Summer 2023

# Estate Planning Update Summer 2023 - A Win for Taxpayers With Offshore Accounts

Taxpayers and practitioners are applauding the U.S. Supreme Court's recent decision in *Bittner v. U.S.*,[1] where the Supreme Court concluded that the hefty foreign bank account reporting (FBAR) penalties for non-willful violations apply on a per report rather than a per account basis. Nevertheless, even though the Supreme Court reigned in the penalty computation, the penalty itself remains intact. Taxpayers must continue to be proactive about their potential reporting requirements and should review their filing obligations annually.

## FBAR Reporting in General

Under the Bank Secrecy Act, every U.S. person[2] that has a financial interest in or signature or other authority over a financial account in a foreign country must report the account annually if the aggregate value of all of such U.S. person's foreign financial accounts exceeds $10,000 at any time during the calendar year. The FBAR form is FinCEN Form 114, Report of Foreign Bank and Financial Accounts. A taxpayer reports all such accounts using one FBAR form.

A taxpayer's failure to file can trigger steep civil penalties against the taxpayer. Generally, a maximum penalty of $10,000 applies to non-willful violations of applicable law. The law specifically states that the penalty applies to each "violation." With all foreign accounts being reported on one FBAR form, one might reasonably infer that only one violation could occur annually. However, the IRS adopted a more aggressive interpretation and historically assessed such penalties on a per account basis. Under the IRS interpretation, a taxpayer who was required, but mistakenly failed, to report nine foreign financial accounts on his FBAR form would face a penalty of $90,000 even if the highest aggregate value of those nine accounts during a calendar year totaled only $50,000. Where the failure to report is deemed "willful," the maximum penalty is the greater of $100,000 or 50 percent of an account value as determined under specific rules.

The law does offer relief for some. No penalty will be imposed for a non-willful violation due to reasonable cause if all account balances are ultimately accurately reported.[3] To qualify for relief, taxpayers must show that they exercised ordinary business care and prudence in failing to fulfill their reporting obligations.

## *Bittner v. United States*

The U.S. Supreme Court recently addressed the question as to whether a penalty applies per account or per violation. The taxpayer in *Bittner* was a U.S. citizen who moved to his native Romania in 1990. He was unaware that as a U.S. citizen, he still had to report his interests in certain foreign financial accounts, so he never filed FBAR forms while in Romania. Upon returning to the United States in 2011, he learned of his filing deficiency and hired a certified public accountant to file the missing FBAR forms for his many reportable foreign accounts. In 2017, the IRS assessed $2.72 million in non-willful FBAR penalties, which the IRS calculated by assessing a $10,000 penalty for each unreported account in each calendar year.

The taxpayer challenged the penalty in court, arguing that the penalty should apply per year or per violation, not per account. The Supreme Court agreed to hear the case due to a "split" among the Circuit Court of Appeals on the issue. Specifically, the Ninth Circuit Court of Appeals had recently ruled that the statute authorizes "only one non-willful penalty when an untimely, but accurate, FBAR is filed, no matter the number of accounts." [4] In *Bittner*, however, while the district court agreed with the taxpayer, the Fifth Circuit Court of Appeals upheld the penalty.

The specific issue before the Supreme Court was the penalty computation. The Court considered the statutory language, the informal IRS guidance for taxpayers and the legislative drafting history with respect to non-willful and willful violations in analyzing the issue. In a 5-4 decision, the majority of the Supreme Court held that a taxpayer's duty under the statute is to file an annual report, and accordingly, the penalty for non-willful violations is computed on a per report, not a per account, basis. As a result, a taxpayer can be fined only up to $10,000 annually for non-willful violations of FBAR reporting obligations.

## After *Bittner*

While the Supreme Court's decision is a welcome relief, U.S. persons should remain diligent with respect to FBAR reporting requirements. For instance, disclosing inaccurate information on an FBAR form or filing late can give rise to a non-willful penalty of up to $10,000.

Presently, the FBAR form is due on the same date as a taxpayer's U.S. federal income tax return, which is April 15 for U.S. persons living in the United States and June 15 for U.S. persons living abroad (or October 15 if filing an automatic extension).

It is also important to note that the FBAR reporting obligation extends to many types of U.S.-based entities, not just U.S. individuals with foreign bank accounts. Moreover, more than one U.S. person can have an FBAR reporting obligation with respect to the same foreign financial account. This is common in personal, financial and wealth planning situations. For example, both a principal and an agent under a power of attorney can have reporting obligations with regard to the same accounts. With a trust formed under the laws of the United States, the grantor, trustees, and beneficiaries all can have reporting obligations with respect to the trust's accounts. Individual, family and business circumstances can change from year to year, so it is important for all U.S. persons in a structure to review their reporting obligations annually.

As it stands, the Supreme Court's decision will be applied by taxpayers going forward. It is not presently clear whether taxpayers that paid penalties in the past on a per account determination by the IRS will be permitted a refund.

If you have a foreign account and would like more information on your obligation to file FBAR reports, please contact your Day Pitney attorney.

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[1] 143 S. Ct. 713 (2023).

[2] For this purpose, a U.S. person includes U.S. citizens (including minor children); U.S. residents; entities, including but not limited to corporations, partnerships, or limited liability companies created or organized in the United States or under the laws of the United States; and trusts or estates formed under the laws of the United States. The U.S. federal tax treatment of an entity is not dispositive. For example, a trust treated as being owned by a non-U.S. person under the "grantor" trust rules is nevertheless treated as a U.S. person for this purpose. While the term "taxpayer" is used hereinafter, such term is intended to include any U.S. person with an FBAR filing requirement regardless of whether such person is in fact subject to U.S. federal income tax as a U.S. taxpayer.

[3] 31 U.S.C. § 5321(a)(5)(B)(ii).

[4] *United States v. Boyd,* 991 F.3d 1077 (9th Cir. 2021).