The annual reporting cycle is on a calendar year basis (January to December). In the past, the deadline for filing **FinCEN 114** has been June 30th following the reportable calendar year. No extension was available. However, for reportable years 2016 and beyond, the due date of the FBAR has been accelerated and is now April 15th. Taxpayers may request a 6-month extension, although guidance has not yet been published whether the extension may be requested in conjunction with the filing of an income tax extension or whether a separate FinCEN filing will be required. Taxpayers

¹³ The Bureau of the Fiscal Service provides current and historical exchange rates to be used to convert foreign currency into US dollars [available at https://www.fiscal.treasury.gov/fsreports/rpt/treasRptRateExch/treasRptRateExch_home.htm, last accessed May 12, 2016]. In the alternative, any other verifiable exchange rate may be used if its source is disclosed on the FBAR.

residing abroad are granted an automatic extension until June 15th and may then apply for an additional 4-month extension.¹⁴

NOTE: FBARs for calendar year 2015 are due June 30th, 2016. FBARs for calendar year 2016 are due April 15th, 2017. First-time filers are entitled to penalty waiver relief if they mistakenly file late but submit the requisite FBAR on or before October 15th.

Mandatory e-File

Filers have the option to prepare and submit individual reports online at <http://bsae filing.fincen.treas.gov/NoRegFBARFiler.html> or engage the services of a Bank Secrecy Act (BSA) e-Filer.¹⁵ Step-by-step instructions are available online to enroll in the BSA e-filing system as a Supervisory User with primary responsibility for the preparation and submission of all BSA filings by authorized users within a professional organization. Users may submit single reports or process multiple reports in batches through third-party software. Acknowledgments of all filings are sent to the user's secure inbox.

Form 114a Record of Authorization to Electronically File FBARS must be completed and signed by the client to authorize a registered BSA user to e-file on the client's behalf. The signed form must be kept on file for 5 years.¹⁶

Corrections to previously filed reports may be made by opening the saved file, checking the box at the top of the form marked "Amendment", making the necessary corrections on affected lines of the form, entering the current date, saving the changes as a new file, and resubmitting the form electronically.

IRS Helpline

- (866) 270-0733 for callers within the US (toll-free)
- (313) 234-6146 for callers outside of the US (not toll-free)

E. Penalties

Unintentional failure to file may result in a maximum fine of \$10,000 per account that was not reported. However, if the government can prove that there was "willful violation" of the filing mandate, the penalty can be raised to the greater of \$100,000 or 50% of the account value, along with potential criminal sanctions (maximum \$250,000) and/or up to five years jail time.¹⁷ The "willful" penalty is computed on a *per year* basis for up to six tax years!

To impose the "willful" penalty, the government must prove that failure to file was the result of the taxpayer's voluntary, conscious and intentional act. The Supreme Court explained that the term willful "consistently has been read by the Courts of Appeal to require both knowledge of the reporting requirement and a specific intent to commit the

¹⁴ The Surface Transportation and Veterans Health Care Choice Improvement Act of 2015.

¹⁵ Some professional tax preparation packages offer FBAR e-filing which eliminates the need to enroll with the BSA System.

¹⁶ 31 CFR 1010.430(d).

¹⁷ If other laws have been violated, the criminal penalty may be increased to \$500,000 and/or 10 years in jail.

crime.”¹⁸ The IRS Internal Revenue Manual goes a step further by suggesting that “willfulness may be attributed to a person who has made a conscious effort to avoid learning about the FBAR recordkeeping requirements.”¹⁹

FBAR failure to file penalties should not be taken lightly: In a well-publicized case,²⁰ penalties totaling \$3.4 million were assessed against a taxpayer who failed to disclose his Swiss bank account which, at its highest, had a balance of only \$1.7 million. By applying the 50% penalty to each year and aggregating the years in question, the taxpayer faced a total penalty that was more than double his account holdings!²¹

NEW in 2015: The IRS has issued guidance to its employees²² in an attempt to rein in FBAR penalties which were found in the National Taxpayer Advocate’s 2014 annual report to Congress to be excessive and disproportionate. As a result, the penalty for willful violations over a period of multiple years will be limited to 50% of the highest-ever aggregate balance of all unreported foreign accounts; this penalty, then, will be the maximum amount that can be assessed and will be allocated on a pro-rata basis for each year of failure.

