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Voluntary Disclosure of Foreign Assets: Current Challenges for Noncompliant U.S. Taxpayers

Options for Compliance, Avoiding Penalties and Potential Criminal Prosecution

THURSDAY, NOVEMBER 14, 2019

1pm Eastern | 12pm Central | 11am Mountain | 10am Pacific

Today's faculty features:

Dennis N. Brager, Esq., Certified Tax Specialist, **Brager Tax Law Group**, Los Angeles

Deborah J. Jacobs, Owner, **The Law Office of Deborah J. Jacobs**, New York

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Voluntary Disclosure of Foreign Assets: Current Challenges for Noncompliant U.S. Taxpayers

Dennis N. Brager, Esq.,

Brager Tax Law Group

Strafford Webinar
November 14, 2019
1:00-2:30 PM EDT

- Ex-IRS Trial Lawyer
- State Bar Certified Tax Specialist
- 30+ Years Tax Dispute Experience with IRS, EDD, CDTFA, and FTB Problems
- Nationally Recognized Tax Litigation Attorney

Dennis N. Brager

Dennis Brager is a California State Bar Certified Tax Specialist and a former Senior Trial Attorney for the Internal Revenue Service's Office of Chief Counsel. In addition to representing the IRS in the United States Tax Court, he advised the Service on complex civil and criminal tax issues. He now has his own five-attorney firm in Westwood and has been featured as a Super Lawyer in the field of Tax Litigation by *Los Angeles Magazine*. He has been quoted as a tax expert by *US News* and *World Report*, *Business Week*, the *Daily Journal*, *The Daily Beast*, *USA Today*, the *Los Angeles Daily Journal*, *Tax Analyst*, *The Chicago Tribune*, *CNN Money*, *Bloomberg BNA*, *Cannabis Daily*, *Accounting Today*, *Tax Notes Today*, and *The National Law Journal.*

Having worked for the IRS for six years, he gained valuable insight into the inner workings of that organization. This not only helps in developing the right strategies, but facilitates working with the system quickly and efficiently. Mr. Brager has limited his practice to representing clients having disputes with the IRS, the Franchise Tax Board, the State Board of Equalization, and the Employment Development Department—both at trial and administrative levels.

He has appeared on ABC Television's Good Morning America, Fox Business News, ABC Eyewitness News, and TV One Access. He has also spoken and given webinars before the IRS sponsored Nationwide Tax Forum, the California Continuing Education of the Bar, the California Society of CPAs, the UCLA Tax Controversy Institute, the California State Bar Tax Section, the Consumer Rights Litigation Conference the California Trial Lawyers Association, the National Association of Consumer Advocates, the American Bar Association, the Warner Center Estate and Tax Planning Council, and the National Association of Enrolled Agents. Dennis Brager has been an instructor at Golden Gate University's Masters in taxation Program and a guest speaker at the University of Southern California. Mr. Brager has also testified as an expert witness on Federal tax matters and has been a guest on KFWB.

His articles have appeared in the *California Lawyer*, *Marijuana Venture*, *Daily Journal*, *Taxation for Lawyers*, *Los Angeles Lawyer*, *The Consumer Advocate*, *Family law News*, *California Tax Lawyer*, *Journal of Tax Practice and Procedure*, *Journal of Taxation of Investments*, and *Accounting Today*. They include "Offshore Voluntary Disclosure – The Next Generation," "Partial Offshore Tax Amnesty – Voluntary Disclosure 2.0." "Anatomy of an OPR Case (Definitely Not R.I.P.)," "FBAR and Voluntary Disclosure," "The Tax Gap and Voluntary Disclosure," "Circular 230: An Overview," "Recent Developments in Tax Procedure," "Damages, Rescission and Debt Cancellation as Client Income," "The Taxpayer Bill of Rights—A Small Step Toward Reining in the IRS," "Challenging the IRS Requires a Cohesive Strategy," "The Innocent Spouse Defense," "IRS Guidelines for Installment-Payment Agreements," "IRS Tightens Inventory Rules for Marijuana Businesses," and "What a Practitioner Needs to Know About Tax Assessment Dates."

Mr. Brager received his undergraduate degree from Pace University (B.B.A., magna cum laude, 1975, Accounting/Finance), and his law degree from New York University (J.D., 1978). He is a former chair of both the Tax Compliance, Procedure and Litigation Committee of the Los Angeles County Bar Association and the California State Bar tax Procedure and Litigation Committee. He is admitted to practice before the U.S. Supreme Court, the Ninth Circuit Court of Appeals, U.S. Claims Court, U.S. Tax Court, U.S. District Court and the U.S. Bankruptcy Court.

Form 8938 — *Statement of Foreign Assets*

Brager Tax Law Group
Tax Controversy Law

- Specified persons must report interests in "specified foreign financial assets" (SFFAs) for tax years after March 18, 2010
- Who must file?
  - "Specified persons" with "specified foreign financial assets" greater than $50,000 at year-end or $75,000 at any point during the year
- When & how to file?
  - Attach Form 8938, *Statement of Specified Foreign Financial Assets*, to tax return by due date (with extension)

Specified Foreign Financial Assets Reportable on Form 8938

- Foreign Financial Accounts. E.g. Bank accounts, securities accounts
- Stock or securities issued by someone that is not a U.S. person
- Any interest in a foreign entity
- Any financial instrument or contract that has an issuer or counterparty that is not a U.S. person
- Examples of other specified foreign financial assets include the following, if they are held for investment and not held in a financial account.
    - Stock issued by a foreign corporation.
    - A capital or profits interest in a foreign partnership.
    - A note, bond, debenture, or other form of indebtedness issued by a foreign person.
    - An interest in a foreign trust or foreign estate.

Form 8938

Statement of Foreign Assets

- Treasury Regulations under I.R.C. § 6038D finalized on Dec. 12, 2014, adopt a number of changes to Form 8938:
  - Dual resident taxpayers now exempt from filing Form 8938 if, in essence, the individual qualifies as a nonresident alien and claims treaty benefits; Treas. Reg. § 1.6038D-2(e)(2)
  - Definition of "financial account" now excludes certain accounts that are subject to the reporting requirements of a Model 1 or Model 2 intergovernmental agreement; Treas. Reg. § 1.6038D-1(a)(7)
  - Jointly owned specified foreign financial assets must now report the entire value of each jointly owned asset (regardless of marital status); and Treas. Reg. § 1.6038D-2(c)(3)
  - Nonvested property rights under I.R.C. § 83 must be reported as of the first date the property is substantially vested in the person, unless an I.R.C. § 83(b) election is made, in which case, it must be reported as of the date the property is transferred. Treas. Reg. § 1.6038D-2(b)(2)

