FBAR | US SUPREME COURT PROVIDES CLARITY ON PENALTIES

OVERVIEW

This alert discusses recent developments with respect to the FBAR (Report of Foreign Bank and Financial Accounts).

Pursuant to the Bank Secrecy Act (the "BSA"), the U.S. Treasury requires U.S. persons to report annually to the U.S. government certain information about their non-U.S. financial accounts, commonly known as an FBAR filing. Although administered by the U.S. Treasury, the FBAR (also known as the FinCEN Form 114) is not filed with the Internal Revenue Service (IRS), but with another bureau within the U.S. Treasury, the office of Financial Crimes Enforcement Network (FinCEN). The purpose of the FBAR is to facilitate the government's ability to trace funds that may be used for illegal purposes and to identify unreported income that may be subject to U.S. tax. Below we summarize the FBAR requirements and discuss the penalties, both civil and criminal, for non-compliance, highlighting the recent Supreme Court decision in Bittner v. United States1 (the "Bittner Decision"), which clarified the penalties to be applied in the case of a "non-willful" failure to file.

WHAT IS THE FBAR?

A U.S. person with a financial interest in, or signatory authority over, one or more non-U.S. (foreign) financial accounts with an aggregate value greater than $10,000 at any time during the calendar year must, subject to limited exceptions,[2] report such accounts annually. This is carried out by filing the FBAR with FinCEN by the same due date (including extensions) for the individual's U.S. federal tax return.

FBAR requirements apply to U.S. citizens and to U.S. residents (i.e., a non-U.S. citizen holding a green card or who is substantially present in the United States during the calendar year). The requirements also apply to U.S. corporations, partnerships, and LLCs, and to trusts or estates created or organized in the United States.

Generally, an account at a financial institution that is located outside the United States is a "foreign financial account" for purposes of the FBAR. Whether the account produces taxable income (such as interest) has no effect on whether the account is reportable for FBAR purposes.

Consequently, a French national who moves to the United States for a period of time and becomes tax resident for U.S. tax purposes, or who otherwise obtains a green card, will be obligated to report any foreign bank accounts on the FBAR, provided the reporting threshold is met.

Determining if the aggregate value of foreign accounts exceeds $10,000 requires valuing each account separately by determining its highest value during the year in question. The highest values for each account are then aggregated to determine if the FBAR reporting threshold is met. For example, if a U.S. person maintained three foreign bank accounts in 2023, each with a maximum determined value that year of $2,000, $5,500, and $9,000 respectively, the

[1] No. 21-1195 (U.S. 2/28/23).

[2] 31 C.F.R. §1010.350(c)(4)(i).

aggregate highest value for the three accounts is $16,500, which exceeds the reporting threshold. As a result, although none of the accounts independently exceeded the reporting threshold, because they did in the aggregate, the U.S. person must file an FBAR with respect to 2023.

The FBAR must be filed electronically with FinCEN. The account information reported is minimal, including, inter alia, the maximum value of each foreign account during the year, the account number, name, and address of the foreign bank.

Although FBAR is in the domain of FinCEN, the issue of FBAR filing is indirectly on the radar of the IRS. In addition to the fundamental requirement for U.S. taxpayers to report any income earned on financial accounts, whether foreign or domestic, U.S. taxpayers also are specifically required to disclose on their federal tax returns the existence of any foreign financial accounts by checking the box "yes" or "no" as to whether the taxpayer held any foreign accounts on Schedule B of Form 1040 (i.e., the U.S. federal tax return). Even where there is no income to report, the failure to correctly complete Schedule B is both an audit risk for the U.S. taxpayer and a factor in determining whether an FBAR filing failure may qualify as "willful" or "non-willful". A finding of willfulness can dramatically impact the penalties that may apply for any filing failure.

WHAT ARE FBAR PENALTIES?

Non-compliance with FBAR requirements can result in severe penalties, both civil and criminal, depending on whether the failure to file was "willful" or "non-willful". While a discussion of the nuances of what constitutes willfulness or non-willfulness is outside the scope of this alert, the penalties that can apply in either case are important to understand.

Civil penalties - non-willful FBAR violations can reach up to $10,000 (adjusted for inflation) per violation. However, whether a violation is determined on a per account basis versus a per FBAR form basis has long been the subject of debate, and conflicting court decisions, prior to the recent Bittner Decision.

On the other hand, where willfulness is found, the penalty structure is quite clear. A U.S. person determined to have willfully[3] failed to file a timely FBAR will face a penalty of up to $100,000 or 50% of the account balance(s) at the time of the violation, whichever is greater.

Criminal penalties - In addition to the civil penalties, the IRS may also pursue criminal charges for willful FBAR violations, which can lead to additional fines of up to $250,000 and up to five years of imprisonment.[4] If a U.S. person violates the FBAR requirements while violating another law of the United States or as part of a pattern of illegal activity involving more than $100,000 in a 12-month period, the FBAR criminal penalty may be increased up to $500,000 or 10 years' imprisonment, or both.[5]

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[3] Willful failure is defined in the Internal Revenue Manual (IRM) as either knowingly or recklessly violating a legal duty, or consciously avoiding learning about it. Willfulness can be established, for example, if the U.S. person filed FBARs in previous years, received an FBAR warning letter, or failed to report income associated with foreign accounts. The government must establish willfulness by "clear and convincing evidence", though some courts have accepted the lower "preponderance of the evidence" standard. IRM 4.26.16.5.5.1 (06-24-21); See, e.g., United States v. Williams, 489 Fed. App'x 655 (4th Cir. 2012); United States v. McBride, 908 F. Supp. 2d 1186 (D. Utah. 2012); United States v. Garrity, 304 F. Supp. 3d 267 (D. Conn. 2018).

