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How can filing form 1040 potentially affect FBAR penalties?

U.S. persons are normally required to report their foreign bank accounts. The U.S. government imposes a penalty on U.S. taxpayers who fail to do so. However, do you know that you can be subject to higher FBAR penalties by merely filing your personal tax return, Form 1040? This Article will explore what FBAR is and how signing your Form 1040 return can affect your FBAR penalties.

What is FBAR?

In 1970, the Bank Secrecy Act was enacted in response to the widespread use of foreign financial accounts for the purpose of evading U.S. tax. Congress gave the Treasury Secretary the authority to prescribe regulations necessary to implement the Bank Secrecy Act. Consequently, the Treasury Secretary required that a U.S. person with an interest in or control over one or more foreign accounts with a value over $ 10,000 at any time during that calendar year file an FBAR before June 30 of the following year.

Why Does Willfulness Matter?

If a U.S. person violates this regulation, the IRS may assess a civil money penalty that does not exceed $ 10,000 on the person unless such violation was due to a reasonable cause. However, if the U.S. person willfully violates this reporting requirement, the penalty will be dramatically increased to the greater of $ 100,000 or 50 percent of the balance in the account at the time of the violation. As one can tell, whether such violation was due to willing action or not makes a significant difference when it comes to civil money penalty assessment. Indeed, to encourage voluntary disclosure of foreign accounts in exchange for leniency on FBAR penalties, the IRS implemented the Streamlined Foreign Offshore Procedures and the Streamlined Domestic Offshore Procedures. To qualify for these programs, the taxpayer must certify that his or failure to report the financial account was no – willful.

Can filing a Form 1040 be used to establish “Willfulness”?

Congress did not define the term “willful” in 31 U.S.C. § 5321. Wherever the Bank Secrecy Act specifically defined the related penalty as “civil money penalty.” When “willfulness” is set as a condition for civil liability, the term “willfulness” generally includes knowing violations as well as reckless ones.

An action is considered reckless when such action enters an unjustifiably high risk of harm that the actor either knows or has constructive knowledge of, meaning the person ought to know of such risk. When establishing “willfulness”, the U.S. government can be very creative.

One common action that can be used to infer “constructive knowledge” is the taxpayer signing his or her Form 1040 under the penalty of perjury with the statement that he or she has reviewed the entire Form 1040, which includes Schedule B. Schedule B asks the question whether the taxpayer has a financial interest or signatory authority over certain foreign accounts. The U.S. government believes that this informs the U.S. person of their responsibility to file FBAR.

The Fourth Circuit Court of Appeal agrees with the reasoning above. The district court explained in Williams that willfulness can be inferred when the taxpayer engaged in conduct designed to conceal financial information, including the taxpayer’s conscious effect to avoid learning about his or her reporting responsibilities. The court further reaffirmed that when a taxpay signs the Form 1040 and, the taxpay acknowledged that he has examined Form 1040 as well as all Schedules attached and that the return was “true, accurate, and complete” to his or her best knowledge. The questions and information in Part III of Schedule B are sufficient to notify the taxpayer of his or her FBAR filing responsibilities. Thus, the taxpayer’s signature constitutes prima facia evidence that the taxpayer knew the content of the Forms filed.

However, if the taxpayers live in Texas, the story may be different. The taxpayer in Smoke tested that “he did not read tax turns‘ word for word, ’and that he‘ didn’t bother the IRS instructions on the FBAR filing requirements. “The U.S. government made the argument that if the court ruled in favor of the taxpayer, the decision would encourage “taxpayers to sign tax returns without reading them in the hope of avoiding any negative consequences from inadequate reporting” and that “taxpayer” could easily avoid liability by simply claiming that he or she did not read or bother reading what he or she was signing. The court rejected the this argument. Instead, the court explained, “If every taxpayer, merely by signing a tax return, is presumed to know the need to file an FBAR, it is difficult to conceive of how a violation could be no – illful.”

Although the District Court in Flume eventually found the taxpayer’s violation willful, the District Court did not reserve its earlier position. The District Court emphasized that the ownership structure of the financial assets used by the taxpayer was carefully crafted and designed as a “sophisticated tax evasion scheme” and that he disclosed a Mexican account on Schedule B, which shows that he was aware of his FBAR duty.

Conclusion

The U.S. government can prove willfulness in an FBAR case by showing that a taxpayer either

knowingly or recklessly violated the FBAR duty. However, it does not appear that different circuits have reached an agreement on whether taxpayers can be found willing by merely signing Form 1040. When a court determines whether a taxpayer's violation was willful or not, it normally takes into consideration multiple elements such as the taxpayer's financial literacy, business sophistication, and the taxpayer's course of dealing with foreign financial institutions. If you have questions when assessing your FBAR compliance process, contact THEVOZ & Partners to consult your particular situation. Our attorneys take the time necessary to fully understand your matter and provide you with quality service and we keep you informed at every stage of the process.