FinCEN Seeks to Establish FBAR Requirement for Cryptocurrency Accounts in 2021

Article By:

Dr. Nick Oberheiden

Federal authorities are cracking down on cryptocurrency investors. The Internal Revenue Service (IRS) began sending “warning letters” to investors after issuing the well-known Coinbase subpoena a couple of years ago; and, since then, it has begun auditing and investigating U.S. taxpayers suspected of underreporting and underpaying their cryptocurrency-related federal income tax liability.

Another area of legal risk for cryptocurrency investors has to do with holding virtual currencies in foreign accounts. Under the Bank Secrecy Act, U.S. residents and citizens are required to disclose qualifying foreign financial accounts to the Financial Crimes Enforcement Network (FinCEN), a bureau of the U.S. Treasury Department tasked with helping to safeguard the U.S. financial system. Recently FinCEN provided guidance regarding its current enforcement of the Bank Secrecy Act’s reporting requirements with regard to virtual currency held offshore—but it also signaled its intent to impose additional reporting requirements in the future.

“Cryptocurrency investors are facing increasing scrutiny from the IRS, FinCEN, and other federal authorities. Investors who have failed to appropriately report and pay their federal income tax liability – and those who have used cryptocurrency to commit other federal crimes – will need to carefully assess the steps they should take to minimize their risk of federal prosecution.” – Dr. Nick Oberheiden, Founding Attorney of Oberheiden P.C.

FBARs and Cryptocurrency: The Current State of the Law

The announcement that FinCEN will seek to enhance reporting requirements for foreign cryptocurrency accounts came in the form of FinCEN Notice 2020-2. As the one-paragraph notice explains:

“Currently, the Report of Foreign Bank and Financial Accounts (FBAR) regulations do not define a foreign account holding virtual currency as a type of reportable account. (See 31 CFR 1010.350(c)). For that reason, at this time, a foreign account holding virtual currency is not reportable on the FBAR (unless it is a reportable account under 31 C.F.R. 1010.350 because it holds reportable assets besides virtual currency). . . .”

So, this is the law as it stands today. Under current federal regulations, cryptocurrency investors are not required to disclose foreign financial accounts that solely contain cryptocurrency assets under the Bank Secrecy Act. However, cryptocurrency investors must disclose foreign financial accounts if they are otherwise "reportable"—meaning that they contain non-cryptocurrency assets that exceed the Bank Secrecy Act's reporting threshold.

Under the Bank Secrecy Act, "United States persons" (a term which encompasses the vast majority of U.S. residents, U.S. citizens, and companies organized or doing business in the United States) must disclose foreign financial accounts that have an "aggregate maximum value" of $10,000 or greater at any time during the reporting year. This means that if a United States person owns two accounts worth $5,000 each at any point in time, then both accounts are subject to reporting. Likewise, if a United States person owns foreign financial accounts worth $10,000 and $1,000 at any point in time during the reporting year, then both accounts need to be reported using FinCEN's online FBAR filing system.

As noted in FinCEN Notice 2020-2, cryptocurrency assets are not considered when calculating the "aggregate maximum value" of a United States person's foreign financial assets under the current Bank Secrecy Act regulations. However, if non-cryptocurrency assets held in an offshore account exceed the reporting threshold *and the account also contains cryptocurrency assets*, then the account is still subject to disclosure.

FBARs and Cryptocurrency: What Investors Should Expect in the Future

After explaining the current state of the Bank Secrecy Act FBAR regulations as they apply (or don't apply) to cryptocurrency assets, FinCEN Notice 2020-2 goes on to state as follows:

"FinCEN intends to propose to amend the regulations implementing the Bank Secrecy Act (BSA) regarding reports of foreign financial accounts (FBAR) to include virtual currency as a type of reportable account under 31 CFR 1010.350."

This is a significant proposal that could impact United States persons who invest in all types of cryptocurrencies worldwide. If the proposal is implemented, not only will United States persons have to consider their cryptocurrency assets when deciding whether to file FBARs for accounts containing both cryptocurrency and non-cryptocurrency assets, but they will have to determine whether their cryptocurrency accounts independently trigger FBAR filing requirements as well.

As of yet, we have not seen any movement on FinCEN's plan to propose amendments to the Bank Secrecy Act regulations. However, given the federal government's other efforts to crack down on cryptocurrency-related tax fraud, money laundering, and other crimes, we would expect FinCEN to follow through with its publicized proposal.

