

# Correcting Corporate Foreign Tax Noncompliance: Identifying and Repairing Incomplete or Incorrect Filings

TUESDAY, OCTOBER 29, 2019, 1:00-2:50 pm Eastern

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Tuesday, October 29, 2019

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Brian Gardner, Attorney  
Taylor English Duma  
[bgardner@taylorenghish.com](mailto:bgardner@taylorenghish.com)

Dirk Gifford, Managing Director  
KPMG, LLP  
[sgifford@kpmg.com](mailto:sgifford@kpmg.com)

Shane M. Vandenberg, Manager  
KPMG, LLP  
[svandenberg@kpmg.com](mailto:svandenberg@kpmg.com)

# Notice

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# Outline

- I. Background and New IRS Large Business & International (LBI) Foreign Compliance Initiatives**
- II. Identifying foreign information noncompliance scenarios**
- III. Streamlined disclosure program for non-willful delinquency**
  - 1. Streamlined filing compliance procedures
  - 2. Streamlined Domestic Offshore Procedure for U.S. residents
  - 3. Streamlined Foreign Offshore Procedure for non-U.S. residents
  - 4. Delinquent FBAR Submission Procedure
  - 5. Delinquent International Return Submission Procedures
- IV. Noisy vs. Quiet Disclosures**
- V. Penalty structures outside of formal IRS programs and procedures**
- VI. Reasonable cause abatement standards**
- VII. Willfulness and reckless disregard--will you know it when you see it?**



# Background and New IRS Large Business & International (LBI) Foreign Compliance Initiatives

# IRS – A range of challenges



## New leadership

- Commissioner – Charles Rettig
- Chief Counsel – Mike Desmond

## The broad challenges

- Implementing TCJA:
  - Timing of guidance, forms, schedules, returns processing requirements
  - Potential fallout from unanticipated impacts of new law
- Budget constrains priorities & programs
- Congress initiated potential IRS restructuring (e.g., Taxpayer First Act of 2019)
- Other workload demands: BBA; FATCA; BEPS; Campaigns

# Challenges ...



## — Resources

- IRS budget has declined by \$2.1 B (15.7 %) from FY 2011 through 2018, after adjusting for inflation
- 2019 budget -- \$ 11.3B
- President's proposed 2020 -- \$11.5B
  - Adds \$362M from “program integrity fund” for increased audit and collection over 10 year trajectory
    - \$14.5B investment projected to yield \$47B in tax collection
  - Taxpayer service appropriation reduced by 7%
- Changes in House majority & IRS commissioner may re-set relationships and resource climate



# Attrition in key enforcement positions\*



	 Employees	 Appeals Officers	 Revenue Agents	 Revenue Officers
2011	1129	11849	4402	
2012	1058	11160	4035	
2013	958	10413	3703	
2014	881	9688	3441	
2015	795	9009	3191	
2016	739	8789	3072	
2017	744	8138	2898	
<b>% Change</b>	<b>-34%</b>	<b>-31%</b>	<b>-34%</b>	

\* Testimony of IRS National Taxpayer Advocate – Senate Finance Committee July 26, 2018

# Other budget indicia

## High net worth individuals

**\$10 M** or more  
**6.7%** audited in 2018

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Down from  
**18.8%** (2016)  
**14.5%** (2017)

## LB&I examinations

**34,676** (2016)

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**31,880** (2017)

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Audits of largest corporations  
( **> \$20B** in assets)

