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WHISTLEBLOWER PROGRAM: Amend IRC §§ 7623 and 6103 to Provide Consistent Treatment of Recovered Foreign Account Tax Compliance Act (FATCA) and Report of Foreign Bank and Financial Accounts (FBAR) Penalties for Whistleblower Award Purposes

TAXPAYER RIGHTS IMPACTED¹

- *The Right to Challenge the IRS's Position and Be Heard*
- *The Right to Confidentiality*
- *The Right to a Fair and Just Tax System*

PROBLEM

Pursuant to two separate statutory regimes, U.S. taxpayers may be required to report their ownership of foreign bank accounts to the government.² If the foreign account balance exceeds \$10,000 at any time during the year, the taxpayer must file an FBAR, pursuant to provisions of Title 31 of the U.S. Code.³ If the balance exceeds \$75,000 at any time during the year or exceeds \$50,000 on the last day of the year, the same taxpayer, if an individual living in the U.S., must again report the foreign account, this time on IRS Form 8938, *Statement of Specified Foreign Financial Assets*.⁴ Filing Form 8938 is required pursuant to provisions of FATCA, codified in the Internal Revenue Code (IRC), which is Title 26 of the U.S. Code.⁵ Both the FBAR and FATCA statutory regimes impose penalties on foreign account holders for failing to report as required, and the IRS may assess and collect penalties under both statutes for the same failure to report.⁶

The IRC permits, and in some cases requires, the IRS to pay an award to whistleblowers who provide information that assists the IRS “in detecting underpayments of tax, or detecting and bringing to trial and punishment persons guilty of violating the internal revenue laws or conniving at the same.”⁷ The amount of the award, paid “from the proceeds of amounts collected,” or “collected proceeds,” takes into account

1 See Taxpayer Bill of Rights, available at www.TaxpayerAdvocate.irs.gov/taxpayer-rights.

2 Bank Records and Foreign Transactions Act, better known as the Bank Secrecy Act (BSA), Pub. L. No. 91-508, 84 Stat. 1114 (1970), portions of which are codified at 31 U.S.C. §§ 5311-5332; FATCA, enacted as part of Title V of the Hiring Incentives to Restore Employment Act, Pub. L. No. 111-147, 124 Stat. 71 (2010).

3 31 U.S.C. § 5314.

4 See Treas. Reg. § 1.6038D-2(a) (containing other thresholds for married taxpayers filing a joint return and those living abroad).

5 FATCA, Pub. L. No. 111-147, § 511(a), 124 Stat. 71, 109 (2010), adding IRC § 6038D to the IRC. As discussed below, FATCA also requires foreign financial institutions (FFIs), in order to avoid withholding on certain U.S. source income, to report to the U.S. government accounts with balances in excess of \$50,000 belonging to U.S. persons. See IRC § 1471.

6 31 U.S.C. § 5322; IRC § 6038D(d). The authority to assess and collect FBAR penalties has been delegated to the IRS. 31 C.F.R. § 1010.810(g). The National Taxpayer Advocate has questioned the appropriateness of twice penalizing the same failure to report, noting “penalizing someone more than once for essentially the same mistake—failing to report a foreign account—may be considered stacking, which is generally not viewed as an effective way to promote compliance, in part because it is perceived as confusing, disproportionate, and unfair.” National Taxpayer Advocate 2014 Annual Report to Congress 335 (Legislative Recommendation: *FBAR Forms: Reduce the Burden of Foreign Account Reporting*).

7 IRC § 7623.

penalties the IRS collected for violations of FATCA.⁸ However, the award does not take into account penalties the IRS collected for FBAR violations.⁹ This imbalance may discourage whistleblowers from reporting foreign bank accounts to the IRS.

