A REPORT TO CONGRESS
IN ACCORDANCE WITH §361(b)

OF THE

UNITING AND STRENGTHENING AMERICA BY PROVIDING APPROPRIATE TOOLS REQUIRED TO INTERCEPT AND OBSTRUCT TERRORISM ACT OF 2001

(USA PATRIOT ACT)

SUBMITTED BY THE
SECRETARY OF THE TREASURY

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I. INTRODUCTION

On October 26, 2001, the President signed into law the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism ("USA PATRIOT Act") of 2001, Pub. L. No. 107-56. Section 361(b) of the USA PATRIOT Act provides:

> (b) COMPLIANCE WITH REPORTING REQUIREMENTS - The Secretary of the Treasury shall study methods for improving compliance with the reporting requirements established in section 5314 of title 31, United States Code, and shall submit a report on such study to the Congress by the end of the 6-month period beginning on the date of the enactment of this Act and each 1-year period thereafter. The initial report shall include historical data on compliance with such reporting requirements.

In accordance with this requirement, the Secretary of the Treasury submits this report.

II. BACKGROUND

The Bank Secrecy Act ("BSA")[1] authorizes the Secretary of the Treasury to issue regulations requiring financial institutions and other persons to keep records and file reports that are determined to have a high degree of usefulness in criminal, tax, regulatory, intelligence, and counter-terrorism matters, and to implement counter-money laundering programs and compliance procedures. Section 5314 of the BSA authorizes the Secretary to require residents or citizens of the United States, or a person in and doing business in the United States, to keep records and/or file reports concerning transactions with a foreign financial agency. This provision reflected congressional concern that foreign financial institutions located in jurisdictions with strict bank secrecy laws were being used to violate or evade domestic criminal,

[1] Titles 1 and II of Public Law 91-508, as amended, codified at 12 U.S.C. 1829b, 12 U.S.C. 1951-1959, and 31 U.S.C. 5311-5330. Regulations implementing Title II of the Bank Secrecy Act (codified at 31 U.S.C. 5311-

tax, and regulatory requirements.[2] Pursuant to this authority, the Secretary promulgated 31 CFR 103.24, which states in pertinent part:

> (a) Each person subject to the jurisdiction of the United States (except a foreign subsidiary of a U.S. 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 Commissioner of the Internal Revenue for each year in which such relationship exists, and shall provide such information as shall be specified in a reporting form ... .[3]

The form required by §103.24 is known as the Report of Foreign Bank and Financial Accounts ("FBAR"), TD F 90-22.1, the most recent version of which is attached as Exhibit B.

The two components of the Department of the Treasury with responsibility for the FBAR program are the Internal Revenue Service ("IRS") and the Financial Crimes Enforcement Network ("FinCEN"). The FBAR is an "information return or report" that is filed with the IRS Detroit Computing Center ("DCC") and input into the BSA financial database, which is jointly administered by DCC and FinCEN. Once FBARs are posted to the BSA financial database, the forms are available to FinCEN analysts, law enforcement, and appropriate regulatory authorities for use, among other things, in tracking flows of money.[4]

Pursuant to Treasury Directive 15-41 (12/1/92), the Secretary delegated to the IRS the authority to investigate possible violations of §103.24. The IRS examines for compliance with the FBAR requirements. The IRS/Criminal Investigation Division ("CI") reviews failures to file identified by the IRS examination staff for possible criminal investigation. CI forwards cases that it recommends for prosecution through the IRS Office of Chief Counsel (which conducts its

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5330) appear at 31 CFR Part 103. The Secretary has delegated the authority to administer Title II of the Bank Secrecy Act to the Director of the Financial Crimes Enforcement Network.

2 *United States v. Clines*, 958 F. 2d 578, 581 (4th Cir.), *cert. denied*, 505 U.S. 1205 (1992).

3 31 U.S.C. 5314 and 31 CFR 103.24 are attached as Exhibit A.

