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After the FBAR Overhaul: Foreign Account Reporting Enforcement

Preparing for IRS Exams, Potential Penalties, Administrative Appeals or Litigation

WEDNESDAY, NOVEMBER 16, 2011

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

Today's faculty features:

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After the FBAR Overhaul: Foreign Account Reporting Enforcement Seminar

Nov. 16, 2011

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Today's Program

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CIVIL PENALTIES WITH FBAR, OTHER FOREIGN REPORTING

FBAR Background

- Part of Bank Secrecy Act (BSA) - 1970
- Codified primarily in Title 31 of the U.S. Code
- Sect. 31 U.S.C. § 5314 requires reporting of Foreign Financial Accounts.
- Severe civil and criminal penalties for failure to comply, under 31 U.S.C. §§ 5321 and 5322

The Regulators

- FinCEN: Overall Title 31 responsibility is delegated to the Financial Crimes Enforcement Network (FinCEN). Unlike with tax information, data is accessible by many agencies.

- IRS: FBAR examination and enforcement authority under an April 10, 2003 delegation/MOU from FinCEN

IRS Role In FBAR Civil Enforcement

The IRS is now authorized to do the following:

1) Investigate possible civil violations
2) Assess and collect civil FBAR penalties
3) Issue summonses re: FBAR matters
4) Issue administrative rulings
5) Undertake any other action for enforcement, including pursuing injunctions

IRS Role In FBAR Criminal Enforcement

- Since 1992, IRS CI has had the authority to investigate criminal FBAR violations.

- IRS CI also investigates money laundering offenses in which the underlying conduct is subject to investigation under Title 26 or the BSA (including FBARs).

New FBAR Regulations

- FinCEN published new FBAR regulations in February 2011.
- Effective March 28, 2011
- Apply to reports filed for calendar year 2010 and future calendar years
- Revised FBAR form was released in November 2011.

Title 31 Regulation Renumbering

- Effective March 1, 2011, Title 31 regulations were renumbered from 31 C.F.R. Part 103 to 31 C.F.R. Chapter X.

- Section references were renumbered from 103.xx to 1000.xxx to 1099.xxx.

- Example: 31 C.F.R. § 103.24 (FBAR) was renumbered to 31 C.F.R. § 1010.350.

Revised FBAR Form

- TD F 90-22.1 revised November 2011
- Input blocks remain the same.
- Instructions to the form were revised.
- No filing extension is available.
- No "mailbox rule" applies (not subject to 26 U.S.C. § 7502).
- Form must be received by IRS by June 30 of the year after calendar year reported.

FBAR Filing Basics

Four elements of FBAR filing:

1) "United States persons" must file if:

2) They have a financial interest or signature authority over

3) A foreign financial account or accounts, and

4) The aggregate value of the account(s) exceeds $10,000 at any point in time during the calendar year.

FBAR Filing: "U.S. Persons"

- "U.S. Persons" means:
- U.S. citizens (no matter where they reside)
- U.S. residents - IRC § 7701(b)
- U.S. entities – any entity created or organized in U.S. or under U.S. law
- Tax status disregarded; i.e., "disregarded entities" may have filing obligation

FBAR Filing: "U.S. Residents"

- "U.S. resident" determined under IRC § 7701(b)
- Green card and "substantial presence" (day-counting) tests
- If elect treatment as resident under IRC § 7701(b), electing person is only required to file FBARs on accounts held during the election period
- Tax treaty or 26 U.S.C. §§ 6013(g) or (h) elections disregarded for FBAR purposes

FBAR Filing: "Financial Interest"

- "Financial interest" means:
- U.S. person is the record owner or holds title directly.
- Someone else holds title for the benefit of U.S. person.
- Special rules for entities owned by U.S. persons
- U.S. person owns >50% of the entity that holds title.
- Applies to tiered entities
- See instructions for details

FBAR Filing: "Signature Authority"

"Signature authority" means:

- Individual(s) can control disposition of account assets (even if control only in conjunction with another).
- By direct communication (oral or written)

"Signature authority" is not:

- Supervisory approvals
- Attributed to entities
- Management of investments

FBAR Filing: "Foreign"

- Outside the "United States," which means:
  - States
  - District of Columbia
  - Territories and possessions (e.g., Guam)
  - Indian lands

- Physical location of account governs

FBAR Filing: "Financial"

- Both monetary and non-monetary assets

- Bank, brokerage and investment accounts; insurance and annuity policies with cash values; and mutual funds are specifically included.

- Generally not real property or physical personal property (e.g., artwork)

FBAR Filing: "Account"

- Relationship with financial institution or person acting as a financial institution

- It would not include gold bars in a bank safety deposit box, but would include certificates representing a bank's obligation to provide a specified amount of bullion to the account holder.

FBAR Filing: "Aggregation"

- "Aggregate value exceeds $10,000"
- Aggregate accounts with financial interest and those with signature authority
- Aggregate accounts owned "directly" and those owned "indirectly"
- No family attribution rule

Reportable Accounts

- Bank accounts (checking, savings, CDs)
- Securities or brokerage accounts (stocks, bonds, etc.)
- Other financial accounts
  - Other deposit accounts
  - Cash value of insurance or annuities
  - Commodity futures or options accounts
  - Mutual funds, or similar pooled funds

Mutual Fund Definition

- "Mutual fund" is defined as:
- Issues shares to the general public
- Shares have a regular net asset value (NAV) determination, and
- Regular redemptions

Reportable Account Exceptions

- U.S. military banking facility
- Accounts of U.S. governmental entities
- International financial institutions
- Correspondent or "nostro" accounts
- Consolidated filing
- Held in an IRA (if owner or beneficiary)
- Held in a tax-qualified retirement plan (if participant or beneficiary)
- Note: Foreign defined-contribution retirement accounts and IRA-like vehicles (e.g., Canadian RRSPs) are reportable

Valuing Accounts For FBAR

- Each account is valued separately at its highest value .
- Periodic statements may be relied upon (no intra-period analysis is required).
- Value in local currency is converted to U.S. dollars, at 12/31 rate.
- Aggregate all accounts
- No double-counting of transferred funds for determining threshold (e.g., balance of Account A transferred into Account B)

Signature Authority Exceptions

- Officer or employee (no financial interest) of:
- Bank examined by U.S. federal regulators
- SEC or CFTC registered institution
- Authorized service provider (SEC-registered)
- U.S.-listed entity (foreign or domestic)
- A U.S. subsidiary of a U.S.-listed entity
- Entity registered under 12(g) of SEC

Trust Beneficiary Exceptions

- Trust beneficiary does not need to file if trust, trustee or agent is a U.S. person and files an FBAR disclosing the trust's foreign financial accounts.

- Reportable beneficial interest does not include remainder interest.

- Discretionary beneficiary filing is not required, based on discretionary status.

Special Filing Rules – Many Accounts

Truncated filing for 25 or more accounts

Financial interest filers

- Check box 14 "yes" and provide number of accounts
- No account detail required (maintain records)

Signature authority filers

- Check box 14 "no"
- Provide account owner's information in Part IV (items 34-43)

Special Filing Rules: Consolidated Filing (Part V)

- Allowed for all types of entities
- All U.S. persons in consolidated group required to file should be shown.

Special Filing Rules - Spouses

- Spouses are allowed to file a single combined FBAR form if:
- Second (non-filing) spouse has only joint accounts with first (filing) spouse.
- All joint accounts are reported on a single FBAR.
- Both spouses sign in item 44.

