Foreign Asset Disclosure Noncompliance and Penalty Abatement After OVDP Closing

WEDNESDAY, DECEMBER 12, 2018, 1:00-2:50 pm Eastern

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Foreign Asset Disclosure Noncompliance and Penalty Abatement ~~After OVDP Closing~~ under updated Offshore Voluntary Disclosure Practice guidelines

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Before focusing his full attention to tax law, Attorney Parent focused on criminal law appeals. He found great success, but also frustrations. He was only able to help about eight clients a year. When he joined forces with his father, David G. Parent, Esq., the two realized that with a fully optimized tax practice, they could help a lot more people. Since 2006, Parent & Parent LLP has helped thousands of US taxpayers all around the globe handle difficult tax problems. In particular, Attorney Parent's extensive criminal law background has been instrumental to the firm becoming one of the nation's leading offshore disclosure firms. And while fixing problems is a source of great pride, helping their clients avoid future tax problems with solid planning and year-to-year compliance also offers incredible satisfaction.

Attorney Parent developed the IRSMedic channel on YouTube which has close to two million minutes of watch time, writes extensively for the IRSMedic blog, and is a featured speaker at events around the country along with being a best-selling author of the "IRS Confidential."

Attorney Parent volunteers as part of a pro-bono effort to represent servicemen and ex-servicemen who are facing daunting tax issues.

Attorney Parent is a source for many international media outlets including the Wall Street Journal, SmartMoney, Fox News, CNBC, ExpatFocus, and others.

Attorney Parent graduated Quinnipiac University School of Law in 2002 and is admitted to practice federal tax law with the IRS along with being a member of both the Connecticut and Vermont Bar associations.

He married to his wife Erika.They have two sons, Ulysses and Ellis. He is a gym rat, and when conditions permit, a cyclist who enjoys both road and mountain, along with snowboarding. He is also a singer-songwriter who enjoys performing at least one a month.

What we will cover

- A domestic voluntary disclosure hypothetical that we will run through the 2018 OVDP.
- We'll then add offshore income and assets to see how it differs.
- Explain how streamlined disclosure are much preferable but some of the psychological hurdles to overcome.
- How to frustrate criminal penalties that IRS CID wants to assess if you are unable to get into a program.
- A history of OVDP since 2009
- Attorney Hanson will be covering the reasonable cause sand abatements standard which are essential for all new 2018 OVDPs — each and everyone is now very similar to an opt-out.

Domestic Disclosure Hypothetical

- Larry was an early "investor" in a Ponzi scheme
- He pretty much knew it was a Ponzi scheme and didn't report $300,000 of income for 2014, $350,000 in 2015 and $250,000 in 2016 and $200,000.
- Larry had no prior convictions.
- Wants to know what to do.

Domestic Disclosure

- Amend 2014-2016 returns and pay taxes with underpayment & late payments penalties.
- Enter into a voluntary disclosure?

Domestic Disclosure

- Pros: Criminal protection
- Cons: Costlier, more time consuming and invites an audit.
- The fact is a later amended return will full payment makes a claim of tax evasion incredibly hard to prove. But IRS CID likes to enlarge charges to non-tax crimes. CID's 2018 report emphasizing bringing down fraudulent individuals for things other than tax evasion.

Domestic Disclosure

- Larry decides on voluntary disclosure. He says he never gets involved with shady guys and this is just going the wrong way. It hasn't been worth the sleepless nights.
- We follow the November 20, 2018 Updated Voluntary Disclosure Guidance
- We file a pre-clearance with CID.
- If granted, we then fill out IRS Form 14457 naming names of who else is involved, who assisted, the facts leading to the taxpayer making a disclosure.
- If denied then what? Need to talk to investigators, DOJ to see what is going on.
- If denied, what should that stop us from filing all amended returns and paying taxes? Are we not under a duty regardless of being accepted into a Voluntary Disclosure to be in full compliance with the law?

Domestic Disclosure

- Form 14457 includes a narrative providing all the facts circumstances, assets, entities, related parties and any professional advisors who knew about or assisting in the non-compliance.
- CID will then determine whether or not to pass disclosure on to civil division at LB&I Austin. If they pass it on, that's just about the last you will here from CID unless something goes wrong.
- LB&I Austin then assigns the case. Could be any office.
- We are now in an examination.
- Six year look back (improvement over 2011, 2012, 2014 OVDP's 8 year look back). But subject to examiner discretion.

Domestic Disclosure Penalties

- One time civil fraud 75% penalty on the one year with the highest tax liability. IRC 6663/6641(f)
- Does this mean corrected highest liability? For instance let's suppose that 2013 was Larry's best year -before he got involved in the Ponzi scheme. He originally and correctly reported all $1.5 million of his income and paid tax of $400,000.
- Examiner discretion will answer this question and expect answers to be inconsistent.
- There are rights to appeal and those can be very helpful, but if you feel that voluntary disclosure practice is an ad hoc, inconsistent, unfair, burdensome in desperate need of judicial review, you will be told if you don't like these rules to try to the alternative civil and criminal rules.
- Administrative law is considered to be a headless fourth branch of government. Voluntary Disclosure isn't even quite administrative law. It is "take-it-or-leave-it-law."