A US taxpayer willfully failed to report foreign accounts totaling \$200K in 2015, \$100K in 2014 and \$50K in 2013. The maximum penalty that the IRS will assess totals \$100,000 (= 50% of \$200K), which will be allocated as follows: \$57,143 for 2015 (= $\$200K \div \$350K \times \$100K$); \$28,571 for 2014 (= $\$100K \div \$350K \times \$100K$); and \$14,286 for 2013 (= $\$50K \div \$350K \times \$100K$).

For non-willful violations, the penalty will generally be limited to \$10,000 for each year, regardless of the number of accounts that were not reported. The examiner may waive the penalty altogether if failure to timely file the requisite FBAR was due to reasonable cause and the taxpayer has since corrected the oversight.

In the case of co-owned accounts, penalties will be assessed against each co-owner independently based on individual facts and circumstances. The penalty will be based on the highest balance of the unreported account(s) and prorated for the co-owner’s ownership percentage.

REMINDER: Taxpayers must also report interest and dividend income received from foreign sources on **Form 1040, Schedule B** and must check the box in Part III, Line 7 as “Yes” if the aggregate value of all foreign accounts was equal to or greater than \$10,000 at any time during the year.

SAFE HARBOR: Presuming that the taxpayer has in prior years reported and paid the tax on income earned from foreign accounts but did not file the required FBARs, the IRS

¹⁸ *Ratzlaf v United States*, 114 S. Ct. (1994).

¹⁹ Rettig, *Jury Determines 150-Percent FBAR Penalty and US Seeks FBAR Related Forfeiture of \$12 million!*, Journal of Tax Practice and Procedure (June-July 2014).

²⁰ *United States v. Carl R. Zwerner*, Case # 1:13-cv-22082-CMA (SD Florida, June 11, 2013).

²¹ On appeal a jury reduced the penalty to \$2.2 million; the taxpayer eventually settled with the IRS for a mere \$1.8 million, still more than the maximum account value at any time during the taxpayer’s tenure.

²² IRS Internal Memorandum SBSE-04-0515-0025 (May 13, 2015).

recommends that he should file the delinquent FBARs along with a statement explaining why the submissions are tardy. As per the IRS website, “the IRS will not impose a penalty” under this procedure if the taxpayer has “not previously been contacted regarding an income tax examination or a request for delinquent returns for the years for which the delinquent FBARs are submitted.”²³

Statute of Limitations

Governed by Title 31 of the US Code,²⁴ penalties for failure to file a foreign bank account report are limited to a statute of six years from the due date of the FBAR, whether or not the form has been filed.²⁵ Therefore, it “appears that six years is a good benchmark on filing FBARs in non-criminal situations.”²⁶

F. Fixes for Failure to File

Various programs are available to allow delinquent taxpayers to become compliant. Taxpayers should seek legal counsel to determine which program (if any) is best suited to their specific situation.

1. Offshore Voluntary Disclosure Program (OVDP)

The program currently in effect is the fourth incarnation²⁷ to be offered by the IRS, allowing taxpayers who have failed to file requisite foreign account reports to provide full disclosure in exchange for reduced civil penalties and no criminal prosecution.²⁸

NOTE: Taxpayers already under civil examination or criminal investigation are ineligible for the program.

The penalty imposed under the OVDP is equal to 27.5% of the highest year’s aggregate value during the period covered by the voluntary disclosure – the most current 8 years.²⁹ The penalty amount is fixed and due at the time that the

²³ Delinquent FBAR Submission Procedures [available on at <https://www.irs.gov/Individuals/International-Taxpayers/Delinquent-FBAR-Submission-Procedures>, last accessed May 12, 2016].

²⁴ In contrast, the Internal Revenue Code (governed by Title 26) allows the IRS to assess penalties for an indefinite period of time if an income tax return has not been filed. Furthermore, the FBAR penalty is a civil – not a tax – penalty that can only be collected through a civil suit filed by the US Department of Justice. As a result, the penalty cannot be appealed to the Tax Court but may be dischargeable in bankruptcy.

²⁵ 31 US Code §5321.

²⁶ Cardoropoli, *FBAR Penalties*, NATP TaxPro, July 2015, p.4.

²⁷ The 2003 program was offered to taxpayers who used offshore credit, debit and other payment cards. The 2009 program was intended to encourage taxpayers who held Swiss bank accounts to come forward voluntarily before UBS was required to disclose the names of roughly 4,450 US clients. In 2011, taxpayers were encouraged to make voluntary disclosures of foreign accounts held in Israel, India, Hong Kong and Asia while the Department of Justice pursued HSBC, a financial services firm headquartered in the UK. The fourth OVDP became effective for all applications made on or after July 1, 2014.