FBAR Recordkeeping Requirements

- Account records must be maintained for five years.
- Exception: Officers or employees who file an FBAR because of signature authority over the foreign financial account of their employers are not expected to personally maintain the records of these foreign financial accounts.
- Grand jury subpoenas or IRS summonses for account records

Civil Penalties (Post-2004)

- Negligence - $500 per violation (31 U.S.C. § 5321(a)(6)(A))
- Non-willful - $10,000 per each non-willful failure to file (31 U.S.C. § 5321(a)(5)(B))
- Pattern of negligence - $5,000 (31 U.S.C. § 5321(a)(6)(A))
- Willful failure to file or retain required records – greater of $100,000 or 50% of the balance in the account (31 U.S.C. § 5321(a)(5)(C))

Criminal Penalties

- Basic willful violation: Including failure to file FBAR, failure to retain records of account – 5-year felony, $250,000 fine (31 U.S.C. § 5322(a))
- Enhanced violation: Violation as part of pattern of illegal activity involving more than $100,000 in a 12-month period (10-year felony, $500,000 fine (31 U.S.C. § 5322(b))
- *Klein* conspiracy to impede IRS/FinCEN: 5-year felony (18 U.S.C. § 371)
- Filing false FBAR: 18 U.S.C. § 1001 (generic false statement offense)

Mitigation Guidelines – Civil Penalties

- Prerequisites for mitigation:
- No history of tax or BSA convictions or FBAR penalty assessments
- No illegal source funds in the account
- Cooperation during the examination
- No fraud penalty related to funds in foreign account

Mitigation Guidelines: Reduced Penalty - Non-Willful Penalties

- Level 1-NW: Aggregate balance < $50,000, $500 per account to a maximum of $5,000

- Level 2-NW: Aggregate balance < $250,000, $5,000 for each violation not to exceed 10% of the maximum value in the account during the year

- Level 3-NW (no mitigation): $10,000 per account

Mitigation Guidelines: Reduced Penalty - Willful Penalties

- Level 1: Aggregate balance < $50,000. Greater of $1,000 per account or 5% of the maximum aggregate balance
- Level 2: Aggregate balance < $250,000. Greater of $5,000 per account or 10% of the maximum aggregate balance
- Level 3: Aggregate balance < $1 million. Greater of 10% of the maximum balance during the calendar year or 50% of balance on last day for filing FBAR
- Level 4: Statutory maximum

Negligence Penalties

- Probably only imposed on entities – e.g., who failed to properly list large number of accounts and signatories – where there is no real tax issue

- More likely to be imposed in a BSA examination (where agents do not obtain Title 26 information) and not a tax examination

FATCA

- Part of HIRE Act (2010)
- Effective for payments made after Dec. 31, 2012
- Imposes withholding on payments to foreign financial entities that do not make disclosures about U.S. customers

New §6038D – "FBAR Plus"

- Effective for tax years beginning after March 18, 2010

- In addition to financial accounts, includes:
  - Any financial instrument or contract issued by a non-U.S. person
  - Any interest in a foreign entity

New Form 8938

"Statement of Specified Foreign Financial Assets"

- Out now in draft form
- Account portion duplicative of FBAR
- Asks for information on "other foreign assets" (information not required if reported on forms 3520, 3520-A, 5471, 8621 or 8865)
- Maximum value
- Cross-reference to tax return

New Component Of Accuracy Penalty: "Undisclosed Foreign Financial Asset Understatement" (§ 6662(b)(7) And (j))

- 40% penalty
- Applies to portion of understatement attributable to an undisclosed foreign financial asset
- Applies to disclosures required by:
- §6038 (controlled foreign corporations and partnerships)
  - §6038B (transfers of property to foreign persons)
  - §6038D (foreign financial assets)
  - §6046A (interests in foreign partnerships)
  - §6048 (foreign trusts)

Penalty – Failure To Disclose Foreign Financial Accounts - § 6038D(d)

- $10,000
- Additional penalty if notified by IRS and fail to correct - $10,000/month up to $50,000
- Reasonable cause exception IRC § 6038D(g)

Penalties For Failure To Properly Report Offshore Activities

- A penalty for failing to file Form 3520 (Annual Return to Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts). Taxpayers must also report various transactions involving foreign trusts, including creation of a foreign trust by a U.S. person, transfers of property from a U.S. person to a foreign trust, and receipt of distributions from foreign trusts under IRC § 6048. This return also reports receipt of gifts from foreign entities under IRC § 6039F. The penalty for failing to file each one of these information returns, or for filing an incomplete return, is 35% of the gross reportable amount (except for returns reporting gifts) where the penalty is 5% of the gift per month, up to a maximum penalty of 25% of the gift.

Penalties For Failure To Properly Report Offshore Activities (Cont.)

I. A penalty for failing to file Form 3520-A (Information Return of Foreign Trust With a U.S. Owner). Taxpayers must also report ownership interests in foreign trusts, by U.S. persons with various interests in and powers over those trusts under IRC § 6048(b). The penalty for failing to file each one of these information returns, or for filing an incomplete return, is 5% of the gross value of trust assets determined to be owned by the U.S. person.

Penalties For Failure To Properly Report Offshore Activities (Cont.)

- A penalty for failing to file Form 5471 (Information Return of U.S. Persons with Respect to Certain Foreign Corporations). Certain U.S. persons who are officers, directors or shareholders in certain foreign corporations (including international business corporations) are required to report information under IRC §§ 6035, 6038 and 6046. The penalty for failing to file each one of these information returns is $10,000, with an additional $10,000 added for each month the failure continues beginning 90 days after the taxpayer is notified of the delinquency, up to a maximum of $50,000 per return.

Penalties For Failure To Properly Report Offshore Activities (Cont.)

- A penalty for failing to 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). Taxpayers may be required to report transactions between a 25% foreign-owned domestic corporation or a foreign corporation engaged in a trade or business in the U.S., and a related party as required by IRC §§ 6038A and 6038C. The penalty for failing to file each one of these information returns, or to keep certain records regarding reportable transactions, is $10,000, with an additional $10,000 added for each month the failure continues beginning 90 days after the taxpayer is notified of the delinquency.

Penalties For Failure To Properly Report Offshore Activities (Cont.)

- A penalty for failing to file Form 926 (Return by a U.S. Transferor of Property to a Foreign Corporation). Taxpayers are required to report transfers of property to foreign corporations and other information under IRC § 6038B. The penalty for failing to file each one of these information returns is 10% of the value of the property transferred, up to a maximum of $100,000 per return, with no limit if the failure to report the transfer was intentional.

Penalties For Failure To Properly Report Offshore Activities (Cont.)

- A penalty for failing to file Form 8865 (Return of U.S. Persons With Respect to Certain Foreign Partnerships). U.S. persons with certain interests in foreign partnerships use this form to report interests in and transactions of the foreign partnerships; transfers of property to the foreign partnerships; and acquisitions, dispositions and changes in foreign partnership interests under IRC §§ 6038, 6038B, and 6046A. Penalties include $10,000 for failure to file each return, with an additional $10,000 added for each month the failure continues beginning 90 days after the taxpayer is notified of the delinquency, up to a maximum of $50,000 per return; and 10% of the value of any transferred property that is not reported, subject to a $100,000 limit.

Other Potential Penalties In Offshore Cases

- Fraud penalties imposed under IRC §§ 6651(f) or 6663. Where an underpayment of tax, or a failure to file a tax return, is due to fraud, the taxpayer is liable for penalties that, although calculated differently, essentially amount to 75% of the unpaid tax.

- A penalty for failing to file a tax return imposed under IRC § 6651(a)(1). Generally, taxpayers are required to file income tax returns. If a taxpayer fails to do so, a penalty of 5% of the balance due, plus an additional 5% for each month or fraction thereof during which the failure continues, may be imposed. The total penalty shall not exceed 25%.

Other Potential Penalties In Offshore Cases (Cont.)

- A penalty for failing to pay the amount of tax shown on the return under IRC § 6651(a)(2). If a taxpayer fails to pay the amount of tax shown on the return, he or she may be liable for a penalty of 0.5% of the amount of tax shown on the return, plus an additional 0.5% for each additional month or fraction thereof that the amount remains unpaid, not exceeding a total penalty of 25%.

- An accuracy-related penalty on underpayments imposed under IRC § 6662. Depending upon which component of the accuracy-related penalty is applicable, a taxpayer may be liable for a 20% or 40% penalty.

Example Of Penalty Calculation

Assume the taxpayer has the following amounts in a foreign account over the period covered by his voluntary disclosure. **It is assumed for purposes of the example that the $1 million was in the account before 2003 and was not unreported income in** 2003.

Year	Amount on Deposit	Interest Income	Account Balance
2003	$1,000,000	$50,000	$1,050,000
2004		$50,000	$1,100,000
2005		$50,000	$1,150,000
2006		$50,000	$1,200,000
2007		$50,000	$1,250,000
2008		$50,000	$1,300,000
2009		$50,000	$1,350,000
2010		$50,000	$1,400,000

Example Of Penalty Calculation (Cont.)