Domestic Disclosure Penalties

- Examiner Discretion: One time penalty can be assessed more than once. Up to six years.
- Examiner Discretion: If taxpayers opens disclosure and walks away (or practitioner non-non-responsive) the IRS can now assess the civil fraud penalty beyond the six years.
- Examiner Discretion: A taxpayer can argue for a lower accuracy-related penalty.
- Examiner Discretion: An examiner can seeks taxpayer be removed from the program if they feel they are not co-operating.

Domestic Disclosure Results

- In this case, Larry was right. In 2017, the promoter of the Ponzi scheme was indicted.
- Larry was relieved to know he didn't need to worry about a crime of tax evasion. He felt comfortable co-operating with the FBI. No charges were ever filed against him.
- However, bankruptcy court forced him to give back his "earnings" for 2014-2016
- Meaning, he really didn't have any income to report in a voluntary disclosure.

Disclosure Game-changers

- Prior convictions - he might not be able to get in
- If CID thinks of him as a bad guy.
- CID is targeting someone like your client. They will make the suit fit the man.But this can also work the other way. Foreign bank/Domestic bank line of credit example.
- If CID invested time investigating taxpayer - they are loathe to give up their time investments with nothing.
- Illegal source income.

Offshore Voluntary Disclosure Practice

- All the facts are the same, however the bank accounts which the income flowed to were overseas and the Ponzi scheme itself was a foreign corporation controlled by US shareholders in which Larry was more than a 10% shareholder.
- This illegal source income issues bugs me - if Larry doesn't know is illegal isn't that the operative inquiry?

Offshore Voluntary Disclosure Practice

- Same process as Domestic Voluntary disclosure with two key additions:
- FBAR examination to assess willful FBAR penalties under IRM 4.26.16 and 4.26.17
- No automatic assessment for the Form 5471 penalties. Examiner Discretion determines penalties if any.
- FBAR penalties will be on the highest balance year, Civil Fraud years on the year with the highest income tax liability. These could be different years.

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Presentation by Dennis N. Brager, Esq.

About Dennis Brager

- Former IRS Trial Attorney
- State Bar Certified Tax Specialist
- 30+ Years of Tax Dispute Experience with IRS, EDD, BOE, and FTB Problems
- Nationally Recognized Tax Litigation Attorney

Increased FBAR Civil Penalties

- Assessed After Jan 15, 2017
  - Nonwillful $12,663. Up from 10k
    - Subject to reasonable cause defense.
  - Willful. Minimum $126,626 per violation. Up from a minimum of $100,000.
    - Maximum 50% of account balance.
    - Maybe Not! U.S. v. Colliot AU-16-CA-01281-SS (WD TX May 16, 2018); *United States v. Wadhan*, 325 F. Supp. 3d 1136 (D. Colo. 2018).
    - *But, Norman v. United States*, 138 Fed. Cl. 189, 190 (2018)(Colliot got it wrong).

International Reporting Form Penalties

IRS Form	Penalty	I.R.C. Section
Form 5471 **Information with respect to certain foreign corporations.**	$10,000 per foreign corporation, plus a $10,000 continuation penalty per month, not to exceed $50,000 (total $60,000), if not filed within 90 days of IRS notice of failure to file.	**§6038; 6046; 6679**
Form 926 **Nonrecognition transfers to foreign corporations.**	Penalties for failure to report transfers of property to a foreign corporation begin at 10% of the value of the property transferred to the corporation. Not to exceed $100,000 per transfer, unless the failure to report was due to intentional disregard.	**§ 6038B**
Form 8865. **Return of U.S. persons with respect to certain foreign partnerships. Section 6046A; 6038B**	For Category 1, 2 and 4 filers. $10,000 per foreign partnership plus a $10,000 per month continuation penalty. Maximum of $60,000. Reduction of Foreign Tax Credits. Section 6038(c). For Category 3 filers. Section 6038B. 10% of the FMV of the property contributed to the partnership. Limited to $100,000 unless due to intentional disregard. In addition, the transferor must recognize gain on the property as if it had been sold for FMV.	**Section 6679. (Category 1, 2 and 4 filers) Section 6038B (Category 3 fillers)**
Form 3520 **Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts**	Greater of 35% of the gross value of the distribution received from or transferred to a foreign trust. 5% per month of the amount of foreign gifts or inheritances, up to 25%	**§ 6048(a), (b)** Penalties I.R.C. § 6677
Form 8858 **Foreign Disregarded Entities**	$10,000 per foreign disregarded entity plus a $10,000 continuation penalty per month, not to exceed $50,000. 10% reduction of the available foreign tax credit. I.R.C. Section 6038(c)	**§ 6038**
Form 8621 **Shareholder of a PFIC**	**No Penalty.**	**§ 1298 (f)**
Form 5472 **U.S. corporations with a 25% foreign shareholder.**	$10,000 per reportable transaction, plus a $10,000 continuation penalty per month, not to exceed $50,000 (total $60,000), if not filed within 90 days of IRS notice of failure to file	**§ 6038A**
Form 3520-A Annual Information Return of Foreign Trust with U.S. owner.	**P**enalty is imposed on the U.S. owner. The initial penalty is the greater of $10,000 or 5 percent of the value of the trust assets treated as owned by the U.S. owner. 6677(b) + a $10,000 per month continuation penalty.	**§ 6048 (c);** 6677(a)
Form 8938	**Specified Persons required to Report Specified Foreign Financial Assets** Generally, $10,000, but may increase up to $50,000 for failure after notice $10,000 per month continuation	**§ 6038D**

IRM Guidelines Limiting Non-Willful FBAR Penalties
IRM 4.26.16.6.4.1 (post May 12, 2015)

- IRS examiners are instructed to use their best judgment when preparing FBAR penalties, taking into account all the available facts and circumstances of each case.
- In "most cases" the non-willful penalty will be limited to one $10,000 (12,663?) per year, regardless of the number of accounts.
- The examiner, with group manager approval, and after consultation with the an Operating Division FBAR Coordinator may assert a single $10,000 (12,663?) penalty in a multi-year case.
- In no event will the total amount of the penalties for non-willful violations exceed 50% of the account balances.