Form 8938

Statement of Foreign Assets

- Additional Treasury Regulations under I.R.C. § 6038D finalized on Feb. 23, 2016, Require "Specified Domestic Entities" (SDE) to File Form 8938:
  - Effective for Taxable years beginning in 2016, i.e. the 2017 filing season
  - SDE are domestic entities that are formed or availed of for the purpose of holding directly or indirectly SFFAs
  - A corporation or partnership meets this test if it is "closely held" by a specified individual, and at least 50% of the gross income is "passive income", or at least 50% of the assets held by the entity are assets that produce or are held for the production of passive income.
  - The percentage of assets held is a weighted average percentage

Form 8938 — *Statement of Foreign Assets*

- Definitions:
  - Closely Held. 80% of the voting power, or total value
    - Constructive Ownership Rules of I.R.C. Section 267 (c) are applied, and also includes spouses
  - Passive income.
    - Dividends
    - Interest
    - Rents and Royalties, other than those derived in the active conduct of a business
    - Annuities
    - Capital gains from passive assets
    - Capital gains from commodities transactions
    - Certain other income

- Domestic Trusts are considered "formed or availed of" only if:
  - It has one or more specified persons as a "current beneficiary"
  - "Current beneficiary" means, with respect to the taxable year, any person who at any time during such taxable year is entitled to, or at the discretion of any person may receive, a distribution from the principal or income of the trust
  - "Current beneficiary" also includes any holder of a general power of appointment, whether or not exercised, that was exercisable at any time during the taxable year, but does not include any holder of a general power of appointment that is exercisable only on the death of the holder.
  - Grantor trusts owned by one or more specified persons do not need to file

Form 8938

Statement of Foreign Assets

- Specified Domestic Entities Do Not Include:
  - Publicly traded stock
  - REITs
  - RICs
  - Banks
  - IRAs
  - Exempt Organizations under I.R.C. 501(a)
  - the United States government or any wholly owned agency or instrumentality thereof,
  - any State, the District of Columbia, any possession of the United States, any political subdivision of any of the foregoing, or any wholly owned agency or instrumentality of any one or more of the foregoing
  - any common trust fund (as defined in section 584(a)), and
  - any trust which is exempt from tax under section 664(c), or is described in section 4947(a)(1).

Form 8938

Statement of Foreign Assets

- Penalties (I.R.C. § 6038D)
  - Generally, $10,000, but may increase to at total of $60,000 for failure after notice
    - $10,000 per month continuation penalty
  - Reasonable cause defense available
  - IRM does not specifically discuss reasonable cause defense with regards to continuation penalty. See IRM § 20.1.9.22.4
  - Able to be reviewed in CDP proceedings, **if there has been no prior opportunity to dispute the penalty.**

Form 5471 — *Foreign Corps.*

- U.S. citizens and residents (including entities) who are officers, directors, or shareholders in foreign corporations may need to file Form 5471, *Information Return of U.S. Persons With Respect to Certain Foreign Corporations*. *See* I.R.C. §§ 6038, 6046.
  - GILTI
  - Officer or director if there are certain 10% changes in ownership by a U.S. person,
  - Shareholders with certain 10% ownership changes in their own holdings
  - Control person in a CFC for at least 30 days;
  - A 10% or more owner of a CFC who owns stock for an uninterrupted period of 30 days or more during the tax year, AND who owned that stock on the last day of the year.
- When to file?
  - Attach to timely filed return of the affected person
- Penalties I.R.C. §§ 6038(b); 6038B(c)
  - $10,000 per foreign corporation plus a $10,000 per month continuation penalty to a maximum of $50,000. Total maximum penalty of $60,000.
  - Reasonable cause defense available
  - Per IRS no reasonable cause defense available for continuation penalty. IRM § 20.1.9.3.5(2)
  - CDP available **if there has been no prior opportunity to dispute the penalty.**

- IRS imposing continuation penalties due to lack of complete information going back many years

Form 5472, 25% Foreign Owned Corp.

- Corporations with reportable transactions between a related party must file Form 5472, Information Return of a 25% Foreign-Owned U.S. Corporation or a Foreign Corporation Engaged in a U.S. Trade or Business. See I.R.C. §§ 6038A, 6038C.
  - Many reportable transactions; examples include: sales & purchases of tangible & intangible; rents & royalties paid; loans. See Treas. Reg. § 1.6038A-2(b)(3).
- When to file?
  - Attach to timely filed return of the reporting corporation
- Penalties I.R.C. § 6038A(d)
  - $10,000 per reportable transaction plus a $10,000 continuation penalty
  - Increased to $25,000, plus a $25,000 per month continuation penalty for taxable years ending after Dec. 31, 2017.
  - Reasonable cause defense available
  - CDP available **if there has been no prior opportunity to dispute the penalty**
  - Per IRS the latest date that reasonable cause can generally exist is 90 days from the date of notification of the failure to file by the IRS. IRM § 20.1.9.5.5(2)

Form 3520 *For Trusts & Gifts*

- Grantors or beneficiaries with reportable transactions with foreign trusts or estates must file Form 3520, *Annual Return to Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts*. *See* I.R.C. §§ 679(c), 6048(a),(b).
  - Many reportable transactions; e.g. formation of a foreign trust; transfer of property to a foreign trust; loans to a foreign trust; the receipt of any distribution by a U.S. beneficiary
  - aggregate gifts or bequests from an NRA or foreign estate greater than $100,000 during a calendar year
  - Gifts from foreign partnerships or foreign corporations of more than $15,601
- When to file?
  - Due April 15th ; If the U.S. person gets an extension then the due date is Oct. 15th.
  - It is filed with Ogden, UT Service Center. It is **not** attached to the tax return
- Penalties I.R.C. § 6677
  - Greater of $10,000 or 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%
  - Reasonable cause defense available per IRM § 20.1.9.10.5
  - CDP available if there has been no prior opportunity to dispute the penalty
  - IRC 6039F(c)(1)(A) states that the Secretary will determine the tax consequence of the receipt of such gift (or bequest) if the information is not filed timely. This adjustment is subject to deficiency procedures.

