



*New Legislation Could Affect Filers
of the Report of Foreign Bank and
Financial Accounts, but Potential
Issues Are Being Addressed*

September 29, 2010

Reference Number: 2010-30-125

This report has cleared the Treasury Inspector General for Tax Administration disclosure review process and information determined to be restricted from public release has been redacted from this document.



HIGHLIGHTS

NEW LEGISLATION COULD AFFECT FILERS OF THE REPORT OF FOREIGN BANK AND FINANCIAL ACCOUNTS, BUT POTENTIAL ISSUES ARE BEING ADDRESSED

Highlights

Final Report issued on September 29, 2010

Highlights of Reference Number: 2010-30-125 to the Internal Revenue Service Commissioner for the Small Business/Self-Employed Division.

IMPACT ON TAXPAYERS

As a result of new legislation on foreign tax reporting and disclosure of financial assets, some taxpayers may be required to file the Report of Foreign Bank and Financial Accounts (FBAR) and the new foreign financial assets disclosure statement with their income tax return. These reporting requirements will potentially add to both taxpayer burden and the complexity of tax law changes. Specifically, United States citizens, residents, and domestic entities that have a financial interest in, or signature authority or other authority over, a foreign financial account that exceed \$10,000 in the aggregate at any time during the calendar year are required to file the FBAR. New legislation will require individual taxpayers with an aggregate balance of more than \$50,000 in foreign financial assets to file a disclosure statement with their income tax return. The Internal Revenue Service (IRS) is working to address the impact that the legislative requirements have on United States citizens and residents.

WHY TIGTA DID THE AUDIT

This audit was initiated as part of our Fiscal Year 2010 Annual Audit Plan and addresses the major management challenge of Globalization. The overall audit objectives of this review were to assess the policies and guidelines in place over information gathered with the FBAR by the Department of the Treasury and to determine how the IRS is monitoring and improving compliance with the FBAR filing.

WHAT TIGTA FOUND

The IRS, in collaboration with the Financial Crimes Enforcement Network, has revised the FBAR form and instructions, conducted education and outreach efforts on the filing of FBARs, increased the number of civil examination closings dealing with FBARs, and increased the number of FBAR penalty assessments and collections. From Calendar Years 2004 to 2009, the number of FBARs filed with the IRS has increased 145 percent from 217,699 to 534,043. In addition, the recently passed new legislation added Internal Revenue Code Section 6038D, requiring an individual taxpayer with an aggregate balance of more than \$50,000 in foreign financial assets to file a disclosure statement with his or her income tax return in addition to possibly being required to file an FBAR.

WHAT TIGTA RECOMMENDED

TIGTA made no recommendations in this report. However, IRS management officials reviewed the report prior to its issuance and agreed with the facts and conclusions presented.



TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20220

September 29, 2010

MEMORANDUM FOR COMMISSIONER SMALL BUSINESS/SELF-EMPLOYED
DIVISION

Michael R. Phillips

FROM: Michael R. Phillips
Deputy Inspector General for Audit

SUBJECT: Final Audit Report – New Legislation Could Affect Filers of the Report of Foreign Bank and Financial Accounts, but Potential Issues Are Being Addressed (Audit # 201030039)

This report presents the results of our review to assess the policies and guidelines in place over information gathered with the Report of Foreign Bank and Financial Accounts (FBAR) by the Department of the Treasury and to determine how the Internal Revenue Service (IRS) is monitoring and improving compliance with the FBAR filings. This audit was conducted as part of our Fiscal Year 2010 Annual Audit Plan and addresses the major management challenge of Globalization.

Although we made no recommendations in this report, we did provide IRS officials an opportunity to review and provide comments on a draft of this report. IRS management did not provide us with any comments on the draft report. We intend to continue to follow the IRS' progression with addressing the FBAR reporting requirement and its impact on United States citizens, residents, and businesses. As appropriate, we will consider conducting a followup review in the future to ensure compliance with the law and regulations.

Copies of this report are also being sent to the IRS managers affected by the report conclusions. Please contact me at (202) 622-6510 if you have any questions or Margaret E. Begg, Assistant Inspector General for Audit (Compliance and Enforcement Operations), at (202) 622-8510.



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Abbreviations

BSA	Bank Secrecy Act
CBRS	Currency Banking and Retrieval System
C.F.R.	Code of Federal Regulations
ECC	Enterprise Computing Center
FBAR	Report of Foreign Bank and Financial Accounts
FinCEN	Financial Crimes Enforcement Network
HIRE	Hiring Incentives to Restore Employment
I.R.C.	Internal Revenue Code
IRS	Internal Revenue Service
SB/SE	Small Business/Self-Employed
U.S.	United States