²⁸ OVDP is available for all foreign reporting delinquencies, including **Forms 8938, 3520 and 5471**, as well as **FinCEN 114**.

²⁹ In fact, 27.5% merely represents the base penalty which may be increased to 50% for any foreign financial account that was held at a bank that is already under or cooperating with a government investigation [IR 2014-73].

requisite amended returns are filed; IRS examiners have no authority or discretion to negotiate alternate penalty amounts.

NOTE: OVDP participants must also file amended income tax returns to report previously omitted income associated with the foreign accounts. Taxpayers will be liable for the full amount of taxes owed, plus interest and a 20% accuracy-related penalty on any under-paid amount.³⁰

Process

Step 1: Taxpayers who wish to participate in the program should begin with a pre-clearance request, along with an executed power of attorney (if represented). In the case of jointly filed returns, each spouse should request pre-clearance. The forms should be faxed to the IRS Criminal Investigation Lead Development Center at (267) 941-1115. While pre-clearance does not guarantee OVDP acceptance, it helps to streamline the process by providing basic taxpayer and foreign account information to the tax authority.

Step 2: Upon receipt of the pre-clearance notification, the taxpayer has 45 days to submit **Form 14457 Offshore Voluntary Disclosure Letter** and **Form 14454 Attachment to Offshore Voluntary Disclosure Letter** (one per financial account) to:

Internal Revenue Service
3651 S. IH 35 - Stop 4301 AUSC
Austin, TX 78741
ATTN: 2014 Offshore Voluntary Disclosure Initiative

Criminal Investigations will review the submission and respond within 45 days indicating preliminary acceptance into the program and requesting further documentation and payment of the total amount of tax, interest and penalties within 90 days.

Step 3: A civil examiner will be assigned to complete the certification of the taxpayer's returns for accuracy, completeness and correctness; a process that is less formal than an audit and does not carry with it all the rights and legal consequences of an examination.

There is no definitive time limit specified for approval or denial of the OVDP request; cases are handled on a first-come, first-served basis.

2. The Streamlined Disclosure Program (SDP)

In 2014,³¹ the IRS introduced a new program for resident and non-resident taxpayers whose failure to comply with FBAR filing requirements was not willful. In fact, the SDP requires taxpayers to sign a self-certifying statement under penalty of perjury that "failure to report all income, pay all tax, and submit all required information returns, including FBARs, was due to non-willful conduct

³⁰ IRC §6662.

³¹ IR 2014-73.

[which was the result of] negligence, inadvertence, mistake or conduct that is the result of good faith misunderstanding of the requirements of the law.” **NOTE:** False certification will expose the taxpayer to civil fraud penalties.

Although the IRS will not impose accuracy-related, information return or FBAR penalties on SDP participants, US taxpayers will nevertheless be subject to a “miscellaneous” penalty equal to 5% of the highest aggregate balance of the taxpayer’s foreign accounts during the most recent six-year period. US taxpayers who lived abroad in any one or more of the most recent three years are exempt from the penalty.

While SDP offers participants the benefit of simplified reporting and reduced penalties, taxpayers should beware that the program is only available to those who acted unintentionally. Regulatory interpretation of willful and fraudulent conduct may differ from the taxpayer’s understanding and lay opinion; expert counsel should be engaged prior to SDP submission.

Taxpayers who are already participating in the OVDP process but have not yet signed a final closing agreement, may request reduced penalty treatment under SDP if they can satisfy (and certify) the non-willfulness standard.³²

3. The Delinquent Information Return Program (DIRP)

If a taxpayer properly included all foreign account income on his originally-filed returns and paid the tax for all years but did not file the required foreign bank account reports, he may simply file the omitted returns as soon as possible. The IRS will not impose failure-to-file penalties on delinquent or late-filed reports if the taxpayer has no outstanding tax liabilities and is not being audited.³³ **BEWARE:** The IRS has taken the position that even a single dollar of unreported income can make a taxpayer ineligible for penalty-free disposition.³⁴

	No Program	OVDP	SDP	DIRP
Penalty	\$10K per acct/yr if unintentional; \$100K or 50% of high balance if willful <i>plus</i> \$250K crim. penalty &/or max 5 years jail [albeit subj. to limits as per IRS]	27.5% of highest balance (max 50% if foreign bank under investigation)	5% of highest balance	None if all income was reported; otherwise \$10,000/violation
Penalty Negotiable	Yes	No	No	Yes
Number of past FBARs required to be filed	6	8	6	No guidance given
Possible criminal prosecution	Yes	No, if accepted into program	Yes	Yes

³² In prior years, participants who wished to discontinue the OVDP process were forced to “opt-out” of the program in hopes of negotiating more favorable settlement terms.

