



CURRICULUM:

Accounting and Auditing

LEVEL:

Basic

DESIGNED FOR:

CPAs in public practice

OBJECTIVES:

To explain and help remediate some of the unknowns surrounding reporting requirements for the Report of Foreign Bank and Financial Accounts, commonly called the FBAR

KEY TOPICS:

Filing requirements, U.S. Supreme Court case of *Bittner v. United States*, how penalties are assessed, interpreting the law, the difference between a “willful” and “nonwillful” violation, and what is reasonable cause

PREREQUISITES:

None

ADVANCED PREPARATION:

None

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What’s Old is New(s): Recent Developments in Foreign Bank Account Reporting

BY KIRK WONIO, CPA, DENTON LUNSFORD, CPA, AND SARAH WINGBERMUEHLE



For most CPAs, when a client shares that they have foreign activity, the immediate reaction can be one of anxiety at the thought

of adding more reporting requirements to the already long list of domestic filing obligations. But knowledge dispels fear and in the following paragraphs, one particular reporting requirement will be explained and hopefully remediate some of the unknowns surrounding foreign reporting, specifically the Report of Foreign Bank and Financial Accounts (commonly called the FBAR).

In this article, the recent U.S. Supreme Court case of *Bittner v. United States* will be explored to better understand how penalties (often tens of thousands of dollars, if not hundreds of thousands) are assessed, the catastrophic differences a single word (or absence thereof) can make when interpreting the law, and how the difference between a “willful” and “nonwillful” violation could mean jail time. It is always a good idea to build our knowledge on a good foundation and

answer the first question – what is an FBAR?

FILING REQUIREMENTS

The Foreign Bank and Financial Accounts Report (FBAR) was brought about by the Bank Secrecy Act (BSA) of 1970 to fight money laundering, tax evasion and other criminal activities.ⁱ A United States person (citizen, resident, corporation, partnership, LLC, trust, estate) must file an FBAR if they have a financial interest in or signature authority over at least one foreign financial account located outside the United States.ⁱⁱ Financial interest is defined as having ownership of records or holding legal title or you have sufficient interest in the entity.ⁱⁱⁱ Signature authority means having authority to control the disposition of assets in the account by direct communication with the financial institution maintaining the account.

A foreign financial account is a financial account located outside of the United States.^{iv} A financial account includes:

- Bank accounts, such as savings and checking accounts and time deposits;





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- Securities accounts, such as brokerage accounts and securities derivatives;
- Commodity futures or options accounts, insurance or annuity policies with a cash value, mutual funds; and
- Any other account maintained by a foreign financial institution.^v

It is the location of the account, not the nationality of the financial institution, that determines whether an account is considered a foreign financial account for FBAR purposes.^{vi}

The aggregate value of all foreign financial accounts must exceed \$10,000 at any time during the calendar year in order to have an FBAR filing requirement.^{vii} To determine if the account meets the reporting threshold, take the maximum value in the account in its local currency and convert it to USD using the year-end exchange rate.^{viii} Even if the maximum amount was reached halfway through the year, the year-end exchange rate (as prescribed by the Treasury's Financial Management Service) is used.

FBARs are technically due on April 15 but are automatically extended to October 15 without request.^{ix} FBARs are filed on Form 114 through the Financial Crimes Enhancement Network, or FinCen, through the U.S. Treasury Department. To fulfill the filing requirements, U.S. persons must complete and timely file the FBAR and answer the FBAR-related questions on their federal tax returns.^x

The most common 2022 forms and questions are found here:

- 7a and 7b on Form 1040, Schedule B;
- 3 on Form 1041, page 3;
- 8 on Form 1065, Schedule B;
- 6a and 6b on Form 1120, Schedule N.

The answers to these questions on the federal tax forms could be critical in determining “willfulness.”