— **100%** in 2010

— **58%** in 2017

# More budget impacts

**Half of IRS executives eligible to retire**

**1/3 of total IRS workforce – 56 or older**

**LB&I agents**

**2762 (FY 18)**

**2980 (FY 17)**

**LB&I hiring 500 new employees – agents, engineers, appraisers, tax law specialists and data scientists**

# More budget impacts ...

## Operational implications

Case interruptions, inconsistencies, delays

Revolving managers, executives, specialists; “actors” throughout

Inadequate & vulnerable technology

Routine matters – not routine; joint committee cases; settlement calculations

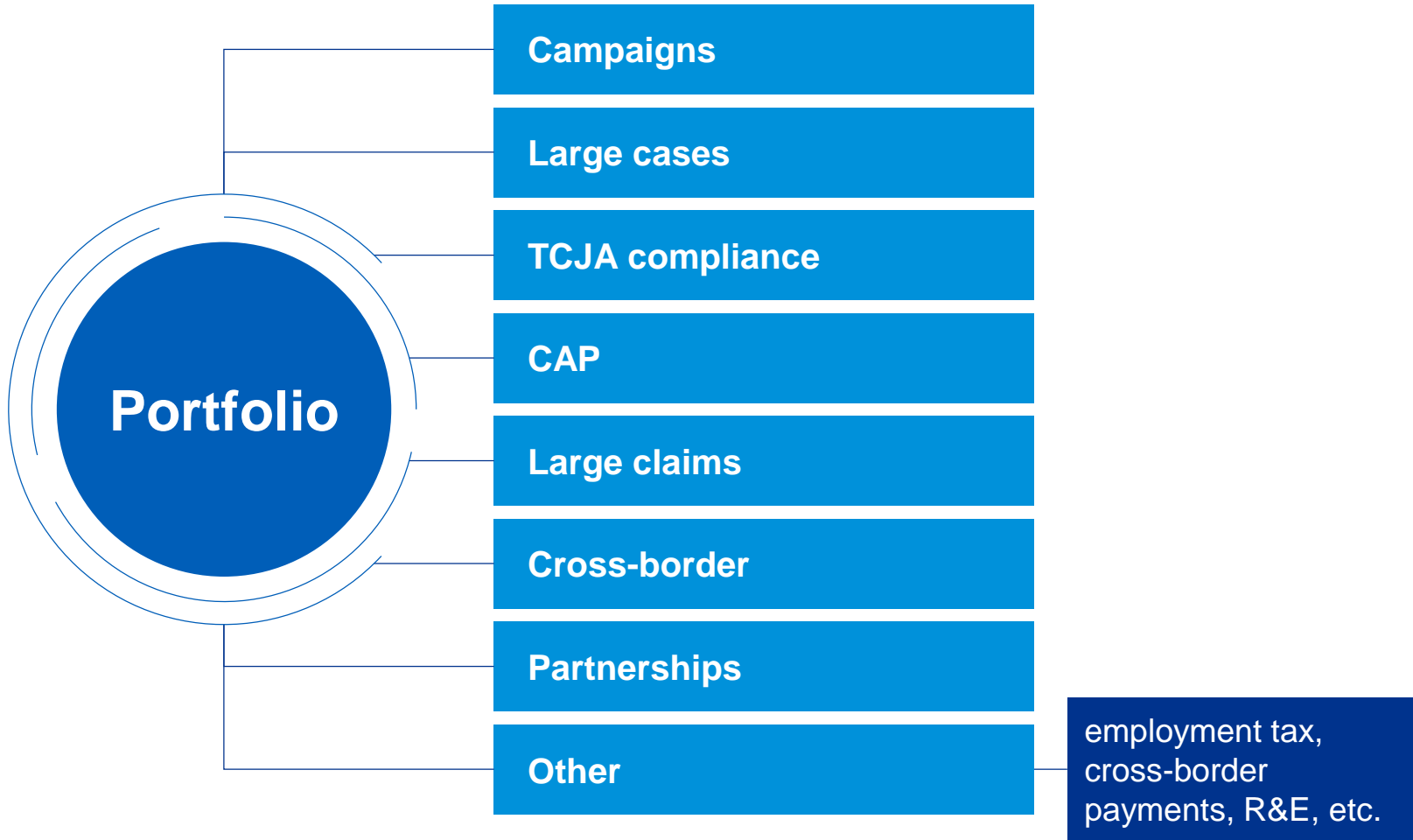
Issue escalation difficult but often necessary

Core programs (PFA, APA, PLR) must compete

For resources with TCJA-related workload demands



# LB&I adopting a portfolio concept



# LB&I Compliance Campaigns

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- 59 identified so far
  - Post OVDP Compliance (July 19, 2019)
  - Expatriation (July 19, 2019)
  - Offshore Private Banking (April 16, 2019)
  - Loose Filed Forms 5471 (April 16, 2019)
  - Individual Foreign Tax Credit (October 30, 2018)
  - Offshore Service Providers (October 30, 2018)
  - FATCA Filing Accuracy (October 30, 2018)
  - Form 3520/3520-A Noncompliance (May 21, 2018)
  - Foreign Earned Income Exclusion (November 3, 2017)

# Campaigns – Where are they headed?

## Campaign impacts to-date

Originally promoted as a “sea-change”

So far, only limited visible impacts – less than 15% of workload

Original design envisioned utilization of significant data analytics, but most campaigns based on agent feedback

Several campaigns address minor compliance risks

IRS: amended returns and Forms 3115 evidence campaign impacts

On-the-ground – many employees & managers still uncertain about process; many field groups report no “campaign” inventory