Form 3520-A

For. Trusts - U.S. Owner

Brager Tax Law Group
Tax Controversy Law

- A foreign trust with a U.S. owner pursuant to the grantor trust rules must file Form 3520-A, *Annual Information of Foreign Trusts With a U.S. Owner*. See I.R.C. §6048(b).
  - Note: Trust obligation, but penalty falls on U.S. person.
- When to file?
  - Generally by March 15th. A separate request on Form 7004 is required to obtain an extension.
  - File with the Ogden, UT Service Center
- Penalties. I.R.C. § 6677
  - Greater of $10,000 or 5% of the gross value of the portion of the trust assets treated as owned by the U.S. person
  - Continuation penalty of $10,000 per month may be imposed up to $50,000
  - The penalty is imposed on the U.S. owner, not the foreign trust. I.R.C. Section 6677(b).
  - Reasonable cause defense available with some limitations per IRM § 20.1.9.13.5
  - IRM does not discuss reasonable cause defense for continuation penalty
  - CDP available **if there has been no prior opportunity to dispute the penalty**

Form 8858 — *Foreign DREs*

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Tax Controversy Law

- Certain U.S. persons who own a foreign disregarded entity must file Form 8858, *Information Return of U.S. Persons With Respect to Foreign Disregarded Entities*. I.R.C. §6038B.
  - A foreign DRE is an entity that is not created or organized in the U.S. and is disregarded as an entity separate from its owner for U.S. tax purposes. *See* Treas. Reg. Section 301.7701-2 and 3.
- When to file?
  - Attach to timely filed return of the owner of the foreign DRE
- Penalties I.R.C. § 6038(b)
  - $10,000 per foreign disregarded entity plus a $10,000 continuation penalty per month, not to exceed $50,000. Total maximum is $60,000.
  - Also, subject to a 10% reduction of the available foreign tax credit. I.R.C. Section 6038(c)
  - Reasonable cause defense available per IRM Exhibit 20.1.9-5
  - IRM does not discuss reasonable cause defense for continuation penalty
  - CDP available **if there has been no prior opportunity to dispute the penalty**

Form 8865

Foreign Partnerships

- Certain U.S. persons who own or engage in transactions with certain foreign partnerships must file Form 8865, *Return of U.S. Persons With Respect to Certain Foreign Partnerships*. See I.R.C. §§ 6038, 6038B, 6046A.
  - U.S. person who, at any time: directly owned more than 50% interest in partnership's capital, profits, or losses; indirectly owned a 10% or greater interest in partnership's capital, profits, or losses; or contributes, acquires, disposes, or has a substantial change in proportionate interest. Numerous exceptions.
- When to file?
  - Attach to timely filed return of the affected person
- Penalties I.R.C. §§ 6038; 6038B
  - For Category 1, 2 and 4 filers. $10,000 per foreign partnership plus a $10,000 per month continuation penalty. Total maximum of $60,000
  - Reduction of Foreign Tax Credits
  - For Category 3 filers. 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.
  - Reasonable cause defense available
  - Per IRS no reasonable cause defense available for continuation penalty. IRM § 20.1.9.3.5(2)
  - CDP available **if there has been no prior opportunity to dispute the penalty**

Form 926

Foreign Corp. Transfers

- U.S. citizens, corporations, and estates and trusts must report certain transfers of property and cash to foreign corporations.
  - I.R.C. 351 incorporation transactions; I.R.C. § 361 reorganizations; I.R.C. § 355 spin-offs; I.R.C. § 367(d) and (e) transactions
- When and how to file?
  - U.S. transferor must file Form 926, *Return by a U.S. Transferor of Property to a Foreign Corporation*, with return for year of transfer.
- 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 and can reach a maximum of $100,000 per return. If due to intentional disregard the penalty can exceed $100,000.
  - Reasonable cause defense available per IRM § 20.1.9.7.5
  - CDP available

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.

The New Updated Voluntary Disclosure Practice (Son of OVDP)

- Set forth in IRS Memo dated November 20, 2018 to be incorporated into the IRM at 9.5.1.9 has not been updated, memo expires 11/20/2020
- The Offshore and Domestic Voluntary Disclosure Practice have been merged into one program.
- 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

Increased FBAR Civil Penalties

- Assessed After Jan 15, 2017
  - Nonwillful $12,921. Up from 10k. Adjusted per IRS Website
  - Subject to reasonable cause defense.
  - Willful. Minimum $129,210 per violation. Up from a minimum of $100,000.
  - Maybe Not! U.S. v. Colliot AU-16-CA-01281-SS (WD TX May 16, 2018)

Son of OVDP
Step 1

- Taxpayer submits a pre-clearance request to CI on Form 14457. New Version as of March, 2019.

- Eligibility still determined under IRM 9.5.11.9(12/2/2009).

  - Taxpayers with illegal-source income are not eligible
  - Disclosure must be timely, truthful and complete
  - Taxpayer must cooperate in determining her correct tax liability

Son of OVDP
Step 1

– Timely Disclosure Before:
  - A civil or criminal investigation has begun 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
  - Generally 50% of the highest balance during the 6-year period should not be imposed
    - Note the reversed burden of proof
- Information return penalties will not automatically be imposed
  - Examiners will take into account the imposition of other penalties and resolve the examination by agreement

Willfulness –Old School

- Willfulness is "a voluntary, intentional violation of a known legal duty." *United States v. Sturman*,951 F.2d 1466 (6^{th} Cir. 1991), quoting *Cheek v. United States*, 111 S. Ct. 604, 610 (1991); IRM 4.26.16.6.5.1(1) (11-06-2015)
- A finding of willfulness under the BSA must be supported by evidence of willfulness. IRM 4.26.16.6.5.1(2) (11-06-2015)
- The mere fact that a person checked the wrong box, or no box, on a Schedule B is not sufficient, in itself, to establish that the FBAR violation was attributable to willful blindness. IRM 4.26.16.6.5.1(5) (11-06-2015)

Willfulness- Old School (Cont.)

- *Willfulness is shown by the person's knowledge of the reporting requirements and the person's conscious choice not to comply with the requirements*. In the FBAR situation, the only thing that a person need know is that she has a reporting requirement. If a person has that knowledge, the only intent needed to constitute a willful violation of the requirement is a *conscious choice* not to file the FBAR. IRM 4.26.16.5.1 (11/6/2015)
- *Willfulness is shown by the person's knowledge of the reporting requirements and the person's conscious choice not to comply with the requirements*. In the FBAR situation, the only thing that a person need know is that she has a reporting requirement. If a person has that knowledge, the only intent needed to constitute a willful violation of the requirement is a *conscious choice* not to file the FBAR. IRM 4.26.16.5.1 (11/6/2015)

What is Willful Blindness, and Why Do You Care?

- Under the theory of "willful blindness," willfulness may be attributed to a person who has made a conscious effort to avoid learning about the FBAR reporting requirements.
- "Willful blindness" requires proof that:
  - a person subjectively believed that there was a high probability that a fact exists and
  - he took deliberate actions to avoid learning of that fact. *Global-Tech Appliances v. SEB, SA,* 131 S. Ct. 2060, 2070-71 (2011).
- "Willful blindness" is more than recklessness or negligence. A willfully blind person 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. A defendant must subjectively believe that there is a high probability that a fact exists and the defendant must take deliberate actions to avoid learning of that fact." *Global-Tech Appliances*. Id at 2070.
- Cf. *United States v. McBride, 908 F. Supp. 2d 1186 (D. Utah 2012)* (Willful blindness found based on the failure to review Schedule B of the tax return) but see, IRM 4.26.16.6.5.1(5) (11-06-2015). ("The mere fact that a person checked the wrong box, or no box, on a Schedule B is not sufficient, *by itself*, to establish that the FBAR violation was attributable to willful blindness").