IRM Guidelines for Willful FBAR Violations (post May 12, 2015)

- In "most cases", the total penalty amount for all years under examination will be limited to 50% of the highest aggregate balance of all unpaid foreign financial accounts during the years under examination. Examiners may recommend an amount which is higher or lower than 50%.
- The total penalty should not exceed 100% of the highest aggregate balance.

FBAR Mitigation Guideline For Smaller Accounts Threshold Requirements. IRM 4.26.16.6.6.1 (11-06-2015)

- The taxpayer has no history of past FBAR penalty assessments.
- No money in the accounts was from an illegal source or used to further a criminal purpose.
- The taxpayer cooperated during the examination.
- The IRS did not sustain a civil fraud penalty against the taxpayer for an underpayment for the years in question due to the failure to report income related to any amount in a foreign account.
- No history of criminal tax or BSA convictions for the preceding 10 years.

FBAR Non-Willful Penalty Mitigation Guideline (Smaller Accounts)

- If the aggregate of all accounts held during the year does not exceed $50,000, then the penalty for each violation is $500, not to exceed a total of $5,000.
- If the aggregate of all accounts is over $50,000, but less than $250,000, the penalty is, per violation, the lesser of $5,000 or 10% of the highest balance in the account during the year for which the account should have been reported.
- For violations regarding an account exceeding $250,000, the penalty per violation is the statutory maximum of $10,000 (12,663?).

FBAR Willful Penalty Mitigation Guidelines (Smaller Accounts)

- If the maximum aggregate balance for all accounts to which the violations relate does not exceed $50,000, the penalty is the greater of $1,000 per violation on 5% of the maximum account balance in the calendar year.
- If the maximum aggregate balance is more than $50,000, but does not exceed $250,000, the penalty is the greater of $5,000 per violation or 10% of the maximum account balance.
- If the maximum aggregate balance is greater than $250,000 and less than $1,000,000, the penalty is the greater of 10% of the maximum account balance or 50% of the closing balance in the account on the last day for filing the FBAR.
- If the account exceeds $1,000,000, the penalty is the greater of $100,000 or 50% of the balance of the account on the last date for filing the FBAR.

Quiet vs. Noisy Disclosure: What's the Difference?

- Quiet = Amended Filings Only
- Pre-OVDP a noisy disclosure included a meeting/tel. conf. with CI.
- Noisy for both domestic and offshore purposes now requires that certain information be disclosed on an IRS Form 14457

Voluntary Disclosures: IRM 9.5.11.9.

- It is the practice of the IRS that a voluntary disclosure will be considered along with all other factors in the investigation in determining whether criminal prosecution will be recommended.
- This voluntary disclosure practice creates no substantive or procedural rights for taxpayers, but rather is a matter of internal IRS practice, provided solely for guidance to IRS personnel.

Voluntary Disclosures: IRM 9.5.11.9. (Cont'd)

- Taxpayers cannot rely on the fact that other similarly situated taxpayers may not have been recommended for criminal prosecution.
- A voluntary disclosure will not automatically guarantee immunity from prosecution; however, a voluntary disclosure may result in prosecution not being recommended. This practice does not apply to taxpayers with illegal source income.

Elements of a Voluntary Disclosure

- A communication from the taxpayer which is timely, truthful, and complete
- The taxpayer shows a willingness to cooperate (and does in fact cooperate) with the IRS in determining his or her correct tax liability; and
- The taxpayer makes good faith arrangements with the IRS to pay in full, the tax, interest, and any penalties determined by the IRS to be applicable

Examples of an IRM Part 9 Voluntary Disclosure (OLD)

- A letter from an attorney which encloses amended returns from a client which are complete and accurate (reporting legal source income omitted from the original returns), which offers to pay the tax, interest, and any penalties determined by the IRS to be applicable in full and which meets the timeliness.
- The letter is an essential part of a Voluntary Disclosure.

The New Updated Voluntary Disclosure Practice (Son of OVDP)

- Effective for all disclosures received after September 28, 2018
- No set penalty structure- just guidelines
- Requires “full cooperation” with the IRS
- Resolution by agreement is stressed
- Taxpayer may request an appeal with the IRS Office of Appeals

Son of OVDP
Step 1

- Taxpayer submits a pre-clearance request to CI on Form 14457 (to be revised)
- Eligibility still determined under IRM 9.5.11.9
  - Taxpayers will illegal source income are not eligible
- Timely Disclosure. Before:
  - a civil or criminal investigation is notified or the IRS has notified the taxpayer of its intention to begin an audit/investigation
  - The IRS has received information from a third party (e.g., informant, other governmental agency, or the media) alerting the IRS to the specific taxpayer's noncompliance.
  - The IRS has initiated a civil examination or criminal investigation which is directly related to the specific liability of the taxpayer
  - The IRS has acquired information directly related to the specific liability of the taxpayer from a criminal enforcement action (e.g., search warrant, grand jury subpoena).