4 The FBAR is not a tax return and is not to be attached to a taxpayer's Form 1040. Because an FBAR is a Title 31 report, it is not subject to the dissemination restrictions of 26 U.S.C. 6103.

own independent review) to the Department of Justice, which has the final say on whether to initiate a criminal prosecution.

Cases that CI declines to investigate as a criminal matter may be referred to FinCEN for possible civil enforcement action. Although, as noted above, the Secretary has delegated examination authority for FBAR compliance to the IRS, the Secretary has delegated to the Director of FinCEN the authority to assess civil money penalties on any person who willfully violates or who willfully causes any violation of the FBAR filing requirements.[5] If a taxpayer refuses to pay the penalty, FinCEN must refer the matter the Department of Justice to institute a penalty action in which both liability and the amount of penalty must be litigated.

III. HISTORICAL DATA: COMPLIANCE WITH FBAR REPORTING REQUIREMENTS

The FBAR is not a tax return, but a report filed with the Secretary stating that the person filing has a financial interest in, or signature authority over, financial accounts in a foreign country with an aggregate value exceeding $10,000 at any time during the calendar year. Filing an FBAR is a two-part reporting process. Form 1040 Schedule B, Part III, instructs a taxpayer to indicate an interest in a financial account in a foreign country by checking "Yes" or "No" in the appropriate box. Form 1040 then refers the taxpayer to Form 90-22.1, the FBAR, which provides that it should be used to report a financial interest in or authority over bank accounts, securities accounts, or other financial accounts in a foreign country. The FBAR's instructions provide more detail on when the form must be filed. The deadline for filing an FBAR for each calendar year is on or before June 30th of the following year.

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[5] By regulation, authority to examine for BSA compliance has been delegated to the regulator of each category of financial institution (*i.e.*, the Securities and Exchange Commission for broker-dealers, the banking regulators for banks), and to the IRS for institutions that do not have a primary regulator. 31 CFR 103.56(b).

FBAR filings since 1991 have increased by 51.9%. In calendar year 1991, the DCC received 116,600 FBARs. In calendar year 2001, the number of FBAR forms posted to the database was 177,151.[6]

It is difficult to determine with any accuracy how many taxpayers are failing to file required FBARs in any calendar year. Extrapolating from the limited information available concerning the number of foreign bank and credit card accounts held by United States citizens, the IRS estimates that there may be as many as 1 million U.S. taxpayers who have signature authority or control over a foreign bank account and may be required to file FBARs.[7] Thus, the approximate rate of compliance with the FBAR filing requirements based on this information could be less than 20 percent.

Both the IRS and FinCEN devote program resources to promoting compliance with the FBAR reporting requirements under the BSA, incorporating both an educational component as well as compliance or enforcement efforts. Set forth below is a summary review of some of the efforts by FinCEN and the IRS to facilitate compliance with the FBAR filing requirements of §103.24.

Educational Guidance

Both the IRS and FinCEN engage in a variety of activities to educate the public about and facilitate compliance with the FBAR filing requirements.

- The primary notification to a person that it may need to file an FBAR form relating to its foreign bank or financial account is the guidance provided in the IRS Form 1040, U.S. Individual Income Tax Return, and the accompanying instructions. Taxpayers that file a Schedule B are instructed to report foreign

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Authority to impose civil penalties rests with the Assistant Secretary of the Treasury for Enforcement or that official's delegatee, 31 CFR 103.56(d), which is FinCEN.

[6] Annual statistics since 1991 reflecting the number of FBAR forms received or posted to the BSA financial database are attached as Exhibit C.

[7] This methodology yields only a rough approximation of the compliance rate, as it is difficult to determine whether the amounts held in the offshore accounts reach the threshold.

accounts and trusts and to file the FBAR, if required, by June 30th of the following year for the previous calendar year.

- The IRS Publication 54-Tax Guide for U.S. Citizens and Resident Aliens Abroad also provides guidance and other filing information for FBAR filers.[8]

- The IRS also makes significant use of its website to inform the public of the FBAR filing requirement and provides assistance by means of referencing its instructions and publications. The IRS's web publication, "The Digital Daily-Forms and Publications," includes the FBAR forms and instructions by form number, date, publication, or notice number. Taxpayers may download this information and file the form.