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Background

Congress passed the Bank Records and Foreign Transactions Act of 1970, commonly referred to as the Bank Secrecy Act (BSA) of 1970,¹ due to concerns about the growing use of secret foreign bank accounts to hide income, manipulate United States (U.S.) securities markets, circumvent insider trading rules, act as a depository for illegally acquired funds, and acquire control of U.S. industries. The law was enacted because of the growing complexity of the national and international economy and a technological revolution in white-collar crime where the activities of white-collar criminals had increased using financial institutions at home and abroad. The Department of the Treasury delegated authority to the Internal Revenue Service (IRS) for the filing and enforcement of Section (§) 5314 of the BSA² that requires citizens or residents of the U.S. or a person in, or doing business in, the U.S. to file reports and keep records if they have a financial interest in, or signature or other authority over, one or more financial accounts outside the U.S. with an aggregate value greater than \$10,000 at any time during the year. Thus, in December 1970, the IRS created the first Report of Foreign Bank and Financial Accounts (FBAR) form, originally named the U.S. Information Return on Foreign Bank, Securities, and Other Financial Accounts (Form 4683), to assist taxpayers in complying with their compliance responsibilities under the BSA on transactions with foreign financial institutions by filing it with their returns.

As a result of the attempted misuse of the IRS and its authority during the Watergate scandal³ and other abuses of tax return and tax return information, Congress revised the law regarding the confidentiality and disclosure of tax return and tax return information with the passage of the Tax Reform Act of 1976,⁴ amending Internal Revenue Code (I.R.C.) § 6103. This revision made fundamental changes in the treatment of tax return and tax return information that required substantial modifications in the methods of filing and enforcement of the FBAR. Consequently, after 1976, access to tax return and tax return information outside the IRS became highly restricted under the new provisions of I.R.C. § 6103. In order for the Department of the Treasury to maintain access to FBAR information for other criminal, tax, and regulatory investigations and proceedings and to comply with the original intent of the 1970 BSA legislation, the Department of the Treasury removed the foreign bank account report from the income tax return and reissued and renamed U.S. Information Return on Foreign Bank, Securities, and Other

¹ Public Law (Pub. L.) 91-508.

² 31 United States Code (U.S.C.) Section (§) 5314 (2010).

³ The Watergate scandal was a political scandal in the U.S. in the 1970s, resulting from the break-in to the Democratic National Committee headquarters at the Watergate office complex in Washington, D.C. Effects of the scandal ultimately led to the resignation of President Richard Nixon on August 9, 1974; the first, and so far only, U.S. President to resign. It also resulted in the indictment and conviction of several Nixon administration officials.

⁴ Pub. L. 94-455.



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Financial Accounts (Form 4683) (the FBAR reporting mechanism from 1970 to 1976) to Treasury Form Report of Foreign Bank and Financial Accounts (TD F 90-22.1) (the existing FBAR reporting mechanism). It also made the form applicable to all U.S. citizens and residents, not just taxpayers. With the passage of the Tax Reform Act of 1976, the IRS' responsibility was generally limited to FBAR processing operations. However, from 1992 to 2003, authority over the FBAR has slowly reverted to the IRS (See Appendix IV for a description of FBAR authorities.)

As a result of these authoritative changes, the IRS is now responsible for:

- The education related to FBAR filings.
- Revisions to the FBAR Form TD F 90-22.1 and its instructions.
- Civil and criminal enforcement of FBAR provisions.
- Receipt and processing of FBAR Form TD F 90-22.1 into the Currency Banking and Retrieval System (CBRS).⁵
- Proposing to the Financial Crimes Enforcement Network (FinCEN) revisions to the regulations in 31 Code of Federal Regulations (C.F.R.) Part 103 to further enhance enforcement of 31 United States Code (U.S.C.) § 5314.

In addition, the IRS' Office of Chief Counsel will provide legal advice, interpretation, and assistance to IRS officers and employees on all matters pertaining to the FBAR. The IRS' Chief Counsel will also advise on, prepare, or issue administrative rulings and proposals for regulatory revisions, including consulting with the FinCEN's Office of Chief Counsel. The FinCEN retained its authority to draft regulations for the FBAR.

On March 18, 2010, the President signed the Hiring Incentives to Restore Employment (HIRE) Act⁶ that contains a provision that will both complement and contrast with the FBAR filing requirement. Specifically, § 511 of the HIRE Act added § 6038D to Title 26 of the U.S.C., the Internal Revenue Code, requiring individual taxpayers with an aggregate balance of more than \$50,000 in foreign financial assets to file a statement with his or her income tax return. Unlike the FBAR information, which originates under Title 31 of the U.S.C. and normally is not permitted to be verified against tax return or tax return information due to privacy and disclosure concerns, the new provision under I.R.C. § 6038D will have none of these restrictions. This change will allow the IRS to use its full complement of tools to verify the information or lack of information filed. The legislative history of the FBAR stresses that its broad, primary purpose is

⁵ The CBRS is a system of databases operated and maintained by the IRS on which information from both paper-filed and electronically filed forms (required by the BSA) reside for research by Federal, State, and local law enforcement organizations.

⁶ Pub. L 111-147.



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intended to be a resource to combat white-collar crime and not just the narrower objectives of the Internal Revenue Code.

This review was performed at the IRS National Headquarters in Washington, D.C., in the Criminal Investigation Division, Large and Mid-Size Business Division, Office of Chief Counsel, and Small Business/Self-Employed (SB/SE) Division and the Enterprise Computing Center (ECC) in Detroit, Michigan, during the period April through June 2010. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective. Detailed information on our audit objectives, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.