EXAMPLE

A U.S. citizen with dual nationality, X, owns a foreign bank account that had a \$10 million balance throughout 2015. X reports on Schedule B of his U.S. tax return that he does not own a foreign bank account and he does not file an FBAR with respect to the account. Pursuant to an agreement with the IRS, X's bank reports to the IRS the names of its account owners who are U.S. persons. Because X has concealed from his bank the fact that he is a U.S. citizen, however, the bank does not report X's account to the IRS. A tax whistleblower, Y, informs the IRS of X's foreign bank account. The IRS verifies the existence of the account and the account balances and assesses against X a \$10,000 penalty for failing to report the account as required by FATCA. The IRS also assesses against X a penalty of \$5 million for failing to file an FBAR. The IRS collects both penalty amounts. Because the IRS would not have known of the bank account had Y not come forward, and because Y meets the other requirements for obtaining an award under IRC § 7623, the IRS proposes to award Y a portion of the \$10,000 FATCA penalty it collected from X. The IRS will not award Y any of the \$5 million FBAR penalty it collected from X.

RECOMMENDATIONS

To address the inconsistency with which amounts collected by the IRS on the basis of whistleblower information are included in a whistleblower award, the National Taxpayer Advocate recommends that Congress amend IRC § 7623 to provide that the terms “proceeds of amounts collected” and “collected proceeds” include civil penalties recovered pursuant to 31 U.S.C. § 5321 for failing to file an FBAR. Information the IRS receives as part of its FBAR investigation should be designated as return or return information within the meaning of IRC § 6103, subject to the same limitations on disclosure, and whistleblowers should be subject to existing penalties for the unauthorized use or re-disclosure of such information.¹⁰

PRESENT LAW

FBAR Reporting Requirements

31 U.S.C. § 5314 authorizes the Secretary of the Treasury to require U.S. citizens, residents, and entities to report their foreign bank accounts.¹¹ Under this authority, the Secretary of the Treasury developed Form TD F 90-22.1, *Report of Foreign Bank and Financial Accounts (FBAR)*, requiring information about all foreign accounts exceeding \$10,000 at any time during the calendar year.¹² Under

8 IRC § 7623.

9 See PMTA 2012-10 (Apr. 23, 2012).

10 See Legislative Recommendation: *Whistleblower Program: Make Unauthorized Disclosures of Return Information by Whistleblowers Subject to the Penalties of IRC §§ 7431, 7213, and 7213A, Substantially Increase the Amount of Such Penalties, and Make Whistleblowers Subject to the Safeguarding Requirements of IRC § 6103(p)*, *supra*.

11 31 U.S.C. § 5314(a) provides: “the Secretary of the Treasury shall require a resident or citizen of the United States or a person in, and doing business in, the United States, to keep records, file reports, or keep records and file reports, when the resident, citizen, or person makes a transaction or maintains a relation for any person with a foreign financial agency. The records and reports shall contain the following information in the way and to the extent the Secretary prescribes...”

12 31 C.F.R. § 1010.350. FBARs are now filed electronically on FinCEN Form 114, *Report of Foreign Bank and Financial Accounts (FBAR)*, available at http://www.fincen.gov/forms/bsa_forms/.

31 U.S.C. § 5321(a)(5)(C), a person who willfully violates the requirement to file an FBAR is subject to a penalty equal to the greater of \$100,000 or 50 percent of the account balance, with no ceiling on the amount of the penalty.¹³ The Financial Crimes Enforcement Network (FinCEN), a bureau of the Department of the Treasury tasked with enforcing the FBAR provisions, delegated its authority to enforce FBAR provisions to the IRS in 2003.¹⁴

FATCA Reporting Requirements

U.S. citizens, resident aliens, and certain non-resident aliens with certain assets, such as foreign bank accounts, in excess of a specified threshold must file IRS Form 8938.¹⁵ A person who fails to make the required disclosure on Form 8938 is subject to a penalty of \$10,000, which rises as high as \$60,000 if the nondisclosure continues after notification from the IRS.¹⁶ Form 8938, as the Government Accountability Office (GAO) has observed, duplicates much of the information required on the FBAR.¹⁷ The National Taxpayer Advocate has recommended coordinating the two regimes by raising the FBAR filing threshold to \$50,000 and aligning the two reporting requirements so that one form could be used to report affected accounts.¹⁸

In addition to requiring the foreign account holder to file Form 8938, FATCA generally requires foreign financial institutions (FFIs) to report to the U.S. government information about individual account holders who are U.S. persons and whose accounts exceed \$50,000.¹⁹

