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#7**FOREIGN ACCOUNT REPORTING: Authorize the IRS to Compromise Assessed FBAR Penalties It Administers****TAXPAYER RIGHTS IMPACTED<sup>1</sup>**

- *The Right to Quality Service*
- *The Right to Pay No More Than the Correct Amount of Tax*
- *The Right to Finality*
- *The Right to a Fair and Just Tax System*

**PROBLEM**

In addition to the administration and enforcement of the penalties contained in the Internal Revenue Code (IRC), the IRS has been delegated the authority to enforce Foreign Bank and Financial Accounts (FBAR)<sup>2</sup> reporting requirements and assess FBAR penalties under Title 31 of the United States Code (U.S.C.).<sup>3</sup> FBAR penalties fall under Title 31 and not under any provisions of the IRC (also referred to as Title 26), which the IRS typically would have the authority to administer.

For Title 26 liabilities, IRC § 7122 authorizes the IRS to compromise any civil or criminal case arising under the Internal Revenue laws (prior to referral of the case to the Department of Justice (DOJ)).<sup>4</sup> Although, the IRS has the authority to compromise assessed tax liabilities under IRC § 7122, the IRS does not have the authority to compromise assessed Title 31 FBAR penalties.<sup>5</sup> Assessed FBAR penalties which exceed \$100,000 can only be compromised by the Department of Justice, while those under that amount can be compromised by the Bureau of Fiscal Service (BFS).<sup>6</sup> In situations when the IRS assesses both tax liabilities, including penalties under the IRC and the FBAR penalties stemming from

- 1 See Taxpayer Bill of Rights (TBOR), [www.TaxpayerAdvocate.irs.gov/taxpayer-rights](http://www.TaxpayerAdvocate.irs.gov/taxpayer-rights). The rights contained in the TBOR are also codified in the Internal Revenue Code (IRC). See IRC § 7803(a)(3).
- 2 See Currency and Foreign Transactions Reporting Act, Pub. L. No. 91-508, Title II, 84 Stat. 1114, 1118 (1970) (codified as amended at 31 U.S.C. §§ 321, 5311–5314, and 5316–5322). Prior to 2003, the Foreign Bank and Financial Accounts (FBAR) reporting requirements were enforced by the Financial Crimes Enforcement Network (FinCEN). In 2003, to increase compliance, FinCEN delegated its FBAR enforcement authority to the IRS. The Director of FinCEN delegated the authority to the IRS to assess FBAR liabilities under Title 31. Specially, the IRS was delegated with assessment of 31 U.S.C. § 5314, 31 C.F.R. § 1010.350, 31 C.F.R. § 1010.306, and 31 C.F.R. § 1010.420, including, with respect to these provisions, the authority to assess and collect civil penalties under 31 U.S.C. § 5321 and 31 C.F.R. § 1010.820 and to take any other action reasonably necessary for the enforcement of these and related provisions. See Memorandum of Agreement Between FinCEN and the IRS (Apr. 10, 2003). See also 31 C.F.R. § 1010.810(g); *Memorandum of Agreement and Delegation of Authority for Enforcement of FBAR Requirements*, Internal Revenue Manual (IRM) Exhibit 4.26.1-3, *FBAR Delegation to IRS* (Apr. 5, 2011).
- 3 31 U.S.C. § 5318(a) provides the Secretary of the Treasury with authority to administer provisions of the Bank Secrecy Act (BSA).
- 4 IRC § 7122. IRS Form 656, *Offer in Compromise* (Rev. Mar. 2018), is the required form for an offer in compromise (OIC).
- 5 There is a *de minimus* exception which allows the head of an executive, judicial, or legislative agency to compromise assessed FBAR penalties up to \$100,000. 31 U.S.C. § 3711(a)(2). However, this authority to compromise falls under the authority of the Bureau of Fiscal Service (BFS). See 31 C.F.R. § 902.1. See also IRM Exhibit 4.26.1-3, *FBAR Delegation to IRS* (Apr. 5, 2011). Prior to assessment, the IRS may compromise the FBAR penalty. For pre-assessment procedures, see IRM 4.26.16, *Report of Foreign Bank and Financial Accounts (FBAR)* (Nov. 6, 2015).
- 6 31 U.S.C. § 3711(a)(2). See also 31 C.F.R. § 902.1.

the same conduct, and it considers an offer in compromise (OIC) for tax liabilities, it cannot consider compromising FBAR penalties to achieve a final, one-stop, complete resolution for the taxpayer.<sup>7</sup>

