F.B.A.R.'S – WHAT YOU NEED TO KNOW

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April 15 is almost here, and while most people know this date as the filing deadline for individual tax returns, it also important to another filing requirement: the Report of Foreign Bank and Financial Accounts ("F.B.A.R."). Although the form (currently Financial Crimes Enforcement Network (FinCen) Form 114) has been around since the 1970's, many people still are unaware of its existence and those that are aware may be confused about the requirements. A recent Federal case illustrates the perils of failing to file a required F.B.A.R. report.

THE RULES

At first glance, the F.B.A.R. instructions seem relatively simple: A U.S. person must file an F.B.A.R. if that person has a financial interest in or signature authority over any financial account(s) outside of the U.S. and the aggregate maximum value of the account(s) exceeds $10,000 at any time during the calendar year. But they also spark certain questions:

- Who is a U.S. person?
- What is a financial account?
- What is a financial interest or signature authority?
- If a filing obligation is not fulfilled, what are the consequences?

Some of these answers are straightforward.

For F.B.A.R. purposes, a U.S. person is (i) a U.S. citizen or resident, (ii) an entity created or organized under the laws of the U.S., (iii) a trust formed under the laws of the U.S., or (iv) an estate formed under the laws of the U.S.

A financial account includes bank accounts, securities accounts, commodity futures, option accounts, insurance policies with a cash value, mutual funds, and any other accounts maintained in a foreign financial institution or by a person performing the services of a financial institution.

However, when delving into the specifics of these rules, there are also some ambiguities.

Recently, the U.S. District Court of Maryland ruled in *U.S. v. Horowitz*[1] on three issues regarding the F.B.A.R. filing obligation. These answers will come in handy when determining whether an F.B.A.R. filing obligation exists.

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[1] *U.S. v. Horowitz*, 2019 U.S. Dist. LEXIS 9484 (D. Md. 2019)

THE CASE

"The statute of limitations for assessing civil penalties for an F.B.A.R. violation is six years, and the clock begins to run on the date the F.B.AR. is due."

Mr. and Mrs. Horowitz (referred to as "H" and "W" respectively) were U.S. citizens who lived in Saudi Arabia from 1984-1992 and 1994-2001. H established an account at Foreign Commerce Bank, a Swiss bank, in 1988. In 1994, when H returned to Saudi Arabia, he traveled to Switzerland to close the account and to open an account at UBS. Both H and W jointly owned the UBS account, and the account opening documents listed an address for them in Saudi Arabia.

During the years 2001-2008, H and W moved back to the U.S. During this time, they did not make any deposits or withdrawals, but H called UBS every year or two to monitor the account.

After reading some troubling news articles about UBS, H traveled to Switzerland to close the account and open a new one at Finter, another Swiss bank. By this time, the balance on the account was almost $2 million. H brought his spouse's passport with him, but Finter would not allow him to open a joint account without her present. H filled out a list of authorized signatories and powers of attorney when he opened the account and designated his spouse as the person to whom he gave an "unlimited power of attorney." However, the form lacked W's signature, which would enable her to communicate with the bank. In October 2009, H and W traveled to Switzerland to add W to the account, as a joint owner.

During these years, H and W retained an accountant to prepare their joint tax returns. H communicated with the accountant and provided an annual summary of tax-pertinent information, but he never mentioned the Swiss accounts. Once each tax return was prepared, H and W signed the joint return. Over this period, they never answered "Yes" on Schedule B of Form 1040 to identify their ownership of a foreign account, and they never filed an F.B.A.R. to disclose either the UBS or the Finter account.

Finally, in 2010, they disclosed the funds for the first time. In June 2014, the government assessed penalties of $247,030 against each of them for their alleged willful failure to disclose the UBS account for the 2007 tax year and penalties of $247,030 against each of them for their alleged willful failure to disclose the Finter account for the 2008 tax year.

In 2016, the government took action to collect the penalties. In response, H and W moved to have the case dismissed, arguing that the government removed the assessed penalties in 2014 and that the collection process was untimely.

