

# Practical Tips and Tricks for FBAR Compliance:

## *A Hands-on Guide for Navigating the FBAR Reporting Regime*

Deidra W. Hubenak, JD, CPA  
Austin C. Carlson, JD



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# Agenda

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1. The Current FBAR Landscape
2. Penalties and Programs
3. Hands on Guide: Seven Examples



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# **THE CURRENT FBAR LANDSCAPE:**

## **ENFORCEMENT EFFORTS AND RESULTS**

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# The Current FBAR Landscape

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- IRS Offshore Voluntary Disclosure Programs
  - Over \$5.5 billion in back taxes, penalties and interest collected
  - 38,000 voluntary disclosures made under the three programs
  - Currently on the third OVDP
  - Estimated by some that less than 1% have come forward



# The Current FBAR Landscape

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What we are seeing in the field:

- IRS Agents tied up with the OVDP and other offshore account disclosure programs; other cases are being put on hold.
- Subpoenas relating to offshore accounts
- Foreign banks no longer accepting U.S. customers - HSBC Holdings ([HBC](#)), Deutsche Bank ([DB](#)), Bank of Singapore, and DBS Group Holdings ([DBS](#))



# U.S. Banks Closing Foreign Accounts with U.S. Citizen Owners

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- Ameriprise; Bank of America; Bank of New Hampshire; Citibank; Citizens Bank; Edward Jones, St. Louis; E-Trade; Fidelity Investments; ING Direct; JPMorgan Chase; Morgan Stanley; National City Bank in Riverview, Michigan; Provident Bank, Maryland; Smith Barney; T. Rowe Price; USAA Federal Saving Bank; Vanguard mutual fund; Wachovia; Washington Mutual; Washington Mutual Investment, Spokane; Wells Fargo; Zions Direct.



# 2011 Enforcement Efforts

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- 3,220 Civil FBAR exams
- 18 Criminal exams



# Criminal Prosecutions

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## Luis Quintero

- Failed to report \$4 million in foreign bank accounts; Filed FBARs for 2 years and then stopped.
- Sentenced to:
  - 4 months in federal prison
  - 3 years supervised release
  - 250 hours of community service
  - \$2 million civil penalty
  - \$20,000 criminal fine





# Why FBAR Enforcement is Escalating

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- FATCA
  - Requires foreign financial institutions to provide the IRS with information of worldwide income of U.S. persons invested outside the U.S.
- Bilateral Treaties
  - Model bilateral and unilateral agreements have been drafted in consultation with France, Germany, Italy, Spain and the U.K. More on the way...
- Form 8938 – Statement of Specified Foreign Financial Assets
- OVDI Questionnaires – Reveal advisors



# Opting Out of the OVDP

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- IRS initially discouraged and used threats to prevent this; Now more receptive – Pronouncement that there should be no negative treatment of taxpayers electing this option.
- Time frame to resolve
  - 2009 – 570 days
  - 2011 – 175 days
- Average civil FBAR penalty for 2009 opt out cases was \$15,737; No criminal prosecutions.



# Who Is Getting Caught in the Net?

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- Tax Evaders
- Individuals with Signatory Authority
- Entities whose lower level partnerships had a filing requirement
- Individuals with no tax due
- **BIGGEST PROBLEM** - individuals with minimal tax due



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# **PENALTIES AND PROGRAMS:**

## **THE 2012 OVDP AND THE STATUTORY FBAR PENALTIES**

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# Penalties and Programs: The 2012 OVDP

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- No Deadline (unlike prior programs)
- Penalty rate increased to 27.5%, 12.5% and 5% rates still available
- No recommendation to criminal
- Opt-out option



# Penalties and Programs: The 2012 OVDP

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- 27.5% Penalty: Default Penalty Rate
- 12.5% Penalty: Highest balance less than \$75,000
- 5% Penalty: (1) Infrequent Contact with Account (four prong test); (2) Unaware they were U.S. Citizens; (3) Foreign Resident with Less than \$10,000 of U.S. Source Income
- No authority to negotiate



