

**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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EXHIBITS

- A.** 31 U.S.C. 5314 and 31 CFR 103.24.
- B.** Report of Foreign Bank and Financial Accounts (FBAR), TD F 90-22.1.
- C.** Memorandum of Agreement and Delegation of Authority for Enforcement of FBAR Requirements, dated April 8, 2003.

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:

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 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.

The Secretary submitted the initial report on April 24, 2002. In accordance with the above requirement, the Secretary submits this first annual report to discuss progress made on reaching the goals set forth in the initial report.

II. BACKGROUND

The initial report by the Secretary discussed the reporting requirements of Section 5314 of the Bank Secrecy Act (“BSA”)¹, which authorizes the Secretary to require persons subject to the jurisdiction of the United States to file reports for transactions with a foreign financial agency. The regulation promulgated hereunder is found at 31 CFR 103.24, and states in pertinent part:

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....²

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 the FBAR is attached as Exhibit B. Upon posting to the BSA financial database maintained at the IRS Detroit Computing Center (DCC), the FBAR forms are available to FinCEN analysts, law enforcement and other appropriate authorities for use in criminal, tax and regulatory investigations and proceedings.³

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. 5311-5330) 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 31 U.S.C. 5314 and 31 CFR 103.24 are attached as Exhibit A.

³ 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.

The initial report filed on April 24, 2002, explained the bifurcated structure that evolved for examination and enforcement of the FBAR requirement.⁴ Pursuant to Treasury Directive 15-41 (12/1/92), the Secretary delegated to IRS authority to investigate possible violations of the BSA, including the FBAR requirement set forth in §103.24. The IRS examines taxpayers and entities for FBAR compliance. As a result, the IRS/Criminal Investigation Division (CI) investigates FBAR matters and recommends criminal actions to the IRS Office of Chief Counsel. IRS Counsel reviews and refers these matters to the Department of Justice, as appropriate, for a final decision on whether a criminal prosecution is warranted.

In the recent past, cases that CI declined to investigate as a criminal matter were referred to FinCEN for possible civil enforcement action. In addition, FinCEN would receive “self disclosures” from taxpayers who failed to comply with the FBAR requirements. While the Secretary has delegated examination authority for FBAR compliance to the IRS, the Director of FinCEN retained authority to assess civil money penalties against any person who willfully violated, or caused any violation of, the FBAR filing requirements.⁵ If a taxpayer refused to settle the matter with FinCEN, it was referred to the Department of Justice for litigation.

Based upon the FBAR compliance rate, which could be as low as 20%, the initial report made five recommendations for improving the compliance rate. Progress on these objectives is discussed below.

III. PROGRESS ON OBJECTIVES

As a result of the study under §361(b) of the USA PATRIOT Act, IRS and FinCEN focused their FBAR program efforts over the past year on achieving the objectives articulated in the first report. Significant progress has been made in achieving these goals, as set forth below:

1. Consider Delegation of Penalty Authority

The most far-reaching recommendation in the initial report involved FinCEN’s delegation of authority to impose civil money penalties for FBARs violations to the IRS. This recommendation was based on FinCEN’s need to concentrate its scarce enforcement resources on reporting requirements such as suspicious activity and currency transaction reports filed by financial institutions, as opposed to individual taxpayers, as well as the greater availability of IRS resources for FBAR enforcement. Further, one could argue the FBAR is directed more towards tax evasion, as opposed to money laundering or other financial crimes, that lie at the core mission of FinCEN.

⁴ 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 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 not to exceed \$100,000, or \$25,000, whichever is greater.

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). 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.

The delegation objective has been fully attained. After review and discussion of issues relating to such delegation, a memorandum of agreement and delegation of authority for enforcement of FBAR requirements was executed by FinCEN and the IRS on April 8, 2003 (Exhibit C). The scope of delegation includes the following: “FinCEN delegates only its authority to enforce the FBAR provisions of the BSA to the Commissioner [of the IRS] as described above, and nothing in this delegation affects FinCEN’s authority over any other provision of the BSA or its implementing regulations.” A regulation reflecting this delegation was published in the Federal Register on May 16, 2003 (68 F.R. 26489).