This example does not provide for compounded interest, and assumes the taxpayer is in the 35% tax bracket, does not have an investment in a passive foreign investment company (PFIC), files a return but does not include the foreign account or the interest income on the return, and the maximum applicable penalties are imposed.

Civil liabilities would (and may) include:

Tax, accuracy-related or delinquency penalties, and accrued interest

FBAR penalties totaling up to $4,375,000 for willful failures to file complete and correct FBARs (2004 - $550,000; 2005 - $575,000; 2006 - $600,000; 2007 - $625,000; 2008 - $650,000; 2009 - $675,000; and 2010 - $700,000)

Potential fraud penalties (75% of the tax)

Potential additional information return penalties, if the foreign account or assets is held through a foreign entity such as a trust or corporation and required information returns were not filed

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STANDARDS FOR IMPOSING PENALTIES, AND POTENTIAL DEFENSES

"Willfulness" Defined

Willfulness is shown by the person's knowledge of the reporting requirements and conscious choice not to comply with the requirements.

The person needs to know he has an FBAR reporting requirement. If a person has that knowledge, then the only intent needed to constitute a willful violation of the requirement is a conscious choice to not file the FBAR or to file a false FBAR.

Internal Revenue Manual Examples Of Willfulness

The following examples of willfulness are set forth in Internal Revenue Manual ("IRM") § 4.26.16.4.5.3(8) (07-01-2008) and are instructive of the government's approach in determining willfulness (at least in the civil penalty context) for criminal cases and normally requiring much stronger proof:

> "A person admits knowledge of, and fails to answer, a question concerning signature authority over foreign bank accounts on Schedule B of his income tax return. When asked, the person does not provide a reasonable explanation for failing to answer the Schedule B question and for failing to file the FBAR. According to the IRS, a determination that the violation was willful likely would be appropriate in this case."

IRM Example (Cont.)

"A person files the FBAR, but omits one of three foreign bank accounts. The person had closed the omitted account at the time of filing the FBAR. The person explains that the omission was due to unintentional oversight. During the examination, the person provides all information requested with respect to the omitted account. The information provided does not disclose anything suspicious about the account, and the person reported all income associated with the account on his tax return. The willful penalty should not apply absent other evidence that may indicate willfulness."

"A person filed the FBAR in earlier years but failed to file the FBAR in subsequent years when required to do so. *When asked, the person does not provide a reasonable explanation* for failing to file the FBAR. In addition, the person *may have failed to report income associated* with foreign bank accounts for the years that FBARs were not filed. [A] determination that the violation was willful likely would be appropriate in this case."

IRM Example (Cont.)

"A person received a **warning letter** informing him of the FBAR filing requirement, but the person continues to fail to file the FBAR in subsequent years. When asked, the person does not provide a reasonable explanation for failing to file the FBAR. In addition, the person may have failed to report income associated with the foreign bank accounts. According to the IRS, a determination that the violation was willful likely would be appropriate in this case."

Williams: A Civil FBAR Case

There are very few court cases addressing willfulness in the context of the FBAR reporting requirements**.** One recent case in which the district court found willfulness lacking is *United States v. Williams*, Civil Action No.: 1:09-cv-437 (E.D. Va. Sept 1, 2010).

In the case, the government sought to enforce its assessments of two FBAR penalties against defendant Williams for willfully failing to report his interest in two Swiss bank accounts for tax year 2000, as required by 31 USC § 5314. The court concluded that the government fell short of meeting its burden (clear and convincing evidence in a civil case) in establishing that Williams willfully failed to disclose offshore assets in violation of that statute.

Williams' Testimony Was Credible

The court, in citing to *U.S. v. Mohney*, 949 F.2d 1397, 1407 (6th Cir. 1991) (a "taxpayer's signature on a return does not in itself prove his knowledge of the contents, but knowledge may be inferred from the signature along with the surrounding circumstances ... ") concluded that "**Williams' testimony that he only focused on the numerical calculations on the Form 1040 and otherwise relied on his accountants to fill out the remainder of the Form was credible**, and should be given more weight than the mere fact that Williams checked 'no' box." The court thus concluded that Williams' **failure to disclose already-frozen assets in a foreign account** was not an act undertaken internationally or in deliberate disregard for the law, but instead constituted an understandable omission given the context in which it occurred.

Browning Case

Browning v. Commissioner, T.C. Memo. 2011-261 (11/3/11)

The taxpayer was the president and CEO of a manufacturing corporation he founded. In 1995, he entered an arrangement with an offshore employee leasing company in Ireland, whereby he would be an employee of the Irish company, which would lease his services to a U.S. employee-leasing company, which would sublease his services to his manufacturing corporation. His role in his manufacturing corporation didn't change. The manufacturing company paid a salary, benefits and the applicable payroll taxes to the petitioner, and paid a fee to the Irish company, which the Irish company used to fund an unqualified deferred compensation account in Texas, held in the name of a subsidiary of the Irish corporation and for the benefit of the taxpayer.

Browning Case (Cont.)

In 1998, the taxpayer was issued a credit card by a Bahamas bank (Leadenhall Bank), and a checking account was opened at Leadenhall Bank to pay the credit card charges. The checking account was funded by the deferred compensation account in Texas and was also held in the name of the Irish company. The taxpayer then used this credit card to access the funds in the deferred compensation account, a substantial portion of which were used for personal expenses. The court held that there was an understatement of income, because the taxpayer was in constructive receipt of the funds placed in the deferred compensation account (finding that he had unrestricted control over the amount deposited into the account and unrestricted access to the funds in the account through the credit card).

Browning Case (Cont.)

The Tax Court found fraud because of the following indicia: (1) concealment of assets, (2) intent to mislead, (3) lack of credibility of the petitioner's and his tax advisor's testimony, and (4) intentional understatement of income. The court found that he concealed the existence of the Leadenhall account by answering "No" to question 7a on Schedule B of the 1040 and by failing to provide the revenue agent with information about the foreign credit card in response to an IDR requesting a list of all foreign and domestic credit cards. The court did not find the taxpayer credible when he testified that he thought "No" was proper for question 7a because he was not a signatory on the account and he did not intend to hide that account. The taxpayer's incomplete answer to the revenue agent in response to her question regarding his foreign and domestic credit cards was also clear and convincing evidence of an intent to mislead the revenue agent.

Browning Case (Cont.)

In the FBAR context, this decision further supports that marking "No" on Schedule B is an indicia of fraud. In this case, the taxpayer had testified that he believed "No" was proper, but the Tax Court did not find his testimony credible. The other factor the court relied on relating to concealment of the foreign accounts was the failure to reveal the foreign credit card in response to an IDR and a direct question from the revenue agent. The case does not mention anything about the FBAR penalty or the requirement to file an FBAR.

Relevant Cases Dealing With Reasonable Cause: Defense To Negligence Penalties

The leading case relating to the taxpayer's reliance on a professional as grounds for reasonable cause is the U.S. Supreme Court's decision in *United States v. Boyle*, 469 U.S. 241, 105 S.Ct. 687 (1984), where the court specifically stated:

> When an accountant or attorney advises a taxpayer on a matter of tax law, such as whether a liability exists, it is reasonable for the taxpayer to rely on that advice. Most taxpayers are not competent to discern error in the substantive advice of an accountant or attorney. To require the taxpayer to challenge the attorney, to seek a "second opinion" or to try to monitor counsel on the provisions of the Code himself would nullify the very purpose of seeking the advice of a presumed expert in the first place. "Ordinary business care and prudence" do not demand such actions. Id. at 251 [Citations omitted.]

Relevant Cases Dealing With Reasonable Cause: Defense To Negligence Penalties (Cont.)

The courts, in three cases dealing with an issue very similar to the one here, held that a professional's *failure to advise* a taxpayer to file a gift tax return established reasonable cause. *See Estate of Sylvia Buring v. Commissioner*, T.C. Memo 1985-610; *Estate of Rosenblatt v. Commissioner*, T.C. Memo 1977-12; *Lasater v. United States*, 81-2 U.S.T.C. Para. 13,346 (N.D. Ill. 1981)

In the *Estate of Buring*, the U.S. Tax Court had the opportunity to interpret the Supreme Court's then-recent decision in *Boyle*. As noted by the Court in *Buring*:

Relevant Cases Dealing With Reasonable Cause: Defense To Negligence Penalties (Cont.)

