FBAR Filing Fiascos Forthcoming? Blame Congress – Not the IRS

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Over the last 18 months, the IRS has issued significant guidance regarding Report of Foreign Bank and Financial Accounts or "FBAR" filing delinquencies. This guidance has been helpful for practitioners, providing additional options for taxpayers with FBAR filing delinquencies and clarifying the penalty calculations for FBAR violations.

However, the United States Congress recently decided to get into the FBAR game. On July 31, 2015, President Obama signed into law the Surface Transportation and Veterans Health Care Choice Improvement Act of 2015 (the "Surface Transportation Act"). Among other tax changes, this new law moves the FBAR filing deadline from June 30 to April 15, making it consistent with the filing due date for Form 1040. While this timing change may appear to reduce confusion, the new FBAR filing deadline may also create duplicative and unnecessary information reporting responsibilities for taxpayers. Thankfully, taxpayers and the IRS have until 2017 to work out the details.

IRS' Expansion of Voluntary Disclosure Program

The most important piece of recent IRS guidance on FBAR filings is likely the June 18, 2014 introduction of the Streamlined Filing Compliance Procedures for resident and non-resident taxpayers. These programs allow taxpayers to correct FBAR (and other information return) filing omissions at significantly reduced penalty rates compared with the traditional Offshore Voluntary Disclosure Program ("OVDP"), provided the reporting delinquencies were non-willful. Unlike the OVDP, where the penalty is 27.5% of the highest balance of taxpayers' "OVDP assets," taxpayers who qualify for one of the streamlined programs pay a penalty of 5% of the highest balance of their "foreign financial assets" if they are U.S. residents, and 0% if they are non-residents.

In addition, the definition of "foreign financial assets" used to compute the penalty owed under the streamlined programs is more limited than "OVDP assets" under the OVDP. For example, if a taxpayer directly owns foreign rental real property, and fails to report income from the property, the value of the property should be included in the penalty computation under the OVDP, pursuant to FAQ 36 of the OVDP FAQs. In contrast, under the

streamlined programs, “foreign financial assets” generally include only interests that are reportable on an FBAR or Form 8938. Because directly owned rental real property does not need to be reported on either of these forms, the value of that real property can properly be excluded from the penalty computation for resident taxpayers under the streamlined program.

FBAR Penalty Guidance

The IRS also recently published an administrative memorandum to IRS employees entitled Interim Guidance for Report of Foreign Bank and Financial Accounts (FBAR) Penalties. Dated May 13, 2015, this memorandum provides welcome clarification of the FBAR penalty rules for both practitioners and taxpayers. The memorandum confirms that, in cases of non-willful FBAR violations, agents should generally apply only one penalty for each open tax year, regardless of the number of unreported foreign financial accounts involved in the violation. While many practitioners viewed this as the correct application of the penalty rules, no prior IRS guidance squarely addressed it. Now, the IRS has clarified that non-willful FBAR violations should only subject a taxpayer to a maximum of $60,000 ($10,000 x 6-year FBAR statute of limitations), regardless of the number of unreported accounts.

The IRS memorandum also makes clear that, where an undisclosed foreign account has multiple owners, the IRS will make a separate determination of whether each co-owner of the account has a filing delinquency and whether that delinquency was willful or non-willful. While FAQs 39 and 40 of the OVDP FAQs indicate that each co-owner’s filing delinquency is analyzed independently, the IRS memorandum confirms that each co-owner is separately liable for penalties based on percentage of ownership and whether the delinquency was willful.

New FBAR Filing Deadline

Just as the IRS has continued to modify its guidance on FBAR violations, Congress has decided to tinker with the FBAR filing deadline. In Section 2006(b)(11) of the Surface Transportation Act, Congress made the FBAR filing deadline consistent with individual tax return filing requirements, and eliminated the current filing deadline of June 30. For foreign accounts held during 2016, the FBAR will now be due April 15, 2017, unless taxpayers extend their filing due date to October 15. Section 2006(b)(11) of the Surface Transportation Act further provides that the IRS may waive penalties for first-time FBAR filers who do not make a timely extension to file the FBAR.

The new law means that, for the first time, a FBAR filer may request a filing extension to keep the FBAR filing deadline aligned with the due date for the filer's income tax return. Instead of a separate filing on June 30, the FBAR will be filed at the same time as the taxpayer’s regular income tax return, whether the due date is extended for that return or not. The addition of a penalty waiver for first-time FBAR filers provides potential relief for individuals who acquire new foreign accounts and belatedly realize that such ownership creates FBAR filing obligations.

In general, the new deadline for 2016 and future FBARs streamlines the filing requirements. However, the new deadline also appears to create duplicative filing requirements with the Form 8938 – what some practitioners call the “super FBAR.” Introduced in 2011, the Form 8938 was intended to track much of the same information as the FBAR, but generally with higher value limits and a broader base of assets to be reported. The Form 8938 must be filed as part of a taxpayer’s return (whether on extension or not).

If the FBAR will be filed at the same time as the Form 8938, has the former become duplicative and unnecessary? In fact, Congress’s change in the FBAR filing deadline effectively requires taxpayers to file

identical information on two separate information returns at the same time.

A potential solution may be for the Form 8938 to exclude reporting of information that is subject to the FBAR filing requirements, as the Form 8938 currently does for certain other information reporting. In Part IV of the Form 8938, taxpayers who file other information returns indicate which additional returns were filed (for example, Form 5471 for controlled foreign corporations or Form 3520 for foreign trusts) and are not required to disclose the information from those returns on the Form 8938. If the IRS adds the FBAR to the list of other information returns in Part IV of the Form 8938, duplicative reporting may be avoided.

Conclusion

It is clear that the FBAR and other information returns regarding foreign interests are here to stay. The IRS and Congress will continue to modify these filing requirements, which could create potential pitfalls for taxpayers attempting to disclose their foreign interests. Taxpayers should consult with their advisors to ensure that they meet the most recent filing requirements and make all necessary disclosures.

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