2. Update and Improve the FBAR Form and Instructions

FinCEN originally took responsibility for this objective and undertook measures to update the FBAR form, including improved instructions on the form. Comments from previous filers and FinCEN’s regulatory and law enforcement partners were considered and added, as appropriate. In light of the delegation of enforcement authority to the IRS, the IRS Small Business/Self Employed Division accepted responsibility for finalizing the updated form and instructions. The initial report proposed a target date of December 31, 2002, for the new FBAR. However, that target date was not met because priority was given to other BSA forms, as mandated in 2002, including new SAR forms for broker-dealers and casinos as well as role out of the SAR requirement for currency exchangers. The IRS will determine a revised target date.

3. Review Filing and Processing Procedures at DCC

FinCEN traditionally worked with DCC to identify barriers that dissuaded persons from filing an FBAR, or not filing complete and accurate forms. DCC receives, processes and posts FBAR filings to the BSA financial database. As part of the delegation of FBAR matters, the IRS will now assume responsibility for this function.

In addition to receiving and uploading FBAR forms, the DCC receives and answers questions from filers about the form and instructions. This process provides a source of useful data for identifying problems and issues frequently encountered by FBAR filers. To tap into that information, FinCEN has requested DCC staff to prepare a list of “Frequently Asked Questions” based on common queries from FBAR filers. If practical, the questions and answers will be posted on the IRS website for use by taxpayers. FinCEN and IRS also discussed the notion of generating periodic error register reports to assess frequent filing errors. Based upon that information, IRS could better determine if amendments to the form are necessary and target outreach efforts, as appropriate.

4. Enhance Outreach and Educational Guidance

IRS took responsibility for assessing whether better education and guidance regarding FBAR compliance is needed, and for implementing such improvements, as appropriate. Significant steps have been made in the past year in planning and hiring personnel to accomplish this objective. IRS has planned a comprehensive educational approach. To increase efficiency and standardize educational materials, the IRS Small Business/Self-Employed Division will utilize its Taxpayer Education and Communication (TEC) Section to handle outreach and educational aspects for FBAR compliance. Six BSA/anti-money laundering specialists were recently hired to work exclusively on anti-money laundering

educational outreach. Along with other BSA-related initiatives, efforts are underway to develop educational products and implement a marketing plan to educate taxpayers about the reporting requirements of §103.24 for FBAR compliance.

The proposed education campaign is designed to repeatedly deliver and reinforce compelling, consistent messages through a variety of communication channels and tactics to improve BSA compliance. The campaign's objectives, in part, are to encourage full compliance and clearly explain the penalties for not filing FBARs. The campaign is built around a direct outreach effort that leverages relationships with outside stakeholders such as tax practitioner groups, financial associations, income tax software developers and the media. Direct outreach leveraged through outside stakeholders is the most economical and effective method to reach a diverse audience. These relationships can provide new insights and access to more target groups. Messages can be tailored and adjusted to reach specific groups. Instant feedback is gained, constantly informing and improving the campaign. The basic campaign messages are reinforced through media relations.

Program activity for this strategic outreach campaign falls generally into the following categories:

- Research and Message Development - The information gathered from research will shape an understanding of the audience, allow IRS to develop messages, use leveraged delivery channels to ensure the widest distribution of materials, engage appropriate media contacts and employ other outreach activities to appropriate parties.
- Direct Outreach - Tested messages will be delivered to a target audience. The IRS will significantly expand available information concerning FBAR compliance by developing and delivering a concise education/information package to all identified or potential FBAR reporting entities. For example, the IRS could insert an applicable short message in the tax packages that every taxpayer uses to complete their tax returns.
- Media - The media efforts will focus on generating articles in mass media publications.
- Constituency Outreach - Direct and media outreach will be complemented with outreach to the target audience through national and regional associations and organizations familiar with FBAR requirements. This component of the campaign allows IRS to work with third party organizations including tax practitioners, financial associations, and income tax software developers to deliver and reinforce the messages. For example, expanding outreach to accountants, tax practitioners, and tax filing services that should be advising their clients to file the FBAR, when appropriate, is one method to improve compliance with both §103.24 and Title 26. Another approach is to work with income tax software developers to add a pop-up message to taxpayers and practitioners who use the tax software programs.
- Measurement and Evaluation - Through research, IRS will develop measures to evaluate the effectiveness of the messages and the methods of outreach.