[4] 31 U.S.C. §5322(a), 31 C.F.R. §1010.840(b).

[5] 31 U.S.C. §5322(b); 31 C.F.R. §1010.840(c).

THE BITTNER DECISION

The recent Supreme Court Bittner Decision was eagerly awaited by taxpayers, tax professionals, and legal experts alike, and will assuredly have significant implications for U.S. persons with foreign financial accounts. The case involved Alexandru Bittner, a Romanian-born U.S. citizen who returned to Romania and achieved financial success. Bittner invested his money in banks around the world, including accounts in Romania, Switzerland, and Liechtenstein. However, like many U.S. taxpayers living abroad, Bittner was unaware of his U.S. reporting obligations for his foreign bank accounts and thus failed to file the FBAR over the course of several years. On the facts of the case, the lower courts found that Bittner's failure to file was non-willful. The only question put before the Supreme Court was the basis upon which the civil penalty of $10,000 "per violation" should be determined. In other words, what does "per violation" mean?

If each unreported account is a singular violation, then the $10,000 penalty would apply per account and, depending on the number of unreported accounts, the total penalty amount could aggregate much beyond $10,000.

If on the other hand a violation exists from the failure to file the FBAR itself, a single form on which multiple accounts are reported, then the total penalty amount, regardless of how many accounts were unreported, would always equal $10,000 per year.

Consequently, the question at the heart of the Bittner case was whether the penalty should be assessed on a per unreported account or per unfiled FBAR basis.

In Bittner's case, the IRS had assessed FBAR penalties totaling $2.72 million against Bittner for annual non-willful violations of the FBAR reporting requirements covering more than 50 accounts each year from 2007 through 2011 (i.e., 272 accounts in the aggregate). Bittner contested the penalties in district court, arguing that the penalty applies on a per FBAR basis, not a per account basis, and that he therefore owed only $50,000 in penalties (i.e., $10,000 per year of an unfiled FBAR). Bittner contested the assessment in court, and the district court agreed with Bittner, holding that the penalty applies per FBAR report (i.e., singular violation per year of failure to file).

The government appealed, and the Fifth Circuit court reversed the district court's decision, agreeing with the IRS position that the penalty should be assessed on a per unreported account basis.[6] However, in a separate but similar case, the Ninth Circuit held that the penalty applies on a per FBAR report basis, finding that the BSA authorizes "only one non-willful penalty when an untimely, but accurate, FBAR is filed, no matter the number of accounts."[7] This created a split in the circuit courts.

The Bittner case eventually made its way to the Supreme Court, which ultimately agreed with the Ninth Circuit's interpretation, concluding definitively that penalties for non-willful violations accrue on a per FBAR report basis, not a per account basis. The Supreme Court noted that the BSA does not speak of accounts but rather of a legal duty to "file reports" that include various kinds of information about the individual's foreign transactions or relationships. Under the BSA, a penalty of up to $10,000 is imposed for "any violation" of those duties, with a violation deemed to occur "when an individual fails to file a report consistent with the statute's commands." (*Emphasis added*).

The Supreme Court focused in its reasoning on the difference in the statute's language addressing the application of FBAR penalties to willful versus non-willful violations. While Congress explicitly authorized per account penalties for certain willful violations, it did not for non-willful violations. The Supreme Court found that this difference should be interpreted as being intentional, meaning that when Congress drafts a statute without using certain language that is specifically used elsewhere, it does so deliberately in order to communicate a distinction. Under this view, the government's position arguably had defied traditional rules of statutory construction.

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[6] 19 F. 4th 734, 739–740 (CA5 2021).

[7] *United States* v. Boyd, 123 AFTR 2d 2019–1651 (CD Cal. 2019).

CONCLUSION

In summary, the Supreme Court's decision means that the penalty for a non-willful failure to file an FBAR accrues per unfiled FBAR report, not per unreported account. The decision resolves the split between the Fifth and Ninth circuits and clarifies the FBAR penalty framework.

While this decision is favorable to U.S. taxpayers who now face less daunting penalties for unintentional FBAR filing mistakes, there are those in the tax bar who see the IRS potentially becoming more aggressive in pursuit of willful violations as a result. In particular, the Bittner Decision will reduce collections on non-willful violations from millions in penalties to more insignificant amounts, positioning the government to better put its resources toward willful violators. This in turn puts increased focus on what the standard is or should be for a finding of willfulness, a determination that remains in a gray area for most taxpayers and their advisors. While the Bittner Decision did not address this question, another recent FBAR case already has petitioned the Supreme Court to clarify the appropriate standard for willfulness. In *Bedrosian v.* United States[8] , the plaintiff has urged the Supreme Court to find that willfulness should be determined according to a subjective standard instead of the objective standard used by several courts. Taxpayers and their counsel will have to wait and see if the Supreme Court grants certiorari to Bedrosian and addresses this crucial question.

We continue to monitor these and other topical U.S. and cross-border tax issues, and would be happy to answer any U.S. tax questions you may have.

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[8] No. 21-1583 (3d Cir. 2022).