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Min (Megan) K. Park

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By: Min K. (Megan) Park

As the Internet continues to grow at the speed of light, various convenient funding methods are available to consumers beyond their geographical locations. A person who owns online accounts that function as traditional bank accounts should be aware of a recent district court's holding on online gambling accounts.

U.S. v. HOM, 113 AFTR 2d 2014-2325, (DC CA, 2014)

In a recent case, the Northern District Court of California held that online gambling accounts through offshore Internet sites were subject to foreign bank and financial accounts (FBAR) filing requirements and upheld the IRS in its assessment of penalties against the taxpayer for the non-willful failure to report the accounts.

Under the Bank Secrecy Act (31 USC §5314) and pertinent regulations, an individual must file a FBAR (FinCEN Form 114) for the previous year by June 30 if a taxpayer meets the following elements: ① he or she is a United States person; ② he or she has a financial interest in or signature or other authority over a bank, securities, or other financial accounts; ③ the bank, securities, or other financial account is in a foreign country; and ④ the aggregate amount in the accounts exceeds $10,000 in U.S. currency at any time during the year (31 CFR 103.24). The Secretary of the Treasury can prescribe statutory regulations to determine the method of reporting requirements based on explicit empowerment by the Bank Secrecy Act.

Failure to timely file the FBAR can lead to substantial penalties. The potential civil monetary penalty for filing violations that are deemed non-willful can be as high as $10,000 with penalties for willful violations as high as the greater of $100,000 or 50% of the balance in the account at the time of the violation. Furthermore, a willful violator can face additional criminal penalties of substantial imprisonment time and additional fines of up to $500,000. Penalties, however, may be waived in cases where the omission of reporting was due to reasonable cause.[1]

In 2006 and 2007, John Hom, a U.S. citizen, maintained online gambling accounts with PokerStarts.com and PartyPoker.com (offshore Internet gambling sites) to deposit money or make withdrawals for his gambling by using his FirePay[2] account, which was funded by his domestic financial accounts (Wells Fargo, Western Union). His gambling accounts were continuously funded via his domestic financial accounts despite FirePay discontinuing services to U.S. customers for transferring funds to offshore Internet gambling sites. The aggregate amount of funds in his FirePay, PokerStars, and

[1] 31 U.S.C. 5321 and 5322

[2] FirePay.com: an online financial organization that receives, holds, and pays funds on behalf of its customers

PartyPoker accounts exceeded $10,000 in U.S. currency at some points in both 2006 and 2007.
Per 31 USC §5321(a)(5), the IRS assessed penalties for his non-willful failure to submit FBARs (a $10,000 penalty for each account): a $30,000 penalty for 2006 and a $10,000 penalty for 2007, respectively.

Both parties conceded that the facts in this case met the first (①a U.S. Person) and fourth (④$10,000 Requirement) FBAR requirements.

The only issues in this case were whether Hom's gambling accounts were "a bank, securities, or another financial account" (second element) and whether each of the three accounts was in a foreign country (third element).

While analyzing the requirement of the second element (②interest in "a bank, securities, or other financial accounts"), the court cited the 4th Circuit's holding in U.S. v. Clines[3] that "by holding funds for third parties and disbursing them at their direction, [the organization at issue] functioned as a bank [under 31 USC §5314]." The court also cited 9th Circuit's holding in U.S. v. Dela Espriella[4] case that "the term 'financial institution' is to be given a broad definition."

The court viewed FirePay, PokerStars, and PartyPoker function as institutions engaged in the business of banking and concluded his accounts were subject to FBAR because the accounts were under his name, he controlled access to the accounts and deposited money into the them, he withdrew or transferred money from the accounts to other entities at will, and the accounts could carry a balance.

The court did not accept Hom's argument that his accounts were not "other accounts" as defined by 31 CFR 103.24 because FirePay, PokerStars, and PartyPoker function as institutions engaged in the business of banking. Thus, the accounts were subject to FBAR.

The court's decision on the issue in light of the third element, which regards whether the accounts were "located in" foreign countries, was in favor of the IRS determining foreign financial institutions according to where they were incorporated and operated, rather than the physical location of their funds. Hom's argument that "located in" refers to the geographic location of the funds was denied.

Hom's accounts with FirePay, PokerStars, and PartyPoker were managed through the companies' websites that were located outside of the United States. FirePay was located in and regulated by the United Kingdom. PokerStars was licensed and regulated by the government of the Isle of Man. PartyPoker was licensed, regulated, and headquartered in Gibraltar.

Therefore, the court held that Hom's accounts were located in foreign countries because FirePay, PokerStars, and PartyPoker were foreign institutions, which opened and maintained his accounts outside of the U.S. regardless of where these three companies place their own funds.

[3] U.S. v. Clines, 958 F.2d 578 (4th Cir 1992)
[4] U.S. v. Dela Espriella, 781 F.2d 1432 (9th Cir. 1986)

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Hom's argument over the IRS's instructions to the 2010 FBAR reporting form, which stated, "[t]he geographic location of the account, not the nationality of the financial institution in which the account is found determines whether it is an account in a foreign country", was rejected by the court because the instructions had no legal weight.

Therefore, the court upheld the IRS's determination of FBAR requirements and the imposition of penalties for the non-willful failure to report three offshore, web-based gambling accounts.

The IRS has yet to explicitly state that virtual currency accounts (e.g. bitcoin) are subject to FBAR requirements. However, this case is worthy of notice to a taxpayer who has offshore digital accounts or currency. If the account functions as a bank account, taxpayers may consider filing FBAR for their accounts and staying tuned for future developments on this issue