Willful Blindness - *Williams*

- *United States v. Williams*, 489 Fed. Appx. 655, 2012 U.S. App. LEX IS 15017 (4111 Cir. July 20, 20 12)(unpublished), *reversing* 2010 U.S. Dist. LEX IS 90794, No. I :09-cv-437 (E. D. Va. Sept. I, 2010).
  - Non-precedential
  - Split panel
- Criminal Conviction -- Mr. J. Bryan Williams pled guilty to a two-count superseding criminal information, charging him with conspiracy to defraud the IRS, in violation of 18 U .S.C. § 3 71 , and criminal tax evasion, in violation of 26 U.S.C. § 7201.
  - Unreported Income of $800,000 on $7,000,000 in deposits
  - Lied to the accountant on the organizer
  - Checked the "No" box
- "I also knew that I had the obligation to report to the IRS and/or the Department of the Treasury the existence of the Swiss accounts, but for the calendar year tax returns 1993 through 2000, I chose not to in order to assist in hiding my true income from the IRS and evade taxes thereon, until I filed my 2001 tax return."

Willful Blindness – *Williams* (cont’d)

- “Unfortunate” aspects of *Williams*
  - Court focused on willful blindness despite ample evidence of willfulness.
  - The Court stated that the fact that Williams admitted he never read, the FBAR form or line 7a of the tax return, 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.“
  - The Court equated “reckless conduct” with willful blindness– an approach rejected by the Supreme Court.

Willful Blindness-*McBride*

- *United States v. McBride*, 2012 U.S. Dist. LEXIS 16 1206, Case No. 2:09-cv-378 ON (D. Utah Nov. 8, 2012)
  - Preponderance of Evidence standard
  - Adopted *Williams* willful blindness standard repeating the assertion that recklessness equates to willful blindness
  - McBride adopted the determination in *Williams* that Schedule B, line 7a's direction to "[s]ee instructions for exceptions and filing requirements for Form TDF 90-22. 1" placed the taxpayer "on inquiry notice of the FBAR requirement."
- Evidence of willfulness should have been sufficient without relying on willful blindness
  - McBride lied about key details to the IRS during the course of an audit, withheld information, and made contradictory statements.
  - McBride read some of the marketing materials which informed him of the duty to report foreign accounts.
  - McBride used nominee entities to move U.S. revenue offshore
  - His stated purpose of entering the financial plan was to make it appear that he did not have a financial interest in foreign accounts that he had established by creating nominee corporations to hold the accounts.
  - His initial reaction to the promoter when told about the details was “This is tax evasion.”
  - McBride’s partner’s accountant expressed concerns about the plan, but McBride did not discuss the plan with his own accountant.

Recklessness =Willfulness

- Recklessness is a lower standard than willful blindness.
- Recklessness "is an objective standard that looks to whether conduct entails "an unjustifiably high risk of harm that is either known or so obvious that it should be known." *Safeco Ins. Co. of Am. v. Burr*, 551 U.S. 47, 68 (2007).
- "Recklessness requires a known or obvious risk that was so great as to make it highly probable that harm would follow. " [S]uch risk is substantially greater than that which is necessary to make his conduct negligent. Id at 52. *Safeco Ins. Co. of Am. v. Burr*, 551 U.S. 47, 52, 127 S. Ct. 2201, 2205 (2007)
- *Norman v. United States*, 138 Fed. Cl. 189, 194-95 (2018) ("Although one of the few consistent pieces of Ms. Norman's testimony was that she did not read her tax return simply not reading the return does not shield Ms. Norman from the implications of its contents").
- *Bedrosian v. United States*, 912 F.3d 144, 153 (3rd Cir. 2018). (Willful intent includes recklessness. A person "recklessly" fails to comply with an IRS filing requirement when he or she "(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 [or she] was in a position to find out for certain very easily."
- *United States v.* Bohanec, 263 F. Supp. 3d 881(C.D. Cal. 2016). Defendant reckless. ("Part III of Schedule B of Defendants' 1998 tax return put them on notice that they needed to file an FBAR.")
- The 3rd Circuit, Multiple District Courts, and the Court of Federal Claims have agreed with these rulings. See e.g. *Stone v. Troy Constr., LLC*, 935 F.3d 141, 149 (3rd Cir. 2019); *Kimble v. United States*, 141 Fed. Cl. 373, 386 (2018); *United States v. Flume*, 390 F. Supp. 3d 847, 855-856 (S.D. Tex. 2019); *United States v. Horowitz*, 361 F. Supp. 3d 51, 527-528 (D. Md. 2019); *United States v. Jung Joo Park*, 389 F. Supp. 3d 561, 570 (N.D. Ill. 2019); *United States v. Rum*, 2019 U.S. Dist. LEXIS 145931, 24-25 (M.D. Fla. 2019)

Willfulness - Standard of Proof

- The IRS must prove willfulness by a preponderance of the evidence); *United States v. Bohanec*, 2016 U.S. Dist. LEXIS 170149, 118 A.F.T.R.2d (RIA) 6757 (C.D. Cal. Dec. 8, 2016); *United States v. Garrity*, 304 F. Supp. 3d 267, 274 (D. Conn. 2018). But see IRS CCA 200603026, 2005 IRS CCA LEXIS 83 **5-7 (Sept. 1, 2005) (willfulness must be proven by "clear and convincing" evidence, and the general presumption of correctness afforded to tax assessments is inapplicable). Disregarded by the court in *Bohanec, and Garrity*.
- In *Carlson v. United States*, 754 F.3d 1223 (11th Cir. 2014) the issue was the plaintiff's liability for the civil " aiding and abetting understatement of tax liability in violation of I.R.C. § 6701." The court held that the standard of proof is by "clear and convincing evidence."
  - Query: Is this applicable to FBAR violations?
- 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 in the failure to file the FBAR on inferences 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 4.26.16.4.5.3(7).
- The National Taxpayer Advocate has argued in favor of the clear and convincing standard. National Taxpayer Advocate, Area of Focus #12, "The IRS's Offshore Voluntary Disclosure (OVD)-Related Programs Have Improved, But Problems Remain," in Objectives Report to Congress, Fiscal Year 2017 (June 2016). The NTA has also set forth other criticisms of the FBAR penalty regime as interpreted by the IRS. Id.

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

- The lines have blurred.
  - Pre-OVDP a noisy disclosure included a meeting/tel. conf. with CI.
  - We now prefer the term "IRM Part 9 Voluntary Disclosure"
- Quiet = Amended Filings Only

- Noisy for Domestic or Offshore purposes requires that certain information be disclosed on an IRS form.

Voluntary Disclosures: IRM 9.5.11.9.

- It is currently 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

- 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.

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.
- IRS appears to be systemically assessing penalties on all late-filed foreign information reporting forms.

