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The Super FBAR Is On Its Way and With It Comes Enhanced Enforcement

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In "Scent of a Woman" Al Pacino's character stated "I'm just getting started here!", well the same can be said for the IRS efforts to gather offshore financial information from U.S. taxpayers. Many taxpayers and tax advisors are now aware of the obligation to file a Report of Foreign Bank Account (FBAR) if they have $10,000 or more in aggregate foreign financial accounts at anytime in the year. An FBAR is required under the Bank Secrecy Act (BSA). Disclosure of the existence offshore accounts was also required under the Internal Revenue Code (IRC) on Schedule B of Form 1040. The Form 1040 disclosure until now required that the taxpayer simply answer Yes or No to the questions on Schedule B. The administrative and enforcement remedies between the BSA and the IRC are substantive . Under the BSA a non-criminal FBAR penalty is enforced by a civil lawsuit filed by the Department of Justice in the US District Court.

Under the IRC non-criminal income tax liabilities, penalties and interest are enforced under the lien and levy rules of the IRC. In the two recent voluntary disclosure programs offered by the IRS, 2009 and 2011, the IRS created a "miscellaneous civil penalty", in lieu of FBAR penalties, to allow it to administer the voluntary disclosures under the IRC. The natural evolution of the process that created the "miscellaneous civil penalty" is the enhanced reporting requirements under the HIRE Act Section 6038D, which created the "Super FBAR".

Under IRC Section 6038D U.S. taxpayers are required to report "specified foreign financial assets" above threshold amounts on Form 8938, the Super FBAR. The draft instructions to Form 8938 describe "specified foreign financial assets" as (1) Any financial account maintained by a foreign financial institution. (2) other foreign financial assets which include any of the following assets that are held for investment such as (a) stock or securities issued be someone other than a U.S. person (b) any interest in a foreign entity (emphasis added), any financial instrument or contract that has an issuer or counterparty that is other than a U.S. person. Form 8938 becomes part of the taxpayers

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Form 1040 and as such enforcement is governed by the IRC not the BSA. Disclosure on Form 8938 is limited to assets or interests not already disclosed on other information returns, like the Controlled Foreign Corporation Return (Form 5471), or the Report of Foreign Gift (Forms 3520 and 3520A). The civil penalty for failure to file a complete and correct a Form 8938 is ranges from $10,000 to a maximum of $50,000 per year. This penalty may be in addition to penalties for failure to file other information returns if required, such as Form 5471, 35020,3520A, etc. An accuracy related penalty of 40% applies to underpayments of tax for undisclosed specified foreign financial assets. The 75% fraud penalty for intentional understatement is still possible as is prosecution for tax evasion.

There are several different parties that are affected by the disclosure requirements of Section 6038D. First, U.S. taxpayers. Among the various taxpayer groups are dual residents/dual nationals and U.S. expatriates. Second, included in as affected parties are tax return preparers. The important point to note is that the disclosure relates to investment assets, not interests in an active trade or business. The taxpayer must disclose the maximum value during the year of each specified foreign financial asset (very much like the highest account balance requirement disclosure on the FBAR). A reasonable estimate is all that is required an appraisal is not required. Presumably tax preparers will be able to rely on their clients for the valuation of these assets, if they are not publicaly traded.

Taxpayers, including dual residents and dual nationals who hold specified foreign financial assets should be prepared to provide supporting documentation to their tax preparer to support the valuation estimates. Just what level of scrutiny that tax return preparer will have to give the taxpayer valuation estimates is unclear, but the draft instructions to Form 8938 described the valuation methods to be applied to certain interests. Tax preparers should be aware of the required valuation methods and advise their clients accordingly. The IRS may very well take the position that tax preparers must test the information provided by their clients in order to avoid discipline. The result of having to review and test valuations may be more expensive tax return costs to the taxpayers.

In addition to the disclosures under Section 6038D beginning in 2014 Foreign Financial institutions will begin reporting foreign held financial accounts of U.S. taxpayers to the IRS under information exchange agreement created under the Foreign Account Tax Compliance Act, (FATCA). Information provided under FATCA agreements will presumably by tied to “matching program” of the IRS. The matching program is used to correlate information returns (such as Form 1099) with income tax returns to make sure taxpayers have reported all reportable income.

So, it should be obvious now to everyone concerned, that the IRS “is just getting started here” when it comes to moving offshore enforcement into the IRS and thereby centralizing the assessment and collection efforts. This is not to say that FBAR’s are not going to be required in the future, they will, for they serve a distinctly different function than tax returns. FBAR’s are used to combat terrorism, drug dealing, money laundering and tax evasion, while tax returns are intended primarily for assessment and collection of tax. For tax preparers it is certainly going to be a challenge to manage the disclosures. For taxpayers, the risks of non-compliance with foreign asset disclosure are increased. If this is the start, what should be expected in the future?

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