"Reasonable cause that would excuse the failure to file a return is defined as the exercise of "ordinary business care and prudence." § 301.6651-1(c)(1), Proced. & Admin. Regs.

Recently, the U.S. Supreme Court sought to clarify the meaning of "reasonable cause" in *United States v. Boyle, supra*. In *Boyle*, the court addressed a situation in which the executor of an estate challenged the addition to tax for failure to file a return under IRC § 6651(a)(1). The executor relied upon counsel to timely file a tax return for the estate. The Seventh Circuit affirmed the judgment of the District Court holding that the executor had demonstrated reasonable cause by his reliance on the advise of counsel. *Boyle v. United States*, 710 F.2d 1251 (7th Cir. 1983). The Supreme Court reversed, holding that reliance on an agent does not excuse the failure to make a timely filing of a tax return. *United States v. Boyle*, 105 S.Ct. at 693-694.

Relevant Cases Dealing With Reasonable Cause: Defense To Negligence Penalties (Cont.)

"In attempting to develop a "bright-line" rule to deal with cases where a taxpayer did not meet a filing deadline, the Supreme Court stated: "Congress has placed the burden of prompt filing on the [taxpayer], not on some agent or employee … That the [agent] was expected to attend to the matter does not relieve the principal of his duty to comply with the statute." 105 S.Ct. at 692-693

"The Supreme Court, in *Boyle*, went to great pains, however, to distinguish the result that would follow where a taxpayer *relied on his tax advisor to determine whether a return should be filed at all*. 105 S.Ct. at 593. We are confronted with just such a case: Sylvia consulted with her accountant of long standing, who, after being fully apprised of the situation, did not advise her to file gift tax returns with respect to the advances made to Jerry."[1]

1/ The Court's footnote 3 states: "Sylvia consulted her accountant for advice. He rendered such advise to her. She filed no returns. However, her accountant, who testified, did not affirmatively state that he advised her not to file returns. We, therefore, infer from the facts that he did not advise her to file returns."

Relevant Cases Dealing With Reasonable Cause: Defense To Negligence Penalties (Cont.)

We find Sylvia's reliance upon the advice of her accountant that it was unnecessary to file a return constitutes reasonable cause for the failure to file a return, even if such advise was wrong. 105 S.Ct. at 693.

- In reaching this conclusion, the Tax Court in *Estate of Buring* followed the teachings of the Supreme Court in *Boyle*, noting that in complex areas of the law, such as whether a gift tax return was actually due, taxpayers are not competent to discern an error in any advice given by an accountant or an attorney and are not required to challenge the attorney or seek a second opinion, which would nullify the very purpose of seeing the advice of an expert in the first place. As noted by the Supreme Court, ordinary business care and prudence does not demand such actions. *Boyle, supra*.

Relevant Cases Dealing With Reasonable Cause: Defense To Negligence Penalties (Cont.)

Other courts have reached a similar conclusion to the Tax Court in *Estate of Buring*. For example, in *Lasater v. United States*, 81-2 U.S.T.C. Para. 13,326 (N.D. Ill. 1981), none of the experts consulted by the taxpayer ever mentioned the gift tax return filing requirement. The court stated that the whole purpose of consulting a tax expert was to be made aware of all tax ramifications of the transaction, and to require a layman to inquire of the tax expert *whether a particular return was due* would defeat the very purpose of consulting an expert.

Similarly, in *Estate of Rosenblatt v. Commissioner*, T.C. Memo 1977-12, the Tax Court dealt with the issue whether a gift tax return was due with respect to a fairly sophisticated legal transaction. The court noted that as a layperson, Mrs. Rosenblatt could not reasonably be expected to realize that the transaction might give rise to a gift tax. The court noted that while Mrs. Rosenblatt was unfamiliar with the tax law, she did exercise ordinary prudence by engaging an attorney who was experienced in taxation and one in whom she felt she could place her trust.

Relevant Cases Dealing With Reasonable Cause: Defense To Negligence Penalties (Cont.)

Importantly, the court discussed whether there was a distinction between affirmatively advising the taxpayer about not filing or simply not appropriately advising the taxpayer to file. As noted by the Court in *Rosenblatt*:

> In the instant case, there is little doubt that Mrs. Rosenblatt placed a great deal of reliance on her attorney to settle the details of her husband's estate. In conjunction with the settlement, her attorney advised her to renounce her one-half interest in the properties that she received as surviving joint tenant. Mrs. Rosenblatt carefully considered the practical effects of the renunciation, but was unaware of any gift tax implications.

Relevant Cases Dealing With Reasonable Cause: Defense To Negligence Penalties (Cont.)

> The renunciation, which was presumably suggested as a means of saving estate taxes, is a fairly sophisticated legal transaction. As a layperson, Mrs. Rosenblatt could not reasonably be expect to realize that it might give rise to a gift tax. While Mrs. Rosenblatt was unfamiliar with the tax law, she did exercise ordinary prudence by engaging an attorney who was experienced in taxation and one who she felt she could place her trust. Under these circumstances, we believe that Mrs. Rosenblatt had 'reasonable cause' not to file the gift tax return and that the penalty under section 6651(a)(1) is inappropriate.

In *Rosenblatt*, the IRS conceded that "if the donor had received actual advice from the tax attorney that this was a gift and that a gift tax return was accordingly not due, she would have had reasonable cause"; but, since "she did not rely on any *affirmative advice* from her attorney telling her that she need not file the gift tax return" [emphasis added], there was not reasonable cause. The Tax Court squarely rejected that argument and held that:

Relevant Cases Dealing With Reasonable Cause: Defense To Negligence Penalties (Cont.)

Reasonable cause must be determined with a focus on the taxpayer. At least in the instant case, *whether the advisor's act was one of commission or omission had little effect on the issue of reasonable cause.* Mrs. Rosenblatt was unfamiliar with the tax law. She relied on the advice of her attorney regarding the disposition of her husband's estate, and depended upon him to prepare whatever papers were necessary in this connection. [Footnote omitted.] Given the sophisticated nature of the renunciation, Mrs. Rosenblatt could not, without further knowledge, be expected to know that a gift tax return was due. She needed and had the right to expect the advice of her attorney on this matter, and reasonable cause for failure to file was no less present than if she had been told directly by her attorney that no return was due.

The Doctrine Of Excessiveness And Its Applicability To Offshore Reporting Penalties

- The Eighth Amendment expressly prohibits "excessive" fines. U.S. Const., Amdt. 8 ("excessive bail shall not be required, nor excessive fines imposed, nor cruel and unusual punishments inflicted.")
- A monetary assessment imposed as punishment, such as the FBAR penalty, is a "fine" within the meaning of the Excessive Fines Clause. *See, e.g., United States v. Bajakajian*, 524 U.S. 321, 327-34 (1998)
- The Excessive Fines Clause "limits government's power to extract payments, whether in cash or in kind, 'as punishment for some offense.'" *Austin v. United States*, 509 U.S. 602, 609-610 (1993)
- "The touchstone of the constitutional inquiry under the Excessive Fines Clause is the principle of proportionality: The amount of the [fine] must bear some relationship to the gravity of the offense that it is designed to punish." *Bajakajian*, 524 U.S. at 334. A fine is excessive if it is grossly disproportional to the gravity of the offense. *Id.*

The Doctrine Of Excessiveness And Its Applicability To Offshore Reporting Penalties (Cont.)

Proportionality is "guided by objective criteria, including (i) the gravity of the offense and the harshness of the penalty; (ii) the sentences imposed on other criminals in the same jurisdiction; and (iii) the sentences imposed for commission of the same crime in other jurisdictions." *See Solem v. Helm*, 463 U.S. 277, 292 (1983).

Two taxpayers committing the same exact offense under 31 U.S.C. § 5314 could be subject to widely varying fines. A person who willfully failed to report a bank account with a maximum balance of $10 million would be subject to an FBAR penalty of $5 million, whereas someone who commits the same offense with respect to an account with a maximum balance of $1 million would be penalized $500,000. This should be raised when challenging significant civil FBAR penalties.