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 unless the amended return is deemed to be a "qualified amended return."
  - SOL on most foreign information reporting forms including Form 8938 also remains open until 3 years after the form is filed

Best Practices for Advising Non-Compliant Taxpayers

- Understand the law, including recent case law and IRS guidelines, if any.
- Make sure you carefully question your client about the facts.
- 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.

Best Practices for Advising Non-Compliant Taxpayers (Cont'd)

- 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.
- 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
- If your client states that he or 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 an audit.

Questions?

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WEBINAR ON

"VOLUNTARY DISCLOSURE OF FOREIGN ASSETS: CURRENT CHALLENGES FOR NONCOMPLIANT U.S. TAXPAYERS"

November 14, 2019

1:00-2:30 PM EDT

Presenter: Deborah J. Jacobs

The Law Office of Deborah J. Jacobs

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Deborah J. Jacobs, Owner
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- Since 2009, Ms. Jacobs has devoted a significant portion of her practice to international tax compliance matters--primarily in the areas of Offshore Voluntary Disclosure, Dual Citizenships, FBAR Compliance, and FATCA Compliance. She has had frequent speaking engagements on the Offshore Voluntary Disclosure Programs, most recently speaking at an American Bar Association Tax Section Meeting and as a panelist for Strafford and Bloomberg BNA Webinars. She also has been quoted in *Tax Notes Today* and Politico's *Morning Tax* on related issues.
- In addition, Ms. Jacobs has more than 28 years of experience in all aspects of international tax practice, including issues related to Subpart F, PFIC, repatriation, foreign tax credit, and tax treaty planning. Her cross-border transactional experience includes mergers and acquisitions, post-merger/acquisition integrations, cross-border financings, private equity transactions, and structured finance.
- A more detailed profile of Ms. Jacobs can be found on her law firm's website at http://jacobstaxlaw.com/lawyer/aboutus/Attorney-Profile_pa10075.htm
- Ms. Jacobs can be reached at 212-332-3248 or at djacobs@jacobstaxlaw.com

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Streamlined Filing Compliance Procedures

- On March 13, 2018, the IRS announced that it will end the Offshore Voluntary Disclosure Program (the "OVDP") on September 28, 2018. However, the IRS has said that the Streamlined Filing Compliance Procedures will remain available after the 2014 OVDP closes. Caution: these programs could be closed at any time.

- Only Taxpayers that can certify under penalties of perjury that their conduct was non-willful may use the Streamlined Filing Compliance Procedures.

- The Streamlined Filing Compliance Procedures has helped about 65,000 taxpayers come into compliance.

- The Streamlined Filing Compliance Procedures are available to both non-resident and resident U.S. taxpayers who can demonstrate that their conduct was non-willful.

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What is the Purpose of the Streamlined Filing Compliance Procedures?

- The Streamlined Filing Compliance Procedures were designed to provide options to help both U.S. taxpayers residing overseas, **AND** in the U.S., comply with their U.S. tax obligations.

- The two programs are:
  (1) the Streamlined Domestic Offshore Procedures ("SDOP") and
  (2) the Streamlined Foreign Offshore Procedures ("SFOP")

- Compared to the Former 2012 Streamlined Program, the SDOP and the SFOP include a broader section of non-compliant, but non-willful, U.S. taxpayers.

- For the first time, U.S. resident taxpayers who are out of compliance with reporting their foreign source income or, who have failed to file international information returns such as the FBAR, could now participate.

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General Eligibility for the Streamlined Filing Compliance Procedures

- The Streamlined Filing Compliance Procedures are designed only for individual taxpayers, including estates of individual taxpayers. However, it should be noted that an estate might have a difficult time demonstrating the non-willfulness of a deceased individual.

- **To be eligible for the SFOP:** the taxpayer must meet the definition of a "non-resident taxpayer" and filed delinquent or amended income tax returns. All penalties are waived.

- **To be eligible for the SDOP:** the taxpayer must fail to satisfy the "non-residency" criteria and file amended income tax returns. There is a 5% miscellaneous penalty on assets reportable on an FBAR or Form 8938.

- **Taxpayers must certify under penalties of perjury:** that their conduct for the failure to report all income, pay all tax and file all information returns, including FBARs**, was due to non-willful conduct.**

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General Eligibility for the Streamlined Filing Compliance Procedures

- Taxpayers who previously made "quiet disclosure" are eligible.
- The IRS cannot have initiated a civil examination of taxpayer's returns for any taxable year, whether or not the examination related to undisclosed foreign financial assets.
- The Taxpayer cannot be under criminal investigation.

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Inherent Risks in the Streamlined Filing Compliance Procedures

- Once a taxpayer makes a submission under either of the Streamlined Procedures (*i.e.*, the SFOP or the SDOP), she/he could *not* participate in the old Offshore Voluntary Disclosure Program (OVDP).

- If the IRS receives or discovers evidence of willfulness, fraud, or criminal conduct on the part of the taxpayer, the IRS could open an examination or investigation that could lead to civil fraud penalties, FBAR penalties, information return penalties, or even a referral to Criminal Investigation. But, a taxpayer can reduce the risk of a false certification by fully disclosing all facts.

- In addition, the IRS has said that there will be no pre-clearance protection under the Streamlined Procedures.

- Accordingly, taxpayers who are concerned that their failure to report income, pay tax, and/or to file required information returns was due to willful conduct should seriously consider participating in the new VDP.

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Inherent Risks in the Streamlined Filing Compliance Procedures, con't

- When the Streamlined Filing Compliance Procedures came into effect in 2014, a number of willful taxpayers tried to convince practitioners that they were, in fact, non-willful.

- Given the end of the 2014 Offshore Voluntary Disclosure Program ("OVDP"), it is likely that some willful taxpayers will try to enter the Streamlined Filing Compliance Procedures rather than go the new voluntary disclosure route.

- Practitioners need to be wary of taxpayers trying to pass themselves off as non-willful by thoroughly vetting prospective clients.

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The Non-Willful Certification Statement for the SDOP (Form 14654) and SFOP (Form 14653)

- Under the FAQs (13 for the SDOP/6 for the SFOP), Taxpayers must include a narrative statement of facts setting forth the specific reasons for a failure to report all income, pay all tax, and submit all required information returns, including FBARs.

- Taxpayers must include the whole story including both favorable and unfavorable facts.

- The narrative should include specific reasons, including the Taxpayer's personal background, financial background, and anything else the Taxpayer believes is relevant to his/her failure to report all income, pay all tax, and submit all required information returns, including FBARs.

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The Non-Willful Certification Statement for the SDOP (Form 14654) and SFOP (Form 14653), con't

- The Taxpayer should provide a complete story about his/her foreign financial account/assets:

1. What is the source of the funds in all of your foreign financial accounts/assets?
2. Was the account/asset inherited?
3. Did the Taxpayer open the account while residing in a foreign country? And, if so, why?
4. Did the Taxpayer have a business reason to open or use the account?
5. What contacts did the Taxpayer have with the account/asset including withdrawals, deposits, and investment/management decisions.