PENALTIES

Those who fail to file an FBAR or those who fail to file a timely, complete and correct FBAR may be subject to the civil or criminal penalties. The intensity

Table 1. Penalty Structure

Violation	Civil Penalties	Criminal Penalties	References
Negligent Violation	Up to \$1,078	N/A	31 U.S.C. §5321(a)(6)(A) 31 C.F.R. 103.57(h) Does not apply to individuals
Non-Willful Violation	Up to \$12,459 for each negligent violation	N/A	31 U.S.C. §5321(a)(5)(B)
Pattern of Negligent Activity	In addition to penalty under §5321(a)(6)(A) with respect to any such violation, not more than \$83,864	N/A	31 U.S.C. §5321(a)(6)(B) Does not apply to individuals
Willful - Failure to file FBAR or retain records of account	Up to the greater of \$124,588 or 50% of the amount in the account at the time of the violation	Up to \$250,000, 5 years imprisonment, or both	31 U.S.C. §5321(a)(5)(C) 31 U.S.C. §5322(a) 31 C.F.R. §103.59(b) for criminal This penalty applies to all U.S. persons.
Willful - Failure to File FBAR or retain records of account while violating certain other laws	Up to the greater of \$100,000 or 50% of the amount in the account at the time of the violation	Up to \$500,000, 5 years imprisonment, or both	31 U.S.C. §5322(b) 31 C.F.R. §103.59(b) for criminal This penalty applies to all U.S. persons.

Table 2. Characteristics of Violations and Reasonable Cause

	Willful	Nonwillful	Reasonable Cause
Penalties	Civil and Criminal	Civil	None
Examples	<p>Signing tax return and incorrectly marking Schedule B</p> <p>Not filing FBARs when knowledge of requirement exists</p> <p>Exclusion of reportable income from foreign accounts</p> <p>Intentionally concealing foreign accounts</p> <p>Recklessly avoiding knowledge of foreign filing requirements</p>	<p>Unaware of filing requirements</p> <p>Filed accurate and complete reports upon knowledge of filing requirements</p>	<p>Person was not fully aware of filing requirements nor would they be expected to given their specific circumstances and they performed due care with regards to the facts at hand</p>

of violation relies upon whether “willfulness” is assessed. Table 1 illustrates the penalty structure. The financial penalties are indexed each year for inflation. Imprisonment is introduced into the penalty structure once “willful” behavior is determined.

RECENT LITIGATION – *BITTNER V. UNITED STATES*

FBAR filing hit the headlines recently due to the finalizing of the *Bittner v. United States* Supreme Court case in February. Bittner, a dual citizen of Romania and the United States, filed delinquent FBARs, upon realizing the filing requirement, for the five calendar years covering 2007 through 2011 and 272 accounts were reported over the span of those five years.

The government accepted Bittner’s filings as accurate and classified them as nonwillful late filings. Since the filings were not reported timely, the government assessed a late filing penalty in the amount of \$2.72 million (\$10,000 per account). And this was the question at hand: should the penalty be assessed on a per account or per filing basis?

For Bittner, the stakes were high. Assessing the penalties on a per account versus per filing basis had dramatic consequences - over a \$2 million difference. The opinion of the Court outlines three main points why it should be per filing (favorable to Bittner). When interpreting the law, the Supreme Court first draws attention to the idea of “expressio unius est exclusio alterius;” that is, “the expression of one thing is the exclusion of the other.” The Court relies heavily upon this idea to distinguish the difference in the wording used to assess willful versus nonwillful penalties. 31 U.S.C. §5314 authorizes the Secretary of the Treasury to impose the \$10,000 nonwillful penalty, but it does not explicitly state whether or not the penalty should be per account or per FBAR for a nonwillful violation.

Interestingly, 31 U.S.C. §5321 does specifically address willful violations and deems those to be penalized on a per account basis.^{xi} The Court chose to highlight this distinction in the language to support the idea that the penalties should be assessed differently for willful and nonwillful violations.

Per the opinion of the Court, Congress chose to use specific verbiage expressing that willful penalties should be calculated based on a per account basis. Therefore, this indicates that the exclusion of such specific language when describing nonwillful

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penalties lends to the idea that they should not be assessed on a per account basis, but rather per filing.^{xii}

The next point of reference to support the opinion the Court employs is the abundance of affirming official literature. The Court found it compelling to express that the communications from the government concerning nonwillful FBAR penalties always state that the penalties shall not exceed \$10,000.

In various IRS letters, Department of the Treasury notices, IRS “Fact Sheets,” etc., the idea is represented that the nonwillful penalty shall not exceed \$10,000 and makes no reference to the number of accounts, nor should it be a multiplying penalty. These guiding communications confer the conclusion that the penalty should be on a per filing basis.^{xiii}

Lastly, the Court expresses the rule of lenity, which is defined as the principle that when the law is unclear, the Court should apply the law in a way that is favorable to the individual and unfavorable to the state or government. The Court agreed that the ambiguity of the FBAR penalty rules were compelling enough to employ the rule of lenity. Using “a dose of common sense,” the Supreme Court reversed the judgment of the Fifth Circuit and declared that the penalty should be \$10,000 per filing, thus ruling favorably for Bittner.^{xiv}

The *Bittner v. United States* case has solidified the gray area around nonwillful penalties and brought much clarity to the BSA’s overall intent for FBARs. The FBAR rules were designed to fight criminal activity, not to maximize revenue.