Ambiguity about how campaigns intersect with other audits







# Identifying foreign information noncompliance scenarios

# Identifying foreign information noncompliance scenarios

Form No.	Form Name	Code Section(s)	Penalty	Add'l Penalty
5471	Information Return of U.S. Persons With Respect To Certain Foreign Corporations	§ 6038	\$10,000 per form	\$10,000 per each 30 day period (max \$50,000); Reduction of Foreign Tax Credit
		§ 6046	\$10,000 per form	\$10,000 per each 30 day period (max \$50,000)
5472	Information Return of a 25% Foreign-Owned U.S. Corporation or a Foreign Corporation Engaged in a U.S. Trade or Business	§ 6038A	\$25,000 per form	\$25,000 per each 30 day period (max \$50,000); Reduction of Foreign Tax Credit
8858	Information Return of U.S. Persons With Respect to Foreign Disregarded Entities (FDEs) and Foreign Branches (FBs)	§ 6038	\$10,000 per form	\$10,000 per each 30 day period (max \$50,000); Reduction of Foreign Tax Credit
8865	Return of U.S. Persons With Respect to Certain Foreign Partnerships	§ 6038	\$10,000 per form	\$10,000 per each 30 day period (max \$50,000); Reduction of Foreign Tax Credit
		§ 6046A	\$10,000 per form	\$10,000 per each 30 day period (max \$50,000)
8621	Information Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund	§ 1298	N/A	N/A

# Identifying foreign information noncompliance scenarios

Form No.	Form Name	Code Section(s)	Penalty	Add'l Penalty
8975	Country by Country Report	§ 6038	\$10,000 per form	\$10,000 per each 30 day period (max \$50,000); Reduction of Foreign Tax Credit
8938	Statement of Specified Foreign Financial Assets	§6038D	\$10,000	
926	Return by a U.S. Transferor of Property to a Foreign Corporation	§ 6038B	10% of the FMV of Property (limited to \$100,000 unless there is intentional disregard)	\$10,000 per each 30 day period (max \$50,000)
3520	Annual Return To Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts	§ 6048	Greater of \$10,000 or 35% of the reportable amount	N/A
3520-A	Annual Information Return of Foreign Trust With a U.S. Owner	§ 6048	Greater of \$10,000 or 35% of the reportable amount	N/A
FinCEN Report 114	Report of Foreign Bank and Financial Accounts (FBAR)	31 USC 5314	See Separate Slide	See Separate Slide

# Identifying foreign information noncompliance scenarios

## Four civil penalties available for FBAR violations:

- Negligence. 31 USC 5321(a)(6)(A). - \$500 per violation (trades or businesses only)
- Pattern of negligent activity. 31 USC 5321(a)(6)(B) -\$50,000 (trades or businesses only)
- Penalty for “non-willful” violation. 31 USC 5321(a)(5)(A) and (B). - \$10,000 per violation

**Note:** The term "non-willful" is not used in the statute, IRS uses it to distinguish this penalty from the penalty for willful violations.

- Penalty for willful violations. 31 USC 5321(a)(5)(C) - greater of \$100,000 or 50% of the balance in the account at the time of the violation

# Identifying foreign information noncompliance scenarios

## Common foreign information noncompliance scenarios

- Change in tax staff at foreign parent co.
  - Loss of knowledge about U.S. filings
  - Loss of knowledge of U.S. structures/investments
- New Acquisition activities
  - Section 338(g) election followed by a “check-the-box election”
  - Tiered-Partnership Acquisitions
- Filing errors
  - Failing to timely file a return where treaty benefits allows for non-filing of foreign information form
  - Multiple-filer exception issues
  - Late Schedule K-1s; Tiered-Partnership information
- Changes in Tax Law

# Identifying foreign information noncompliance scenarios

- Substantial compliance issues
  - Forms 5471 and 5472 (IRC §§6038,6038A) are allowed to be substantially complete per the regulations (note, however, that this term is not defined in the code or the regulations)
  - Forms 8865, 8858, 926, 3520, 3520-A do not have a specific regulatory reference allowing them to be substantially complete. However, the general judicial substantial completion doctrine may apply.

# Identifying foreign information noncompliance scenarios

- Substantial compliance issues – IRS Position

In determining whether a tax return satisfies a reporting requirement or whether a taxpayer has complied with a statute or regulatory requirement, there are two standards that may apply.