Awards to Whistleblowers

Both Title 31 and the IRC authorize the payment of awards to whistleblowers. Under 31 U.S.C. § 5323, which the IRS does not administer, the payment of such an award, which cannot exceed \$150,000, is discretionary.²⁰ Funds for such awards must be appropriated (*i.e.*, paying the awards must be separately

13 Under 31 U.S.C. § 5321(a)(5)(A), the Secretary of the Treasury has discretion to impose a penalty of up to \$10,000 for non-willful violations. Criminal sanctions for failing to file FBARs also apply, and can result in penalties of up to \$500,000. See 31 U.S.C. § 5322(a), (b) (providing for a penalty of up to \$250,000 and imprisonment of up to five years for willful violations and a penalty of up to \$500,000 and imprisonment of up to ten years for willful violations “while violating another law of the United States or as part of a pattern of any illegal activity involving more than \$100,000 in a 12-month period”). As discussed in PMTA 2012-10 (Apr. 23, 2012), pursuant to 42 U.S.C. § 10601(b)(1), such amounts are currently paid into the Crime Victims Fund. This proposal does not include making these recovered criminal fines subject to awards under IRC § 7623.

14 31 U.S.C. § 310; 31 C.F.R. § 1010.810(g).

15 IRC § 6038D; Treas. Reg. § 1.6038D-2(a)(1)-(4). An unmarried taxpayer living in the U.S. must file a Form 8938 if the total value of the taxpayer’s specified foreign financial assets is more than \$50,000 on the last day of the tax year or more than \$75,000 at any time during the tax year. This threshold is doubled in the case of specified individuals who are married filing jointly. A qualifying unmarried taxpayer living abroad must file a Form 8938 if the total value of the taxpayer’s specified foreign financial assets is more than \$200,000 on the last day of the tax year or more than \$300,000 at any time during the tax year. This threshold is doubled as well in the case of qualified individuals living abroad who are married filing jointly.

16 IRC § 6038D(d)(1) and (d)(2). The two penalties contemplated by IRC § 6038D(d) can potentially aggregate to \$60,000.

17 GAO, GAO-12-403, *Reporting Foreign Accounts to IRS, Extent of Duplication Not Currently Known, but Requirements Can Be Clarified* 15 (Feb. 2012).

18 See Legislative Recommendation: *Foreign Account Reporting: Eliminate Duplicative Reporting of Certain Foreign Financial Assets and Adopt a Same-Country Exception for Reporting Financial Assets Held in the Country in which a U.S. Taxpayer is a Bona Fide Resident*, *supra*; National Taxpayer Advocate 2014 Annual Report to Congress 343-45.

19 See IRC § 1471(c),(d)(1). Non-compliant FFIs will be subject to a thirty percent withholding penalty on certain U.S. source payments made to the institution. See IRC § 1471(a).

20 31 U.S.C. § 5323(a).

authorized by Congress).²¹ No funds have been so appropriated, and no awards have been paid under this provision.²² Under IRC § 7623(a), the IRS has discretionary authority to make awards to whistleblowers out of “proceeds of amounts collected.” If the requirements of IRC § 7623(b) are met, the IRS *is required* to pay an award out of “collected proceeds.” For awards under IRC § 7623(b), appropriated funds are apportioned by the Office of Management and Budget (OMB) based on prior year actual awards.²³

IRC § 7623 authorizes awards for detecting “underpayment of tax” or violations of the “internal revenue laws” “in cases where such expenses are not otherwise provided for by law.” Thus, the IRS’s position is that IRC § 7623 does not permit awards for recovered FBAR penalties, which are not derived from violations of the internal revenue laws and for which an award provision exists under Title 31.²⁴ The Tax Court, while it has been presented with the issue, has not decided whether the IRS’s position is correct.²⁵ In the Tax Court case in which the issue arose, a whistleblower sought to recover an award under IRC § 7623(b) for recovered FBAR penalties. When informed of the IRS’s position that FBAR proceeds are not the subject of an award under IRC § 7623, the whistleblower viewed the communication as a de facto denial of his claim, arguing to the court that “[b]ecause the bulk of the proceeds collected from Taxpayer 1 consisted of FBAR payments for violation of title 31...there was nothing meaningful left for the Office [IRS Whistleblower Office] to investigate with respect to this claim.”²⁶ The court held that the communications from the IRS did not constitute a “determination regarding an award” within the meaning of IRC § 7623(b)(4) sufficient to confer jurisdiction on the court and thus did not address the issue of whether FBAR penalties are “collected proceeds.”²⁷