The main driver behind Bittner’s case was the fact that he was found to be nonwillful in his late filings without reasonable cause. It was on this point that all the Courts agreed. If Bittner had been found willful, assessing the penalties would have been simple enough.

In contrast, had Bittner been able to prove “reasonable cause” for his late filings, he could have avoided penalties altogether. These three circumstances are worth diving into further - how does the Court define willful versus nonwillful violations and what is considered reasonable cause?

WILLFUL VS. NONWILLFUL

With no clear definition of willfulness available, recent Court cases can be a valuable tool when understanding

how the courts declare a violation willful. In the case *United States v. Warner*,^{xv} the Court found Warner's violation to be willful due to:

- The exclusion of the interest income generated by the offshore accounts on his individual tax return;
 - Fraudulently stating on his tax return that he had no foreign accounts (Federal Form 1040, Schedule B, line 7a); and
 - Failing to file an FBAR form.
- Similarly, in *United States v. Ott*,^{xvi} the Court found Ott was willful based on the following facts:
- He had constructive knowledge of his reporting requirements by signing his tax returns (which included marking the Schedule B question "no");
 - He listed his sister's Canadian address on the foreign accounts rather than his U.S. address to redirect any paper statements generated by the accounts and thus committed an act of concealment; and
 - The account balances of the foreign accounts represented a large portion of his overall wealth, which demonstrated that he recklessly failed to file the FBARs.^{xvii}

One thing all the Courts agreed on with regards to the Bittner case was that it was a nonwillful violation. As with willfulness, the IRS does not give us a clear definition of what it means to be nonwillful. However, in the case of Bittner, the Court agreed to accept his violation as nonwillful since he was unaware of his filing requirements. This was supported by the fact that he hired a CPA and began filing all the necessary returns and reports upon his re-entrance to the U.S. in 2012.

Being nonwillful did not dispense Bittner from penalties altogether, but it did relieve him of any possible criminal penalties – and per account penalties!

REASONABLE CAUSE

The only way to avoid penalties altogether is to establish reasonable cause for nonwillful violations. The Fifth Circuit stated that reasonable cause "requires showing that the individual exercised ordinary business care and prudence, considering all pertinent facts and circumstances on a case-by-case basis."^{xviii}

In Bittner's defense, he stated that he filed the returns as soon as he became aware, but when asked why he hadn't inquired about the filing requirements sooner, he responded that he "didn't feel like it."^{xix} Obviously, this was not a very compelling response.

The Court also observed that Bittner was a sophisticated business professional with business dealings with the Romanian government, had transferred assets to holding companies, and invested in various industries and European countries. With his overall business acumen, the Court

denied Bittner's request for reasonable cause and made him subject to the nonwillful penalties.

Table 2 summarizes some characteristics of willful and nonwillful violations and reasonable cause.

ACTION ITEMS

There are a few options available for taxpayers with undisclosed foreign financial assets. The first option available to taxpayers is the Voluntary Disclosure Practice (VDP). The VDP is a practice of IRS Criminal Investigation (CI) and is not limited to FBARs.^{xx}

A voluntary disclosure occurs when a truthful, timely and complete disclosure is provided to CI.^{xxi} Individuals going through the VDP must fill out Part I of Form 14457, *Voluntary Disclosure Practice Preclearance Request and Application*.^{xxii} Once individuals receive preclearance, they are able to fill out Part II of the application.

Second is the Streamlined Filing Compliance Procedures. The Streamlined Filing Compliance Procedures are specifically designed for nonwillful delinquent or incorrect FBARs. This program allows taxpayers with unreported income related to the foreign accounts to file amended tax returns and delinquent FBARs and resolve their tax and penalty obligations.^{xxiii}

The IRS outlines the specific eligibility requirements for both non-U.S. residents and U.S. residents. In both cases, taxpayers must certify that conduct was not willful and pay any previous penalty assessments.^{xxiv} If the IRS has initiated a civil examination or a criminal investigation, the taxpayer is not eligible for the streamlined programs.