Cryptocurrency Investors May Also Need to Comply with FATCA

Importantly, the Bank Secrecy Act is not the only federal statute that establishes reporting requirements for United States persons who own assets offshore. The Foreign Account Tax Compliance Act (FATCA) also establishes reporting requirements—and its requirements are not specific to "foreign financial accounts." Rather, FATCA applies to all "foreign financial assets" that exceed the statute's reporting thresholds. Individuals residing in the United States are subject to FATCA reporting if they own more than $50,000 in foreign financial assets at any point during the tax year, while this threshold increases to $200,000 for individual U.S. taxpayers living abroad. These thresholds double for married spouses who file jointly.

While foreign cryptocurrency accounts do not currently qualify as foreign financial accounts under the Bank Secrecy Act (although they may qualify soon), virtual currencies held offshore may qualify as foreign financial assets under FATCA. In other words, while the FBAR filing requirement doesn't currently apply to cryptocurrency investors (unless their foreign accounts also hold reportable assets), the FATCA filing requirement does. Like the Bank Secrecy Act, FATCA imposes substantial penalties—including criminal penalties for willful and intentional violations.

Options for Cryptocurrency Investors Who Have Failed to Meet Their Reporting Obligations

Given the relative novelty of cryptocurrency and the continuing development of the federal statutes and regulations surrounding cryptocurrency assets, many United States persons are likely to make mistakes when it comes to reporting their holdings to the IRS (and potentially FinCEN). For those who make mistakes, what options are available?

1. IRS Streamlined Filing Compliance Procedures

The IRS's Streamlined Filing Compliance Procedures are available to U.S. taxpayers who have inadvertently failed to meet their reporting obligations. This applies to the FBAR reporting requirements (which fall under the IRS's enforcement jurisdiction even though FBARs must be filed with FinCEN), the FATCA reporting requirements, and taxpayers' obligations under the Internal Revenue Code.

There are different Streamlined Filing Compliance Procedures for taxpayers residing in and outside of the United States. However, the basic eligibility criteria are the same for all U.S. taxpayers. In order to utilize the IRS's Streamlined Filing Compliance Procedures, taxpayers must:

- Have a valid Social Security Number (SSN) or Tax Identification Number (TIN);
- Certify that their violation of the Bank Secrecy Act, FATCA, or the Internal Revenue Code was non-willful;
- Not currently be the subject of an IRS audit or investigation; and,
- Be current on any previously-assessed IRS penalties.

The IRS's Streamlined Filing Compliance Procedures do not provide relief from the penalties for non-compliance. However, they do allow taxpayers to avoid the potential additional consequences of facing an IRS audit or investigation. As a result, for those who have committed non-willful violations with respect to reporting their cryptocurrency assets, utilizing the Streamlined Filing Compliance Procedures will often be the best option available.

2. IRS Criminal Investigation (IRS CI) Voluntary Disclosure Practice

For U.S. taxpayers who are unable to make the certification of non-willfulness required in order to take advantage of the IRS's Streamlined Filing Compliance Procedures, an alternative is to utilize the IRS Criminal Investigation (IRS CI) Voluntary Disclosure Practice. In appropriate circumstances, making a voluntary disclosure can allow taxpayers to avoid criminal prosecution for willful cryptocurrency-related reporting violations. However, IRS CI makes clear that, "[a] voluntary disclosure will not automatically guarantee immunity from prosecution."

Voluntary disclosure is currently an option for cryptocurrency investors who have violated FATCA and the Internal Revenue Code. If FinCEN's FBAR proposal leads to a change in the Bank Secrecy Act regulations, it will be an option for investors who fail to file FBARs as well. Similar to the Streamlined Filing Compliance Procedures, there are eligibility criteria for utilizing the Voluntary Disclosure Practice as well. Most notably, IRS CI must not currently have access to the information being disclosed as a result of its own investigative efforts or from third-party sources.

3. Other Means of Pre-Charge Resolution

Depending on the circumstances involved, cryptocurrency investors who fail to meet their reporting obligations may have other options as well. Settlement is generally an option, and the IRS will consider settling controversies under the Bank Secrecy Act, FATCA, and the Internal Revenue Code in appropriate cases.

However, one option that is generally *ill-advised* is what is commonly referred to as a "quiet disclosure." This involves attempting to correct past mistakes through current or amended filings rather than through the IRS's designated means. If IRS revenue agents or IRS CI investigators uncover a quiet disclosure, this can lead to additional consequences above and beyond those imposed for the original statutory violation.

National Law Review, Volume XI, Number 147

Source URL:https://natlawreview.com/article/fincen-seeks-to-establish-fbar-requirement-cryptocurrency-accounts-2021