Son of OVDP
Step 2 the Civil Audit

- After pre-clearance the taxpayer will be subject to a civil audit
- The VD period is generally 6 years
- If the audit is not resolved by agreement the audit may be expanded, and penalties may be imposed for all years
  - Requires "management" approval
- All required returns (amended?) must be submitted for the disclosure period
- Generally full payment is expected of all taxes, penalties and interest
  - OICs or Installment Agreements are not ruled out

Son of OVDP
Step 3. Penalty Framework

- Fraud Penalty for 1 year only
  - i.e. 75% under 6663 or 6651(f)
  - Applies to the year with the highest tax deficiency
  - May apply fraud penalty to more than 1 year in "limited circumstances" e.g. where there is no agreement about the tax liability.
- Willful FBAR penalties will be asserted in accordance with IRM 4.26.16, and 4.26.17
- Taxpayer may request non-fraud/non-willful penalties
  - Taxpayer must present convincing evidence that a willful penalty should not be imposed.
- Information return penalties will not automatically be imposed
  - Examiners will take into account the imposition of other penalties, and resolve the examination by agreement

Are Quiet Disclosures Still Viable?

- In 2014, the GAO released a report critical of the IRS for failing to follow-up and audit taxpayers who had filed quiet disclosures.
- New IRS guidance specifically endorses "quiet disclosures," but it is clear that they provide no criminal protection.
  - They may, however, be "qualified amended returns."
  - On the other hand they may just be admissions

Prospective Disclosures

- Filing accurate 2018 tax returns, and/or FBARs, but not self correcting prior years
- Advantages Over Quiet Disclosure
  - Less Chance of scrutiny
  - Lower transactional costs
- Advantages Over Streamlined
  - No 5% Streamlined penalty for domestic taxpayers
- Disadvantages
  - More chance of criminal exposure if discovered
  - 20% Accuracy Penalty will be imposed if there is no reasonable cause
  - SOL on most foreign information reporting forms including Form 8938 also remains open until 3 years after the form is filed

Tips for Avoiding Malpractice

- Considerations Upon Discovery of Undisclosed Accounts
  - The Preparer as IRS witness
    - Federal Practitioner Privilege v. Attorney Client Privilege
  - Circular 230, Section 10.34(c). The practitioner has a duty to advise a client of any potential penalties likely to apply to a position taken on a return
- Statement on Standards for Tax Services No. 6, Knowledge of Error: Return Preparation
    - If a member is requested to prepare the current year's return and the taxpayer has not taken appropriate action to correct an error in a prior year's return, the member should consider whether to withdraw from preparing the return and whether to continue a professional or employment relationship with the taxpayer. If the member does prepare such current year's return, the member should take reasonable steps to ensure that the error is not repeated.
    - While performing services for a taxpayer, a member may become aware of an error in a previously filed return or may become aware that the taxpayer failed to file a required return. The member should advise the taxpayer of the error and the measures to be taken. Such recommendation may be given orally. If the member believes that the taxpayer could be charged with fraud or other criminal misconduct, the taxpayer should be advised to consult legal counsel before taking any action.
  - Potential Conflict of Interest. Can the client claim reliance on the preparer?

Tips for Avoiding Malpractice (Continued)

- Understand the law including recent case law, and IRS guidelines if any
- Advise clients of the potential criminal risks
- Each year of a multiple year case must be addressed
- Prepare a spreadsheet of possible penalties under different alternatives
- Alert the client to worst case scenarios
- If you decide to submit a borderline Streamlined case make sure to include ALL of the "bad facts."

Tips For Avoiding Malpractice (Continued)

- Do not rely on the unverified facts set forth by your client. Instead review all back-up documentation including prior tax returns, relevant bank statements, and emails
- Remember that the Federally Authorized Tax Practitioner Privilege (IRC Section 7525) doesn't apply in criminal cases
- Obtain copies of any organizer that your client filled out, and sent back to the tax preparer
- Take into account unlimited SOL for most Foreign Information Reporting Forms, as well as other SOL issues
- Each year of a multiple year case must be addressed
- If you're client states that she relied on a third party – interview that person (usually the tax preparer)
- File a Freedom of Information Act (FOIA) Request if an appeal is necessary, or sometimes during audit

Going to Court

- The Tax Court has no jurisdiction over FBAR penalties since it is not a Title 26 penalty. *Williams v. Commissioner*, 131 T.C. 54 (2008).

- FBAR penalties can not be discharged in a Chapter 7 bankruptcy. *United States v. Simonelli*, 614 F. Supp. 2d 241 (D. Conn. 2008).

Other Court Challenges to FBAR Penalties

- Taxpayer can wait until the IRS files a civil action to recover the FBAR penalty after it has been assessed. See e.g. *United States v. Wadhan*, 325 F. Supp. 3d 1136, 1137 (D. Colo. 2018)
- The IRS has only two years from the date of the IRS assessment to bring suit. 31 USCS § 5321(b)(2).
  - The IRS currently has no procedures for soliciting a waiver of this two-year statute of limitations. IRM 5.21.6.6 (02-18-2016)

Other Court Challenges to FBAR Penalties (Continued)

- The taxpayer can pay some or all of the FBAR and then file suit under the Tucker Act. 28 USC 1491. Jarnagin v. United States, 134 Fed. Cl. 368, 375 (2017).