Lastly, if a U.S. person has no unreported income and learns they should have filed an FBAR for an earlier year, they can electronically file a late FBAR through the BSA.^{xxv} An individual will include an explanation for the late filing on Form 114 and indicate whether the filing is made in conjunction with an IRS compliance option.^{xxvi} If the IRS assesses the violation was due to reasonable cause, no penalty will be imposed.

IN SUMMARY – FBAR FILING REQUIREMENTS

If a client has foreign accounts, it is always best practice to inform them of the potential of FBAR filings. Remember, if the aggregate highest balance of foreign accounts exceeds \$10,000, there is a filing requirement. The penalties, indexed for inflation, start in the thousands of dollars and go up from there with the potential for jail time if the filing is willfully violated.

The Courts take FBAR filing very seriously, as shown in the Bittner case with the nonwillful violation and the Warner and Ott cases that had willful violations.



It is always in the client's best interest to keep detailed records of all foreign activity and report when necessary. Assisting clients with these reporting efforts can be a crucial service considering the consequences. Let the question on Schedule B of the 1040 serve as an opportunity to discuss these reporting obligations with clients, offering that second mile of service, and ensuring quality and compliance remain in the forefront of the return preparation.

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FOOTNOTES

ⁱ 31 U.S.C §5311(4)
ⁱⁱ 31 U.S.C. §5316
ⁱⁱⁱ Id.
^{iv} Department of the Treasury and Internal Revenue Service. "Report of Foreign Bank & Financial Accounts" Publication 5569 (Rev. 3-2022) 2.
^v Id.
^{vi} Id.
^{vii} 31 U.S.C. §5316(a)(1)
^{viii} Department of the Treasury and Internal Revenue Service. "Report of Foreign Bank & Financial Accounts" Publication 5569 (Rev. 3-2022) 3.
^{ix} Id.
^x Id.
^{xi} 31 U.S.C. §5314(a)(5)(D)(ii)
^{xii} Bittner v. U.S. 598 U. S. 1 (2023)
^{xiii} Id.
^{xiv} Id.
^{xv} U.S. v. Warner No. 14-1330 (7th Cir.2015)
^{xvi} U.S. v. Ott 441 F. Supp. 3d 521 (E.D. Mich. 2020)
^{xvii} U.S. v. Ott 441 F. Supp. 3d 521 (E.D. Mich.

2020)
^{xviii} U.S. v. Bittner No. 20-40597 (E.D. Tex. 2021)
^{xix} Id.
^{xx} "IRS Criminal Investigation Voluntary Disclosure Practice." Internal Revenue Service. IRS.gov
^{xxi} Id.
^{xxii} Id.
^{xxiii} "Streamlined Filing Compliance Procedures" Internal Revenue Service. IRS.gov
^{xxiv} Id.
^{xxv} Department of the Treasury and Internal Revenue Service. "Report of Foreign Bank & Financial Accounts" Publication 5569 (Rev. 3-2022).
^{xxvi} Id.
^{xxvii} 31 U.S.C §5311(4)
^{xxviii} 31 U.S.C. §5316
^{xxix} Id.
^{xxx} Department of the Treasury and Internal Revenue Service. "Report of Foreign Bank & Financial Accounts" Publication 5569 (Rev. 3-2022) 2.
^{xxxi} Id.
^{xxxii} Id.

^{xxxiii} 31 U.S.C. §5316(a)(1)
^{xxxiv} Department of the Treasury and Internal Revenue Service. "Report of Foreign Bank & Financial Accounts" Publication 5569 (Rev. 3-2022) 3.
^{xxxv} Id.
^{xxxvi} Id.
^{xxxvii} 31 U.S.C. §5314(a)(5)(D)(ii)
^{xxxviii} Bittner v. U.S. 598 U. S. 1 (2023)
^{xxxix} Id.
^{xl} Id.
^{xli} U.S. v. Warner No. 14-1330 (7th Cir.2015)
^{xlii} U.S. v. Ott 441 F. Supp. 3d 521 (E.D. Mich. 2020)
^{xliiii} U.S. v. Ott 441 F. Supp. 3d 521 (E.D. Mich. 2020)
^{xliiv} U.S. v. Bittner No. 20-40597 (E.D. Tex. 2021)
^{xli v} Id.
^{xli vi} "IRS Criminal Investigation Voluntary Disclosure Practice." Internal Revenue Service. IRS.gov
^{xli vii} Id.
^{xli viii} Id.
^{xli x} "Streamlined Filing Compliance Procedures" Internal Revenue Service. IRS.gov



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