The first requires strict compliance with the statute or regulatory requirement; the second requires substantial compliance. In analyzing the statute or regulatory requirement, the first step is to determine which standard applies.

# Identifying foreign information noncompliance scenarios

- **Substantial compliance issues – IRS Position**

When determining which standard applies, courts may consider the following:

- If the particular information or requirement at issue is determined to be related to the “substance or essence” of the statute or regulation, then strict compliance is necessary.
- If, instead, the requirement is seen as “procedural or directory” then substantial compliance can apply.

See generally, **Indiana Rolling Mills Co. v. Commissioner - 13 BTA 1141 (1928)**

See also, IRS Practice Unit “The Meaning of “Substantially Complete” with Reference to International Information Return Penalties” (06/016/2017)





# Streamlined disclosure program for non-willful delinquency

# Streamlined Disclosure Program for Non-Willful Delinquency

- Taxpayers must certify that conduct was non-willful
  - Non-Willful conduct is conduct that is due to negligence, inadvertence, or mistake or conduct that is the result of a good faith misunderstanding of the requirements of the law
- Must be voluntary disclosure
  - Taxpayer can't be under civil or criminal examination.
- Taxpayers who have previously done quiet disclosures are eligible for streamlined procedures.

# Streamlined Foreign Offshore Procedure for Non-U.S. Residents

- Non-residency Requirement: If, in any one or more of the most recent three years for which the U.S. tax return due date (or properly applied for extended due date) has passed, the individual did not have a U.S. abode and the individual was physically outside the United States for at least 330 full days.
- Eligible Taxpayers Must:
  - (1) for each of the most recent 3 years for which the U.S. tax return due date (or properly applied for extended due date) has passed, file delinquent or amended tax returns, together with all required information returns (e.g., Forms 3520, 5471, and 8938) and
  - (2) for each of the most recent 6 years for which the FBAR due date has passed, file any delinquent FBARs (FinCEN Form 114).
  - (3) The full amount of the tax and interest due in connection with these filings must be remitted with the delinquent or amended returns.
  - (4) Submit Form 14653 certifying (a) that you are eligible for the Streamlined Foreign Offshore Procedures; (b) that all required FBARs have now been filed; and (c) that the failure to file tax returns, report all income, pay all tax, and submit all required information returns, including FBARs, resulted from non-willful conduct.

# Examples of Non-Residency Requirement for Streamlined Procedures

- **Example 1:** Mr. W was born in the United States but moved to Germany with his parents when he was five years old, lived there ever since, and does not have a U.S. abode. Mr. W meets the non-residency requirement applicable to individuals who are U.S. citizens or lawful permanent residents.
- **Example 2:** Assume the same facts as Example 1, except that Mr. W moved to the United States and acquired a U.S. abode in 2012. The most recent 3 years for which Mr. W's U.S. tax return due date (or properly applied for extended due date) has passed are 2013, 2012, and 2011. Mr. W meets the non-residency requirement applicable to individuals who are U.S. citizens or lawful permanent residents.
- **Example 3:** Ms. X is not a U.S. citizen or lawful permanent resident, was born in France, and resided in France until May 1, 2012, when her employer transferred her to the United States. Ms. X was physically present in the U.S. for more than 183 days in both 2012 and 2013. The most recent 3 years for which Ms. X's U.S. tax return due date (or properly applied for extended due date) has passed are 2013, 2012, and 2011. While Ms. X met the substantial presence test for 2012 and 2013, she did not meet the substantial presence test for 2011. Ms. X meets the non-residency requirement applicable to individuals who are not U.S. citizens or lawful permanent residents.

# Streamlined Offshore Procedures for U.S. Residents

- For taxpayers that are U.S. Residents there are several other requirements:
  - (1) have previously filed a U.S. tax return (if required) for each of the most recent 3 years for which the U.S. tax return due date (or properly applied for extended due date) has passed;
  - (2) have failed to report gross income from a foreign financial asset and pay tax as required by U.S. law, and may have failed to file an FBAR (FinCEN Form 114, previously Form TD F 90-22.1) and/or one or more international information returns (e.g., Forms 3520, 3520-A, 5471, 5472, 8938, 926, and 8621) with respect to the foreign financial asset, and
  - (3) such failures resulted from non-willful conduct.