³³ FAQ 17, Offshore Voluntary Disclosure Program FAQs [available at <http://www.irs.gov/Individuals/International-Taxpayers/Offshore-Voluntary-Disclosure-Program-Frequently-Asked-Questions-and-Answers>, last accessed May 13, 2016].

³⁴ Fisher and McManus, *Offshore Voluntary Disclosure: IRS simplifies path back to tax compliance*, NATP TAXPRO Journal (Fall 2014).



PRACTITIONER WARNING: Because the penalties are high and the consequences extreme, practitioners should beware of offering advice outside of their areas of expertise and should instead refer clients with unreported foreign accounts and/or income to a competent tax attorney.

I was cc'd on a tax attorney's recent request for counsel from fellow attorneys: "I just picked up a case [in which] my client is in the process of being hit with a FBAR penalty in excess of \$4,000,000. [During the] civil audit (most likely sparked by the client's name being turned over in an investigation of UBS) it was discovered that [he] had made a quiet disclosure... The CPA [who] took the client through the quiet disclosure told the IRS that he was unfamiliar with the offshore voluntary disclosure program; [t]his looks like a malpractice case on a silver platter against the CPA."

G. The Trouble with the FBAR

Although the FBAR filing requirement has been mandated since 1970 to help combat money laundering and related financial criminal activities, the rule was only sporadically enforced. When Congress linked the FBAR to its counter-terrorism efforts in 2004 but failed to adjust the decades-old filing threshold,³⁵ ordinary and unsuspecting taxpayers were soon ensnared in the sticky web of foreign account reporting.

Often oblivious to a filing requirement that is separate and distinct from income tax reporting, taxpayers with no criminal intent whatsoever who live, work and study abroad are surprised to discover that they have inadvertently overlooked an important filing obligation. For these individuals, "FBAR noncompliance constitutes nothing but a paperwork crime."³⁶ On the other hand, those who comply find that they must submit personal information to a federal financial crimes enforcement registry!

IV. Foreign Asset Reporting

A. Form 8938, Statement of Specified Foreign Financial Assets

The **Form 8938** filing requirement was enacted in 2010³⁷ to improve tax compliance by US taxpayers with offshore financial accounts.³⁸ US citizens, residents, non-residents who elect to file a joint return with a US citizen or resident, and certain non-residents who live in a US territory must file if the total value of specified foreign assets exceeds specified thresholds. **Form 8938** must be filed along with the taxpayer's income tax return. If the taxpayer is not required to file an income tax return, he does not have to file **Form 8938**.

³⁵ The FBAR threshold has been fixed at a mere \$10,000; far lower than the income tax filing threshold for most taxpayers which tops out at more than double that amount for married taxpayers in 2015.

³⁶ Christians, *Paperwork and Punishment: It's Time to Fix FBAR*, Tax Analysts (October 13, 2014).

³⁷ Hiring Incentives to Restore Employment Act of 2010 (HIRE).

³⁸ The Foreign Account Tax Compliance Act (FATCA), enacted as part of HIRE, is intended to apply to "specified entities" as well as individuals. Prop. Reg. §1.6038D-6 was introduced to establish conditions under which a domestic entity would be required to file **Form 8938**. The implementation of reporting requirements for domestic entities and trusts was temporarily postponed as per IRS Notice 2013-10 but new rules have since been issued and are effective for tax years 2016 and beyond. Therefore, any domestic corporation, partnership or trust "formed or availed of for purposes of holding, directly or indirectly, specified foreign financial assets", is now subject to the reporting mandate [IRC §6038D].

NOTE: The filing thresholds are higher for taxpayers who live abroad (referred to as “foreign” taxpayers) than for those who live in the US (“domestic” taxpayers).