Protection of Taxpayer Information

IRC § 6103 generally prohibits IRS employees from disclosing a taxpayer’s “return” or “return information,” and civil and criminal penalties are imposed for violating the bar.²⁸ Form 8938, which is filed with the tax return, qualifies as “return” or “return information.”²⁹

21 See PMTA 2012-10 (Apr. 23, 2012) (noting “amounts paid as BSA penalties should be deposited into Treasury’s General Fund). See GAO, 2 *Principles of Federal Appropriations Law* 6-166 – 6-175 (3d ed. 2006) (agencies must deposit into the General Fund of the Treasury any funds received from sources outside the agency absent statutory authority to retain the funds or deposit them elsewhere). Once these amounts go into the General Fund, only a specific appropriation can get them out. See *id.* at 6-168 – 6-169.” See also OMB Circular No. A–11, *Section 20 Terms and Concepts* 3 (noting “[a]ppropriation means a provision of law... authorizing the expenditure of funds for a given purpose”).

22 IRS Whistleblower Officer (WO) response to TAS information request (Aug. 26, 2015).

23 See OMB Circular No. A–11, *Section 20 Terms and Concepts* 3, noting “[a]pportionment is a plan, approved by OMB, to spend resources provided by one of the annual appropriations acts, a supplemental appropriations act, a continuing resolution, or a permanent law (mandatory appropriations)”; Internal Revenue Manual (IRM) 25.2.2.13, *Award Payment Procedures* (Aug. 7, 2015).

24 See PMTA 2012-10 (Apr. 23, 2012).

25 *Whistleblower 22231-12W v. Comm’r*, T.C. Memo. 2014-157 (2014).

26 *Id.* slip op. at 6-7.

27 *Id.*

28 IRC § 6103 (a); IRC §§ 7431, 7213, 7213A.

29 IRC § 6103(b)(1) defines “return” as “any tax or information return, declaration of estimated tax, or claim for refund required by, or provided for or permitted under, the provisions of this title which is filed with the Secretary by, on behalf of, or with respect to any person, and any amendment or supplement thereto, including supporting schedules, attachments, or lists which are supplemental to, or part of, the return so filed.” IRC § 6103(b)(2)(A) defines “return information” to include “a taxpayer’s identity, the nature, source, or amount of his income, payments, receipts, deductions, exemptions, credits, assets, liabilities, net worth, tax liability, tax withheld, deficiencies, overassessments, or tax payments, whether the taxpayer’s return was, is being, or will be examined or subject to other investigation or processing, or any other data, received by, recorded by, prepared by, furnished to, or collected by the Secretary with respect to a return or with respect to the determination of the existence, or possible existence, of liability (or the amount thereof) of any person under this title for any tax, penalty, interest, fine, forfeiture, or other imposition, or offense.”

The status of information the IRS gathers in an FBAR investigation under IRC § 6103 is not as straightforward, and stems from rules pertaining to how the IRS may access Title 26 information during a Title 31 investigation. IRC § 6103(h)(1) permits the IRS to share returns and return information with Department of Treasury employees “whose official duties require such inspection or disclosure for tax administration purposes.” IRC § 6103(b)(4) defines “tax administration” as including “the administration, management, conduct, direction, and supervision of the execution and application of the internal revenue laws or *related statutes*” (emphasis added). Thus, if the IRS determines that a Title 31 investigation is considered to be tax administration under the “related statute” portion of the definition of tax administration, IRS employees are authorized to access returns or return information in conducting a Title 31 investigation.³⁰ It follows, according to IRS Chief Counsel guidance, that “information collected or generated in that [Title 31] investigation after the related statute call has been made is protected by section 6103.”³¹ However, if in a particular case Title 31 is not a related statute (*e.g.*, because there are no possible Title 26 violations), the information would not be return information under IRC § 6103.³²