Does Removing Penalties from the I.R.S. Module Actually Bar the Assessment of Penalties Under the Statute of Limitations?

The statute of limitations for assessing civil penalties for an F.B.A.R. violation is six years, and the clock begins to run on the date the F.B.AR. is due.[2]

The parties agreed that in 2014 the government assessed the penalty within the statute of limitations and that the statute ran out on December 31, 2015. The question presented to the court was whether certain I.R.S. actions negated the penalties assessed in 2014.

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[2] 31 U.S.C. §§5314, 5321(b)(1).

The government conceded that around October 24, 2014, an I.R.S. agent removed the penalty input dates from the database. This action appears to be in response to a request to remove or reverse the assessed penalties. However, the government disagreed that these actions amounted to an actual removal of the penalties themselves.

In its ruling, the court pointed out that the defendant bears the burden of proof. Here, H and W failed to show that, even if the I.R.S. agent reversed the penalty, she had the authority to do so. When the actual penalty was assessed, the agent was required to obtain a manager's signature before inputting the data. Therefore, the court reasoned that treating the penalties as removed without the manager's signature was incongruous with the initial signature requirement.

The government also noted the absence of other required approvals. Under Federal regulations, the Department of Justice must approve the settlement of a claim that exceeds $100,000. Further, the penalty section of the Internal Revenue Manual advises I.R.S. employees that post-assessed F.B.A.R. penalties in excess of $100,000[3] cannot comprise the penalty by Appeals without the approval of the D.O.J.

What Constitutes a Financial Interest in a Foreign Account?

In its argument, the government relied on the definition of "financial interest" found in the 2011 Treasury regulations:

> A United States person has a financial interest in each bank . . . account in a foreign country for which the owner of record or holder of legal title is—(i) A person acting as an agent, nominee, attorney or in some other capacity on behalf of the United States person with respect to the account.[4]

The government also relied on the 2011 definition of "signature or other authority," arguing that it is the authority of an individual (alone or in conjunction with another) to control the disposition of money, funds, or other assets held in a financial account by direct communication (whether in writing or otherwise) to the person with whom the financial account is maintained.[5]

W pointed out that while those regulations were promulgated in 2011, she relied on the 2008 F.B.A.R. instructions, which are more limited in scope and in part provide as follows:

> A United States person has a financial interest in . . . [a] financial account in a foreign country for which the owner of record or holder of legal title is . . . a person acting as an agent, nominee, attorney, or in some other capacity on behalf of the U.S. person.
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> And, [possessing the authority to] control the disposition of money or other property in it by delivery of a document containing his or her signature . . . to the bank . . . with whom the account is maintained. Other authority exists in a person who can exercise comparable power over an account by communication with the bank or

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3 31 U.S.C. §3711(a).

4 31 C.F.R. §1010.350(e)(2)(i).

5 31 C.F.R. §1010.350(f)(1).

other person with whom the account is maintained, either directly or through an agent, nominee, attorney or in some other capacity on behalf of the U.S. person, either orally or by some other means.[6]

The court did not address which definition applied but ruled that, even under the broad definition provided by the government, W did not have authority over the Finter account in 2008 and that her husband could not be seen as acting on her behalf.

In its discussion, the court pointed out the following facts. Finter would not allow H to open the account in both of their names. H was able to withdraw funds from their joint account and deposit it into the Finter account with his name only. Without a signature specimen, W could not write to, or otherwise, directly communicate with, the bank "to control the disposition of money, funds or other assets" in the Finter account.[7]

"Form 1040, Schedule B, asks whether a foreign bank account exists and not whether it is taxable."

Therefore, W could not exercise signature authority over the Finter account, and by taking money that was in W's name and placing it in an account that was not in her name, H could not, in any light, be seen as acting on her behalf.

What Facts Amount to "Willful Blindness"?