After the IRS makes assessments under both Title 26 and Title 31, if a taxpayer seeks to compromise his or her Title 26 and Title 31 assessments, the following steps would have to occur:

1. The taxpayer would submit an OIC to the IRS. This OIC would be limited to the Title 26 taxes and penalties. Any amounts owed for the Title 31 FBAR penalty cannot be considered by the IRS.
2. While the IRS is considering the OIC, all debt-collection activity on the Title 26 assessment would be held in abeyance.<sup>8</sup> However, the government, through BFS, can continue collecting the Title 31 FBAR penalty.<sup>9</sup>
3. BFS may eventually refer the Title 31 FBAR penalty to DOJ.<sup>10</sup>
4. The Attorney General or delegate may compromise both the Title 26 and Title 31 case after referral to DOJ for prosecution or defense.<sup>11</sup> However, if in the meantime, the IRS has accepted the OIC, DOJ would only be able to consider a compromise for the FBAR assessments.<sup>12</sup>

Affected taxpayers need to complete multiple steps to compromise all liabilities (FBAR and tax), which increases taxpayer burden not limited to costs of representation and undermines the taxpayer's *right to finality* and the *right to a fair and just tax system*. This process is also inefficient for the government as it may create rework at different stages for several government agencies—the IRS, BFS, and DOJ.

## EXAMPLE

In 2015, Taxpayer A, a citizen of the Republic of India, co-inherited an offshore account in India from his parents, along with his two brothers. Taxpayer A currently is a U.S. legal permanent resident (green card holder) residing in the U.S. but his two brothers, citizens of the Republic of India, live and work in New Delhi, India. Taxpayer A's parents owned a Swiss bank account in the amount of \$1,000,000 and named all three children as beneficiary owners. When the parents passed away all three brothers made withdrawals from the account, which earned six percent in interest per annum. In 2015, Taxpayer A made several withdrawals totaling \$200,000 while his brothers withdrew the remaining balance and closed the account. In 2015, the account accrued \$60,000 in interest.

Taxpayer A failed to report the foreign financial account on the FinCEN Form 114, *Report of Foreign Bank and Financial Accounts* (FBAR), and Form 8938, *Statement of Specified Foreign Financial Assets*. He also failed to indicate he had a beneficial interest in a foreign account on Schedule B of his U.S. federal income tax return for tax year (TY) 2015.

After an audit in 2018, the IRS determined that Taxpayer A acted willfully and assessed a willful FBAR penalty of \$500,000 for TY 2015, 50 percent of the maximum account value during that year. It also attributed the interest of \$60,000 to Taxpayer A's income for TY 2015 which resulted in an additional

<sup>7</sup> IRM 5.21.6.7, *Collection of FBAR Penalties* (Feb. 18, 2016).

<sup>8</sup> See IRC § 7122; 26 C.F.R. § 301.7122-1.

<sup>9</sup> See IRM 5.21.6.7, *Collection of FBAR Penalties* (Feb. 18, 2016).

<sup>10</sup> See 31 C.F.R. §§ 285.1-8, 285.11-13.

<sup>11</sup> IRC § 7122(a); 31 U.S.C. § 3711(a)(2).

<sup>12</sup> See 31 U.S.C. § 3711.

tax, interest and accuracy-related penalties of about \$9,500. The IRS also assessed the penalty for the failure to file the Form 8938, *Statement of Specified Foreign Financial Assets*, of \$10,000 under IRC § 6038D(d)(1).<sup>13</sup>

Taxpayer A experienced economic hardship along with significant medical expenses. Taxpayer A has approached the IRS, seeking to compromise both his tax liabilities and the assessed FBAR penalty. The IRS does not have a statutory authority to compromise the Title 31 assessment. Therefore, Taxpayer A submits a doubt as to collectibility OIC to the IRS to compromise the Title 26 tax debt (\$19,500 for TY 2015). After taking into consideration his allowable living expenses, the IRS accepts Taxpayer A's monthly payments, under the terms of the OIC, consisting of \$125.00 per month for three years. Meanwhile, because Taxpayer A has not been able to afford any payments on his FBAR penalty of \$500,000 (the Title 31 FBAR penalty), the IRS referred that debt to BFS. Taxpayer A approaches BFS to compromise the debt and BFS refers him to DOJ as it does not have authority to compromise an amount above \$100,000. Taxpayer A gives up on finding a settlement with DOJ because he is afraid it would jeopardize his OIC with the IRS.