# Streamlined Offshore Procedures for U.S. Residents

- (1) for each of the most recent 3 years for which the U.S. tax return due date (or properly applied for extended due date) has passed, file amended tax returns, together with all required information returns (e.g., Forms 3520, 3520-A, 5471, 5472, 8938, 926, and 8621),
- (2) for each of the most recent 6 years for which the FBAR due date has passed, file any delinquent FBARs and
- 3) pay a 5% miscellaneous offshore penalty. The full amount of the tax, interest, and miscellaneous offshore penalty due in connection with these filings should be remitted with the amended tax returns.

# Title 26 Streamlined Disclosure Penalty

- Penalty is 5% of the highest aggregate balance/value of the taxpayer's foreign financial assets that should have been, but were not reported, for that tax year.
- This includes the following:
  - Highest aggregate bank account balances that were not reported on FBAR
  - Assets not reported on a Form 8938 for that year.
    - financial accounts held at foreign financial institutions;
    - financial accounts held at a foreign branch of a U.S. financial institution;
    - foreign stock or securities not held in a financial account;
    - foreign mutual funds; or
    - foreign hedge funds and foreign private equity funds.
  - A foreign financial asset is also subject to the 5% miscellaneous offshore penalty in a given year in the covered tax return period if the asset was properly reported for that year, but gross income in respect of the asset was not reported in that year.

# Delinquent FBAR Submission Procedures

- Taxpayers who do not need to use either the OVDP or the Streamlined Filing Compliance Procedures to file delinquent or amended tax returns to report and pay additional tax, but who:
  - have not filed a required FBAR;
  - are not under a civil examination or a criminal investigation by the IRS, and
  - have not already been contacted by the IRS about the delinquent FBARs
- The IRS will not impose a penalty for the failure to file the delinquent FBARs if you properly reported on your U.S. tax returns, and paid all tax on, the income from the foreign financial accounts reported on the delinquent FBARs, and you have not previously been contacted regarding an income tax examination or a request for delinquent returns for the years for which the delinquent FBARs are submitted.



# Delinquent FBAR Submission Procedures

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- File late FBARs electronically
- On the cover page of the electronic form select a reason for filing late
- Include a statement explaining why you are filing FBARs late.
  - Always include facts showing reasonable cause.

# Delinquent International Return Submission Procedures

- Taxpayers who do not need to use the OVDP or the Streamlined Filing Compliance Procedures to file delinquent or amended tax returns to report and pay additional tax, but who:
  - have not filed one or more required international information returns,
  - have reasonable cause for not timely filing the information returns,
  - are not under a civil examination or a criminal investigation by the IRS, and
  - have not already been contacted by the IRS about the delinquent information returns
- should file the delinquent information returns with a statement of all facts establishing reasonable cause for the failure to file.

# Delinquent International Returns: Reasonable Cause

- As part of the reasonable cause statement, taxpayers must also certify that any entity for which the information returns are being filed was not engaged in tax evasion.
  - If a reasonable cause statement is not attached to each delinquent information return filed, penalties may be assessed in accordance with existing procedures.
- All delinquent international information returns other than Forms 3520 and 3520-A should be attached to an amended return and filed according to the applicable instructions for the amended return.
  - All delinquent Forms 3520 and 3520-A should be filed according to the applicable instructions for those forms.
- A reasonable cause statement must be attached to each delinquent information return filed for which reasonable cause is being requested.



# Noisy disclosures vs. quiet disclosures

# Noisy Disclosures v. Quiet Disclosures

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- While some may still consider a quiet disclosure or “qualified amended return” a legitimate option for taxpayers, the IRS disagrees.
- The 2014 Modified OVDP FAQ 47 provides that “[a] practitioner whose clients decline to make full disclosure of the existence of, or any taxable income from, a foreign financial account during a taxable year, may not prepare the client’s income tax return for that year without being in violation of Circular 230.”





# Penalty structures outside of formal IRS programs and procedures

# Penalties for Non-Compliance and Penalty structures outside of formal IRS programs and procedures

## **Section 6501(c)(8): Extension of statute of limitations on entire return until required information is furnished to IRS**

- (A) In General - In the case of any information which is required to be reported to the Secretary pursuant to an election under section 1295(b) or under section 1298(f), 6038, 6038A, 6038B, 6038D, 6046, 6046A, or 6048, the time for assessment of any tax imposed by this title with respect to any tax return, event, or period to which such information relates shall not expire before the date which is 3 years after the date on which the Secretary is furnished the information required to be reported under such section.
- (B) Application to Failures Due to Reasonable Cause – If the failure to furnish the information referred to in subparagraph (A) is due to reasonable cause and not willful neglect, subparagraph (A) shall apply only to the item...related to such failure.