- If the Taxpayer (or return preparer) inadvertently checked "no" on Schedule B, the Taxpayer should provide an explanation.

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The Non-Willful Certification Statement for the SDOP (Form 14654) and SFOP (Form 14653), con't

- If the Taxpayer owned or controlled a foreign entity (eg. corporation, trust, partnership) and failed to properly report ownership of the entity or control of the entity, the Taxpayer should explain why he/she failed to do so, including whether the Taxpayer had any knowledge of his/her reporting obligations.

- If the Taxpayer relied on a professional advisor, then he/she should provide the name, address, and telephone number of the advisor and a summary of the advice. Also provide background on how the Taxpayer came into contact with the advisor and frequency of communication with the advisor.

- If married taxpayers submit a joint certification and have different reasons for their non-compliance, then each should provide the individual reasons separately in the statement of facts.

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What is Non-Willful Conduct?

- In order to participate in the SFOP or the SDOP, a Taxpayer must certify under penalty of perjury that his/her conduct was non-willful.

- The IRS has said that "non-willful conduct" for the Streamlined Programs **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."***

- The IRS also has said that it will give no further definition of non-willful conduct **for** purposes of the SFOP or the SDOP (other than that stated above). It has said that the concept of willfulness is well documented in case law and expects practitioners to apply those definitions, as well as relevant portions of the IRS Manual in advising clients on whether their conduct fits within the definition of non-willfulness.

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What is Non-Willful Conduct?, con't

- What kind of evidence is relevant to demonstrate "non-willfulness" for purposes of the SDOP and the SFOP when the definition of non-willful conduct ranges from negligent conduct to conduct resulting from a good faith misunderstanding of the law?

- How does a taxpayer actually prove that he/she did not know about including offshore income on his/her U.S. tax return or that he/she never knew about the FBAR filing requirement? What kind of supporting evidence does the taxpayer need to show?

- In determining whether the taxpayer can legitimately certify that he or she is non-willful, **ALL** relevant facts and circumstances should be analyzed to determine whether the taxpayer's conduct is really non-willful.

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What is Non-Willful Conduct?
Use of an Accountant/Tax Preparer

Questions relevant to a finding of non-willfulness:

- Did the taxpayer use an accountant or paid return preparer to prepare the tax returns?
- If so, was the taxpayer given a tax organizer? If yes, did the taxpayer fill it out truthfully? Does the taxpayer have a copy of the organizer?
- If the taxpayer did not receive an organizer from the tax advisor, was he/she asked about the existence of any offshore accounts or assets, or about any foreign source income?
- If the advisor did not ask the taxpayer the above questions, did the taxpayer affirmatively tell the accountant or tax return preparer about the existence of any offshore accounts, offshore assets, or foreign source income?

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What is Non-Willful Conduct?
Taxpayer's Knowledge and Level of Sophistication

- Did the taxpayer have any knowledge of the foreign source income, foreign accounts or foreign assets? Why was there income?

- What is taxpayer's level and type of education?

- Does the taxpayer have any specialized knowledge of tax rules or finance or the fact that the U.S. requires U.S. persons to report income on a worldwide basis on their tax returns?

- Does the taxpayer know anything about an FBAR or international information returns, such as a Form 5471?

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What is Non-Willful Conduct?
Taxpayer's Connection to the Country, etc.

- Was the taxpayer a citizen or resident of the country where the accounts/assets were/are located? If not, why were the accounts opened in that country?
- If the taxpayer opened the account, did he/she do so with a U.S. passport, if applicable? Was the account opened in a jurisdiction with no bank secrecy laws?
- What were/are the sources of the funds in the accounts?
- Is the source of funds traceable to previously taxed income? Were the funds an inheritance? Were the funds from taxpayer's work in the country where the accounts are located?

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What is Non-Willful Conduct?
Activities in the Offshore Account

- What type of activities took place with respect to the accounts? Deposits, withdrawals, wire transfers? If so, how frequent were these activities?

- Were there any trades in the accounts? If so, who managed the accounts?

- Was there a credit card associated with the account? If so, did the taxpayer ever use it? If so, how frequently?

- Did the taxpayer receive regular statements from the bank? If not, did a relative or friend receive statements or did the bank have instructions not to send any statements to the taxpayer?

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What is Non-Willful Conduct?
Activities in the Offshore Account, con't.

- Has the account ever been moved? If so, why? Was it moved to a tax transparent country or to a jurisdiction with a tradition of bank secrecy?

- Was an entity used when the account was opened? If so, did the bank require the use of an entity? Was it used to disguise the true identity of the account owner?

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The Concept of Willful Blindness

- The IRM defines willfulness in the FBAR context as "a voluntary, intentional violation of a known legal duty." (IRM 4.26.16.4.5.3).
- Under the concept of "willful blindness," willfulness may be attributed to a person who has made a conscious effort to avoid learning about the FBAR reporting requirements.
- **Key Question:** Under all the facts and circumstances, should the taxpayer have inquired about the reporting of a foreign financial account and/or its income?
- What if the wrong box is checked on Schedule B? Implications? The mere fact that a person checked the wrong box, or no box, on a Schedule B is not sufficient, by itself, to establish that an FBAR violation was due to willful blindness.

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Differences Between the SDOP and the SFOP

The primary differences between the SFOP and the SDOP are:

1. **<u>Residency vs. non-residency</u>:** in the SFOP, the taxpayer qualifies as a non-resident U.S. taxpayer, whereas in the SDOP, the taxpayer qualifies as a resident U.S. taxpayer;

2. **<u>Penalties</u>:** in the SFOP, all penalties are waived--the taxpayer only needs to file original or amended returns, pay taxes and interest due over a three-year period, and file delinquent or amended FBARs for the most recent 6 years. In the SDOP, the taxpayer must file **AMENDED RETURNS** and pay taxes and interest due over a three-year period AND a 5% miscellaneous penalty on the highest account balances of the taxpayer's offshore assets (using a six-year look back period and the year-end balances). In the SDOP, the taxpayer MUST have filed an original return.

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Eligibility Requirements for the SFOP

In addition to the general eligibility requirements discussed before, the Taxpayer must:

1. Meet the applicable non-residency requirement (for joint filers, both spouses must meet the applicable non-residency requirement);
2. Have failed to report the income from a foreign financial asset and failed to pay tax on it;
3. May have failed to file an Information Return, such as an FBAR; and
4. Such failures resulted from non-willful conduct.

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Non-Residency Requirement of the SFOP

Individual U.S. citizens or lawful permanent residents (e.g., Green Card Holders) or their estates meet the applicable non-residency requirement if:

1. In any one or more of the most recent three years for which the U.S. tax return due date (or properly extended due date) has passed, the taxpayer did not have a U.S. "abode" and the taxpayer was physically outside the U.S. for at least 330 full days.