5. Establish Joint Task Force on FBAR Prosecutions/Enforcement

IRS, FinCEN, and the Department of Justice agreed to form a joint Task Force to study ways to enhance prosecutions and enforcement actions related to FBAR reporting. This objective has been attained in large part. As a result of the IRS' offshore initiative discussed in the initial report, increased FBAR compliance is expected, as discussed below.

In November 2002, analysts from the IRS Criminal Investigation, Financial Crimes Section, met with representatives of the Department of Justice Tax Division, Department of Justice Asset Forfeiture and Money Laundering Section and Immigration and Customs Enforcement to discuss the proliferation of offshore mechanisms to further criminal violations of U.S. tax laws, money laundering and the BSA. Specifically, the group discussed avenues to enhance prosecution and enforcement of criminal statutes related to FBAR reporting requirements.

The IRS Criminal Investigation and the Department of Justice had recently formulated a framework to investigate criminal violations related to the utilization of offshore tax havens to facilitate tax evasion and money laundering activities. The IRS is currently engaged in a large-scale initiative to seek out tax evaders with undisclosed overseas accounts. Offshore banks issue credit cards upon deposit of a certain amount of cash. The majority of the credit card transactions are processed through the major credit card companies' in the United States. By utilizing data from these domestic processing centers, the IRS identified numerous U.S. persons with foreign accounts and no accompanying FBARs.

Immigration and Customs Enforcement demonstrated a desire to participate in appropriate investigations related to money laundering, terrorism and BSA compliance. It was agreed the existing framework would be formalized as a task force and utilized as a vehicle to enhance enforcement of U.S. laws, including the FBAR requirement. The statutory violations related to FBAR reporting requirements will be considered and charged in appropriate cases.

FinCEN worked closely with the IRS on the offshore tax haven initiative. Specifically, as part of the IRS's Offshore Voluntary Compliance Initiative, the Director of FinCEN granted a waiver from Title 31 liability to persons who entered into the program, backfiled FBARs, disclosed unreported offshore holdings and paid back taxes and fines in accordance with the terms and conditions prescribed by the IRS. Taxpayers would have been reluctant to settle tax evasion penalties under this Title 26 program, and still face potential liability for related activities by FinCEN under the BSA. A website entry serving notice of the waiver was posted on FinCEN's website. As a result of this initiative, 1,299 taxpayers have applied to participate in the program. IRS is currently evaluating or investigating these cases towards resolution.

IV. CONCLUSION

Substantial progress has been made in the past year, particularly with respect to streamlining the administration and enforcement of the FBAR. In the coming year, Treasury intends to address the remaining tasks and continue making progress in our ongoing projects to improve compliance with the FBAR reporting requirement. Towards that end, we are setting the following specific goals:

- Emphasize Examination of Offshore Activities - The IRS received 1299 applications from taxpayers for the Offshore Voluntary Compliance Initiative (OVCI). Once accepted by the IRS, taxpayers have 150 days to submit complete packages including FBARs, under the provisions of the OVCI. An initial review of the applications by the IRS indicates that approximately 450 applications involve previously unreported foreign bank accounts;
- Identify Potential Non-Filers of FBARS - Building on the success of the offshore examinations, the IRS will continue to explore new ways of identifying persons who should be filing FBARs;

- Continue Outreach and Education – Outreach and educational efforts will continue in fiscal year 2004, based upon the results of initial activities. In addition, coordination with the IRS Off-Shore Credit Card Program will be an area of emphasis to facilitate identification of targeted audiences. Outreach about the filing requirements of Section 103.24 will be reinforced with cogent, consistent messages relative to application of penalties for failure to meet the FBAR filing requirements;
- Use Input from Filers to Improve Form - IRS will work towards finalizing an improved FBAR to better enable taxpayers to comply with the law.