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Results of Review

The Internal Revenue Service Is Engaged in Public and Employee Awareness Activities on the Filing of the Report of Foreign Bank and Financial Accounts

Individuals required to file the FBAR form are defined as a United States person⁷ who has a financial interest in or signature or other authority over any foreign financial accounts, including bank, securities, or other types of financial accounts in a foreign country,⁸ if the aggregate value of these financial accounts exceeds \$10,000 at any time during the calendar year. These individuals must report that relationship each calendar year by filing this report with the Department of the Treasury on or before June 30 of the succeeding year. FBAR filers send the reports to the IRS' Enterprise Computing Center (ECC) where they are received, numbered,⁹ and perfected.¹⁰ The reports are then shipped to a private contractor who transcribes the data. The information from the FBAR is then downloaded and posted onto the CBRS for use by Federal and State criminal, tax, and other government regulatory agencies.

Each United States person who has a financial interest in or signature or other authority over a foreign financial account exceeding \$10,000 at any time during the calendar year must file an FBAR on or before June 30 of the succeeding year.

⁷ The term "United States person" means a citizen or resident of the United States or a person in and doing business in the United States. A "person" is defined in 31 C.F.R. § 103.11(z) as an individual, a corporation, a partnership, a trust or estate, a joint stock company, an association, a syndicate, a joint venture or another unincorporated organization or group, an Indian Tribe, and all entities cognizable as legal personalities. "United States" is defined in 31 C.F.R. § 103.11(nn) as the States of the United States, the District of Columbia, the Indian lands, and the Territories and Insular Possessions of the United States. To address concerns raised about a change in the definition of United States person appearing in the instructions to October 2008 revision of the FBAR. The IRS issued guidance to FBAR filers advising them to rely on the early definition found in the instructions to July 2000 version of the form in making their reports for 2009 and earlier calendar years. The July 2000 instructions describe the term "United States person" to mean (1) a citizen or resident of the United States, (2) a domestic partnership, (3) a domestic corporation, or (4) a domestic estate or trust. See Announcement 2009-51, 2009-25 I.R.B. 1150, and Announcement 2010-16, 2010-11 I.R.B. 450.

⁸ A "foreign country" includes all geographical areas located outside the United States as defined in 31 C.F.R. § 103.11(nn).

⁹ FBAR reports are individually numbered with a document locator number.

¹⁰ FBAR report entries are standardized and then reviewed for accuracy.



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The transcribed documents are returned to the ECC, where they are temporarily stored before being sent for final storage at a Federal Records Center. Based on our prior audit,¹¹ the SB/SE Division established a Quality Review process to perform periodic statistically valid reviews of documents input to the CBRS database to identify any problems, determine their cause, and implement appropriate corrective actions. The Program Manager, Currency Transaction Report Operations, at the ECC informed us on June 3, 2010, that the recommended change in control from our prior report remains in place and continues to provide beneficial information to identify and correct problems with FBAR report processing and transcription.

Revisions to the Report of Foreign Bank and Financial Accounts

With the delegation of civil enforcement authority from the FinCEN to the IRS in April 2003, the IRS' SB/SE Division was given the task of revising the FBAR Form TD F 90-22.1 and its instructions. Prior to handing over the effort to revise the form, the FinCEN had gathered comments from FBAR filers indicating that an updated form should eliminate duplicate information in the form, incorporate user-friendly instructions, use understandable definitions, contain a continuation sheet for use by multiple filers, address procedures for joint accounts of spouses or business partners, and include updated terminology and more examples of the types of financial accounts that are to be reported on the FBAR.

During the 2003 and 2004 FBAR filing periods, the IRS gathered additional information from the following sources to determine areas of confusion in completing the form:

- Questions received from FBAR filers.
- Questions and comments from the IRS' FBAR examiners.
- Requests for clarification from tax practitioners of what should be reported, and by whom, as well as requests to consider new exceptions to the current requirements.
- Requests from various groups to be exempted from the filing requirements.
- Responses to IRS correspondence regarding errors on FBAR filings.

In addition, requests from the public clarified for the FinCEN and the IRS that the new form and instructions needed to explain and expand, if possible, the filing exceptions for persons with no financial interest in, but signature or other authority over, foreign financial accounts. Based on all the information gathered by the IRS and the FinCEN, the FinCEN and the IRS prepared a revised FBAR form and related instructions. In early Calendar Year 2006, a revised form and instructions were published on the IRS web site and in the Federal Register for public comment. As a result, a revised FBAR Form TD F 90-22.1 modifying several aspects of the FBAR form

¹¹ *The Detroit Computing Center Adequately Processed Paper Bank Secrecy Act Documents, but Quality Reviews Should Be Implemented to Ensure Compliance With Quality Standards* (Reference Number 2004-30-070, dated March 9, 2004).



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and instructions was issued in October 2008. An electronic version of the FBAR form is under development jointly by the FinCEN and the IRS for future use.