- FinCEN uses its website to post the FBAR along with instructions. FinCEN's website also posts a "Reminder of Requirement to File Report of Foreign Bank and Financial Accounts, Form TD F 90-22.1 (FBAR)" to highlight the need to file the form.[9]

Enforcement Efforts

Enforcement is the final component of the FBAR program. The BSA provides for both criminal and civil sanctions for failing to file an FBAR. Under 31 U.S.C. 5322, criminal violations of §5314 are punishable by a fine of not more than $250,000 or 5 years in prison or both. Where the failure to file an FBAR is part of a pattern of illegal activity, the fine is up to $500,000 and up to 10 years in prison, or both. Under 31 U.S.C. 5321(5), the Director of FinCEN can assess against a person who willfully fails to file an FBAR civil money penalties equal to the balance in the account at the time of the violations not to exceed $100,000, or $25,000, whichever is greater.

During the past three fiscal years (annual periods ended September 30), the IRS audited or examined the following numbers of tax returns:[10]

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[8] Excerpts from IRS forms, instructions and publication that provide guidance on when to file an FBAR are attached as Exhibit D.

[9] A copy is attached as Exhibit E.

[10] Data obtained from "IRS Data Book"(Pub. 55B) for 1999, 2000, and 2001. Of the returns audited or examined, the number of "field" audits (not correspondence audits by the Service Centers) were as follows:

FY1999 – 505,847 total returns (384,484 individual taxpayers)
FY2000 – 342,660 total returns (251,108 individual taxpayers)

FY1999 – 1,228,406 total returns (1,100,273 individual taxpayers)

FY2000 – 715,915 total returns (617,765 individual taxpayers)

FY2001 – 815,057 total returns (731,756 individual taxpayers)

These audits and examinations discovered and addressed very few FBAR failure-to-file issues. During this same three year period, the number of CI investigations of FBAR violations and subsequent referrals to the Department of Justice for prosecution has dwindled to significantly low proportions.

Statistics indicate that there are relatively few criminal prosecutions and civil enforcement actions initiated for the failure to disclose foreign financial accounts on the FBAR form. Between 1996 and 1998, Justice Department statistics reveal that only nine indictments were filed charging 31 U.S.C. 5314; in 1999 and 2000, no one appears to have been charged. The Customs Service reports only three convictions since 1995.

Based upon discussions with Department of Justice personnel, there appear to be a number of reasons for the limited number of FBAR charges. First and foremost, as the FBAR filing program relies on self-reporting, it is difficult to obtain sufficient admissible evidence of undisclosed foreign accounts. Persons trying to hide money abroad often open their financial accounts in jurisdictions well known for their strict banking secrecy laws. Some of these jurisdictions do not have mutual legal assistance treaties with the United States, while others that may have treaties providing for disclosure of relevant information do so only under strict and specific circumstances.[11] Even if there is a treaty that provides for adequate disclosure, obtaining the information is often a cumbersome, time-consuming process.

FY2001 – 280,111 total returns (202,515 individual taxpayers)

[11] For example, the current MLAT with the Cayman Islands does not provide for the disclosure of foreign bank accounts in which U.S. citizens have a financial interest, unless the case involves conduct that the Cayman Islands recognizes as criminal under its laws or for other specific types of crimes under U.S. law. The Cayman

Second, charging decisions by prosecutors affect the prosecution rate. There is often other criminal conduct associated with the failure to comply with the requirement to disclose foreign financial accounts on the FBAR form. Concealment of the foreign account in violation of 31 U.S.C. 5314 goes hand-in-hand with concealment of other criminal activity. Prosecutors prefer charges that are easily understood and which have greater jury appeal, such as tax evasion, fraud, or money laundering, rather than a failure-to-file FBAR charge that a jury may consider hyper-technical. In addition, in criminal tax matters, prosecutors sometimes charge willfully subscribing false tax returns in violation of 26 U.S.C. 7206(1) for failing to "check the box" on the Schedule B providing for disclosure of the foreign financial accounts.

