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Common Pitfalls to Avoid When It Comes to FBAR Reporting

The most common mistakes that taxpayers make relate to the following:

1. Although it might appear as though a foreign account does not need to be reported if its highest balance falls below $ 10,000, this is only partially true. Beware of the maximum aggregate value rule! The following example illustrates how the rule works. Assume that John has three foreign accounts, the highest balances of which never exceed $ 10,000 (USD). The highest balance in each account is $ 9,000. Although none of the accounts by themselves trigger an FBAR reporting requirement because no single account exceeds the $ 10,000 reporting threshold, together they do. Indeed, the highest aggregate balance of the three accounts is $ 27,000. Therefore, all three accounts must be reported on an FBAR, even though none of them alone triggers an FBAR reporting requirement.

2. An FBAR violation can occur in one of two ways: (1) first, by failing to disclose a foreign account on an FBAR altogether or (2) second, by disclosing a foreign account on an FBAR but underreporting the correct amount (i.e., the maximum value during the calendar year). It is the latter violation that many overlook. Nary a day goes by that I don't talk to a client who thinks that as long as the account has been disclosed, there can be no violation, even though the amount was underreported. That is nothing more than a myth. An example will help drive home this point. If Jason reports $ 50,000 (USD) as the maximum value of his offshore account but the maximum value is actually $ 150,000 (USD), he has committed an FBAR violation, notwithstanding the fact that he properly disclosed the account on an FBAR.

3. A person has a "financial interest" in a foreign account not only if he is the owner of record or holder of legal title, but also if he has signatory authority of the account or maintains it jointly with another person. There are additional ways in which a person can have a "financial interest" in a foreign account but

this section only covers joint ownership of an account. Very simply, to the extent that two people jointly own a foreign financial account, each must file an FBAR reporting the entire value of the account because each has a financial interest in that account. An exception applies for the spouse of an individual who files an FBAR. The spouse need not file a separate FBAR if: (1) all the financial accounts that the non-filing spouse is required to report are jointly owned with the filing spouse; (2) the filing spouse reports the jointly owned accounts on a timely filed FBAR; and (3) the filers have completed and signed Form 114a, Recording of Authorization to Electronically File FBARs. Otherwise, both spouses must file separate FBARs and each spouse must report the entire value of the jointly owned accounts.

4. What is the date of an FBAR violation? Contrary to popular belief, it is not the last day of the calendar year. A recent bill signed by President Obama, the short-term highway funding extension, has changed the due date for several common IRS information returns, including FinCEN Form 114, Report of Foreign Bank and Financial Accounts (FBAR) and Form 3520, Annual Return to Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts. Whereas the deadline for filing an FBAR was once June 30 of the year following the calendar year for which the account is being reported, it has now been pushed up to April 15, and for the first time taxpayers will now be allowed a six-month extension. In other words, absent an extension, April 15 is the last possible day for filing the FBAR. Therefore, the close of the day with no filed FBAR represents the first time that a violation has occurred. For example, if John opened up a Swiss bank account on October 1, 2015, then he would have until April 15, 2016 to report that account on an FBAR. The due date for Form 3520, Annual Return to Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts, will be April 15 for calendar-year filers, with a maximum six-month extension. These changes take effect for due dates after December 31, 2015.

5. That the foreign account generated no interest income or negligible interest income does not amount to a defense for failing to disclose it on an FBAR. As the IRS has said time and time again, no amount of unreported income is

considered de minimis for purposes of determining whether there has been tax non-compliance with respect to a foreign account or asset.

6. How far back in time can the IRS go to assert an FBAR penalty? The statute of limitations for asserting an FBAR penalty is six years from the date of the violation. If today is June 1, 2015, then the farthest back in time that the IRS can go to assert an FBAR penalty would be 2008. Why? Because the due date for a 2008 FBAR was June 30, 2009 and six years later is June 30, 2015. Thus, the statute of limitations for assessing a 2008 FBAR penalty is still open, albeit for just another 29 days. Of course, all of the later tax years are also fair game, namely 2009, 2010, 2011, 2012, and 2013. At the extreme, this means that FBAR penalties can potentially be asserted for the last six tax years, assuming of course that the taxpayer committed an FBAR violation in each one of these years.

7. Outside of the OVDP, FBAR penalties are determined per account, and not per unfiled FBAR. Even though all of a taxpayer's foreign accounts are itemized on a single FBAR, in no way does that mean that a taxpayer who has multiple unreported accounts in a single tax year is subject to only one FBAR penalty. On the contrary, because FBAR penalties are determined per account, a taxpayer with multiple unreported accounts in a single tax year could be subject to multiple FBAR penalties. For example, if John fails to report five foreign accounts in 2013, then he is subject to five separate FBAR penalties in that year alone.

8. The combination of the six-year statute of limitations and the fact that FBAR penalties are determined per account packs a "one-two" punch. Very simply, it can catapult a taxpayer's FBAR liability into the penalty stratosphere.