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ANTICIPATED IRS DIRECTION, TIMELINE GOING FORWARD

IRS Direction

- IRS pressure on Swiss banks continues.

- Process has begun for turnover of Credit Suisse undisclosed U.S. client information has begun.
  - See sample letter from Credit Suisse in reference materials for this program

- What about banks in other jurisdictions?

IRS Direction (Cont.)

- Ongoing civil investigations of taxpayers that/who did not participate in OVDI

- Taxpayers opting out of OVDI because "one size fits all" approach didn't really fit.

IRS Direction (Cont.)

- Ongoing criminal investigations and prosecutions
  - Some statistics and sentences
- Continued availability of voluntary disclosure
  - Criminal implications
  - Civil implications

Caroline Ciraolo, Rosenberg | Martin | Greenberg , LLP

PREPARING FOR AN AUDIT WITH PENALTIES IN MIND

Audit Issues: Burden Of Proof

To establish a willful violation for purposes of the civil FBAR penalty under 31 U.S.C. §5321, the government must establish "a voluntary intentional violation of a known legal duty." The government must prove that the taxpayer was aware of the requirement to file the FBAR and intentionally failed to do so (or filed a false FBAR). Short of a concession or a confession, the government will rely on circumstantial evidence and infer willfulness based on a course of conduct.

I. *Ratzlaf v. United States*, 510 U.S. 135, 141 (1994)

II. *U.S. v. J. Bryan Williams, 2010-WL-3473311* (E.D. Va. Sept. 1, 2010)

III. *U.S. v. Dollar Bank Money Market Account*, 980 F.2d 233, 238 n. 2 (3d Cir. 1992)

IV. *United States v. Sturman*, 951 F.2d 1466, 1476 (6th Cir. 1991)

V. *United States v. Bank of New England, N.A.*, 821 F.2d 844, 855 (1st Cir. 1987)

VI. *Williams v. Commissioner,* T.C. Memo. 2011-89

VII. *Lerch v. Commissioner,* T.C. Memo. 1987-295

VIII. I.R.M. § 4.26.16.4.5.3 (07-01-2008) (examples of willfulness)

IX. IRS CCA 200603026, 2006 WL 148700 (January 20, 2006)

Audit Issues: Proving Willfulness

In considering whether to impose the civil penalty for willful violations, the Service will use the same criteria established for the civil fraud penalty under 26 U.S.C. § 6663, and bear the same burden of proving willfulness by clear and convincing evidence. To assist in their review, FBAR examiners will request a wide range of documents, from the tax returns to correspondence with investment managers and brokers.

Unlike with assessments of tax or civil tax penalties, there is no presumption of correctness in connection with the imposition of FBAR penalties. Similarly, 26 U.S.C. § 7491(c), which imposes on the Service the burden of production with respect to all penalties and additions to tax asserted under Title 26, does not apply to the FBAR penalty.

I. IRS CCA 200603026, 2006 WL 148700 (January 20, 2006)

II. I.R.M. § 4.26.16.4.5.4 (07-01-2008) (documents establishing willfulness)

III. 18 U.S.C. §3282

International Information Returns: Reasonable Cause Defenses

***Form 5471*:** Penalties for failure to timely file a complete and accurate Form 5471 may be avoided or abated for reasonable cause. The requirements for establishing reasonable cause are set forth in Treas. Reg. §1.6038-2(k)(3)(ii):

> To show that reasonable cause existed for failure to furnish information as required by section 6038 and this section, the person required to report such information must make an affirmative showing of all facts alleged as reasonable cause for such failure in a written statement containing a declaration that it is made under the penalties of perjury. The statement must be filed with the district director for the district or the director of the service center where the return is required to be filed. The district director or the director of the service center shall determine whether the failure to furnish information was due to reasonable cause, and if so, the period of time for which such reasonable cause existed. In the case of a return that has been filed as required by this section except for an omission of, or error with respect to, some of the information required, if the person who filed the return establishes to the satisfaction of the district director or the director of the service center that the person has substantially complied with this section, then the omission or error shall not constitute a failure under this section.

International Information Returns: Reasonable Cause Defenses (Cont.)

See also IRC § 6679(a) (imposing penalties for failure to provide information required by IRC § 6046 "unless it is shown that such failure is due to reasonable cause")

An examiner should consider reasonable cause prior to assessing any information return penalty. I.R.M. § 20.1.9.1.1(4) (04-22-2011) (citing I.R.M. § 20.1.1)."Examiners must consider any reason a taxpayer provides in conjunction with the guidelines, principles and evaluating factors relating to reasonable cause based on the facts and circumstances." I.R.M. § 20.1.9.2(15) (04-22-2011). A taxpayer must be in full compliance before reasonable cause will be considered. *Id.;* IRS CCA 200645023, 2006 WL 3251973 (Nov. 10, 2006) (request for reasonable cause relief denied based on large number of incomplete forms 5471 filed and despite history of compliance and belief that forms 5471 were not required).

IRS campus employees are authorized to abate information return penalties assessed by the campus. Other abatements must be approved by the organizational unit that asserted the penalty (LMSB or SBSE Examination). I.R.M. § 20.1.9.1(9) (04-22-2011).

International Information Returns: Reasonable Cause Defenses (Cont.)

With respect to Form 5471 penalties, the Service has taken the position that, "[a]ny person required to file Form 5471 and Schedule J, M, or O who agrees to have another person file the form and schedules for him or her may be subject to the above penalties if the other person does not file a correct and proper form and schedule." Instructions to Form 5471.

In late 2008, the Service issued recommendations for seeking reasonable cause relief with respect to amended Forms 5471. For amended forms 5471 filed with forms 1120 after Dec. 31, 2008, the Service recommends that taxpayers wait to submit any request for reasonable cause relief until the Service notifies the taxpayer that penalties will be proposed. For amended forms 5471 filed with other income tax returns, the Service suggests that taxpayers attach a statement titled "Reasonable Cause 5471" to the return.

http://www.irs.gov/businesses/corporations/article/0,,id=188039,00.html

International Information Returns: Forms 3520 And 3520A – Reasonable Cause

I. The total penalty cannot exceed the amount of money transferred. The penalties will not apply if the failure to file is due to reasonable cause and not willful neglect. IRC §§ 6039F(c)(2) and 6677(d).

II. The fact that a foreign country would impose penalties for disclosing the required information, or reluctance of a foreign fiduciary to provide such information, does not constitute reasonable cause. IRC § 6677(d).

Audit Issues: Statute Of Limitations

The Service has six years after "the transaction with respect to which the penalty is assessed" to assess a civil penalty related to an FBAR violation. 31 U.S.C. § 5321(b)(1)

I. Failure to file FBAR report (either willful or negligent): Six years from the due date of the FBAR report (due date is 06/30/yyyy)

II. Failure to maintain required records (either willful or negligent): Six years from the date the IRS first asks for the records

I.R.M. § 8.11.6.3.1 (11-01-2011). The FBAR assessment date is the date the IRS stamps the Form 13448. 31 U.S.C. § 5321(b)(2); IRM § 4.26.17.5.5.1(4) (01-01-2007).

While the civil statutes on assessment and collection of the FBAR penalty can be waived, a waiver of limitations for purposes of a Title 26 audit will not extend the limitations with respect to the FBAR penalties. IRM § 4.26.17.3.1(2) (05-05-2008).

Failure to file a complete and accurate international information return will extend the period of limitations on assessment and collection of any tax imposed with respect to any event or period to which the international information return applies to three years after the date on which the required information is reported. IRC § 6501(c)(8).

Audit Issues: The Process

In FBAR examinations, the Service instructs an examiner to set up a separate FBAR file if an FBAR violation has occurred, regardless of whether the examiner intends to assert penalty. IRM § 4.26.17.1(2) (05-05-2008). Step one is to determine if an FBAR should have been filed, whether it was in fact filed, and what records have been retained.

If a revenue agent conducting a Title 26 audit seeks information regarding potential FBAR violations, the agent must obtain a "relevant statute memorandum" (Form 13535) ("RSM") signed by a territory manager before information from the tax audit can be obtained and used in the FBAR investigation. IRM § 4.26.17.2 (01-01-2007). An RSM is required because the audit involves information subject to the disclosure rules of IRC § 6103.