B. Reportable Assets

Specified foreign financial assets include:³⁹

- Depository or custodial accounts at foreign financial institutions
- Stocks or securities issued by foreign persons
- Foreign pension or deferred compensation plans⁴⁰
- Any other financial instrument or contract held for investment that is issued by or has a counter-party that is not a US person
- Any interest in a foreign entity⁴¹
- Gold certificates

Assets that do not have to be reported include:

- Foreign real estate (e.g., personal residence or rental property)⁴²
- Foreign currency holdings
- Directly held shares of a US mutual fund that owns foreign stocks and securities
- A financial account maintained by a US financial institution that holds foreign stocks and securities, such as IRAs, 401(k) plans, qualified US retirement plans, and brokerage accounts maintained by US financial institutions
- A financial account maintained by a US branch or US affiliate of a foreign financial institution
- A financial account (e.g., depository, custodial or retirement account) held through a foreign branch or foreign affiliate of a US-based financial institution
- Payments or the rights to receive the foreign equivalent of social security, social insurance benefits or another similar program of a foreign government
- Directly held tangible assets, such as art, antiques, jewelry, cars and other collectibles (once these assets are sold, the resulting proceeds become reportable)
- Directly held precious metals, such as gold

³⁹ IRC §1471(d).

⁴⁰ Canadian Registered Retirement Savings Plans (RRSP), for example, are reportable on **Form 8938** (and **FinCEN 114**). Such reporting should not be confused with income tax reporting requirements which have recently changed: As per the US-Canada Income Tax Convention Art. XVIII (7), US citizens and residents could previously elect to treat an RRSP in a manner similar to an IRA, thereby deferring tax on the income accrued under the retirement plan. The election was made by attaching **Form 8891 US Information Return for Beneficiaries of Certain Canadian Registered Retirement Plans** to a timely filed income tax return. Rev. Proc. 2015-55 has since eliminated the **Form 8891** filing requirement; in fact, **Form 8891** is now obsolete effective December 31, 2014. All taxpayers are now deemed to have made the election; thus, RRSP income is automatically tax-deferred in the same manner as other qualified US retirement account income.

⁴¹ IRC §6038D(b).

⁴² Non-Mexican citizens may not hold title to real property in Mexico within 100 km of international borders and 50 km of the coastline and are instead required to establish a Mexican Land Trust (MLT), also known as a “fideicomiso”. Upon purchase, legal title is transferred to a Mexican bank which acts as fiduciary but otherwise disclaims all responsibility for the property, allowing (forcing) the foreign buyer to pay maintenance, taxes and all expenses associated with his investment. Rev Rul 2013-14 clearly states that an MLT is not a “trust” for income tax purposes; hence, no **Form 8938** filing is required.

C. Filing Thresholds

The filing requirement applies only to US taxpayers, including US citizens and residents as well as certain non-resident aliens. Thus, the reference to “domestic” and “foreign” filers may be misleading. In fact, the terms merely distinguish between those US taxpayers who live in the US and those who live abroad.

Domestic Taxpayers

An individual taxpayer residing in the US must file **Form 8938** if he has an interest in one or more specified foreign financial assets with an aggregate value of either \$50,000 on December 31st or \$75,000 at any time during the year. Married individuals must file if they exceed the thresholds of \$100,000 and \$150,000, respectively.⁴³

Foreign Taxpayers

If residing abroad,⁴⁴ **Form 8938** must be filed if the taxpayer has an interest in one or more specified foreign financial assets with an aggregate value of either \$200,000 on December 31st or \$300,000 at any time during the year. Married individuals must file if they exceed the thresholds of \$400,000 and \$600,000, respectively.⁴⁵

	Single or MFS	MFJ
Domestic – living in the US	\$50K on 12/31 OR \$75K at any time	\$100K on 12/31 OR \$150K at any time
Foreign – living outside of the US	\$200K on 12/31 OR \$300K at any time	\$400K on 12/31 OR \$600K at any time

To avoid duplicative reporting, foreign financial assets that have been reported on other forms [listed in FN 46] do not also have to be reported on **Form 8938**.⁴⁶

The valuation of assets is based on the highest fair market value during the year, converted into US dollars at the applicable exchange rate on December 31st.⁴⁷

D. Penalties

Failure to disclose foreign assets may result in a maximum fine of \$10,000 plus an additional \$10,000 penalty for each 30-day period after IRS issues its 90-day failure to disclose notification. The maximum penalty equals \$50,000.⁴⁸

⁴³ Reg. §1.6038D-2T(a)(1), Reg. §1.6038D-2T(a)(2).