Education and outreach activities encouraging filing compliance

In prior FBAR reports to Congress,¹² it was recommended by the Secretary of the Treasury to implement outreach and education efforts to improve compliance with the FBAR reporting requirements. The IRS received delegation of civil enforcement authority from the FinCEN in April 2003 and, therefore, became responsible for assessing better education and guidance on FBAR filing requirements and implementing improvements.

In CY 2003, the SB/SE Division's Taxpayer Education and Communications Unit created the brochure, *Do You Have a Foreign Financial Account?* (Publication 4261). Additionally, IRS educational and outreach activities have been extensive. Using CY 2008 as an example, the following outreach events occurred:

- The International Office, Large and Mid-Size Business Division, conducted four presentations to the American Bar Association addressing FBARs and civil penalties. Attendees estimated at 240 attorneys.
- The Large and Mid-Size Business Division conducted an additional 12 seminars on FBAR filing requirements at 6 IRS Nationwide Tax Forums with approximately 150 attendees at each session.
- The Large and Mid-Size Business Division also made 2 presentations on the FBAR filing requirement to the National Association of Enrolled Agents, which included approximately 80 participants.
- The Office of Stakeholder Liaison, SB/SE Division, conducted 4 FBAR-related outreach events attended by more than 600 tax practitioners, including one event that addressed the directors of 20 national practitioner associations.
- The IRS Criminal Investigation Division made several presentations to the American Bar Association addressing FBAR compliance and voluntary disclosure issues.
- On October 28, 2008, the Director, Fraud/BSA, SB/SE Division, participated in a panel discussion on FBAR compliance at the 2008 Annual University of California Los Angeles Tax Controversy Institute, which was attended by approximately 300 tax practitioners.
- On October 28, 2008, the BSA staff members discussed the new FBAR form at a meeting of the FBAR Task Force, a subgroup of the International Tax Technical Resource Panel of the American Institute of Certified Public Accountants.

¹² Required by § 361(b) of the USA PATRIOT Act, Pub. L. 107-56.



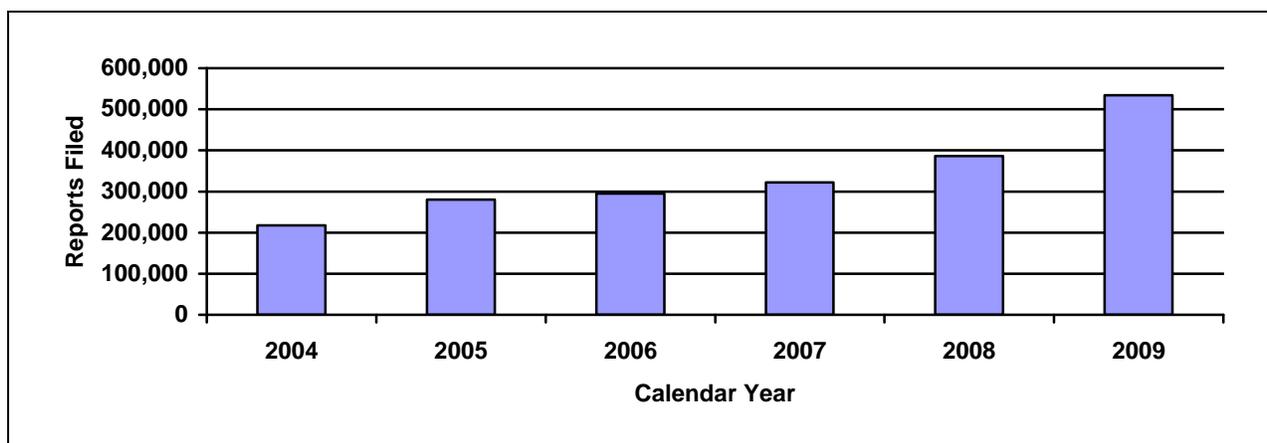
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In addition to the CY 2008 events, the IRS issued a news release, assisted in answering individual taxpayer’s FBAR questions, and assisted with an FBAR article published by the Journal of Tax Practice & Procedure.¹³ Also, the IRS Currency Transaction Report Operations in the Fraud/BSA Unit established a toll-free telephone line to address FBAR questions from the public and received 5,213 inquiries. The Currency Transaction Report Operations also handled 64,089 FBAR written inquiries, most of which were responses to correspondence generated by the ECC regarding FBAR filings.

Report filings and compliance activities increased from Calendar Year 2004 to 2009

Since the IRS assumed civil compliance efforts in April 2003, the number of FBAR filers has continued to increase each year. Specifically, between Calendar Years 2004 and 2009, the number of FBARs filed increased 145 percent from 217,699 to 534,043 (see Figure 1).

Figure 1: Report Filings – Calendar Years 2004 to 2009



Source: IRS Information Provided to FinCEN

The IRS and the FinCEN currently do not have an established method to estimate the potential population of required filers.¹⁴ First and foremost, the FBAR filing program relies on self-reporting. Persons trying to hide money abroad often open their financial accounts in jurisdictions well known for their bank secrecy laws. In addition, some of these jurisdictions do

¹³ Steven Toscher and Michel R. Stein, “FBAR Enforcement Five Years Later,” *Journal of Tax Practice & Procedure*, (June-July 2008): pages 37–58.