Exceptions to the general rule of nondisclosure in IRC § 6103 permit the IRS to disclose a taxpayer’s return or return information to a whistleblower in limited circumstances and for specific purposes. For example, IRC § 6103(h)(4) permits the IRS to disclose, to the extent necessary, a taxpayer’s return information to a whistleblower in a whistleblower administrative proceeding.³³ The preliminary award the IRS communicates to the whistleblower includes “a summary report that states a preliminary computation of the amount of collected proceeds, the recommended award percentage, the recommended award amount... and a list of the factors that contributed to the recommended award percentage.”³⁴ The National Taxpayer Advocate has noted that existing procedures do not protect taxpayers from re-disclosure of their confidential information by whistleblowers and has recommended corrective legislation.³⁵

Whether or not they qualify as “return” or “return information,” FBARs and information derived or extracted from FBARs are not subject to disclosure under the Freedom of Information Act.³⁶ FBARs

30 See IRM 4.26.14.2, *Access to Title 26 Returns and Return Information* (July 24, 2012) (providing guidance on “related statute” determinations). Moreover, according to IRM 4.26.17.2(1)(d), *FBAR Procedures Starting the Case - Related Statute Memorandum* (Jan. 1, 2007), “[i]f the source of the FBAR information is a Title 26 examination... the information acquired is return information protected by IRC Section 6103. The examiner must obtain a related statute determination, signed by a Territory Manager before using the return information in an FBAR case.” The IRM does not specify what the “source” of the FBAR information is where a whistleblower provides information that leads to a Title 26 examination.

31 IRS Chief Counsel, Procedure and Administration, Publication 4639, *Disclosure & Privacy Law Reference Guide* (Rev. 10-2012) 7-5. An accompanying note advises “[a]lthough there are no cases addressing the related statute determination, there are cases suggesting that a money laundering charge, standing alone, is not ‘tax administration.’ See *United States v. Hobbs*, 991 F.2d 569, 573 (9th Cir. 1993); *United States v. Callahan*, 981 F.2d 491, 494 n.3 (11th Cir. 1993), *cert. denied*, 508 U.S. 976 (1993).”

32 See IRM 4.26.17.2.3, *Cases Where No Related Statute Memorandum (RSM) Needed* (May 5, 2008) (noting “[i]f the examiner is conducting an examination under the BSA, a related statute determination is not needed to examine for FBAR compliance. This is because no information from a tax examination or other 6103 protected source is involved.”).

33 IRC § 6103(h)(4); Treas. Reg. § 301.6103(h)(4)-1.

34 Treas. Reg. § 301.7623-3(c)(2)(ii) (regarding preliminary awards under IRC § 7623(b)). See Treas. Reg. § 301.7623-3(b)(1) (regarding a similar provision for preliminary awards under IRC § 7623(a)).

35 See Most Serious Problem: *Whistleblower Program: The IRS Whistleblower Program Does Not Meet Whistleblowers’ Need for Information During Lengthy Processing Times and Does Not Sufficiently Protect Taxpayers’ Confidential Information from Re-Disclosure by Whistleblowers*, *supra*; Legislative Recommendation: *Whistleblower Program: Make Unauthorized Disclosures of Return Information by Whistleblowers Subject to the Penalties of IRC §§ 7431, 7213, and 7213A, Substantially Increase the Amount of Such Penalties, and Make Whistleblowers Subject to the Safeguarding Requirements of IRC § 6103(p)*, *supra*.