# Penalties for Non-Compliance and Penalty structures outside of formal IRS programs and procedures

## Potential IRS Criminal Penalties

### **I.R.C. § 7203:**

Any person required under this title to pay any estimated tax or tax, or required by this title or by regulations made under authority thereof to make a return, keep any records, or supply any information, who willfully fails to pay such estimated tax or tax, make such return, keep such records, or supply such information, at the time or times required by law or regulations, shall, in addition to other penalties provided by law, be guilty of a misdemeanor and, upon conviction thereof, shall be fined not more than \$25,000 (\$100,000 in the case of a corporation), or imprisoned not more than 1 year, or both, together with the costs of prosecution. In the case of any person with respect to whom there is a failure to pay any estimated tax, this section shall not apply to such person with respect to such failure if there is no addition to tax under section 6654 or 6655 with respect to such failure. In the case of a willful violation of any provision of section 6050I, the first sentence of this section shall be applied by substituting “felony” for “misdemeanor” and “5 years” for “1 year”.

**Explicitly cross referenced in I.R.C. §§ 6038, 6038A, 6046, 6046A**

# Penalties for Non-Compliance and Penalty structures outside of formal IRS programs and procedures

## Potential IRS Criminal Penalties

### **I.R.C. § 7206: Fraud and false statements**

Any person who—

#### (1) Declaration under penalties of perjury

Willfully makes and subscribes any return, statement, or other document, which contains or is verified by a written declaration that it is made under the penalties of perjury, and which he does not believe to be true and correct as to every material matter; \* \* \*

shall be guilty of a felony and, upon conviction thereof, shall be fined not more than \$100,000 (\$500,000 in the case of a corporation), or imprisoned not more than 3 years, or both, together with the costs of prosecution.

# Penalties for Non-Compliance and Penalty structures outside of formal IRS programs and procedures

## Potential IRS Criminal Penalties

### **I.R.C. § 7207: Fraudulent returns, statements, or other documents**

Any person who willfully delivers or discloses to the Secretary any list, return, account, statement, or other document, known by him to be fraudulent or to be false as to any material matter, shall be fined not more than \$10,000 (\$50,000 in the case of a corporation), or imprisoned not more than 1 year, or both. Any person required pursuant to section 6047(b), section 6104(d), or subsection (i) or (j) of section 527 to furnish any information to the Secretary or any other person who willfully furnishes to the Secretary or such other person any information known by him to be fraudulent or to be false as to any material matter shall be fined not more than \$10,000 (\$50,000 in the case of a corporation), or imprisoned not more than 1 year, or both.



# Reasonable cause abatement standards

# Reasonable Cause

- No penalty shall be imposed under IRC § 6677 on any failure to file a Form 3520 that is shown to be due to reasonable cause and not due to willful neglect. *See* IRC § 6677(d).
  - Neither IRC § 6677, nor the regulations thereunder defines reasonable cause for failure to timely file a Form 3520.
- The Internal Revenue Manual (“IRM”) 20.1.1, as well as other analogous regulations, suggests some standards when determining whether reasonable cause exists. *See* Treas. Reg. § 301.6651-1(c).
- Although the regulations do not define “reasonable cause” or “willful neglect” within the specific contexts of IRC § 6048 or IRC § 6677, the cases that exist adopt the reasonable cause definition set forth in *Boyle*. *See In re Wyly*, 552 B.R. 339 at \*579 (Bkrcty. N.D. Tex. 2016); *James v. United States*, 2012 U.S. Dist. LEXIS 114356 at \*5 (M.D. FL. 2012) (applying *Boyle* reasonable cause standard for failure to file Form 3520).
- Reasonable cause exists when there is an absence of willful neglect. The United States Supreme Court has defined willful neglect in *United States v. Boyle*, 469 U.S. 241 (1985) as a “conscious, intentional failure or reckless indifference.”
- The Court stated that for reasonable cause “a U.S. person needs to demonstrate that he/she exercised ordinary business care and prudence but was nevertheless unable to file the return within the prescribed time.”
- This reasonable cause standard has been incorporated in the Internal Revenue Service’s regulations and manual. *See* Treas. Reg. §301.6651-1(c)(1).