¹⁴ In April 2002, the Department of the Treasury reported to Congress that as many as 1 million U.S. taxpayers may be required to file FBARs; however, the IRS notified the Treasury Inspector General for Tax Administration during this review that the estimate could not be relied upon because factors used in making the original estimate were later found to have no actual correlation to the population.



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not have Mutual Legal Assistance Treaties¹⁵ with the United States, while others that may have treaties providing for disclosure of relevant information do so only under strict and specific circumstances. Therefore, third-party information that does exist and might be useful in developing a population estimate or be used in some form as part of a matching program with the FBAR data is often of limited value or is unavailable due to legal restrictions.

When the IRS is conducting compliance activities under its delegated authority from the FinCEN regarding the FBAR, it is acting as the FinCEN's agent and it is not normally permitted to use tax return or tax return information gathered under Title 26. This stipulation is because the authority to enforce the FBAR filing requirements is derived from delegations of authority from the FinCEN and is wholly independent from the IRS' tax administration enforcement authority under Title 26. Under the basic principles of agency law, a principal (the FinCEN) may not delegate to its agent or nominee (the IRS) authority that it does not possess. Because the FinCEN could not access or disclose tax return or tax return information for purposes of enforcing the FBAR provision of Title 31 unless a related statute determination is made, the FinCEN cannot achieve that same purpose by delegating enforcement authority to the IRS. As a result, when the IRS is operating solely on its delegated authority from the FinCEN while enforcing FBAR provisions, it is precluded from using tax return or tax return information or information systems derived from that information. Therefore, not only does the IRS have separate examination guidelines in the Internal Revenue Manual for FBAR examinations,¹⁶ it has also been required to develop FBAR processing and inventory case control systems separate and apart from the tax return processing and examination return control systems. The IRS is permitted to use return information in a limited case-by-case basis for FBAR compliance purposes only if a related statute determination is made that the information needed in the FBAR case is also relevant to the ongoing income tax examination.

Based on its FBAR authority from the FinCEN, the IRS operated two Compliance Initiative Projects.¹⁷ In one initiative, a test group of 117 individuals was identified that had not filed an FBAR, but filed another BSA report that indicated they might have an FBAR filing requirement. Letters were sent to the test individuals asking them to respond to indications of a potential FBAR filing liability. Of the 117 letters mailed, 26 were returned undeliverable. Of the 91 letters not returned, 25 responses were received with 3 people filing 5 FBAR reports. Due to the small and non-statistical nature of the sample size, the IRS does not consider the results meaningful and, therefore, closed the initiative. During our review, the IRS advised us they plan to conduct additional work in this area in the future.

¹⁵ Mutual Legal Assistance Treaties are bilateral treaties for criminal matters that seek to improve the effectiveness of judicial assistance and to regularize and facilitate procedures.

¹⁶ Internal Revenue Manual 4.26.16, Report of Foreign Bank and Financial Account (FBAR) and Internal Revenue Manual 4.26.17, Report of Foreign Bank and Financial Accounts (FBAR) Procedures.

¹⁷ A Compliance Initiative Project is any activity involving contact with specific taxpayers and collection of taxpayer data within an Examination function group, using either internal or external data to identify potential areas of noncompliance with the Examination function group, for the purpose of correcting the noncompliance.