Third, charging an FBAR count is considered unnecessarily complicated by some prosecutors because of the interplay between 31 U.S.C. 5314, the implementing regulations at 31 CFR 103.24, and the penalty provision at 31 U.S.C. 5322(d). Prosecutions for violation of 31 U.S.C. 5314 raise concerns about the burden of proof (*i.e.*, whether specific intent must be shown) after *Ratzlaff v. United States*, 510 U.S. 135 (1994).[12]

On the civil side, different considerations come into play. Once IRS-CI declines a criminal investigation, IRS may refer the matter to FinCEN for consideration of whether a civil money penalty is appropriate. Since 1993, the IRS has referred 12 such matters to FinCEN. (Customs referred an additional matter, but subsequently withdrew its referral.) In the 12 cases, FinCEN issued 4 letters of warning and assessed 2 civil money penalties.[13] The remaining six

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Islands will only provide assistance for offenses such as FBARs or tax evasion where such offenses arise from the proceeds of other crimes covered by the MLAT.

[12] In *Ratzlaff*, the Supreme Court held that a charge for violating the anti-structuring provisions of the BSA required not only proof of intent to prevent a bank from complying with its reporting requirement, but also proof of the individual's knowledge that such conduct violated the law. Although Congress overruled *Ratzlaff* in amending the BSA's anti-structuring provision, 31 U.S.C. 5324(c), *Ratzlaff's* willfulness analysis may still apply to other BSA violations.

[13] FinCEN issues a letter of warning in cases in which significant mitigating factors are present.

matters were not pursued for a variety of reasons, including lack of evidence of willfulness and a determination to direct enforcement resources toward more egregious violations of the BSA.

It is often difficult to prove that the failure to file an FBAR was willful, that is, that a person knew of, or was reckless in not knowing, the FBAR filing requirement. During the examination, taxpayers generally assert to the IRS that they were not aware that they were required to file an FBAR. Often, the administrative record lacks evidence to the contrary, such as an advice letter from an accountant or financial planner or any witness to testify that the taxpayer knew of the filing requirement. In such cases, the litigation risk in assessing a penalty is substantial, particularly where, after notice from the IRS or FinCEN, the person has voluntarily backfiled the missing forms. Rather than go forward with penalty assessments based on a less than substantial record, FinCEN's limited resources have been allocated to other compliance and enforcement efforts, particularly as the number of industry groups and BSA requirements have expanded in recent years.[14]

IV. IMPROVING COMPLIANCE WITH FBAR REPORTING REQUIREMENTS

Unlike other reports filed under the BSA, such as Currency Transaction Reports or Suspicious Activity Reports, FBARs do not rely on reporting by third parties. Therefore, compliance outreach aimed at educating filers, while important, is not alone sufficient to enhance compliance. Certainly there appear to be a number of taxpayers who fail to file because of lack

[14] FinCEN's Office of Compliance and Regulatory Enforcement currently has five employees devoted to all aspects of BSA enforcement. The program focuses on financial institutions, and has resulted in substantial penalties for material violations of BSA regulations over the past several years. *See, e.g.*, *Sovereign Bank* (No. 2002-01) ($700,000 penalty), *Polish and Slavic Federal Credit Union* (No. DI 99-011) ($185,000 penalty) and *Sunflower Bank, N.A.*, (No. DI 99-008) ($100,000 penalty).

of knowledge or confusion about the filing requirements. Education and outreach will go a long way toward reaching these people and improving their FBAR compliance.

However, there also appear to be taxpayers who fail to file because they are concealing income or are engaged in some kind of criminal activity such as money laundering. No amount of education and outreach will result in increased FBAR filings from this latter group. To achieve deterrence here will require a series of highly publicized criminal actions against intentional violators in order to raise the cost of being an FBAR scofflaw. Ideally, such cases would be brought not only as adjuncts to other types of criminal conduct such as tax evasion and bankruptcy fraud, but also as stand-alone cases.