⁴⁴ “Foreign” taxpayers must satisfy the Bona Fide Residence (BFR) or Physical Presence (PPT) tests (IRC § 911). BFR requires that the taxpayer is a resident of one or more foreign countries for an uninterrupted period that includes an entire tax year. PPT requires that the taxpayer is present for at least 330 full days during any 12-month period that ends during the current tax year.

⁴⁵ Regulations have not clarified the filing thresholds for joint returns if one spouse resides abroad and the other lives in the US.

⁴⁶ **Form 926** Filing Requirement for US Transferors of Property to a Foreign Corporation, **Form 3520** Annual Return to Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts, **Form 5471** Information Return of US Persons With Respect, **Form 5472** Information Return of a 25% Foreign-Owned US Corporation or a Foreign Corporation Engaged in a US Trade or Business, **Form 8621** Information Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund, **Form 8865** Return of US Persons With Respect to Certain Foreign Partnerships.

⁴⁷ Taxpayer may use the Treasury Department Financial Management Service rate [Treas. Reg. §1.6038D-5T(c)].

⁴⁸ IRC §6038D(d).

Statute of Limitations

The statute for an income tax return (**Form 1040**) remains open until three years after an associated **Form 8938** with *all* reportable assets has been filed – if even just one asset is omitted, the entire return remains at risk! If failure to file **Form 8938** is due to reasonable cause, the open statute will apply only to the item(s) related to the failure.⁴⁹

If a taxpayer fails to report gross income in excess of \$5,000 attributable to reportable assets, the statute of limitations is extended to six years after the return was filed, whether or not the assets were reported on **Form 8938**.⁵⁰

E. Streamlined Offshore Compliance Procedure (SOCP)

In 2012, the IRS established procedures to help non-compliant taxpayers who live overseas and pose a “low compliance risk”⁵¹ to resolve their filing delinquencies.⁵² In 2014, the procedures were revised to also include taxpayers residing *in* the US and the low-risk criteria were removed. SOCP is available only to individual taxpayers and the estates of individual taxpayers whose failure to disclose was non-willful – defined as conduct that is due to negligence, inadvertence, or mistake or conduct that is the result of a good faith misunderstanding of the requirements of the law.⁵³ The penalty imposed on eligible taxpayers is limited to 5% of the highest aggregate balance of all unreported assets during the most recent six years, regardless whether the taxpayer failed to report the account on **FinCEN114**, the asset on **Form 8938**, and/or the income on **Form 1040**.⁵⁴ The SOCP-eligible taxpayer will not be subject to accuracy-related, information return or FBAR penalties, even if a return filed under the program is later audited, unless the examiner determines that the original return was fraudulent or the FBAR violation was willful.

Process for Domestic Taxpayers

Step 1: To participate in the program, the taxpayer must prepare **Form 1040X Amended US Individual Income Tax Return** for each of the three most recent years for which the (extended) due date has passed and attach the previously omitted foreign account reporting forms.⁵⁵ “Streamlined Domestic Offshore” should be clearly notated in red at the top of the first page of each amended return. **Form 14654 Certification by US Person Residing in the US for Streamlined Domestic Offshore Procedures** should be completed and attached to the amended returns, attesting that the taxpayer has now complied with all filing requirements and that his previous failure was not willful. The taxpayer must submit all tax due (plus penalties and interest) with the amended returns and should mail the complete packet to:

⁴⁹ IRC §6501(c)(8).

⁵⁰ Additionally, a penalty equal to 40% of the resulting under-payment of tax will be assessed [IRC §6662(b)(7)].

⁵¹ These taxpayers generally file simple returns and owe less than \$1,500.

⁵² IR 2012-65.

⁵³ IR 2014-73.

⁵⁴ Miscellaneous Offshore Penalty as per Title 26.

⁵⁵ **Form 8938** and/or other [see FN 46 for list of forms].

Internal Revenue Service
3651 South I-H 35 - Stop 6063 AUSC
ATTN: Streamlined Domestic Offshore
Austin, TX 78741

Step 2: The taxpayer should then *electronically* submit all delinquent FBARs for each of the most recent six years for which the filing deadline has passed, along with a statement that these reports are being filed as part of the SOCP.

Under the mandate, US citizens are required to file all delinquent tax returns for the past three years, as well as delinquent foreign account reports for the past six years. While the returns will be subject to examination, the IRS will not assess penalties or pursue follow-up actions. Taxpayers who present higher compliance risks will be subject to a more thorough review and an audit that might cover more than three years.