36 31 U.S.C. § 5319 provides that FBARs are exempt from disclosure under the Freedom of Information Act (5 U.S.C. § 552) and “may not be disclosed under any State, local, tribal, or territorial ‘freedom of information,’ ‘open government,’ or similar law.” See *Berger v. I.R.S.*, 487 F. Supp. 2d 482, 496 (D.N.J. 2007) *aff’d*, 288 F. App’x 829 (3d Cir. 2008) (holding the IRS was not required to disclose information derived or extracted from BSA reports).

may be disclosed at the discretion of the Secretary, but guidelines issued pursuant to this authority do not specifically contemplate IRS disclosures of FBAR information to whistleblowers.³⁷

REASONS FOR CHANGE

The FATCA and FBAR statutory regimes allow the IRS to recover penalties against taxpayers who fail to report the same foreign bank account, an outcome about which the National Taxpayer Advocate has significant concerns. However, once the IRS actually collects both penalties on the basis of information provided by a whistleblower, it is anomalous to pay awards to whistleblowers with respect to recovered FATCA penalties but not recovered FBAR penalties. Moreover, information from whistleblowers may be the *only* way for the IRS to learn of foreign accounts that do not meet the FATCA third-party reporting thresholds or those that exceed the FATCA reporting thresholds but escape third-party reporting. As the whistleblower in one Tax Court case asserted, FBAR penalties may far exceed amounts recovered under Title 26.³⁸ Thus, whistleblowers would have more of an incentive to report undetected foreign bank accounts if FBAR penalties were included in the award amount.

Information the IRS collects as part of an FBAR investigation may not constitute “return” or “return information” under IRC § 6103, but may nevertheless be unavailable to a whistleblower pursuant to nondisclosure provisions of Title 31. To the extent a whistleblower cannot access information the IRS obtains in the course of an FBAR investigation, he or she may not be able to effectively challenge the IRS’s determination about the amount of a proposed award that stems from collected FBAR penalties.³⁹ The proposal to include FBAR proceeds in whistleblower awards necessitates additional proposals to allow the IRS to disclose FBARs and information the IRS receives in ascertaining a taxpayer’s liability for FBAR violations to whistleblowers and to simultaneously ensure the confidentiality of that information. Designating such information as return or return information within the meaning of IRC § 6103, subject to the same limitations on disclosure and making whistleblowers subject to existing penalties for violating IRC § 6103, would accomplish both objectives.

EXPLANATION OF RECOMMENDATIONS

The proposal would:

- Amend IRC § 7623 to include collected FBAR penalties in the definition of “proceeds of amounts collected” and “collected proceeds;”
- Designate FBARs and information the IRS receives in ascertaining a taxpayer’s liability for FBAR violations as return or return information within the meaning of IRC § 6103; and
- Make whistleblowers subject to existing penalties for the unauthorized use or re-disclosure of such information.

37 31 C.F.R. § 1010.950 provides “[t]he Secretary may within his discretion disclose information reported under this chapter for any reason consistent with the purposes of the Bank Secrecy Act.” According to IRM Exhibit 4.26.14-3, *Re-Dissemination Guidelines for Bank Secrecy Act Information*, Section VI (July 24, 2012), the IRS may not disseminate BSA information without the consent of FinCEN in the absence of exceptions that would not apply to whistleblowers. See also IRM Exhibit 4.26.14-2, *Memorandum of Understanding Between the FinCEN and the IRS dated Sept. 24, 2010* (July 24, 2012) (including FBARs in the definition of BSA information).

38 *Whistleblower 22231-12W v. Comm’r*, T.C. Memo. 2014-157 (2014), slip op. at 6-7.

39 See, e.g., *Berger v. I.R.S.*, 487 F. Supp. 2d 482, 496 (D.N.J. 2007) *aff’d*, 288 F. App’x 829 (3d Cir. 2008) (rejecting the contention that the IRS, based on IRM provisions, had discretion to release information it obtained in a Title 31 investigation).

The proposal would lead to consistent treatment, for whistleblower award purposes, of recovered FATCA and FBAR penalties, supporting the *right to a fair and just tax system*. The proposal would strengthen the right to be heard and the right to confidentiality by:

- Clearly bringing within the ambit of IRC § 6103 information the IRS obtains as part of its FBAR investigation without the need for a “related statute” determination; and
- Allowing the IRS to share that information pursuant to exceptions of IRC § 6103, which in turn would permit whistleblowers to make an informed decision about whether to challenge a proposed whistleblower award; yet
- Adopting measures to prevent whistleblowers from re-disclosing that information.

The proposal would also provide incentive to whistleblowers to report foreign accounts that are likely to escape detection by the IRS.