I try here to anticipate possible arguments from either the IRS or FinCEN in defense of the FinCEN-114 reporting regime, and then refute them. I also discuss the hardship caused.

Possible IRS argument 1: Maintaining the FBAR database allows the IRS to identify suspected cases of underreported income more effectively, resulting in increased and better targeted examination, adjustment, penalty and possibly criminal action, all of which have a positive deterrent effect.

Refutation: The FBAR database receives data on all manner of foreign financial accounts, regardless of whether the account will or can ever contribute to reportable and potentially taxable income. Examples of accounts which do not contribute to income are non-interest-bearing checking accounts, investment accounts with no dividend or net-capital-gain income and all manner of retirement accounts in which the account holder has a later financial interest but no cash-redemption value. These may even make up a majority of the accounts reported.

Yet, the IRS has no ability to differentiate between reported accounts that may be tax-relevant, that is, income producing, and those that aren't. The FinCEN-114 reporting scheme simply does not capture the information in the detail needed to make this judgment. If the IRS is to use the information in the FBAR database as a primary source for identifying taxpayers to target for further examination, how can this be performed efficiently? It can't, which essentially makes the information unusable for any desired enforcement purpose, and the gathering and maintenance of such information unnecessary.

It is true that the IRS has attempted to reconcile the FBAR database with data gleaned from FATCA reporting by foreign financial institutions. However, a report not too long ago by the Treasury Inspector General for Tax Administration (TIGTA, a non-partisan official) found that this reconciliation was ineffective and produced few, if any, usable results. Some of the reasons were the complete lack of uniformity for account and account holder identification, as well as the different reporting thresholds under each regime.

Another major point is that the FinCEN-114 regime relies on self-reporting. What are the chances that someone who is not reporting and paying tax on income generated in a foreign account will then voluntarily report that account to the IRS? If the taxpayer believes that the chances of being discovered are low, the penalties for not complying with the FinCEN-114 reporting regime are little deterrent.

Furthermore, the FinCEN-114 reporting regime enables some taxpayers not to report any details of their foreign financial accounts without any risk of penalties at all, since they will still be in compliance with the reporting regime. Any FBAR filer with an interest in 25 or more foreign financial accounts need not report the details of these accounts individually, but must simply provide the information if and when it is requested. This provides a convenient loophole for avoiding detailed reporting. I am definitely aware of US persons in the UK who simply have up to 25 transit-fare cards with small balances remaining on them, each of which qualifies under FinCEN-114 reporting as a separately reportable foreign financial account with a unique account number, enabling them to check this box.

Thus, the usefulness of maintaining the FinCEN-114 database as a primary source for enforcement purposes is extremely limited, mainly because it cannot be done efficiently.

Possible IRS argument 2: Maintaining the FBAR database allows the IRS to expand the scope of examination of cases that have already been identified through other avenues, which can result in increased penalties even if the accounts were not used in the avoidance of tax but simply weren't reported. This can also act as a positive deterrent.

Refutation: Penalties for failure to comply with the FinCEN-114 reporting regime can apply even if no tax was evaded since these penalties are for failure to report information and not for tax evasion. Since having a foreign financial account, income-producing or not, is not a crime, and having one when living abroad is not even a suspicious activity, it's obvious that the entire FinCEN-114 reporting regime exists only so that the IRS will have a bigger club to beat you with if they catch you doing something wrong. Yet in this case, "something wrong" simply means not providing the IRS with specific information, regardless of its tax-relevance.

Furthermore, it seems reasonable to conclude that when the FinCEN-114 reporting regime was originally introduced (under its original name), it was with the intention that the IRS could keep an eye on such accounts. This has proven to be an impossibility, and every effort in that direction has fallen woefully short. Since the IRS has no need to collect this information, the same deterrence goals could be achieved simply by rolling the penalties for FinCEN-114 noncompliance into the penalties for tax evasion, when a foreign financial account was actually used in the evasion.

Possible IRS argument 3: The simple act of having to report foreign financial accounts, regardless of what the IRS does with the information, increases the reporting of income from such accounts, thus resulting in increased tax compliance.

Refutation: This argument may indeed be true, but must be examined in the context of our other laws. Firearms, for example, which are generally legal to own, can be used for illegal purposes. Despite that, in most parts of the US we generally don't need to tell the government that we possess any. There may be licensing requirements I need to comply with as an owner of firearms, but once I do, there is no further reporting. The same is true of explosives. As long as I am licensed to possess and store them, I generally do not need to report to the government what I have. Both of those are areas of supervision that fall within the Treasury Department, and both are certainly potentially more harmful.

Possible FinCEN argument 1:

The FBAR database is useful in FinCEN's efforts to combat money laundering and the financing of terrorism.

Refutation: This claim defies credulity. It is well known that international money transfers of any significant size are required to be reported, usually by the transfer agent, in virtually all financially modern nations. FinCEN surely has access to these data. Such flows of money are surely more interesting to FinCEN than money simply sitting in an account. Furthermore, such third-party reporting is certainly more reliable than the self-reporting of the FinCEN-114 reporting regime. I am also unaware of any media report in which the FBAR database was mentioned as having been useful in the uncovering or prosecution of any financial crime.

Hardship caused by the FinCEN-114 reporting regime for those living outside of the United States who need to comply with it:

Most Americans abroad have multiple "foreign" financial accounts in their country of residence, which often complicates simply determining if one has an FBAR-filing requirement for the year in question at all. Then comes the task of determining the maximum balance of each account during the year. Since I have assisted many clients with this task, I personally witness the effort that must be gone through to find this number, often requiring contact with the financial institution. Then, in filling out the FBAR form, the number one question is always, "What is my TIN-Type?". The next most frequent question is, "I know my Social Security number, but what is my Taxpayer Identification Number?". This clearly shows that filling out the FBAR form is not designed to be easy for Americans abroad, including many who have never lived in the USA.

Another point to keep in mind is that the $10,000 filing threshold, introduced in 1970, has never been adjusted for inflation. If it had been, it would be around $70-80,000 today, still hitting many working families but leaving out many with low income and low wealth who are forced to file today. Indeed, in the 1974 Supreme Court decision upholding FBAR reporting, an opinion by Justices Powell and Blackmun justified the obvious violation of privacy mandated by FBAR reporting with the at-the-time high filing threshold of $10,000. While it may well have been true in 1970 that someone with $10,000 or more in a foreign financial account was indeed trying to hide income, today that argument has no basis. An overwhelming number of people who are of no interest to the IRS are forced to comply.