In a pure Bank Secrecy Act/Title 31 investigation, no RSM is required, but the examiner is also prevented from accessing IRC § 6103 protected information using the IRS databases.

The RSM is the "initial input document for the monitoring of FBAR cases." IRM § 4.26.17.2.1 (01-01-2007). It is a "good faith determination" by the revenue agent, group manager and territory manager that "the apparent FBAR violation was in furtherance of an apparent Title 26 violation."

Audit Issues: The Process (Cont.)

If the territory manager determines that the FBAR violations are *not* in furtherance of a Title 26 violation, this determination terminates the examiner's FBAR responsibilities. IRM § 4.26.17.2.2(1) (05-05-2008). The RSM is placed in the audit file, and the FBAR examination will not be pursued. If the territory manager believes that the FBAR violation *was* in furtherance of a Title 26 violation, then the FBAR investigation will proceed.

> ***Note:*** In the October 2008 guidance to LMSB, the Service noted the need to "heighten awareness among LMSB personnel" of the FBAR reporting requirements. *LMSB-4-0908-047* (Oct. 30, 2008). While FBAR filings increased from 205,000 in 2003 to more than 322,000 in 2007, the IRS believed that "as many as one million U.S. taxpayers are required to file the FBAR in any given year."
>
> LMSB examiners were advised to determine the existence of foreign bank accounts and whether an FBAR was required, whether the records were being maintained, whether the income was being reported and whether any FBAR violations were in furtherance of Title 26 offenses.

Audit Issues: IRS Resources

I. Examiners have various resources within the IRS when in need of assistance with an FBAR investigation, including Technical Services FBAR specialists, SB/SE Counsel Area FBAR Coordinators (and other SB/SE attorneys), and Bank Secrecy Act FBAR Analysts.

II. If the case also involves a tax related offense, a Title 26 summons may be used. IRM § 4.26.17.3.1(2) (05-05-2008).

III. If an examiner is seeking information that is limited to Bank Secrecy Act violations, he may not issue a Title 26 summons; he is limited to a Bank Secrecy Act summons (TD F 90.22-31).

IV. Under either option, if a taxpayer refuses to comply, the examiner will consult with counsel with regard to summons enforcement action under IRC §7604. IRM § 4.26.17.5.3.2 (01-01-2007).

International Information Returns: Summons Enforcement

The Service may issue a summons to enforce a request for certain records pursuant to IRC §§ 7602-7604. IRC § 6038A(e)(2).

A taxpayer served with a summons may move to quash within 90 days after the summons is issued. IRC § 6038A(e)(4)(A).

If the Service determines that a taxpayer has not substantially complied with a summons, the taxpayer has 90 days to appeal, or the determination becomes final and is not subject to judicial review. IRC § 6038A(e)(4)(B).

Any motion to quash or appeal of an adverse determination suspends the limitations period for assessment and collection of the tax, and for criminal prosecution, during the pending action. IRC § 6038A(e)(4)(D).

A penalty will be asserted for failure to comply with the summons provisions of IRC § 6038A. *See* IRC § 6038A(e)(3). If such a penalty is asserted, then there is no reasonable cause relief. IRM § 20.1.9.9.5 (04-22-2011).

Audit Issues:
Decision To Propose FBAR Penalty

If the examiner decides that a FBAR penalty is appropriate and either has opted not to refer the case to Criminal Investigation or a referral was declined, the examiner determines the penalty based on the FBAR penalty guidelines and submits the case file to SB/SE Counsel Area FBAR Coordinator for review. IRM § 4.26.17.4.3 (05-05-2008). (Counsel review is not required if a taxpayer enters a special program, such as the OVDI).

If examiner finds both failure to file the FBAR and failure to maintain required records, the IRM provides that an examiner can assert both penalties on the same account for the same period. IRM § 8.11.6.3.1 (11-01-2011). However, IRM § 4.26.16.4.7 allows examiners discretion over whether to assert multiple violations against one FBAR report.

If counsel finds that a penalty should not be asserted, the memorandum should state the basis for disagreement and whether further investigation is recommended.

If counsel agrees with the examiner, he or she will prepare a memorandum recommending the issuance of a Letter 3709 (the FBAR 30-day letter) and stating the basis for that decision to assist in the event the taxpayer appeals.

Audit Issues:
Practice Tip - FOIA

A **Freedom of Information Act** request can be helpful in an FBAR examination, but it is important to know what should be there. In a Bank Secrecy Act investigation, the examiner is instructed to use the Title 31 FBAR lead sheet to commence the investigation. If the examiner finds an FBAR violation, he or she must establish a separate file (distinct from the Bank Secrecy Act file) since the FBAR penalties are imposed by the IRS, while non-FBAR related Bank Secrecy Act penalties are assessed by FinCEN. IRM § 4.26.17.2.3(4) (05-05-2008)

An FBAR examination case file may include the following documents (IRM § 4.26.17.3(1) (05-05-2008)):

a. Agent activity record – FBAR Activity Code 545
b. Related statute memorandum (Form 13535), if appropriate
c. FBAR lead sheet and work papers
d. Brief summary memorandum explaining any FBAR violation(s)
e. Copy of any delinquent FBAR(s) annotated in red on the top "Secured by Examination"

Audit Issues:
Practice Tip - FOIA

When the FBAR examination is closed, the following documents should be added to the file (where applicable) IRM § 4.26.17.3(2-4) (05-05-2008) and IRM § 8.11.6.2 (11-01-2011):

I. FBAR Monitoring Document, providing closing information for the FBAR database
II. Letter 3800 (Warning Letter for Apparent FBAR Violations)
III. Letter 3709, FBAR 30-day letter (Transmitting Agreement for Assessment and Collection, F-13449)
IV. Form 13449 [Agreement to Assessment and Collection of Penalties Under 31 U.S.C. §§ 5321(a)(5) and 5321(a)(6)]
V. Notice 1330 (Information on Making FBAR Penalty Payment By Check)
VI. Power of attorney (Form 2848) or general power of attorney
VII. Form 13448 (Penalty Assessments Certification Summary)
VIII. Letter 3708 (Notice and Demand for Payment of FBAR Penalty)
IX. Notice 1330 (Information on Making FBAR Penalty Payment By Check)

Audit Issues:
When The FBAR Penalty Is Assessed

I. With the approval of counsel, the examiner issues a Letter 3709 and Form 13449 (FBAR Agreement to Assessment and Collection), which also serves as the examiner's report and the basis for the assessment. IRM § 4.26.17.4.3(6) (05-05-2008).

II. If the taxpayer agrees to the penalty, he or she may file the delinquent FBARs and send in full payment of the penalty within 30 days of the date on the Letter 3709 without incurring interest. 31 U.S.C. § 3717(b).

III. If the taxpayer fails to pay within 30 days of the date of the notice, interest will accrue from the date of assessment, and a 6% delinquency penalty will be assessed based on the amount of penalty that remains unpaid 90 days after the notice date. IRM § 4.26.17.4.3(6) (05-05-2008).

IV. If the taxpayer is unable to pay the penalty in full, a Letter 3708 (Notice and Demand for Payment of FBAR Penalty) will be issued reflecting the interest accrued.

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PREPARING FOR AN ADMINISTRATIVE APPEAL OR LITIGATION

Administrative Appeals: FBAR Penalties

I. If the taxpayer does not agree with the penalty, the taxpayer has 30 days from the date of the Letter 3709 to file an appeal. IRM § 4.26.17.4.6(2) (01-01-2007). FBAR penalties come to Appeals as stand-alone cases or together with a related income tax or international penalty. IRM § 8.11.6.1(4) (11-01-2011).

II. Appeals requires 180 days remaining on the assessment statute of limitations at the time the administrative file is received. IRM § 8.11.6.2 (11-01-2011). Extensions of limitations must be obtained from each individual under examination.

III. The written protest is filed with the examiner and must be postmarked by the deadline set forth in the Letter 3709. IRM § 4.26.17.4.6(2) (01-01-2007). The examiner forwards the file to his or her group manager, who then sends the file to Appeals. IRM § 4.26.17.4.7 (01-01-2007).

IV. The appeals officer assigned to the case will contact the Appeals FBAR coordinator prior to scheduling the initial appeals conference with the taxpayer, and will follow the *IRS Foreign Bank and Financial Account Requirements Guidance for Appeal Officers*. *Id*.