- Partial Payment of the FBAR penalty may be sufficient to bring suit under the Tucker Act. See *Kentera v. United States*, No. 16-CV-1020-JPS, 2017 U.S. Dist. LEXIS 12450, 119 A.F.T.R.2d (RIA) 634 (E.D. Wis. Jan. 30, 2017).
  - CF. *Flora v. United States*, 362 U.S. 145, 150-51 (1960) holding that tax refund suits require full payment of the tax or other amount alleged to be due. However, the FBAR penalty is not assessed under Title 26 so should not apply.

Other Court Challenges to FBAR Penalties(Cont.)

- The Taxpayer has 6 years under the Tucker Act to file suit in the Court of Federal Claims from the time the claim "first accrues." 28 USC 2501
  - A claim accrues when all of events which fix government's alleged liability have occurred, and plaintiff was, or should have been, aware of their existence. *Colon v United States,* 35 Fed Cl 515 (1996).
  - Presumably the 6 years begins to run when the IRS assesses the FBAR penalty.
  - Don't wait 6 years! The Government may invoke the doctrine of laches to assert the claim should be dismissed. See e.g. *Eurell v United States,* 215 Ct Cl 273, 566 F2d 1146 (1977).

Other Court Challenges to FBAR Penalties(Cont.)

- There is no right to a jury trial in the Court of Federal Claims

Questions?

 @TaxProblemEsq

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Offshore Voluntary Disclosure Practice compared with prior initiatives and programs

- 2009 Offshore Voluntary Disclosure Initiative: 6 year look back, 20% in-lieu-of FBAR penalty regardless of state of mind. No examiner discretion on to items of state-of-mind.
- 2011 Offshore Voluntary Disclosure Initiative: 8 year look back, 25% in-lieu-of FBAR penalty regardless of state of mind unless opting of the the 25% penalty. Streamlined-program few qualified for.
- 2012 Offshore Voluntary Disclosure Program (OVDP): 8 year look-back, 27.5% in-lieu-of FBAR penalty regardless of state of mind unless opting out of the 27.5% penalty. A streamlined program few qualify for.
- 2014 Streamlined Procedures: 90% of our clients benefited from this.
- With the 2018 Offshore Voluntary Disclosure Practice so vague as to civil penalties and what could happen, the goal will be trying to shoe horn taxpayers into a Streamlined Disclosure.

Streamlined Hypothetical

- Mona is UK-born US green card holder.
- She moved to the US 20 years ago to expand her publishing business.
- Her publishing business involves trade magazines that include the US accounting industry.
- Despite her sophistication she did not know that unlike the UK, the US imposing a worldwide taxing regime.
- She saw Part III of Schedule B but she didn't think it applied to her because her accounts in the UK aren't foreign to her. So she always checked no.
- She is convinced she has no option but to possible surrender her entire fortune to the IRS because of mistakes she should have known not to make.
- She has researched the issue and wants your help in getting criminal protections and a civil settlement via the November 20, 2019 OVDP guidelines.

Streamlined Hypothetical

- Under the prior OVDPs, if a client who had very low risk of criminal prosecutions still wanted the 'extra protections' of a full OVDP we would represent them as long as they knew the time commitment, a general idea of our cost and the final bill.
- But now, with so much examiner discretion, it is difficult to estimate what a final bill would be.
- The costs of the 'extra protections' of the 2018 OVDP are so uncertain that it is difficult to say if the 2018 OVDP provides anything of value except for those who truly are at risk of criminal prosecution. We really have to analyze what her risks are.
- Second look at quiet disclosures for taxpayers that can't qualify for Streamlined?

Streamlined Hypothetical - Why Mona's case is a terrible case to prosecute

- She's from the UK. The income she didn't report was in the UK. These facts would confuse a jury as a jury is likely to be made up regular Americans. And regular Americans are fairly clueless about Universal tax jurisdiction. Out of 12 adults how many of them do you think have a foreign issue? Inheritances, pensions, life insurance…etc.
- She has a connection to the country in which they accounts were located. This is not the same thing as a US businessman trying to find the country least likely to report his accounts and then sending his money there.
- Who will testify against her? We see no criminal intent, thus it is going to be difficult to find a criminal conspiracy. Without a conspiracy, there is no other person who could testify against Mona in order to receive a lighter sentence.
- No prior convictions. No prior convictions related to fraud or the like. CID likes to go after people who "didn't learn their lesson." It's easier to get a longer sentence out of someone whose was already been convicted once.
- No one from CID spent any time investigating her.
- She pays her tax bill: Jurors think tax evasion means not paying your bill. They think: "If I have to pay my taxes, shouldn't everyone?" So if Mona pays all her taxes, the jury will likely not understand why they are there.