When BFS starts to garnish his wages and offsets a portion of his social security benefits<sup>14</sup> in payment of the FBAR penalty (*i.e.*, \$500,000 for TY 2015), Taxpayer A defaults on his OIC and the total tax liability (*i.e.*, \$19,500 for TY 2015) plus interest and penalties is reinstated.

## RECOMMENDATION

To promote the taxpayers' *right to finality* and *the right to a fair and just tax system*, and to improve efficiency of IRS's administration of the FBAR penalty, the National Taxpayer Advocate recommends that Congress amend IRC § 7122(a) to allow the IRS to compromise the FBAR penalties assessed by the IRS under U.S.C. Title 31.

## PRESENT LAW

IRC § 7122 authorizes the Secretary to enter into an agreement with a taxpayer that settles the taxpayer's tax liabilities for less than the full amount owed, as long as the liabilities have not been referred to DOJ.<sup>15</sup> Such an agreement is known as an "offer in compromise" (OIC). Treasury regulations provide that the IRS may compromise liabilities to the extent there is doubt as to liability, doubt as to collectibility, or to promote effective tax administration.<sup>16</sup> The regulations further define these terms and provide instances when compromise is appropriate. The IRS has statutory authority to compromise any civil or criminal case arising under the Internal Revenue laws prior to referral to DOJ for prosecution or defense. The Internal Revenue laws are those laws contained in Title 26 of the United States Code.<sup>17</sup>

13 The Foreign Account Tax Compliance Act (FATCA) added IRC § 6038D, which requires U.S. citizens, resident aliens, and certain non-resident aliens to file Form 8938, *Statement of Specified Foreign Financial Assets*, with their federal income tax returns to report foreign assets exceeding specified thresholds. See Pub. L. No. 111-147, Title V, Subtitle A, 124 Stat. 71, 97 (2010).

14 See 31 C.F.R. §§ 285.4(e) and 285.11(d).

15 IRC § 7122(a).

16 Treas. Reg. § 301.7122-1(b).

17 See generally IRC §§ 1-9834.

The requirement to report foreign bank and financial accounts was added to the United States Code in 1970 as part of the “Currency and Foreign Transactions Reporting Act of 1970,” which came to be known as the “Bank Secrecy Act” or “BSA.”<sup>18</sup> Each United States person having a financial interest in, or signature or other authority over, a bank, securities, or other financial account in a foreign country shall report such relationship to the Department of the Treasury each year.<sup>19</sup> Individuals required to file FinCEN Form 114, *Report of Foreign Bank and Financial Accounts* (FBAR), who fail to properly file this form, may be subject to civil monetary penalties under 31 U.S.C. § 5321.

The BSA was codified in Title 31.<sup>20</sup> 31 U.S.C. § 5318(a) provides the Secretary of the Treasury with authority to administer provisions of the BSA. The Secretary of the Treasury delegated the authority to administer civil compliance with Title II of the BSA to the Director, FinCEN.<sup>21</sup> While FinCEN retains its rule-making authority for FBAR, it re-delegated civil FBAR enforcement authority to the IRS.<sup>22</sup> The civil FBAR enforcement authority includes the assessment and collection of civil FBAR penalties.<sup>23</sup> Title 31 FBAR liabilities are not tax debts, which would fall under Title 26.<sup>24</sup>

## REASONS FOR CHANGE

In situations when the IRS assesses both tax liabilities, including penalties under the IRC, and the FBAR penalties stemming from the same conduct, and it considers an OIC for tax liabilities, it cannot consider compromising FBAR penalties to achieve global resolution.<sup>25</sup>

After the IRS makes assessments under both Title 26 and Title 31, if a taxpayer seeks to compromise both assessments, as noted earlier, the taxpayer will need to deal with two or sometimes three different government agencies.<sup>26</sup> First, the taxpayer would submit an OIC to the IRS to compromise his or her tax liabilities, which, however, would not preclude BFS from collecting the Title 31 FBAR penalty during the pendency of the OIC. Then the taxpayer would need to separately request BFS to consider a compromise of the FBAR penalties if the assessment does not exceed the \$100,000 threshold,<sup>27</sup> or to request both BFS and the IRS to refer their respective assessments to DOJ if the FBAR assessment

18 A civil penalty not to exceed \$10,000 may be imposed against anyone who violates or causes a violation of 31 U.S.C. § 5314 and its regulations, including the failure to file an FBAR. 31 U.S.C. § 5321(a)(5)(A)-(B). For willful violations, the maximum penalty is the greater of \$100,000 or 50 percent of the amount of the transaction or the balance in such account at the time of the violation. 31 U.S.C. § 5321(a)(5)(C). See also IRM 4.26.16, *Report of Foreign Bank and Financial Accounts (FBAR)* (Nov. 6, 2015).