Administrative Appeals: FBAR Penalties (Cont.)

I. If the case involves both FBAR reporting violations and Title 26 offenses, the examiner may choose to hold the FBAR case until the tax issues are resolved. IRM § 4.26.17.4.7(6) (01-01-2007). The IRM cautions the examiner to monitor the period of limitations.

II. The administrative files are sent to the Appeals Office by Compliance Tech Services (for pre-assessed FBAR penalties) and by the FBAR Penalty Coordinator at the Enterprise Computing Center (for post-assessment appeals). Examiners are advised to email SBSE BSA Compliance – FBAR Penalty Coordinator for information on the penalty assessment. IRM § 8.11.6.2 (11-01-2011).

III. Appeals will conduct post-assessment hearings as provided in 31 C.F.R. § 5.4. The IRM provides that post-assessment FBAR penalty cases are priority cases that must be completed and approved within 60 days of the appeals officer-assigned date (ASGNDATE). IRM § 8.11.6.1(6) (11-01-2011).

Administrative Appeals: FBAR Penalties (Cont.)

FBAR penalties are considered an Appeals-coordinated Issue (category of case) and require a referral to International prior to holding the first conference. IRM § 8.11.6.1(5) (11-01-2011). The Service defines an Appeals-coordinated issue (ACI) or an Appeals-coordinated issue, category of case (ACIcc) as:

> An issue or category of case, is an issue of Service-wide impact or importance that requires Appeals' coordination to ensure uniformity and consistency nationwide. This is achieved through the coordination of efforts between Appeals officers (AOs) and designated Appeals technical guidance coordinators (TGCs). The ACI program encompasses legal issues and factual issues and category of case.

When an Appeals officer is assigned a case involving an ACI, as opposed to an ACIcc, he or she is required to consult with the TGC prior to scheduling the initial conference to obtain current information. Since the FBAR penalty appeals are considered an ACIcc, *not* an ACI, the TGC need not review and concur with any settlement proposals before the Appeals officer discusses the proposal with the taxpayer.

* IRS technical guidance programs, www.irs.gov/individuals/article/0,,id=128327,00.html

Administrative Appeals: FBAR Penalties (Cont.)

The IRM provides for three types of FBAR penalty cases (IRM § 8.11.6.8(1) (11-01-2011)):

1. Premature referral (sent back to referring office)
2. Pre-assessment
3. Post-assessment

These cases can be closed as follows:

Pre-assessment:

Agreed with signed waiver (Form 13449 Agreement to Assessment and Collection of Penalties under 31 U.S.C. §§ 5321(a)(5) and 5321(a)(6)

No change – Form 13449 not required

Unagreed where FBAR penalty is partially or fully sustained – Form 13449 not signed

Post-assessment:

Not sustained

Partially sustained

Not sustained

Administrative Appeals: FBAR Closed Office File

When Appeals closes a case, the Appeals officer must prepare an office file, which should contain the following documents (IRM § 8.11.6.9 (11-01-2011)):

I. Form 5402 (Appeals Transmittal and Case Memo) and ACM
II. Form 13449 (Agreement to Assessment and Collection of Penalties under 31 U.S.C. § 5321(a)(5) and § 5321(a)(6), and itemized attachments)
III. Copy of any checks received in Appeals
IV. Closing letter that has been dated
V. Case activity record codes
VI. Copy of any FBAR(s) received by Appeals
VII. FBAR penalty computation spreadsheet/worksheet
VIII. Form 13448, ECC (enterprising computing center) penalty assessment, if applicable
IX. ACDS (appeals centralized database system) case summary card
X. Additional items identified as necessary

International Information Returns: Post-Assessment Review And Reconsideration

I. Persons against whom information return penalties have been imposed may seek reconsideration of the penalty determination. IRM § 20.1.9.2.3 (04-22-2011).

II. The examiner is advised to determine whether all relevant facts were considered and, in appropriate cases involving hardship or specific requests for referral to the Taxpayer Advocate Service, to refer to the TAS Guidelines for Referral or TAS Criteria. TAS Guidelines for Referral, IRM § 21.1.3.18 (10-01-2011); TAS Criteria, IRM §13.1.7.2 (07-23-2007).

Judicial Review: No USTC Review Of FBAR Penalties

Williams v. Commissioner, 131 T.C. 54 (2008): The U.S. Tax Court held that it does not have jurisdiction to review the Service's decision to impose an FBAR penalty. The court noted that the FBAR penalties arise under Title 31 and are not subject to the deficiency procedures under IRC §§6212-6214.

The court acknowledged that if a taxpayer receives a final notice of intent to levy under IRC §6331, or notice of federal tax lien under IRC § 6321 with respect to an assessable penalty not otherwise subject to deficiency procedures under IRC § 6212; and files a timely collection due process appeal under IRC §§ 6330 or 6320, a resulting notice of determination issued by the IRS Appeals Office would be subject to the court's review.

However, unlike other assessable penalties, the FBAR penalty does not fall within the scope of the collection procedures under Title 26, and therefore there is no opportunity to file a collection due process appeal or seek the Tax Court's review.

International Information Returns: Judicial Review (*Wheaton*)

A penalty imposed for failure to file a Form 5471 is an "assessable penalty" that is not subject to the deficiency procedures under IRC §§ 6211-6214. To obtain judicial review, a person must pay the amount due and file suit for refund. 28 U.S.C. § 1346(a); *see also Wheaton,* 888 F. Supp. at 627 (*citing Flora v. United States,* 362 U.S. 145 (1960))

In *Wheaton v. United States,* 888 F. Supp. 622 (D.N.J. 1995), the court acknowledged the heavy burden this imposes on taxpayers, but was without authority to rule otherwise under the Anti-Injunction Act. *Id. (citing Iannelli v. Long,* 487 F.2d 317, 318 (3d Cir. 1973) (Anti-Injunction Act "reflects an evident purpose to protect the public revenue from court imposed delays in the collection of taxes, leaving aggrieved taxpayers to sue for refunds of any amounts improperly collected.")).

The Service issued several notices advising Wheaton of his obligation to file forms 5471 based on his ownership of foreign corporations. The Service also issued notices of deficiency proposing income tax adjustments, but omitting any reference to Form 5471 penalties. Wheaton filed timely petitions with the U.S. Tax Court. When he failed to file the required forms 5471, the Service assessed the applicable penalties and subsequently denied Wheaton's request for reasonable cause relief.

International Information Returns: Judicial Review (*Wheaton*), Cont.)

In response to Wheaton's administrative appeal, the Appeals officer abated certain penalties related to corporations for which Wheaton filed late forms 5471, reserved ruling on penalties related to the corporations at issue in the U.S. Tax Court proceedings, and refused to consider abatement of the remaining penalties.

The Service eventually filed a notice of federal tax lien in the amount of $2,599,432.39 representing the penalties imposed under IRC §6038, and issued a notice of levy in an effort to collect the amounts due. *Wheaton* arose prior to the enactment of the collection appeal procedures in IRC §§ 6320 and 6330 (i.e., collection due process appeals). Pub.L. 105-206, Title III, §§ 3401 (a) and (b) (July 22, 1998), 112 Stat. 746 and 747

Wheaton filed a complaint in district court seeking a preliminary injunction compelling the government to release the tax liens, to prevent any further collection proceedings, and to require the government to adjudicate the penalties in the U.S. Tax Court. The government moved to dismiss, arguing that Wheaton's claims were barred by the Tax Anti-Injunction Act, 26 U.S.C. § 7421, which provides in relevant part, "Except as provided in §§ 6212(a) and (c), 6213(a), ... no suit for the purpose of restraining the assessment or collection of any tax shall be maintained in any court by any person, whether or not such person is the person against whom such tax was assessed."

International Information Returns: Judicial Review (*Wheaton*), Cont.)