The IRS currently is engaged in a large-scale initiative to seek out taxpayers who have undisclosed accounts overseas. The initial focus of this initiative was to obtain information on credit cards issued by banks located in three tax haven jurisdictions (Antigua/Barbuda, the Bahamas, and the Cayman Islands), where the majority of the activities for which the cards were used occurred in the United States. Most offshore banks require that an account be maintained with the bank before the bank will issue a credit card. Using IRS summonses to obtain information from these offshore jurisdictions can be prohibitively difficult and time consuming. However, the majority of the credit card transactions are routed through the major credit card companies' United States processing centers. The IRS has sought credit card processing information from the U.S.-based facilities over which the U.S. courts have jurisdiction. From this information, the IRS already has identified numerous U.S. persons as having foreign accounts (without having a record of an FBAR on file). It anticipates that future initiative activity will include the issuance of additional summonses and will identify a significantly larger number of U.S. persons with FBAR violations. The additional actions of this initiative may

result in the kind of targeted prosecutorial "sweep" that has been shown in other law enforcement contexts to enhance compliance with regulatory requirements.

Notwithstanding ongoing efforts to administer the FBAR provisions of the BSA, FinCEN and IRS recognize that there is room for improvement. As a result of the study under §361(b) of the USA PATRIOT Act, IRS and FinCEN will focus their FBAR program efforts over the next year on achieving the following objectives:

1. **Update and Improve the FBAR Form and Instructions**

   FinCEN will take responsibility for updating the FBAR form, TD F 90-22.1, and the accompanying instructions. Comments received from filers indicate to FinCEN that an updated form should:

   - eliminate duplication of information in the form;
   - incorporate user-friendly instructions;
   - use understandable definitions;
   - develop a continuation sheet for use by multiple filers;
   - address procedures for joint accounts with spouses and business partners; and
   - include updated terminology and new types of financial transactions.

   An updated form will assure that the form itself is not a barrier to compliance. FinCEN's target date to propose a revised form for public comment is no later than December 31, 2002.

2. **Review Filing and Processing Procedures at DCC**

   FinCEN will work closely with staff from DCC, which receives the FBAR form, and processes and posts it to the BSA financial database, to determine if any barriers exist that dissuade persons from filing an FBAR. As part of the FBAR processing, DCC may contact filers and the evaluation will cover whether any such communication results in confusion as to when and how the FBAR should be filed. Such procedures will be improved, if appropriate. Furthermore, such review may also result in other suggestions on how to improve compliance with the FBAR filing requirements.

3. **Evaluate Enhancing Outreach and Educational Guidance**

IRS will take responsibility for assessing whether better education and guidance regarding the requirements to file an FBAR is needed and, if so, will implement recommended improvements. For example, expanding outreach to accountants, tax practitioners, and tax filing services who should be advising their clients to file the FBAR, when appropriate, may be one method to improve compliance with §103.24.

4. **Establish Joint Task Force on FBAR Prosecutions/Enforcement**

IRS, FinCEN, and the Department of Justice will form a joint Task Force to study ways to enhance prosecutions and enforcement actions related to FBAR reporting.

5. **Consider Delegation of Penalty Authority**

In light of the disparity of resources between IRS and FinCEN, they will review whether the authority to impose civil sanctions for the failure to file FBARs should be delegated from FinCEN to the IRS, and recommend appropriate action to the Secretary.

V. CONCLUSION

Section 361(b) of the USA PATRIOT Act has provided the Department of the Treasury with the opportunity to evaluate the current educational and enforcement efforts devoted to compliance with the FBAR reporting provisions, and to evaluate how such efforts may be enhanced. Although the circumstances surrounding foreign financial accounts make it difficult to provide a clear estimate of compliance levels, it is evident that existing compliance programs can be strengthened. Over the next year, FinCEN and IRS will address the five objectives outlined above as the first step to improving compliance with the FBAR reporting provisions.