2. Neither temporary presence of the taxpayer in the U.S. nor maintenance of a dwelling in the U.S. by an individual necessarily means that the taxpayer's "abode" is in the U.S.

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What is a U.S. Abode?

- The SFOP looks to the definition of Abode in IRC Section 911(d)(3) and Treas. Reg.§ 1.911-2(b).
- Abode has been defined as one's home, habitation, residence, domicile, or place of dwelling.
- It does not mean your principal place of business.
- Abode has a domestic rather than a vocational meaning and does not mean the same thing as "tax home."
- The location of your abode often will depend on where you maintain your economic, family, and personal ties.
- You are not considered to have a tax home in a foreign country for any period in which your abode is in the U.S.

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What is a Non-Resident for Purposes of the SFOP?

- **<u>Example One</u>**: Taxpayer was born in the U.S. but moved to France with his parents when he was six years old, has lived in France ever since, and does not have a U.S. abode. Taxpayer meets the non-residency requirement applicable to individuals who are U.S. citizens or green card holders.

- **<u>Example Two</u>**: Assume the same facts except that Taxpayer moved to the U.S. and acquired a U.S. abode in 2012. The most recent 3 years for which the Taxpayer's U.S. tax return due date (or properly extended due date) has passed are 2013, 2012 and 2011. Taxpayer meets the non-residency requirement applicable to individuals who are U.S. citizens or green card holders because in one or more of the most recent three years for which the U.S. tax return due date has passed, the taxpayer did *not* have a U.S. abode.

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Non-Residency Requirement For Taxpayers who are not U.S. Citizens or Green Cardholders

- The SFOP provides a different non-residency requirement for taxpayers who are not U.S. citizens or green card holders.

- Taxpayers in this category will meet the non-residency requirement if, in any one or more of the last three years for which the U.S. tax return due date (or properly extended due date) has passed, the taxpayer did not meet the "substantial presence" test.

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Non-Residency Requirement For Taxpayers Who are not U.S. Citizens or Green Card Holders, con't.

- **Example:** Taxpayer is not a U.S. citizen or a green card holder. Taxpayer was born in Italy and resided in Italy until May 1, 2012, when her employer transferred her to the U.S. Taxpayer was physically present in the U.S. for more than 183 days in both 2012 and 2013. The most recent 3 years for which the taxpayer's U.S. tax return due date (or properly extended due date) has passed are 2013, 2012 and 2011. While Taxpayer did meet the substantial presence test for 2012 and 2013, she did not meet it for 2011.

Result: Taxpayer meets the non-residency requirement for purposes of the SFOP.

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The SFOP Procedure

Once it is determined that a Taxpayer is eligible to participate in the SFOP, the Taxpayer must:

- File delinquent or amended tax returns, together with all required information returns for each of the most recent three years and pay any tax and interest due;
- File delinquent or amended FBARs for each of the most recent six years; *and*
- File a Certification in which the Taxpayer certifies under penalty of perjury that the failure to file tax returns, report all income, pay all tax, and submit all information returns, including FBARs was due to non-willful conduct.

There are special rules if the Taxpayer is seeking relief for failure to elect deferral of income from retirement plans.

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Eligibility Requirements for the SDOP

In addition to the general eligibility requirements discussed before, the Taxpayer must:

1. **<u>FAIL</u>** to meet the applicable non-residency requirement (for joint filers one or both spouses must **<u>FAIL</u>** to meet the applicable non-residency requirement);

2. Have previously filed a U.S. tax return for each of the most recent 3 years for which the U.S. tax return due date (or properly extended due date) has passed;

3. Have failed to report gross income for a foreign financial asset and pay tax on it and may have failed to an information return, such as an FBAR, with respect to such asset; ***and***

4. Certify that such failures resulted from non-willful conduct.

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The SDOP Procedure

Once it is determined that a Taxpayer is eligible to participate in the SDOP, the Taxpayer must:

- File amended tax returns, together with all required information returns for each of the most recent three years and pay any tax and interest due;
- File delinquent FBARs for each of the most recent six years; ***and***
- File a Certification in which the Taxpayer certifies under penalty of perjury that the failure to file tax returns, report all income, pay all tax, and submit all information returns, including FBARs, was due to non-willful conduct.

There are special rules if the Taxpayer is seeking relief for failure to elect deferral of income from retirement plans.

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The SDOP Miscellaneous Penalty

- In addition to paying any tax and interest due, a taxpayer participating in the SDOP must pay a 5% miscellaneous penalty on the highest aggregate balance/value of the Taxpayer's foreign financial assets that are subject to the miscellaneous offshore penalty during the years in the covered FBAR period.

- In this case, year-end account balances and year-end asset values are used in lieu of the highest balances over the course of the year—and the 5% penalty is assessed on the highest year.

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Assets Included in the Miscellaneous Penalty

- For the six years covered in the FBAR period, all foreign financial accounts (as defined in the instructions for FinCEN Form 114) in which the taxpayer has a personal financial interest that should have been, but were not reported on an FBAR.

- For the three years covered in the tax return period, all foreign financial assets (as defined in the instructions for Form 8938) in which the taxpayer has a personal financial interest that should have been, but were not reported on Form 8938.

- For the three years covered in the tax return period, all foreign financial accounts/assets (as defined in the Instructions for FinCEN Form 114 or IRS Form 8938) for which gross income was not reported for that year.

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Assets Included in the Miscellaneous Penalty

- All of the assets that meet the definition of foreign financial assets in the instructions for Form 8938 and not reported on that form should be included in the 5 percent penalty, unless the taxpayer reported them on timely filed Forms 3520 or 5471. (If they are reported on timely filed Forms 3520 or 5471, they do not have to be reported on Form 8938 for the same tax year.)

- The penalty base includes the stock in the corporation, but not the underlying financial accounts, unless the entity is a disregarded entity for federal tax purposes. If the corporation is a disregarded entity, then the Taxpayer must report the underlying foreign financial accounts.

- The same principal would apply to assets that are held in a foreign partnership or trust.

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Delinquent FBAR Submission Procedures

- Taxpayers who do not have any unreported income and have not filed a required FBAR are eligible to use the Delinquent FBAR Submission Procedures.
- Taxpayers must not be under a civil examination or a criminal investigation by the IRS.
- Taxpayers must not already have been contacted by the IRS about the delinquent FBARs.
- Taxpayers should file the delinquent FBARs electronically at FinCEN with a statement explaining the reason for filing late.
- Taxpayers should be non-willful.
- The IRS will not impose a penalty for the failure to file timely FBARs if the Taxpayer properly reported all income on his U.S. tax return, and paid all tax on this income from the foreign financial accounts reported on the delinquent FBARs.
- No automatic audit but existing audit selection processes will apply.