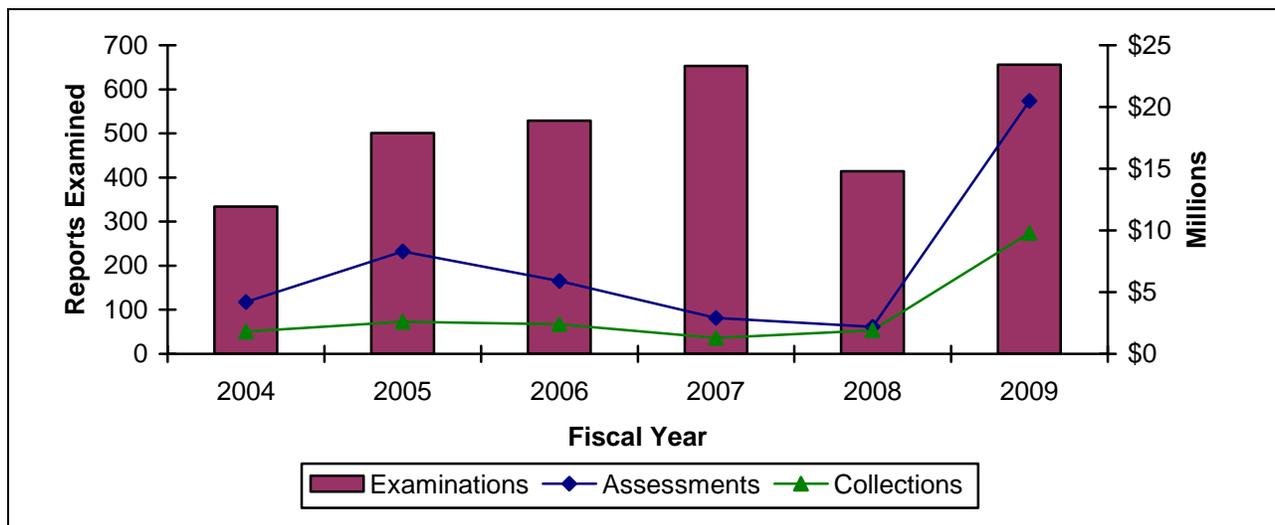


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A second initiative for FBAR compliance is the FBAR Stop Filer Project. This Project identifies individuals who filed FBAR reports in prior calendar years, but did not file in the current year. Correspondence is generated to remind those identified individuals that an FBAR filing may be required if the account(s) still exist. The SB/SE Division's Fraud/BSA Unit staff at the ECC is coordinating with the IRS Information Technology Office to develop an automated system within the CBRs that identifies individuals who filed in prior calendar years, but not in the current year. There are no results yet for this initiative as it is still being worked.

Between Fiscal Years 2004 and 2009, FBAR-related examinations created a 96 percent increase (from 334 to 656) in FBAR civil examinations. In addition, Examination function FBAR penalty assessments grew from \$4.2 million to \$20.5 million, an increase of 388 percent over the same period, while FBAR penalty collections grew from \$1.8 million to \$9.8 million, an increase of 444 percent (see Figure 2). Between Calendar Years 2007 and 2009, criminal sentencings for failure to file an FBAR declined from four to two.

**Figure 2: The Report of Foreign Bank and Financial Accounts
Civil Examinations, Assessments, and Collections
(Fiscal Years 2004 to 2009)**



Source: 2004, 2005, and 2006 Reports to Congress in Accordance with Section 361(b) of the PATRIOT Act and IRS Information Provided to FinCEN.

Actions Are Being Taken to Address Taxpayers' Concerns With New Foreign Reporting Requirements

On March 18, 2010, the President signed the HIRE Act, containing the Foreign Account Tax Compliance Act, into law. Section 511 of the HIRE Act added I.R.C. § 6038D, requiring an individual taxpayer with foreign financial assets with an aggregate balance exceeding \$50,000



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during a taxable year to file a disclosure statement with his or her income tax return for that taxable year. The new law requires that the disclosure statement describes the maximum value of the assets during the taxable year. The disclosure statement should also provide the following information in the case of a:

1. Financial account – the name and address of the foreign financial institution in which such account is maintained and the number of such account.
2. Stock or security – the name and address of the foreign issuer and such information as is necessary to identify the class or issue of which such stock or security is part.
3. Contract, interest, or other instrument – such information as is necessary to identify such contract, interest, or other instrument and the names and addresses of all foreign issuers and counterparties with respect to such contact, interest, or other instrument.

The IRS is in the process of developing procedures and releasing guidance to implement these new Foreign Account Tax Compliance Act provisions. On April 19, 2010, the Department of the Treasury and the IRS asked for public comment regarding guidance projects and issues concerning interpretation and implementation of the new provisions.¹⁸ Unlike its FBAR compliance efforts that rely on delegated authority from the FinCEN and that are restricted due to concerns in the use of tax return or tax return information under I.R.C. § 6103, the new provision under I.R.C. § 6038D eliminates these concerns and allows the IRS to use its own tax administration authority. This authority should allow the IRS to develop a matching system where it can verify the I.R.C. § 6038D data against the Automatic Exchange Information Program¹⁹ data to identify undisclosed accounts or assets.

While there are benefits to the IRS using its own tax administration authority, I.R.C. § 6038D is not a cure. Many of the problems encountered with the FBAR will continue to plague the new provision as well. For example:

- The IRS will face the same problem with the new provision as it does with the FBAR provision as there is no easy method to determine what constitutes the potential population filing base.
- The new provision will be self-reported, similar to the FBAR. Therefore, persons trying to hide money abroad will open financial accounts in jurisdictions well known for their bank secrecy laws where they do not exchange information with the United States, making it unlikely that these accounts will ever be reported.

¹⁸ Announcement 2010-22, 2010-16 I.R.B. 602.

¹⁹ The Automatic Exchange Information Program works through operation of U.S. income tax treaties, in which a treaty partner will send income data on income earned on the treaty partner's soil by U.S. addressees and the U.S., will send income data on income earned in the U.S. by addressees of the treaty partner.



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Another problem is that many taxpayers will find that their filing requirements will not only have increased, but also become considerably more complicated as a result of the addition of I.R.C. § 6038D. For example:

- Taxpayers not only will be required to file the new information for I.R.C. § 6038D, but they may also be required to file an FBAR.
- Taxpayers may also find that certain terms are defined differently in the BSA regulations and the Internal Revenue Code. For example, the term United States is defined in the BSA regulations as *...the States of the United States, the District of Columbia, the Indian lands, and the Territories and Insular Possessions of the United States.*²⁰ While in the I.R.C. it is defined as *“United States” when used in a geographical sense includes only the States and the District of Columbia.*²¹
- Complexity will also be encountered because of the differences between the FBAR requirements and I.R.C. § 6038D; individual taxpayers in similar circumstances could have different reporting outcomes. (See Appendix V for the differences with these two provisions.)