# Penalties and Programs: Opt-Out - Statutory Penalties

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- **Civil Penalties:**
  - **Worst Case: Willful Violation**
    - Before October 22, 2004, Greater of \$25,000 or the amount in the account, capped at \$100,000
    - After October 22, 2004, Greater of \$100,000 or 50% of the amount in the account
    - Can argue for Reasonable Cause
  - **Non-Willful Violation**
    - After October 22, 2004, Not to exceed \$10,000
    - Can argue for Reasonable Cause
  
- **Criminal Penalties: \$250,000/\$500,000; 5/10 years in jail**



# Penalties and Programs: Willful

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- The test for willfulness is whether there was a voluntary, intentional violation of a known legal duty.
- The burden of establishing willfulness is on the Service.
- Can be established with “willful blindness”
- 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.





# Penalties and Programs: Reasonable Cause

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- Facts and Circumstances Test
  - The taxpayer's education;
  - Whether the taxpayer has previously been subject to the tax or penalized before.
  - Whether there were recent changes in the tax forms or law that the taxpayer could not reasonably be expected to know;
  - The level of complexity of a tax or compliance issue;
  - Reliance on the advice of a professional tax advisor who was informed of the account;
  - Evidence that the foreign account was established for a legitimate purpose.



# Penalties and Programs: Reasonable Cause

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- Evidence that there was no effort to intentionally conceal the reporting of income and assets;
- Evidence that there was no tax deficiency, or a small tax deficiency, related to the account.
- Ignorance of the law, if reasonable along with a good faith effort to comply with the law if you could not reasonably be expected to know of the FBAR requirement.



# Penalties and Programs: Non-Resident Procedures

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- Went into effect on September 1, 2012.
- Eligibility:
  - Non-Resident U.S. Taxpayer
  - Resided out of the U.S. since January 1, 2009
  - Not Filed a U.S. tax return since 1/1/2009
  - Low Level of Compliance risk (generally less than \$1,500 in tax due)
- Result: No FBAR penalties.
- Risk: No Criminal Non-Referral



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# **HANDS ON GUIDE TO NAVIGATING THE FBAR REGIME:**

## **SEVEN EXAMPLES AND SUGGESTED ACTIONS**

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# Example One - Facts

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- U.S. Citizen and resident.
- Taxpayer has been operating a business out of the Bahamas with revenues of \$2M/year using a bank account also in the Bahamas since 2005 with a highest balance of \$1.5M and average balance of \$1M.
- Taxpayer has not reported the income or paid U.S. taxes on the income from the business or interest earned on the bank account.
- Taxpayer has never filed an FBAR.



# Example One – Suggested Action

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## Taxpayer should enter the 2012 OVDP

- 27.5% of Highest Balance (\$1.5M): \$412,500 FBAR Penalty
- Other Tax Penalties (Failure to File, Failure to Pay, Failure to make ETPs) and Interest
- **Alternative: 50% of balance each year (500,000\* 6 years) + Criminal (\$500,000 and 10 years in Jail): 3.5M, Jail Time**



# Example Two - Facts

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- U.S. Citizen and resident.
- Taxpayer gets the majority of her income in the U.S. but also has a rental home she bought in 2009 in France where she receives \$10,000 a year of rent payments. The payments are made to a French bank account with a highest balance of \$40,000 and average balance of \$20,000.
- She has included the rental income on her U.S. tax return each year and paid all U.S. and French tax on the amounts.
- She has never filed an FBAR.



# Example Two – Suggested Action

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## **Taxpayer should not enter the 2012 OVDP**

- Taxpayer should file the delinquent FBARs and attach a statement explaining why the reports are filed late. (Quiet Disclosure – See FAQ #17)
- The IRS will not impose a penalty for the failure to file the delinquent FBARs if there are no underreported tax liabilities and you have not previously been contacted regarding an income tax examination or a request for delinquent returns.





# Example Three - Facts

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- Taxpayer is a dual U.S./Canadian Citizen residing in Canada.
- Taxpayer has never filed his required U.S. tax returns or FBARs for his accounts in Canada.
- Taxpayer was current on all taxes on Canada and, after Foreign Tax Credits, owed less than \$1000/year of U.S. taxes.



