Bank Secrecy Act - 31 USC 5321(a)(5)(E)

Limitations on Bank Secrecy Act Penalties in a Tax Case

Proposed amendment

31 USC 5321(a)(5) is amended to add new sub-section (E) to read as follows:

(E) Notwithstanding (B) or (C) above, in any case where a penalty is asserted under this section in Peconjunction with or as a result of any audit under Title 26 of the United States Code, the amount of any penalty shall not exceed ten percent of the assessment of taxes due thereunder, not including interest or other penalties, finally determined to be due.

Reasons for change

The Bank Secrecy Act provides establishes a penalty for willful failure to maintain foreign bank account records or file foreign bank account report forms are fifty percent (50%) of the highest balance in the account per year. This provision was originally aimed at drug smugglers, terrorist financiers, and other criminals to deprive them of the financial results of their crimes. Recently, however, the Internal Revenue Service has taken this weapon designed for those who threaten our society and begun to use it against United States citizens and other taxpayers instead of the criminals for which it was enacted.

The Internal Revenue Service has been asserting substantial FBAR penalties in cases where the taxpayer has voluntarily filed amended tax returns and foreign bank account report forms upon learning that they had incorrectly declared their income or failed to file foreign bank account report forms. Our system of taxation is based on voluntary compliance, and there had been a long recognized administrative practice permitting the filing of amended tax returns to correct omissions.

In one instance, a taxpayer amended their tax returns and filed foreign bank account report forms late. After audit, the taxpayer was found to owe no tax or penalties under Title 26, but was assessed a penalty of $500,000 for willfully failing to timely file a foreign bank account report form.

In other instances, the taxpayer is being assessed a penalty of fifty percent (50%) of the highest balance in their bank for failure to file a foreign bank account report form. The taxpayer is also being assessed a penalty of thirty five percent (35%) of the amount in their bank account for failure to file information returns. The taxpayer is also being assessed a penalty of twenty percent (20%) of the amount of tax owed for substantial underreporting of a tax liability. If all of these penalties are added together, in many cases the penalties exceed the value of the bank account, let alone any taxes and interest that may be due.

Imposition of penalties for failure to file a foreign bank account report form should not be an alternative route to substantial penalties when penalties are not imposed under the Internal Revenue Code. Yet, that is what is taking place.

The use of substantial penalties for failure to file a form, as is being asserted by the Department of Justice, raised substantial questions about whether the Eighth Amendment prohibition against Excessive Fines and Forfeitures is being violated by the Government. *See, United States v. Bajakajian,* 524 U.S. 321 (1988). The Supreme Court explained that the test to be applied under the Eighth Amendment is one of proportionality.

The proposed amendment cures the present constitutional infirmity in the penalty structure under the Bank Secrecy Act by imposing proportionality. Where a taxpayer has placed funds in a previously undeclared foreign bank account that have not been subject to United States taxation and which would have been subject to tax if declared, the taxpayer will incur tax substantial tax liability under the Internal Revenue Code. For example, if a taxpayer tells a foreign manufacturer to overcharge them and pay the difference into an undeclared foreign bank account, upon discovery the taxpayer will pay substantial amounts of taxes. In that circumstance, a substantial penalty for violation of the Bank Secrecy Act is appropriate and provided for in the amendment. If, on the other hand, the taxpayer has funded the foreign bank account with after tax assets, or if the taxpayer has inherited assets from non-United States persons outside of the United States, the current substantial penalties in the Bank Secrecy Act are out of proportion to the harm caused – the failure to file a form rather than any substantial tax liability. In that case, the penalty under the Bank Secrecy Act should be limited since the potential non-payment of tax is on the income and gains earned through the foreign bank account, and not the full amount of the foreign bank account itself

The proposed amendment also fosters voluntary compliance so that United States citizens who learn that they have become non-compliant are encouraged to file either amended or belated reports without fear that they will lose half of their assets.