19 31 C.F.R. § 1010.350.

20 31 U.S.C. §§ 5311–5314, 5316–5332.

21 See Memorandum of Agreement Between FinCEN and the IRS (Apr. 10, 2003). See also 31 C.F.R. § 1010.810(g). IRS Criminal Investigation (CI) has authority to enforce the criminal provisions of the BSA.

22 See Memorandum of Agreement and Delegation of Authority for Enforcement of FBAR Requirements, available in IRM Exhibit 4.26.1-3, *FBAR Delegation to IRS* (Apr. 5, 2011).

23 *Id.*

24 The FBAR requirements under 31 U.S.C. § 5311 et seq. are separate from the requirements to report income from accounts on the relevant tax returns under Title 26. For more information distinguishing these two requirements, see IRS, *Comparison of Form 8938 and FBAR Requirements* (July 17, 2018), <http://www.irs.gov/Businesses/Comparison-of-Form-8938-and-FBAR-Requirements>.

25 IRM 5.21.6.7, *Collection of FBAR Penalties* (Feb. 18, 2016).

26 If the FBAR assessment is under \$100,000, then the taxpayer will have to deal with two agencies—IRS and BFS. If the FBAR assessment is \$100,000 or more, then it is possible that three agencies will be involved—IRS, BFS, and Department of Justice (DOJ). BFS is involved if the debt is referred to the agency and BFS is taking collection action. BFS, however, will not be involved in the compromise process, though, since only DOJ will have authority at that point. See 31 C.F.R. §§ 285.1-8, 285.11-13. See also IRC § 7122(a); 31 U.S.C. § 3711(a)(2).

27 This amount is excluding interest. See 31 U.S.C. § 3711(a)(2).

exceeds the threshold. Eventually once the taxpayer's case reaches DOJ, the Attorney General or delegate may compromise both tax and FBAR assessments. However, if, in the meantime, the IRS has accepted the OIC, DOJ would be able only to consider a compromise for the FBAR liability.<sup>28</sup> This process involves multiple steps which may duplicate efforts by the government and cause additional burden for taxpayers, including representation costs, extensive delays, and uncertainty.

Granting the IRS the authority to compromise Title 26 and Title 31 assessments would benefit both the government, as a whole, and taxpayers seeking to compromise their debts. The government benefits because one agency has jurisdiction over the whole process and a taxpayer's individual circumstances will be considered in their entirety when an OIC is submitted to the IRS.

## EXPLANATION OF RECOMMENDATION

The recommendation would allow the IRS to compromise FBAR debt it assessed against a taxpayer along with tax liabilities under the IRC. Adding language in IRC § 7122(a) to allow the IRS to compromise FBAR penalties it has assessed would be a cost-effective fix for the government and taxpayers alike.

This legislative change would not create a conflict with the statutory framework for compromise of nontax debts under 31 U.S.C. § 3711.<sup>29</sup> Instead, it would be in line with the IRS's existing authority to compromise any civil or criminal penalties assessed arising under the Internal Revenue laws, prior to referral of the case to DOJ. For Title 26 tax liabilities, IRC § 7122 currently authorizes the IRS to compromise any civil or criminal penalties assessed in cases arising under the Internal Revenue laws *prior* to referral of the case to DOJ. Similarly, if adopted, this legislative change would authorize the IRS to compromise Title 31 FBAR penalties it has assessed but *only prior* to referral of the case to DOJ. DOJ would retain jurisdiction to compromise both tax and nontax (FBAR penalty) liabilities after a case is referred to it by the IRS. This legislative change would allow the IRS to evaluate the taxpayer's financial situation and compromise all tax liabilities and the assessed FBAR penalties stemming from the same conduct, under the principles set forth in IRC § 7122, in one setting. The FBAR compromise authority would allow the IRS to provide taxpayers with a consistent, comprehensive resolution for all liabilities assessed by the IRS, the agency most familiar with the taxpayer's circumstances; thereby also conserving government resources.

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<sup>28</sup> See 31 U.S.C. § 3711.

<sup>29</sup> *Id.*