The current compliance lesson of Williams

- The Williams FBAR decision explains so much.
- Taxpayer funded account in Switzerland with the admitted purpose of paying taxes.
- The indictment is unsealed in 2001.
- In 2002, Williams pleads guilty to concealing assets and income to the US Treasury naming the specific account and the amount of money in the account.
- Mr. Williams serves his sentence.
- He comes out and the IRS looks to assess him FBAR penalties for not filing a 2001 FBAR.
- His criminal law team didn't think of filing an 2001 FBAR in June of 2002. What's the purpose? Mr. Williams is pleading guilty to owning this account.
- Willful penalties upheld.

Streamlined Program

- No criminal protections, but they probably not needed anyway.
- Clients will want to know what is the worst case. As it is now the worst case of a Streamlined is to be audited. If everything checks out, then no penalty.
- If not, then the FBAR penalties will be imposed as if one made a full disclosure. And Information Return penalties may be assessed.
- I would rather have my streamlined audited then go through a OVDP.

Streamlined Program

- Streamlined Foreign is what we want.
- That means for in just one of the disclosure years, the taxpayer was out of the country for 330 days or more.
- Kind of an issue with Green Card holders as being outside the US for 330 or more days during a year can be a problem for their status.
- So if Mona lived in Costa Rica in 2015, we have our one qualifying year and that means a 0% penalty.
- If we have no qualifying year, then the penalty of 5% of YEAR END value. Not high balance.

Delinquent Returns/Amended disclosures

- We have had no issues in case where there is no income to report by filing under the Delinquent FBAR reporting Information Return Reporting.
- Streamlined Disclosures can be amended and often should be - big issue as people realize that he lowest cost-providers may not understand intentional taxation completely.

Reasonable Cause & Penalty Abatement Standards

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What are we abating?

1. (Delinquent) International Information Reporting Forms

2. FBAR Penalties

(Delinquent) International Information Reporting Forms

8938	$10,000	Sec. 6038D
5471	$10,000	Sec. 6038A
8865	$10,000	Sec. 6038, 6038B
8858	$10,000	Sec. 6038(b)
3520	$10,000	Sec. 6677
3520A	$10,000	Sec. 6677

Others

(Delinquent) International Information Reporting Forms

Decision Tree

- Must you file? Y/N
- Did you file? Y/N
- Penalty.

DIIRF – Hypothetical

- A taxpayer comes to you with a newly discovered problem. She received a gift two years ago from her NRA parents in China of around $500,000 USD. She just learned about the international information reporting forms while doing tax prep this year.

- She needs to report the foreign gift (3520) and the accounts she held the gift in (8938).

- How does she show reasonable cause?

DIIRF – Reasonable Cause

- The IRM generally provides reasonable cause relief when the taxpayer exercised ordinary business care and prudence when determining his tax obligation but was otherwise unable to comply [IRM 20.1.1.3.2 (11-21-2007)].
- For informational returns specifically, reasonable cause exists where the taxpayer (1) acted in a responsible manner and (2) had significant mitigating factors [IRM 20.1.7.12.1 (10-12-2017)].

DIIRF – Reasonable Cause

- Acting in a responsible manner is when the taxpayer exercises the same level of care of a reasonably prudent person when determining filing obligations; or put another way, a taxpayer is said to be acting in a responsible manner when exercising "ordinary care and prudence."

- Significant mitigating factors, under IRM 20.1.7.12.1 (10-21-2017), include being a first time filer, i.e. the filer had not been previously required to file the particular form in question and an overall history of compliance, or was not previously penalized under the applicable statute.

DIIRF – Reasonable Cause

- Ordinary Care and Prudence, or Ordinary Business Care
- In *Congdon v. U.S. [108 AFTR 2d 2011-6343 (E.D. Texas, 2011)],* the IRS sought to impose penalties on a taxpayer for failure to file form 5471 and maintained that the taxpayer did not have reasonable cause because of ignorance of the law or complexity. The court held for the taxpayer, stating that while ignorance of the law alone is insufficient to constitute reasonable cause, inexperience in tax matters, the complexity of the area of law, and a track record of compliance can show reasonable cause.

Ignorance of the Law

- IRM 20.1.1.3.2.2.6:
- Reasonable cause may be established if the taxpayer shows ignorance of the law in conjunction with other facts and circumstances. For example, consider the following:
  - The taxpayer's education.
  - If the taxpayer has previously been subject to the tax.
  - If the taxpayer has been penalized before.
  - If there were recent changes in the tax forms or law which a taxpayer could not reasonably be expected to know.
  - The level of complexity of a tax or compliance issue.

- Must also have made a good faith and reasonable effort to comply and that the taxpayer was unaware of the requirement and could not reasonably be expected to know of the requirement.

Mistake Was Made

- IRM 20.1.1.3.2.2.4:
- the reason for the mistake may be a supporting factor if additional facts and circumstances support the determination that the taxpayer exercised ordinary business care and prudence but nevertheless was unable to comply within the prescribed time.

- Information to consider when evaluating a request for an abatement or non-assertion of a penalty based on a mistake or a claim of ignorance of the law includes, but is not limited to the following:
  - When and how the taxpayer became aware of the mistake.
  - The extent to which the taxpayer corrected the mistake.
  - The relationship between the taxpayer and the subordinate (if the taxpayer delegated the duty).
  - If the taxpayer took timely steps to correct the failure after it was discovered.
  - The supporting documentation.