The following example demonstrates the potential differences in these two provisions:

Two individual taxpayers owning foreign stocks worth \$55,000 can end up with entirely different reporting outcomes. One taxpayer that owns \$55,000 in foreign stocks through a foreign stock brokerage account would be required to file both an FBAR and complete the I.R.C. § 6038D disclosure on his or her tax return, while the other taxpayer that held \$55,000 worth of foreign stocks issued by a person other than a U.S. person outside of a foreign financial account would only be required to complete the I.R.C. § 6038D disclosure on his or her tax return. In this example, if the amount the stock is worth is reduced from \$55,000 to \$45,000, the first taxpayer is only required to file an FBAR and the second taxpayer is not required to file a disclosure of any type.

The IRS continues to make progress in compliance, education, and outreach programs for the FBAR that are resulting in increased FBAR filings despite the legal impediments that exist. The new reporting provision under I.R.C. § 6038D should remedy many of the current legal restrictions that the IRS now faces when using the FBAR provision or FBAR data in tax investigation of foreign financial accounts that result from the interaction of the disclosure provisions of Title 26, I.R.C. § 6103, with Title 31. This change should permit the IRS to use its full range of tax administration tools on tax investigations for foreign financial accounts with balances of more than \$50,000. However, taxpayers with foreign financial assets may face additional complexity and burden resulting from an additional layer of the new disclosure requirements. We intend to continue to follow the IRS’ progression with addressing the FBAR

²⁰ 31 C.F.R. § 103.11(nn) (2010).

²¹ I.R.C. § 7701(a)(9) (2010).



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reporting requirements and their impact on U.S. citizens, residents, and businesses. As appropriate, we will consider performing a followup review in the future to ensure compliance with the laws and regulations.



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Appendix I

Detailed Objectives, Scope, and Methodology

Our overall objectives were to assess the policies and guidelines in place over information gathered with the Report of Foreign Bank and Financial Account (FBAR) by the Department of the Treasury and determine how the IRS is monitoring and improving compliance with the FBAR filing. To accomplish our objectives we:

- I. Reviewed the history surrounding the FBAR and the IRS' history in administering it by:
 - A. Reviewing the committee reports and other pertinent information regarding passage of the Bank Secrecy Act of 1970¹ that established the FBAR.
 - B. Reviewing the changes to the FBAR and FBAR administration brought about due to revision of I.R.C. § 6103 concerning disclosure of tax return and tax return information in the Tax Reform Act of 1976.²
 - C. Reviewing the delegation orders that transferred authority to the IRS for administering the FBAR.
- II. Identified and reviewed the legal requirement in the United States Code and Combined Federal Regulations requiring information in the FBAR and the civil and criminal penalty provisions for failure to file the FBAR or maintain the information.
- III. From information provided by the IRS, determined:
 - A. The number of FBARs filed annually between CY 2004 and CY 2009.
 - B. The number of civil FBAR examinations closed annually between FY 2004 and FY 2009.
 - C. The number of civil FBAR enforcement actions closed annually between FY 2004 and FY 2009 resulting in no action, a warning letter, or civil penalties.
 - D. The number of criminal sentencings obtained between CY 2004 and CY 2009.
 - E. Reviewed Internal Revenue Manual 4.26 Bank Secrecy Act sections regarding civil examinations and assessments of the FBAR penalty.
 - F. Reviewed the information from the CY 2002 through CY 2008 annual reports submitted to Congress on FBARs required by Section 361 of the Uniting and

¹ Public Law (Pub. L) 91-508.

² Pub. L. 94-455.



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Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism (USA PATRIOT) Act of 2001³ and a draft of the CY 2009 report submitted to FinCEN regarding IRS taxpayer and practitioner outreach and educational activities.

- IV. Reviewed IRS activities to use other Title 31 information and reports to identify potentially unfiled FBARs and activities to identify or determine the universe of FBAR filers.
- V. Reviewed pending legislative actions that the Administration and Congress were considering, including:
 - A. Reviewed the Hiring Incentives to Restore Employment Act,⁴ containing the Foreign Account Tax Compliance Act, to determine how it would impact FBAR filers by comparing and contrasting the provisions.
 - B. Reviewed the General Explanation of the Administration's Fiscal Year 2010 and 2011 Revenue Proposals (Green Book).
 - C. Reviewed Senate Bill 506, the Stop Tax Haven Abuse Act.

Internal controls methodology

Internal controls relate to management's plans, methods, and procedures used to meet their mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance. We determined the following internal controls were relevant to our audit objective: FBAR document processing providing data for the CBRS and the FBAR examination and penalty assessment process in the FBAR case tracking system at the ECC. We conducted a walkthrough of the FBAR return processing and FBAR case processing systems at the ECC. We evaluated these controls based on information contained in our prior audit report,⁵ observations, onsite interviews with management and personnel, review of procedures, and inspection of some completed FBAR examination case input files.