If a taxpayer fails to file a timely F.B.A.R., the Secretary of the Treasury may impose a financial penalty.[8] If the failure is not "willful," the amount is capped at $10,000.[9] However, if the failure is a willful violation, the amount is greater of (i) $100,000 or (ii) 50% of the balance in the account at the time of the violation.[10]

According to H and W, they conversed with other expatriates living in Saudi Arabia and were led to believe that they were not required to pay U.S. tax on the income they earned in the country if the funds remained overseas. H stated that he did not think he needed to file the F.B.A.R., while W stated that she did not even know what an F.B.A.R. was at that time. Further, she pointed out that she never participated in filing the income tax returns and that her husband handled all of the taxes. According to the pair, their accountant neither asked about overseas bank accounts nor explained the F.B.A.R. or the question on Form 1040, Schedule B, that addresses foreign accounts. H and W insisted that neither of them had actual knowledge of the F.B.A.R. requirement and therefore penalties for willful violations were not appropriate.

The government countered by pointing out that despite H and W's testimony, the simple instructions in Part III of Form 1040, Schedule B, state that "you must complete this part if you (a) had over $1,500 of taxable interest or ordinary dividends, or (b) had a foreign account." According to the government, H and W met both of the requirements. Interestingly, the government pointed out Form 1040, Schedule B, asks whether a foreign bank account exists and not whether it is taxable.

The court discussed various cases and concluded that H and W declared, under

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6 Form TD F 90-22.1 (Rev. 10-2008).

7 31 C.F.R. §1010.350(f)(1).

8 31 U.S.C. §5321(a)(5)(A).

9 31 U.S.C. §5321(a)(5)(B)(i).

10 31 U.S.C. §5321(a)(5)(C)(i).

penalty of perjury, that they had examined the returns and accompanying schedules and statements and that, to the best of their knowledge, the return was true, accurate, and complete. The tax return included a question about whether they had foreign accounts, followed by a cross-reference to exceptions and filing requirements for the F.B.A.R. Further, the court reiterated that a taxpayer who signs a tax return will not be able to claim innocence because they did not actually read the return. Their signatures were *prima facie* evidence that they, by application of reasonable care or diligence, knew the contents of the return, including the question about foreign accounts and the cross-reference to filing requirements, which put them "on inquiry notice of the F.B.A.R. requirement."[11]

In response to the claim that other expatriates advised H and W that they did not need to pay taxes on the interest in the foreign accounts, the court noted that these expatriates' credentials were not before the court nor was there any information from which to assess whether it was reasonable for them to accept this information as legally correct. And, in any event, these views would not override the clear instructions on Schedule B, which, as noted, requires a "Yes" answer if the taxpayer has an interest in a foreign account, regardless of whether the funds within it constituted taxable income.

Moreover, the fact that the H and W discussed the tax liabilities on these foreign accounts demonstrated their awareness that the income could be taxable. The failure to have the same conversation with their accountant easily showed "a conscious effort to avoid learning about reporting requirements." Based on these facts, the court ruled that willful blindness can be inferred.

THE CONCLUSION

To reiterate, a U.S. person must file the F.B.A.R. if that person has a financial interest in or signature authority over any financial account(s) outside of the U.S. and the aggregate maximum value of the account(s) exceeds $10,000 at any time during the calendar year. Question 7a of Form 1040 Schedule B specifically asks whether the taxpayer has a financial interest in or signature authority over a foreign financial account and whether the taxpayer was required to make an F.B.A.R. filing.

The recent Horowitz case is helpful when we look at the application of this rule. The case stands out for three reasons: First, the removal of penalties from I.R.S. database does not negate the actual penalties without additional approvals. Further, it is notable that, even under the broad definition used by the government, the court did not find that a spouse has control over a foreign account opened by her husband and funded from a joint account if she is not empowered to communicate directly with the bank. Finally, and most crucially for many taxpayers, marking "No" on Form 1040, Schedule B, can negate non-willfulness, as the taxpayer is expected to know what is in the tax return.

[11] *Williams II*, 489 Fed App'x at 659.