Hypothetical 2

- A taxpayer comes to you who is originally from Switzerland, inherited a rental property and it's operating account with UBS. He comes to you after realized he made a mistake. He received a "FATCA Letter" back in 2009 from UBS, which he showed to a Swiss accountant, a US attorney, and contacted the bank. He was told that he had nothing to do, but recently learned this was incorrect.

The FBAR – Title 31

- 31 USC 5314(a):
  - Considering the need to avoid impeding or controlling the export or import of monetary instruments and the need to avoid burdening unreasonably a person making a transaction with a foreign financial agency, 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.
- 31 CFR 1010.350

The FBAR – Title 31

- 31 USC 5321
  - (a) Penalties for non-filing
  - (a)(6) Negligence – only for businesses, limited penalty
  - (a)(6)(B) Pattern of Negligence – only for businesses
  - (a)(5)(B)(i) Non-willful Violations – for individuals, $10,000 per violation
  - (a)(5)(C), (D) Willful Violation – for individuals, "the greater of $100,000 or 50% of balance… at time of the violation" – but *Colliot*?

The FBAR – IRS Authority

- IRS has been delegated authority to assess Title 31 FBAR penalties.
  - *IRS was delegated the authority to assess and collect civil FBAR penalties. 31 CFR 1010.810(g). The delegation includes the authority to investigate possible civil FBAR violations, provided in Treasury Directive No. 15-41 (December 1, 1992), and the authority to assess and collect the penalties for violations of the reporting and recordkeeping requirements.* -- [IRM 4.26.16.6.1 (11-06-2015)]
  - *When performing these functions, IRS is not acting under Title 26 but, instead, is acting under the authority of Title 31. Provisions of the Internal Revenue Code generally do not apply to FBARs.* -- [IRM 4.26.16.6.1 (11-06-2015)]

Willfulness – Evidence

- Willfulness can rarely be proven by direct evidence, since it is a state of mind. It is usually established by drawing a reasonable inference from the available facts. The government may base a determination of willfulness on inference from conduct meant to conceal sources of income or other financial information. For FBAR purposes, this could include concealing signature authority, interests in various transactions, and interests in entities transferring cash to foreign banks. – [IRM 4.26.16.6.5.2 (11-06-2015)]

Willfulness – Evidence, Helpful Documents

- Copies of statements
- Correspondence with tax preparer
- Promotional material from an offshore bank
- Statements showing use of the funds to cover daily living expenses in a manner that conceals source of the funds
- Previously filed FBARs
- Hold mail order
- Failure to disclose accounts to tax preparer
- Organizer from tax preparer
- Accounts held in an entity
- “Yes” or “No” for Schedule B, Pt. III

Willfulness – Defined

- A voluntary, intentional violation of a known legal duty.
  - *Ratzlaf v US*, 510 US 135, 142
  - IRM 4.26.16.6.5.1 (11-06-2015)
- Shown by the person's knowledge of the reporting requirements and the person's conscious choice not to comply with the requirements.
  - IRM 4.26.16.6.5.1 (11-06-2015)

Willfulness – And Willful Blindness

- Willfulness is attributed to a person who made a conscious effort to avoid learning about the FBAR reporting and recordkeeping requirements – [IRM 4.26.16.6.5.1 (11-06-2015)]

Willfulness – And Recklessness

- Recklessness can substitute for willful blindness. Therefore, recklessness can be willfulness.
  - *US v. Williams*, 489 Fed.App'x 655(4th Cir. 2012)
  - *US v. McBride*, 908 F.Supp.2d 1186 (D Utah 2012)
  - *Bedrosian v. US*, 2017 WL 4946433 (ED PA)
  - *US v. Garrity*, 304 F.Supp.3d 267 (D Conn. 2018)

Willfulness – And Recklessness

- *Global-Tech Appliances, Inc. v. SEB S.A.*, 563 US 754 (2011)
- "While the Courts of Appeals articulate the doctrine of willful blindness in slightly different ways, all appear to agree on two basic requirements: (1) the defendant must subjectively believe that there is a high probability that a fact exists and (2) the defendant must take deliberate actions to avoid learning of that fact.

- We think these requirements give willful blindness an appropriately limited scope that surpasses recklessness and negligence. Under this formulation, a willfully blind defendant is one who takes deliberate actions to avoid confirming a high probability of wrongdoing and who can almost be said to have actual known the critical facts. . . .

- By contrast, a reckless defendant is one who merely knows of a substantial and unjustified risk of such wrongdoing. . . and a negligent defendant is one who should have known of a similar risk but, in fact, did not. . . . [Citations omitted]"

Willfulness – The "Big Two"

Williams

- Taxpayer plead guilty to criminal tax evasion and signed a statement saying that he knew of his FBAR filing obligations but chose not to file because reasons.
- Court held that a person's conduct meant to conceal or mislead can show willfulness, but that willful blindness requires both being subjectively aware of a high probability of the existence of a tax liability and the purposeful act of avoiding learning the facts to point to such a liability

McBride

- The defendant, a partner in a manufacturing company, contacted a financial management firm who put him in an elaborate and obviously fraudulent transfer pricing scheme and he did not file FBARs. After being contacted, he failed to cooperate during an audit and is on record repeatedly lying to the examiner.
- The court held that the defendant committed a willful violation because he actually knew of the FBAR requirement and did not file. The court went on to use the willful blindness definition from the *Williams* case.