# Example Three – Suggested Action

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## **Taxpayer should follow the “New Streamlined Procedures”**

- Must file delinquent tax returns, delinquent FBARs for the past six years, and pay tax and interest due.
- No FBAR penalties.
- If “high compliance risk”, could have in depth examination
- No criminal protection. Once entered, cannot enter OVDP.



# Example Four - Facts

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- U.S. Citizen and resident.
- Taxpayer gets the majority of his income in the United States but also has a rental home he bought in 2009 in France where he receives \$10,000 a year of rent payments. The payments are made to a French bank account with a highest balance of \$40,000.
- He has paid French tax on the income but had not been reporting it on his U.S. tax return or paying U.S. tax on the income.
- He has never filed an FBAR.



# Example Four – Suggested Action

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## **Taxpayer should enter the 2012 OVDP and qualify for the 12.5% Penalty**

- Balance was always under \$75,000, qualifies for 12.5% Penalty (\$5000 Penalty)
- Must pay taxes due and tax penalties and interest



# Example Five - Facts

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- Taxpayer inherited a \$80,000 offshore account in Sweden in 2009.
- He has been to Sweden only once, and on that one visit he withdrew \$1000 from the account .
- He has never made any deposits to the account. In 2012, he closed the accounts and repatriated the money to a U.S. bank.
- He never reported earnings, which were minimal, on the accounts on his U.S. tax returns and he never filed an FBAR.



# Example Five – Suggested Action

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## Taxpayer should enter the 2012 OVDP and qualify for the 5% Penalty

- Met the 4 Conditions:
  - Did not open
  - Minimal contact
  - No more than \$1,000 withdrawn a year
  - Only account earnings have escaped U.S taxation
- 5% Penalty on Highest Balance ( $\$80k \cdot .05 = \$4k$ ) and Tax and Penalties on Earnings



# Example Six - Facts

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- U.S. citizen and resident (Moved to U.S. 7 years ago from Europe for work)
- Several foreign accounts established before moving to U.S. Total account balance \$2 million.
- Taxpayer filed U.S. tax returns, but no FBARs and excluded foreign income from these accounts.
- You prepare returns and no tax is due because of the FTC.



# Example Six – Suggested Action

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## **Client should enter the 2012 OVDP and then opt-out of the program**

- Taxpayer is NOT eligible for FAQ #17 quiet disclosure because there is unreported income. (See FAQ #51).
- Risk of higher penalties if “willful” is found
- Chance for no penalties with Reasonable Cause





# Example Six – Penalty Analysis

OVDP Structure	Willful	Non-Willful	Reasonable Cause
Penalty Rate: 27.5% of Highest Balance over Last Six years	50% of Highest Balance in Each of the Last Six years	\$10,000 per year for Each of the Last six years	No FBAR Penalties
One Time Penalty: \$2,000,000 *27.5%	\$1,000,000*6	\$10,000*6	No Penalties
<b>\$550,000</b>	<b>\$6,000,000</b>	<b>\$60,000</b>	<b>\$0</b>



# Example Seven - Facts

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- Same as example six, except during the IRS examination, it is found out that taxpayer had intentionally been hiding an additional \$2M/year of income from a business in a tax haven country. Taxpayer had not told the attorney or the IRS about this income before the examination.



# Example Seven – Suggested Action

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## **Taxpayer should retain a Criminal Defense Attorney**

- Will very likely face willful civil penalties and the criminal penalties



# Conclusion

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- Client must be 100% honest with you. CPAs: Consider bringing in an attorney to bring in attorney-client privilege so client can have more security in being completely transparent with information.
- Kovel Arrangement with CPA



# Thank you!

Deidra W. Hubenak  
[dhubenak@lrmlaw.com](mailto:dhubenak@lrmlaw.com)

713-986-7188

Austin C. Carlson  
[acarlson@lrmlaw.com](mailto:acarlson@lrmlaw.com)

713-986-7213



**LOOPER REED**

LOOPER REED & MCGRAW P.C.