

Select IRS listed Frequently Asked Questions regarding FBAR

FAQ # 17. I have properly reported all my taxable income but I only recently learned that I should have been filing FBARs in prior years to report my personal foreign bank account or to report the fact that I have signature authority over bank accounts owned by my employer. May I come forward under this new initiative to correct this?

Answer: The purpose for the voluntary disclosure practice is to provide a way for taxpayers who did not report taxable income in the past to come forward voluntarily and resolve their tax matters. Thus, if you reported and paid tax on all taxable income but did not file FBARs, do not use the voluntary disclosure process.

For taxpayers who reported and paid tax on all their taxable income for prior years but did not file FBARs, you should file the delinquent FBAR reports according to the instructions (send to Department of Treasury, Post Office Box 32621, Detroit, MI 48232-0621) and attach a statement explaining why the reports are filed late. The IRS will not impose a penalty for the failure to file the delinquent FBARs if there are no underreported tax liabilities and the FBARs are filed by September 9, 2011. However, FBARs for 2010 are due on June 30, 2011 and must be filed by that date.

FAQ 50. Will examiners have any discretion to settle cases?

Answer: No. Voluntary disclosure examiners do not have discretion to settle cases for amounts less than what is properly due and owing. However, because the 25 percent offshore penalty is a proxy for the FBAR penalty, other penalties imposed under the Internal Revenue Code, and potential liabilities for years prior to 2003, there may be cases where a taxpayer making a voluntary disclosure would owe less if the special offshore initiative did not exist. Under no circumstances will taxpayers be required to pay a penalty greater than what they would otherwise be liable for under the maximum penalties imposed under existing statutes. For example, if a taxpayer had \$100,000 in an offshore bank account in only one year and foreign income-producing real estate with a fair market value of \$1,000,000, only the bank account would be subject to the FBAR penalty. Consequently, the maximum FBAR penalty would only be \$100,000 (that is, the greater of \$100,000 or 50% of the amount in the foreign account), which is substantially less than the offshore penalty of \$275,000 (25% of \$1,100,000). If this FBAR penalty, plus tax, interest and all other applicable penalties, are less than what is due under this offshore initiative, the taxpayer will only pay the lesser amount.

Examiners will compare the amount due under this offshore initiative to the tax, interest, and applicable penalties (at their maximum levels and without regard to issues relating to reasonable cause, willfulness, mitigation factors, or other circumstances that may reduce liability) for all open years that a taxpayer would owe in the absence of the 2011 OVDI penalty regime. The taxpayer will pay the lesser amount. If the taxpayer disagrees with the result, the taxpayer may request that the case be referred for an examination of all relevant years and issues (see FAQ 51).

FAQ 52. Under what circumstances would a taxpayer making a voluntary disclosure under this initiative qualify for a reduced 5 percent offshore penalty?

Answer: Unless the taxpayer would owe a lesser amount under FAQ 50, taxpayers making voluntary disclosures who fall into one of the three categories described below will qualify for a 5 percent offshore penalty. Examiners have no authority to negotiate a different offshore penalty percentage.

1. Taxpayers who meet all four of the following conditions: (a) did not open or cause the account to be opened (unless the bank required that a new account be opened, rather than allowing a change in ownership of an existing account, upon the death of the owner of the account); (b) have exercised minimal, infrequent contact with the account, for example, to request the account balance, or update accountholder information such as a change in address, contact person, or email address; (c) have, except for a withdrawal closing the account and transferring the funds to an account in the United States, not withdrawn more than \$1,000 from the account in any year for which the taxpayer was non-compliant; and (d) can establish that all applicable U.S. taxes have been paid on funds deposited to the account (only account earnings have escaped U.S. taxation). For funds deposited before January 1, 1991, if no information is available to establish whether such funds were appropriately taxed, it will be presumed that they were.

Example 1: When the taxpayer's father died, the taxpayer inherited two offshore accounts. His father's last deposit to the accounts was more than 30 years ago. The taxpayer provided his email address to the bank to receive bank statements by email and indicated an investment approach as required by the bank to open the account in the taxpayer's name. Twice he has been to the foreign jurisdiction and talked to a banker—during one of those visits he withdrew \$1,000 from one of the accounts. Otherwise, he did not withdraw any money from the accounts until last year, when he closed the accounts and repatriated the money to a U.S. bank. He never reported earnings on the accounts on his U.S. tax returns and he never filed an FBAR. He is entitled to the reduced 5% offshore penalty.

Example 2: The facts are the same as in example 1, except that \$40,000 of the funds were deposited to one of the accounts in 1995. The taxpayer would have to identify the source of the deposit and, if the source was taxable in the U.S., prove that U.S. income tax was paid on those funds. In the absence of such proof, the taxpayer is not entitled to the reduced 5% offshore penalty.

Example 3: The facts are the same as in example 1, except that subsequent to opening the account, the taxpayer voluntarily provided instructions to the bank concerning the investment of funds. The taxpayer is not entitled to the reduced 5% offshore penalty.