# Reasonable Cause

- Courts have ruled consistently with *Boyle* that a taxpayer may rely on his tax advisors on the substantive issue of whether a return is required and the due date of the return. *See James v. United States*, 2012 U.S. Dist. LEXIS 114356 at \*5 (M.D. FL. 2012) (“It is clear that a taxpayer may reasonably rely on an expert’s advice that no return is required. The taxpayer should also be able to rely on his advisor when they tell the taxpayer that the return has been properly filed.”).
- While ignorance of the law, by itself, does not constitute reasonable cause, it may, however, in conjunction with other factors allow for reasonable cause.
- IRM 20.1.1.3.2.2.6 provides that the Service should consider:
  - 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; and
  - the level of complexity of a tax or compliance issue.

# Using Collection Due Process to Appeal International Tax Penalty

- For Non-FBAR penalties “Patience is a virtue.”
- Wait for Final Notice of Intent to Levy or Notice of Federal Tax Lien to request CDP hearing.
- As long as TP has not filed appeal before CDP request, they are entitled to de novo CDP and judicial review in U.S. Tax Court.
- *Flume v. Commissioner*, T.C. Memo. 2017-21



Willfulness and  
reckless disregard--  
will you know it when  
you see it?



# Willfulness & Reckless Disregard

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- The government can establish willfulness by showing that a taxpayer either knowingly or recklessly violated their duty to file an FBAR.
  - The government is only required to prove willfulness by a preponderance of the evidence
- Three Primary Legal Theories of Willfulness
  - Actual Knowledge
  - Constructive Knowledge
  - Reckless Disregard of Duty
    - Willful Blindness

# Willfulness & Reckless Disregard: Actual Knowledge

- Government must prove that taxpayer knew about the FBAR requirements.
  - *Safeco Ins. Co. of Am. v. Burr*, 551 U.S. 47, 56-57 (2007) (assuming that when willfulness is alleged, actual knowledge requires acts "known to violate" a statute);
  - *United States v. Wynn*, 61 F.3d 921, 928 (D.C. Cir. 1995) ("[W]hile ignorance of the law generally is no excuse, Congress may decree otherwise . . . by requiring proof of 'willfulness' . . . .");
  - *United States v. McBride*, 908 F. Supp. 2d 1186, 1208 (D. Utah 2012) (holding the defendant liable because he had "actual knowledge of his duty" to file an FBAR).

# Willfulness: Constructive Knowledge (*McBride*)

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- A taxpayer's signature on a return is sufficient proof of a taxpayer's knowledge of the instructions contained in the tax return form and in other contexts. *Mcbride*, 908 F. Supp. 2d 1186, 1205 (D. Utah 2012).
  - "In general, individuals are charged with knowledge of the contents of documents they sign—that is, they have 'constructive knowledge' of those contents." *Consol. Edison Co. of N.Y., Inc. v. United States*, 221 F.3d 364, 371 (2d. Cir. 2000).

# Willfulness: Constructive Knowledge (*Williams*)

- In *United States v. Williams*, the Fourth Circuit held that a taxpayer was willful in failing to comply with FBAR requirements when he signed a federal tax return that failed to disclose the existence of foreign accounts, "thereby declaring under penalty of perjury that he had 'examined this return and accompanying schedules and statements' and that, to the best of his knowledge the return was 'true, accurate, and complete.'" See *United States v. Williams*, Case No. 10-2230, 489 Fed. Appx. 655 (4th Cir. Jul. 20, 2012).
- The Fourth Circuit reversed the district court's findings of fact as "clearly erroneous," on the grounds that the district court failed to consider the taxpayer's signature on his returns sufficient evidence of his knowledge of his failure to comply with the FBAR requirement.
  - "A taxpayer who signs a tax return will not be heard to claim innocence for not having actually read the return, as he or she is charged with constructive knowledge of its contents." *Id.* (quoting *Greer v. Comm'r*, 595 F.3d 338, 347 n.4 (6th Cir. 2010)).
- At a minimum, "line 7a's directions to '[s]ee instructions for exceptions and filing requirements for Form TD F 90-22.1'" puts a taxpayer "on inquiry notice of the FBAR requirement." See *United States v. Williams*, Case No. 10-2230, 489 Fed. Appx. 655 (4th Cir. Jul. 20, 2012).
- As a result, the Fourth Circuit held that Williams's explicit statement that he never consulted Form TD F 90-22.1 or its instructions, never read line 7a, and "never paid any attention to any of the written words on his federal tax return" constituted a "conscious effort to avoid learning about reporting requirements," and his false answers on his federal tax return "evidence conduct that was 'meant to conceal or mislead sources of income or other financial information.'" *Id.* (quoting *Sturman*, 951 F.2d at 1476).

