Forbes

Robert W. Wood
THE TAX LAWYER

TAXES 6/02/2015

IRS Says If You're Willful, Penalties Hit 100%, $10,000 If You're Not

What's an FBAR? Now called FinCEN Form 114, an FBAR is a non-U.S. bank account report. If you have non-U.S. bank accounts that aggregate over $10,000 at any time during the year, you need to file one. You must file if you are a signatory even if the money is not yours beneficially.

FBARs are distinct from tax returns. You must report any income from the accounts on your 1040, even though the bank does not send out Forms 1099 like U.S. banks. And you must file an FBAR. Although FBARs have been required since 1970, they were not widely discussed until 2008 when the UBS offshore bank scandal exploded.

FBAR penalty exposure—civil and criminal—is quite high, worse than tax evasion. FBARs have figured prominently in offshore account cases, netting the IRS big penalties. As a result, most people with undisclosed offshore accounts since 2009 have gone into the IRS Offshore Voluntary Disclosure Program (OVDP).

In the OVDP, you file up to 8 amended tax returns and 8 FBARs, and you pay taxes, penalties and interest. Plus, you pay a 27.5% penalty based on your account balances. Depending on who you bank with, the penalty can go up to 50%. Since June 2014, some taxpayers can choose the IRS Streamlined program instead of the OVDP. The Streamlined program offers less certainty but is far less expensive.

Some people just file forms quietly and hope they won't be penalized. Some people still ignore these issues and either do nothing or just file prospectively. For people outside of the OVDP or Streamlined programs, the IRS has released some interim guidance about FBAR penalties.

If you are willful, the IRS says you probably will just get a penalty of 50% of the highest balance year. That is much better than the possible 300% you could reach with 50% per year for six years! However, the IRS seems to have left some wiggle room for higher penalties, but not beyond 100%. The IRS helpfully refers to IRM 4.26.16.4 for a primer on FBAR willfulness.

For non-willful penalties, the interim guidance says the default is one $10,000 penalty for each year. That is much better than $10,000 *per account* per year! But not everyone will get the same deal, and the new guidance lays out three tiers of non-willful penalties:

1. Default: $10,000 for each year;
2. Lenient: $10,000 once, to cover all years; and
3. Harsh/Strict: $10,000 for each violation/account for each year.

The language for the Lenient tier says if the IRS agent or manager does not think penalties for *each* year are warranted, the IRS may apply a single $10,000 penalty to cover *all* years. Does that mean there is no option to get out of penalties entirely? The statute authorizes a penalty of *up to* $10,000. Perhaps the IRS has decided to apply the maximum.

Plainly, the OVDP and Streamlined programs have extra benefits. For example, the Streamlined program waives all late-filing, late-payment, accuracy-related, failure to file, and FBAR penalties entirely in lieu of 5% of your account balance. The OVDP imposes a single accuracy penalty and takes a larger chunk of your accounts, but it also ends with a closing agreement.

In contrast, the interim guidance does not address any other penalties that can crop up for other foreign account-related forms. Consider Forms 8938, 3520, 3520A, 5471, 8621, 8865, and Schedule B. It still seems possible to be under the Lenient regime ($10,000 once for all years), and to get hit with penalties for an incorrect Schedule B, a missing 8938, etc. You could argue reasonable cause, but where there is one failure, there may be others. The list of potential penalties may add up fast. And that may make the OVDP look pretty attractive.

For alerts to future tax articles, follow me on Forbes. You can reach me at Wood@WoodLLP.com. This discussion is not intended as legal advice, and cannot be relied upon for any purpose without the services of a qualified professional.