Process for Foreign Taxpayers

A US taxpayer who has resided abroad for at least 330 days in any of the most recent 3 years⁵⁶ may file under the Streamlined Foreign Program and be eligible for a *full* penalty waiver; although he will remain liable for any outstanding tax due. The filing process is identical to the domestic procedure outlined above in all manners except:

- The taxpayer should notate “Streamlined Foreign Offshore” at the top of each amended return.
- The taxpayer must complete **Form 14653 Certification by US Person Residing Outside of the United States for Streamlined Foreign Offshore Procedures** in lieu of **Form 14654**.
- The taxpayer should mail his completed packet to the same address but should send it ATTN: Streamlined Foreign Offshore.

NOTE: “Taxpayers who are in a situation where they are concerned about the risk of criminal prosecution should be advised that this new procedure does not provide protection from criminal prosecution if the IRS and Department of Justice determine that the taxpayer’s particular circumstances warrant such prosecution.”⁵⁷ These taxpayers should consult their legal advisers about the Offshore Voluntary Disclosure Program. However, once a taxpayer makes a submission under the new procedures [detailed in the prior paragraph], OVDP is no longer available. Furthermore, taxpayers who are ineligible to participate in OVDP are also ineligible to participate in the new procedure.



PRACTITIONER WARNING: In the event that an OVDP or SOCP application goes awry or the IRS finds cause to institute criminal proceedings, a taxpayer may only avail himself of privilege if he has in fact engaged an attorney during the application process. Taxpayers who were instead represented by EAs, CPAs and other non-attorney practitioners will not be protected under the attorney-client privilege; in that case, a practitioner may be forced to testify against his client.

⁵⁶ While non-residency is defined in IRC §911 for purposes of the Foreign Earned Income Exclusion, non-residency for purposes of the Streamlined Foreign Offshore Procedures is defined in Treas. Reg. 1.911-2(b). The distinction is critical in that the taxpayer may qualify for the income exclusion under either the Physical Presence Test (PPT) or the Bona Fide Residence Test but can only qualify for the streamlined program under the 330-day rule of the PPT.

⁵⁷ Excerpted from *New Help for US Citizens Overseas*, TheTaxBook News (June 28, 2012).

F. State Conformity

It is left to each state whether to conform to the federal FATCA reporting mandate. California, for instance, has elected to require foreign financial asset reporting from all California taxpayers – including residents, part-year residents and even non-residents who have a California filing requirement – beginning on January 1, 2016.⁵⁸ At this time, the state does not provide its own form and instead requires taxpayers to attach a copy of the federal **Form 8938** when submitting the state return. California has also conformed to the federal penalty structure for failure to comply with foreign asset reporting requirements; therefore, a delinquent taxpayer may find himself subject to a \$10,000 federal penalty as well as a \$10,000 state penalty. **NOTE:** California conformity is limited to FATCA reporting requirements and does not apply to the FBAR.

V. Is all this reporting working?

It is widely acknowledged that “offshore tax evasion is a significant contributor to the tax gap.”⁵⁹ A US Senate report estimates that more than \$100 billion of tax revenues are lost each year, giving the IRS plenty of incentive to pursue scofflaws and not-so gently prod these taxpayers to step forward voluntarily.⁶⁰

And as FATCA becomes the global standard in the universal battle against offshore tax evasion, increasing numbers of foreign governments continue to sign on through intergovernmental agreements (IGAs) which have been developed by the US Treasury to facilitate the exchange of tax information between countries. While Americans abroad were initially treated as pariahs and the embodiment of a banker’s record-keeping and reporting nightmare, many foreign regulatory authorities have recognized the power and benefit of international cooperation enabling governments to fill their own coffers with tax revenues that previously eluded detection.⁶¹

⁵⁸ Rev & Tax Code §19141.5(d).

⁵⁹ Stack, *Myth vs. FATCA: The Truth about Treasury’s Effort to Combat Offshore Tax Evasion* (September 20, 2013).

⁶⁰ The US Treasury Department reports that it received 1,163,229 FBARs in 2015 (up more than 8% from the prior year) although the US State Department estimates that roughly 7.6 million US citizens reside abroad who likely have foreign account reporting requirements. Form 8938 filings for tax year 2014 totaled a mere 300,000 (unchanged from the prior year). As our government brags about its successes and anticipates an as-yet untapped tax revenue stream, the *International Financial Law Prof Blog* suggests that “FATCA is a huge failure, a multi-billion dollar program that has not come close to producing its promised outcome” [Byrnes, *What do FATCA & St Patrick’s Day Have in Common? Leprechauns!* (March 17, 2016)].