# Willfulness: Constructive Knowledge (*Flume*)

- In a recent decision, the U.S. District Court for the Southern District of Texas refused to follow the “constructive knowledge” standard for three reasons:
  - 1) It ignores the distinction congress drew between willful and non-willful violations of 31 U.S.C. 5314;
  - 2) The Court has to make a factual inquiry into whether the taxpayer examined his returns and knew about the FBAR requirements merely by signing the returns; and
  - 3) There is no policy need to treat constructive knowledge as a substitute for actual knowledge.
- *United States v. Flume*, 2018 U.S. Dist. 226285 (S.D. Tx. 2018) (denying government’s motion for summary judgment).

# Willfulness & Reckless Disregard: Willful Blindness

- Willful Blindness to the known consequences of one's actions satisfies the willfulness requirement. See *Global-Tech Appliances, Inc. v. SEB S.A.*, 563 U.S. 754 (2011) ("persons who know enough to blind themselves to direct proof of critical facts in effect have actual knowledge of those facts") (citing *United States v. Jewell*, 532 F.2d 697, 700 (9th Cir. 1976) (en banc)).
- Under the "willful blindness" standard, "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 actually known the critical facts." *United States v. McBride*, 908 F. Supp. 2d 1186, 1205 (D. Utah 2012).
- Where a taxpayer makes a "conscious effort to avoid learning about reporting requirements," evidence of such willful blindness is a sufficient basis to establish willfulness. *United States v. Williams*, Case No. 10-2230, 489 Fed. Appx. 655 (4th Cir. Jul. 20, 2012).

# Willfulness & Reckless Disregard: Reckless Disregard of Duty

- A person acts recklessly when he “(1) clearly ought to have known that (2) there was a grave risk that the filing requirement was not being met and if (3) he was in a position to find out for certain very easily.” *Bedrosian v. United States*, 912 F. 3d 144, 153 (3d Cir. 2018) (quoting *United States v. Vespe*, 868 F.2d 1328, 1335 (3d Cir.1989)).
- Taxpayer’s failure to inform his accountant about the existence of a foreign account is a strong indicator of intent to violate the law. *See United States v. Bohanec*, 263 F. Supp. 3d. 881, 890 (C.D. Cal. 2016); *United States v. McBride*, 908 F. Supp. 2d 1186, 1208 (D. Utah 2012).

# Willfulness & Reckless Disregard: Recklessness (*Bedrosian*)

- In *Bedrosian*, the Government alleged that a taxpayer (Bedrosian) had recklessly failed to file an accurate FBAR for tax year 2007. 2017 U.S. Dist. LEXIS 154625.
  - In the early 1970s, Bedrosian opened a Swiss bank account. 2017 U.S. Dist. LEXIS 154625, [WL] at \*1.
  - For twenty years, he did not tell his accountant about the account. *Id.* When he finally told his accountant about the account in the mid-1990s, the accountant told him he had been breaking the law every year for more than twenty years by not reporting the account. *Id.* In 2005, the bank converted his account into two separate accounts. *Id.*
  - And it was not until 2008 that he finally reported that he had a Swiss account and filed an FBAR. 2017 U.S. Dist. LEXIS 154625.
  - But despite the fact that he had two Swiss accounts by that time, he only reported one of them. *Id.*
  - The one he reported had roughly \$240,000; the other had roughly \$2 million. *Id.* He denied that his failure to report the other account was willful, insisting he thought he had only one account. *Id.*
  - The court not only denied summary judgment to the government but also found after a bench trial that Bedrosian was not reckless. *Id.*
- The court concluded that Bedrosian had at most been negligent even though he (1) had annual meetings with a UBS representative and "easily" could have discovered he had two accounts; (2) was on notice of the importance of filing proper FBARs because his accountant had warned him he had been breaking the law; (3) filed an FBAR for the other account; and (4) sent two letters to UBS closing the two accounts just weeks after he signed his inaccurate FBAR. 2017 U.S. Dist. LEXIS 154625.



# Willfulness & Reckless Disregard of Duty: Recklessness

- Other recent cases addressing reckless disregard of duty:
  - *United States v. Horowitz*, 361 F. Supp. 3d 511 (S.D. Md. 2019) (taxpayers friends told them they did not need to pay taxes on the interest in their foreign accounts) (government wins).
  - *United States v. Garrity*, 2018 U.S. Dist. LEXIS 91665 (D.C. Conn. 2018) (taxpayer opened trust account in 1989, failure to disclose account prevented government from fully investigating other potential crimes during his lifetime).



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