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Delinquent International Information Return Submission Procedures

- Taxpayers who do not have any unreported income and have not filed one or more international information returns (eg. Forms 8938, 5471, 3520, 3520A) are eligible.
- Taxpayers should be non-willful and have reasonable cause for not timely filing the information return.
- Taxpayers must not be under a civil examination or a criminal investigation by the IRS.
- Taxpayers must not already have been contacted by the IRS about the delinquent international information returns.
- Taxpayers should file the delinquent international information returns with a statement of facts establishing reasonable cause for the failure to file.
- Statement must be made under penalty of perjury.
- Taxpayer must certify that any entity for which the information returns are being filed was not engaged in tax evasion.
- No automatic audit but existing audit selection processes will apply.

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Reasonable Cause

- Reasonable cause is based on all the facts and circumstances.
- The IRS will consider any reason which establishes that the Taxpayer used all ordinary business care and prudence to meet filing obligation but was nevertheless unable to do so.
- The IRS will consider any sound reason such as:

  Fire, casualty, natural disaster or other disturbances;

  Inability to obtain records

  Death, serious illness, incapacitation or unavoidable absence of the Taxpayer or a member of the Taxpayer's immediate family

  Any other reason which establishes ordinary business care and prudence

Note: a lack of funds, in and of itself, is not reasonable cause for failure to file or pay on time. However, the reasons for the lack of funds may meet reasonable cause criteria for the failure to pay penalty.

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Relief Procedures for Certain Former Citizens

On September 6, 2019, the IRS announced new procedures that will enable certain individuals who relinquished their U.S. citizenship to come back into compliance with their U.S. tax and filing obligations and receive relief for back taxes.

Eligible individuals:

- (1) have relinquished their U.S. citizenship after March 18, 2010;
- (2) **HAVE NOT** filed U.S. tax returns as U.S. citizens or residents;
- (3) have an aggregate tax liability of $25,000 or less for the five years preceding expatriation and in the year of expatriation;
- (4) have net assets of less than $2 Million (at the time of expatriation and at the time of making their submission under these procedures);
- (5) did not exceed the threshold in IRC 877(a)(2)(A) related to average annual net income for the period of 5 years ending before the date of expatriation ($168,000 for 2019); and
- (6) agree to complete and submit with their submission all required Federal tax returns for six tax years at issue.

- Taxpayers non-compliance **MUST** be non-willful.

- If Taxpayers meet the requirements of these procedures and submit the required documents, then they will not be "covered expatriates" under IRC 877A, and they will not be liable for any unpaid taxes and penalties for these years or any previous years.

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What is a Covered Expatriate

With some exceptions that are not applicable for these procedures, IRC 877(a)(2) will treat a Taxpayer as a "covered expatriate" if:

- Taxpayer has an average annual net income tax liability of the five years preceding the year of expatriation that exceeds a specified amount adjusted for inflation ($168,000 for 2019);
- Taxpayer has a net worth of $2 million or more as of the expatriation date (the "net worth test"); **OR**
- Taxpayer cannot certify, under penalties of perjury, on Form 8854, that Taxpayer is compliant with all Federal tax obligations for the five tax years preceding the tax year, and including the expatriation date.
- A "covered expatriate" is treated as having disposed of all worldwide assets on the day before their expatriation date, are required to pay a mark-to-market exit tax on the gain (subject to an exclusion amount of $725,000 in 2019) resulting from the deemed distribution of their worldwide assets, and are subject to other tax consequences for certain deferred compensation and trust distributions.

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Relief Procedures for Certain Former Citizens

- These procedures are available **ONLY** to individuals who have not filed U.S. tax returns, so estates, trusts, corporation partnership and other entities cannot participate.
- Taxpayers who filed a Form 1040-NR under the good faith belief that they were not U.S. citizens or residents won't be disqualified from using these relief procedures.
- There is no specific termination date, but Taxpayers should be encouraged to use the procedures sooner rather than later. However, the IRS will announce a closing date prior to ending the procedures.
- Eligible individuals must have relinquished their U.S. citizenship any time after March 18, 2018.
- Since relinquishing U.S. citizenship and the tax consequences that accompany this involve irrevocable decisions, these procedures can help certain individuals come into compliance with their taxes and filing obligations and receive relief from back taxes.

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Relief Procedures for Certain Former Citizens
Submission Documents

- Certificate of Loss of Nationality (CLN) of the U.S., Form DS-4083, or a copy of court order cancelling a naturalized citizen's certificate of naturalization (see IRC 877A(g)(4)(D). Form DS-4083 must indicate that Taxpayer expatriated after March 18, 2010. The CLN must be stamped "Approved" by the State Department;
- Identification: Copy of a valid passport **OR** birth certificate and government issued ID;
- Year of Expatriation: "Dual-status" return including Form 1040NR with all required information returns; Form 8854 with Form 1040 attached as an information return reporting all worldwide income up to date of expatriation; and all other required information returns, including but not limited to Form 8938;
- Five tax years preceding the tax year of expatriation: Forms 1040 with all required information returns.

NOTE: On the first page of the documents submitted write **"Relief for Certain Former Citizens"** at the tope of each document.

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Relief Procedures for Certain Former Citizens
Net Worth Test, FBARs

- In order to satisfy the net worth test, Taxpayers should maintain records of their tax basis and keep copies of any information used to establish the fair market value of their assets.

- While audits are uncommon, the IRS may audit or examine a submission, particularly on the valuation of assets, so keeping good records is important.

- It is important to note that formal appraisals **ARE NOT REQUIRED TO DETERMINE NET WORTH.**

- It is also important to note that FBAR filings **ARE NOT** an eligibility criterion for individuals, but FBAR compliance is strongly encouraged.

- However, if delinquent FBARs are filed contemporaneously with a submission to the relief procedures, FBAR penalties will not be asserted.

- In 2015,the IRS notes that fewer than 1 million of an estimated 9 million Americans living in foreign countries filed an FBAR, so there is a large compliance gap.

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Relief Procedures for Certain Former Citizens

- There is no preclearance process for these procedures.

- Taxpayer does not need an SSN in order to make a submission under these procedures. If Taxpayer does not have an SSN, leave the boxes blank where an SSN is requested. If Taxpayer applied for and received an ITIN in the past, include Taxpayer's ITIN on the submission.

- Returns submitted under these procedures will not be automatically subject to an IRS audit, but they may be selected under the existing audit selection process.

- After reviewing the Taxpayer's submission to confirm that Taxpayer meets the eligibility criteria, the IRS will send a letter notifying Taxpayer that the submission was received and complete.

- The IRS will process the submissions as quickly as possible, but suggest that you allow for at least two months before contacting them if Taxpayer has not received this notification.

- Taxpayers should be aware that relinquishing U.S. citizenship is irrevocable (unless it is vacated by the State Department), so Taxpayer can't change his/her mind. Taxpayer also can't retract an income tax return signed under penalties of perjury, but can usually file amended tax returns.

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