2. Taxpayers who are foreign residents and who were unaware they were U.S. citizens.

Example 1: The taxpayer was born in the U.S. to parents of foreign citizenship. She grew up in a foreign jurisdiction, unaware that she had been born in the U.S. She has a \$60,000 account in the foreign jurisdiction. She has never filed U.S. returns or FBARs. She became aware she was a U.S. citizen when she had to get a birth certificate in order to obtain a passport from the foreign jurisdiction where she resides. She is entitled to the reduced 5% offshore penalty. Subsequent to learning of her U.S. citizenship, taxpayer took no action with respect to her foreign accounts that would disqualify a U.S. taxpayer from the 5

percent penalty under paragraph 1, above.

Example 2: The facts are the same as in example 1, except that the taxpayer always knew she was a U.S. citizen and never inquired about her U.S. tax obligations. The taxpayer is not entitled to the reduced 5% offshore penalty, unless she qualifies under paragraph 1 or 3.

3. Taxpayers who are foreign residents and who meet all three of the following conditions for all of the years of their voluntary disclosure: (a) taxpayer resides in a foreign country; (b) taxpayer has made a good faith showing that he or she has timely complied with all tax reporting and payment requirements in the country of residency; and (c) taxpayer has \$10,000 or less of U.S. source income each year. For these taxpayers only, the offshore penalty will not apply to non-financial assets, such as real property, business interests, or artworks, purchased with funds for which the taxpayer can establish that all applicable taxes have been paid, either in the U.S. or in the country of residence. This exception only applies if the income tax returns filed with the foreign tax authority included the offshore-related taxable income that was not reported on the U.S. tax return.

Example 1: The taxpayer is a U.S. citizen who has lived and worked as a corporate executive in Country X since 1995. His income has included earnings in excess of \$250,000 in each year, as well as bank interest and investment income on financial accounts that had a high aggregate balance of \$1.2 million in 2009. He has paid all required taxes on his earnings and investment income in Country X in every year, but has filed no U.S. income tax returns since moving out of the United States. In addition to his financial accounts, the taxpayer has acquired a personal residence in Country X with an equity of \$900,000 and an automobile worth \$85,000, both financed with previously taxed savings from the U.S., as well as his salary and investment earnings in Country X.

Because the taxpayer was fully tax compliant in Country X, he will be eligible for a reduced offshore penalty of 5 percent of the value of the financial accounts, or \$60,000. The residence and automobile will not be included in the penalty base because the funds used to acquire them were fully taxed in the Country X.

Example 2: The taxpayer is a U.S. citizen who has lived in Country X since 1995. He is an entrepreneur who developed his own software business, which he operated as a wholly owned corporation, ABC Corp., incorporated in Country X, until he took the corporation public in 2005. After the IPO, the taxpayer sold ABC stock at a capital gain of \$5 million, and retained other ABC stock with a market value of approximately \$20 million. He used \$2 million of the stock proceeds to purchase a personal residence and put the remainder in his investment accounts. His income has included salary exceeding \$250,000 in each year, the \$5 million capital gain in 2005, and bank interest and investment income on financial accounts that had a high aggregate balance of \$3.8 million in 2009. He has paid all required taxes on his earnings, capital gain, and investment income in Country X in every year, but has filed no U.S. income tax returns since moving out of the United States.

Because the taxpayer was fully tax compliant in the country of residence, he will be eligible for a reduced offshore penalty of 5 percent of the value of the financial accounts, or \$190,000. The ABC stock and the personal residence will not be included in the penalty base because the funds used to acquire them were fully taxed in the country of residence.

FAQ 53. Under what circumstances would a taxpayer making a voluntary disclosure under this initiative qualify for a reduced 12.5 percent offshore penalty?

Answer: Unless the taxpayer qualifies for a lesser payment as calculated under FAQ 50 or a 5 percent offshore penalty under FAQ 52, taxpayers whose highest aggregate account balance (including the fair market value of assets in undisclosed offshore entities and the fair market value of any foreign assets that were either acquired with improperly untaxed funds or produced improperly untaxed income) in each of the years covered by the 2011 OVDI is less than \$75,000 will qualify for a 12.5 percent offshore penalty. As in other cases, examiners have no authority to negotiate a different offshore penalty percentage.

Example 1: The taxpayer was born in a foreign jurisdiction and is now a U.S. citizen. He has a landscaping business in the U.S. He sends money to an account in the foreign jurisdiction that he owns jointly with his mother (who is a resident of that jurisdiction). The account never has more than \$75,000 in it. He has never filed an FBAR or paid U.S. tax on the earnings from the account. He is entitled to the reduced 12.5% offshore penalty. The result would be the same for taxpayers who are U.S. citizens by birth.

Example 2: The facts are the same as in example 1, except that the taxpayer made a deposit to the account in 2005 that briefly brought the account balance to \$78,000. Because the highest account balance during the years covered by the 2011 OVDI was greater than \$75,000, the taxpayer is not entitled to the reduced 12.5% offshore penalty.