⁶¹ Reuters reports that prosecutors in Germany have followed in US footsteps and launched their own proceedings against the Swiss Bank UBS, yielding criminal convictions in 14 cases and closing another 340 in exchange for fines totaling roughly \$18 million [*German prosecutors launch 2,000 tax cases against UBS clients* (January 14, 2016)]. The United Kingdom (UK) has formulated its own Swiss Disclosure Facility in hopes of closing its tax gap but admits to less success than initially anticipated [Byrnes, *UK Amnesty Not Leading to Disclosure of Tax Evasion in Channels* (July 21, 2015)].

APPENDIX A

Comparison of Form 8938 and FinCEN 114 Requirements⁶²

	Form 8938	FinCEN 114
Who Must File?	Specified individuals, which include US citizens, resident aliens, and certain non-resident aliens that have an interest in specified foreign financial assets and meet the reporting threshold	US persons, which include US citizens, resident aliens, trusts, estates, and domestic entities that have an interest in foreign financial accounts and meet the reporting threshold
Does the United States include US territories?	No	Yes, resident aliens of US territories and US territory entities are subject to foreign account reporting
Reporting Threshold (Total Value of Assets)	\$50,000 on the last day of the tax year or \$75,000 at any time during the tax year (higher threshold amounts apply to married individuals filing jointly and individuals living abroad)	\$10,000 at any time during the calendar year
When do you have an interest in an account or asset?	If any income, gains, losses, deductions, credits, gross proceeds, or distributions from holding or disposing of the account or asset are or would be required to be reported, included, or otherwise reflected on your income tax return	Financial interest: you are the owner of record or holder of legal title; the owner of record or holder of legal title is your agent or representative; you have a sufficient interest in the entity that is the owner of record or holder of legal title. Signature authority: you have authority to control the disposition of the assets in the account by direct communication with the financial institution maintaining the account.
What is Reported?	Maximum value of specified foreign financial assets, which include financial accounts with foreign financial institutions and certain other foreign non-account investment assets	Maximum value of financial accounts maintained by a financial institution physically located in a foreign country
How are maximum account or asset values determined and reported?	Fair market value in US dollars in accord with the Form 8938 instructions for each account and asset reported Convert to US dollars using the end of the taxable year exchange rate and report in US dollars.	Use periodic account statements to determine the maximum value in the currency of the account. Convert to US dollars using the end of the calendar year exchange rate and report in US dollars.
When Due?	By due date, including extension, if any, for income tax return	Received by June 30 (no extensions of time granted)
Where to File?	File with income tax return pursuant to instructions for filing the return	Must be electronically filed
Penalties	Up to \$10,000 for failure to disclose and an additional \$10,000 for each 30 days of non-filing after IRS notice of a failure to disclose, for a potential maximum penalty of \$60,000; criminal penalties may also apply	If non-willful, up to \$10,000; if willful, up to the greater of \$100,000 or 50 percent of account balances; criminal penalties may also apply

⁶² Available at <http://www.irs.gov/Businesses/Comparison-of-Form-8938-and-FBAR-Requirements> [last accessed May 17, 2016].

APPENDIX B
Options Available to FBAR Noncompliant Taxpayers⁶³

	OVDP	SDP	DIRP
Who may participate	Individuals, estates, partnerships, corporations and other entities	Individuals and estates	Individuals and estates
Willful failure to report	Eligible	Not eligible	Not eligible
Prior tax returns filed	Not required	Not required	Must have filed
Under IRS audit	Not eligible (even if taxpayer not aware of audit)	Not eligible	Not eligible
Must self-certify non-willfulness	Not required	Required	Required
File amended tax returns with payment	Required	Required	Required
Applicable penalty	27.5% of foreign financial assets (or 50% if bank publicly under investigation), plus standard tax penalties	None	5% of foreign financial assets
Required filings	Original or amended tax returns (8 years), FBARs (8 years) and other miscellaneous forms	Original or amended returns (3 years), FBARs (6 years)	Amended returns (3 years), FBARs (6 years)

⁶³ Fisher and McManus, *Offshore Voluntary Disclosure: IRS simplifies path back to tax compliance*, NATP TAXPRO Journal, Fall 2014.