Willfulness – Title 31 vs. Title 26

- *Ratzlaf v. US*, 510 US 135 (1994)
  - The defendant was convicted of violating Title 31, and then appealed.
  - The Supreme Court held that the willfulness provision of Title 31 required that the government prove that the defended acted with knowledge that his conduct was unlawful.
  - "A term appearing in several places in a statutory text is generally read the same way each time it appears."

Willfulness – Title 31 vs. Title 26

- *Williams, McBride*

- or -

- *Ratzlaf*
- Statutory Interpretation
- How do other areas of law treat civil and criminal willfulness?

Willfulness – The IRS Understanding

- IRS Memo (Number 200603026, Release Date 01/20/2006 https://www.irs.gov/pub/irs-wd/0603026.pdf)
  - There are no cases in which the issue presented is construing "willful" in the civil penalty context. *Ratzlaf v. United States*, 510 U.S. 135 (1994), is a Supreme Court case that addressed the standard for willfulness in the context of a criminal violation of a structuring provision of the Bank Secrecy Act (BSA). The standard applied in *Ratzlaf*, at 141, was "a voluntary intentional violation of a known legal duty"; that is, the government had to prove that the defendant had acted with knowledge that his conduct was unlawful in order to establish he had willfully violated the anti-structuring law. It was not enough that he knew the bank had a duty to report the transactions. **In his dissenting opinion, Justice Blackmun argued for a lower standard (one where the person has knowledge of the third party's reporting requirement but not specific knowledge of the illegality of his own actions).**

Willfulness – The IRS Understanding

- IRS Memo (Cont.) First Question
  - … [I]n the case of the FBAR penalty, in order for there to be a voluntary intentional violation of a known legal duty, the accountholder would just have to have knowledge that he had a duty to file an FBAR, since knowledge of the duty to file an FBAR would entail knowledge that it is illegal not to file the FBAR. A corollary of this principle is that there is no willfulness if the accountholder has no knowledge of the duty to file the FBAR.

    We agree that cases involving willful FBAR violations will **generally have to rely on circumstantial evidence**. Also, as noted in the memorandum, **willfulness can be inferred** where an entire course of conduct establishes the necessary intent. An example of where such an inference was made in the context of a criminal FBAR violation can be found in *United States v. Sturman*, 951 F.2d 1466, 1476 (6th Cir. 1991).

Willfulness – The IRS Understanding

- IRS Memo (Release date: 05/23/2018; https://www.irs.gov/pub/lanoa/pmta_2018_13.pdf)
  - Where "willfulness" is a statutory condition of civil liability, the Supreme Court has generally interpreted "willfulness" to not only include knowing violations of a standard, but reckless ones as well. Safeco, supra, at 59. Willful blindness to the obvious or known consequences of one's action also generally satisfies a "willfulness" requirement in the civil context. *Glob.-Tech Appliances, Inc. v. SEB S.A.*, 563 U.S. 754, 769 (2011).
  - The district court in *Bedrosian* rejected the argument that in order for the government to sustain a civil willful FBAR penalty, it must meet the standard used in the criminal context and show "that the actions POSTS-135605-17 3 amounted to a voluntary, intentional violation of a known legal duty.

Willfulness – The Spectrum

Where does the taxpayer land?

Willfulness Reckless Proper

Willful Negligence

Blindness

Your Task

- How to prepare?
  - Call client, review facts, review facts, review facts
  - Checklist:
    - Citizenship/Resident Status
    - Education: Highest degree? Major?
    - Work history: Industry? Duties? Title? Licenses?
    - Tax prep history: Schedule B? Organizer? Conversation?
    - Why the mistake?
    - When/how did you discover your mistake?
    - What did you do after your discovery? How quickly did you act?
    - What kind of accounts/assets abroad?
    - Why did you open them? Why did you keep them open? Funded?
    - What did you do with the funds? Transfers? Reliance?
    - Any tax non-compliance? How much?

Your Task – The Audit or Appeal

- Put your client in the best light possible
- Counsel your client on what to say and what not to say
- Demonstrate
  - How the client's education and work history do not involve tax, law, finance, or accounting
  - How the client has a close connection to the country or countries with accounts
  - How the client did not know of the legal duty
  - How the client did not intend to violate any legal duty
  - How, if possible, the client did not rely on the undisclosed funds for US living expenses

Important Cases Sampling

- *US v. Williams*, 489 Fed.App'x 655 (4th Cir. 2012)
- *US v. McBride*, 908 F.Supp.2d 1186 (D Utah 2012)
- *US v. Moore*, 2012 U.S. App. LEXIS 24621 (4th Cir. 11/28/12) (unpublished)
- *Bedrosian v. US*, 2017 WL 4946433 (ED PA)
- *US v. Garrity*, 304 F.Supp.3d 267 (D Conn. 2018)
- *US v. Sturman*, 951 F.2d 1466 (6th Cir. 1991)
- *Safeco Insurance v. Burr*, 551 US 47 (2007)
- *Ratzlaf v. US*, 510 US 135 (1994)
- *Global-Tech Appliances, Inc. et al. v. SEB SA*, 131 S.Ct 2060 (2011)
- *Cheek v. US*, 498 US 192 (1991)
- *US v. Pomerantz*, 6/8/17 WD WA 2:16cv00689
- *US v. Hom*, 2014 U.S. Dist. LEXIS 77489 (N.D. CA 2014)