³ Pub. L. 107-56.

⁴ Pub. L. 111-147.

⁵ *The Detroit Computing Center Adequately Processed Paper Bank Secrecy Act Documents, but Quality Reviews Should Be Implemented to Ensure Compliance With Quality Standards* (Reference Number 2004-30-070, dated March 9, 2004),



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Appendix II

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Appendix III

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Appendix IV

*Authoritative Aspects of the
Report of Foreign Bank and Financial Accounts*

Year	Description of Authority
1992	The Assistant Secretary of the Treasury (Enforcement) delegated authority to investigate possible violations of the regulations with respect to the reporting and record keeping on foreign bank accounts to the Commissioner of the IRS. This authority permitted the IRS Criminal Investigation Division to review failure to file cases identified by the IRS Examination function staff for possible criminal investigation. The Criminal Investigation Division would forward cases that it recommended for prosecution through the IRS Office of Chief Counsel, which would conduct its own independent review, to the Department of Justice, which would make the final decision to prosecute or not.
1994	The Secretary of the Treasury delegated his authority to administer FBAR and other provisions of the Bank Secrecy Act of 1970 ¹ to the FinCEN, a bureau of the Department of the Treasury. The FinCEN's mission is to enhance U.S. national security, deter and detect criminal activity, and safeguard financial systems from abuse by promoting transparency in the U.S. and international financial systems. The FinCEN carries out its mission as a market integrity regulator of the financial industry by receiving and maintaining financial transactions data, analyzing and disseminating that data for law enforcement purposes, and building global cooperation with counterpart organizations in other countries and with international bodies.
2001	In response to the September 11, 2001, attack, Congress passed the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism (USA PATRIOT) Act of 2001. ² Section 361(b) of the Act requires the Secretary of the Treasury to study methods for improving FBAR compliance and report to Congress each year.
2003	The IRS was delegated authority from the FinCEN to assess and collect civil penalties; ³ investigate possible civil violations of these provisions; employ the summons power of 31 C.F.R. Part 103, Subpart F.; issue administrative rulings under 31 C.F.R. Part 103, Subpart G; and take any other action reasonably necessary for the enforcement of these and related provisions, including injunctions.

Source: Our analysis of Treasury Directive 15-41; 2002 and 2003 Reports to Congress in Accordance with §361(b) of the USA PATRIOT Act; and Memorandum of Agreement and Delegation of Authority for Enforcement of FBAR Requirements, dated April 2, 2003.

¹ Public Law (Pub. L.) 91-508.

² Pub. L. 107-56.

³ Under 31 U.S.C. §5321 and 31 C.F.R. § 103.57



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Appendix V

*Comparison of 31 United States Code Section 5314
and Internal Revenue Code Section 6038D Provisions*

Description	31 U.S.C. § 5314 Provisions	I.R.C. § 6038D Provisions
Type of Taxpayer	U.S. person (defined as individual, corporation, partnership, trust or estate, a joint stock company, or other unincorporated organization or group ¹) means a citizen or resident of the U.S. or a person in and doing business in the U.S.	Individual, U.S. citizen or resident alien, or any domestic entity formed or availed of for purposes of holding, directly or indirectly, specified foreign financial assets.
Time period covered	Any time during the calendar year.	Taxable year.
Information due date	June 30, with no extensions.	April 15, with extensions.
Type of interest in foreign financial accounts/assets	Financial interest in, or signature authority over, foreign financial accounts.	Any interest in foreign financial asset.
Value making foreign account/asset reportable	Aggregate value of financial accounts exceeds \$10,000.	Aggregate value of all such assets exceeds \$50,000.
Type of foreign financial accounts/assets reportable	Bank account, securities account, or other financial account in a foreign country. Term also includes savings, demand, checking, deposit, time deposit, or other account (including debit card and prepaid credit card accounts) maintained with a financial institution or other person engaged in the business of a financial institution.	<ol style="list-style-type: none"> 1. Any financial account maintained by a foreign financial institution. 2. Any of the following assets which are not held in an account maintained by a financial institution— <ol style="list-style-type: none"> A. Any stock or security issued by a person other than a U.S. person.² B. Any financial instrument or contract held for investment that has an issuer or counterparty which is other than a U.S. person. C. Any interest in a foreign entity.

Source: Our analysis of 31 U.S.C. § 5314, 31 C.F.R. § 103.11, 31 C.F.R. § 103.24, 31 C.F.R. § 103.27(c), Instructions to FBAR Form TD F 90-22.1, and 26 U.S.C. § 6038D.

¹ List is not all inclusive.

² I.R.C. § 7701(a)(30) United States person. The term “United States person” means (A) a citizen or resident of the United States, (B) a domestic partnership, (C) a domestic corporation, (D) any estate (other than a foreign estate, within the meaning of paragraph 31), and (E) any trust if— (i) a court within the United States is able to exercise primary supervision over the administration of the trust and (ii) one or more United States persons have the authority to control all substantial decisions of the trust (2010).