The court rejected Wheaton's argument that penalties asserted under IRC § 6038(b) are subject to the deficiency proceedings under IRC §§ 6212 and 6213, finding that the penalties, which arise under Subtitle F, Chap. 61 of the Code, did not fall within the definition of "deficiency," which is limited by IRC § 6211 to "income, estate, and gift taxes imposed by subtitles A and B and excise taxes imposed by chapters 41, 42, 43, and 44." *Wheaton,* 888 F. Supp. at 625

The court also rejected Wheaton's attempt to bootstrap the Form 5471 penalties to the statutory exception provided in IRC § 6665(b) for additions to tax [i.e., late filing penalties under IRC § 6651(a)], where the additions are "attributable to a deficiency." IRC § 6665(b)(1).

Finally, while the court recognized that a reduction in foreign tax credits under IRC § 6038(c) is subject to the deficiency procedures, since the credit arises under IRC § 901, Subtitle A, Chap. 1 (falling within IRC §§ 6211-13), it maintained that penalties for failure to file a Form 5471 under § 6038(b) clearly fall outside any exception to the Anti-Injunction Act. 888 F. Supp. at 626.

International Information Returns: Judicial Review (*Heydemann*)

In *Heydemann v. United States,* 2008 WL 2502188 (D. Md. April 23, 2008), the District Court considered whether the bankruptcy court erred in refusing to abate penalties imposed for failure to file forms 5471 under IRC §6038. Heydemann argued that "the bankruptcy court erred because: (1) her cooperation with the Service obviated the need for her to file Form 5471, (2) she was entitled to prior notice of the penalties, and (3) the bankruptcy court had the discretion to waive the penalties." *Heydemann,* 2008 WL 2502188, at *1

The District Court reviewed the penalty scheme under IRC § 6038 and found that while Heydemann provided the Service with the required information during the Service's investigation of her husband, she did not file the Form 5471 and therefore was subject to the penalties. The court further held that the Service is not required to provide notice prior to assessing penalties under IRC § 6038. *Id.* at *2 (*citing Wheaton,* 888 F. Supp. at 625-26). Finally, the court held that it lacked authority under 11 U.S.C. § 505(a)(1) to waive the penalties. *Id.* at *3

Judicial Review: Collection Due Process Appeals Information Return Penalties

Under IRC §§ 6320 and 6330, after the Service files a notice of federal tax lien under IRC § 6321 and prior to the Service issuing a notice of levy under IRC § 6331, a person is entitled to notice and a hearing with respect to the collection action. If Appeals issues an adverse notice of determination in a timely collection appeal, the person may, within 30 days, appeal the determination to the U.S. Tax Court. IRC § 6330(d)(1); *Wagenknecht v. United States,* 533 F.3d 412, 415, n.3 (6th Cir. 2008) (recognizing expansion of U.S. Tax Court jurisdiction in collection due process appeals by the Pension Protection Act of 2006, PL 109-280, § 855, 120 Stat. 780, 1019 (Aug. 17, 2006))

If an information return penalty is the subject of a collection due process appeal, the taxpayer can challenge liability for the penalty by filing a petition in the U.S. Tax Court in response to an adverse notice of determination. *Callahan v. Commissioner,* 130 T.C. 44, 48 (2008) (court has jurisdiction to review collection efforts directed to assessable penalties not otherwise subject to deficiency procedures); *Mason v. Commissioner,* 132 T.C. No. 14 (May 6, 2009) (court considered liability for trust fund recovery penalty under IRC § 6672).

International Information Returns: Form 3520 – Judicial Review

I. Deficiency procedures do not apply to the initial monetary penalties assessed for failure to timely file a complete and accurate Form 3520. IRC § 6677(e).

II. However, when the required information under IRC § 6048 is not provided, the Service is authorized to treat any distribution from a foreign trust to a U.S. beneficiary as an accumulation distribution includible in gross income of the distributee. IRC § 6048(c)(2).

III. Moreover, when information required by IRC § 6039F is not provided to the Service, it can determine the tax consequences of a gift. IRC § 6039F(c)(1)(A).

IV. These determinations and related adjustments to tax are subject to deficiency procedures. IRM § 20.1.9.10.3(2) (04-22-2011).

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COLLECTION ISSUES

Collections:
FBAR Penalties – Authority To Collect

I. The IRS has been delegated the authority to assess FBAR penalties in 31 C.F.R. § 103.56(g) (2007), but it does not have the authority to enforce collection activity. ("Collection is not delegated any enforcement authority with respect to FBAR penalties." IRM § 5.21.6.4(2) (02-17-2009).

II. Upon assessment, the IRS makes notice and demand for payment by sending a Letter 3708 to the taxpayer and power of attorney on file, and forwards collection information to the Department of Treasury's Financial Management Services (FMS). IRM § 4.26.17.4.4(4)(e-f) (05-05-2008).

III. IRM § 8.11.6 (11-01-2011) provides guidance to Appeals officers for post-assessment review. If Appeals partially or fully sustains the FBAR penalty, the case is closed and sent to FMS. IRM § 8.11.6.8.3 (11-01-2011).

Collections: Statutes Of Limitations

There are two statutes of limitation with respect to the collection of FBAR penalties. IRM § 8.11.6.3.1.1(2) (11-01-2011):

1. Two years to sue to collect from the later of the assessment date or the date any judgment becomes final in a criminal action involving the same transaction that resulted in the penalty. IRM § 4.26.17.5.5.2(1) (01-01-2007).

2. Ten years from the assessment date during which it, through FMS, can collect through certain offsets. IRM § 8.11.6.3.1.1(2) (11-01-2011)

There is no statute of limitations for collection of debts using administrative offset of federal benefits. 31 U.S.C. §3716 (e)(1). ("Notwithstanding any other provision of law, regulation, or administrative limitation, no limitation on the period within which an offset may be initiated or taken pursuant to this section shall be effective."); 31 C.F.R. § 285.5(d)(3)(v) ("Debts may be collected irrespective of the amount of time the debt has been outstanding."); *Lockhart v. U.S.,* 546 U.S. 142, 142 (2005) (affirming offset of Social Security benefits to collect student loan debt outstanding for over 10 years).

Collections:
Federal Debt Collection - Statutes And Regs

FBAR penalties constitute debts owed to an U.S. executive agency. *See* 31 U.S.C. § 3701(b)(1)(F) (2001) (debts include "any fines or penalties assessed by an agency"); 31 U.S.C. § 3701(a)(4) (2001) (agency means any "agency ... in the executive, judicial, or legislative branch of Government"); 31 C.F.R. § 103.56(g) and IR-2003-48 (April 10, 2003) (authorizing the IRS to assess FBAR penalties); *see also United States v. Simonelli*, 614 F. Supp. 2d 241, 246 (D. Conn. 2008) (FBAR penalty is a civil penalty, not a tax penalty)

The IRS is authorized to collect debts using any of the methods enumerated in 31 U.S.C. § 3711 (2008). *See* 31 C.F.R. § 5.4(a)(6) (authorizing "treasury entities" to collect debts by offset of tax refunds or benefits, private collection agency, credit bureau reporting, administrative wage garnishment or litigation); *see also* 31 C.F.R. § 5.1 ("treasury entity" includes the IRS).

Collections:
Federal Debt Collection - Statutes And Regs (Cont.)

The IRS may also refer debts to FMS for collection and, in the case of debts over 180 days delinquent, it IRS *must* refer such debts to FMS. 31 C.F.R. §§ 5.4(a)(6)-(7).

Upon referral, FMS must "take appropriate action to collect … the transferred debt … in accordance with the statutory and regulatory requirements and authorities applicable to the debt and the action." 31 C.F.R. § 285.12(c)(2).

If collection efforts are unsuccessful, then FMS refers debts to another debt collection center, a private collection contractor or the Department of Justice for litigation. 31 C.F.R. § 285.12(c)(2).

Collections: Administrative Offset

The federal government may offset federal benefits to collect any non-tax debt. 31 U.S.C. § 3716; *see also* 31 CFR § 285.4 (FMS may collect delinquent, non-tax debts by offsetting federal benefit payments); 31 C.F.R. § 285.5(a) (FMS administers centralized offset through the Treasury Offset Program (TOP)); 31 C.F.R. § 5.10 (When centralized administrative offset through the TOP is not available or appropriate, the IRS may collect debts directly using non-centralized administrative offset.).

Even federal benefit programs that statutorily proscribe garnishment or levy of benefits are subject to administrative offset, pursuant to 31 U.S.C. § 716(c)(3)(A)(i). Treasury regulations permit the *offset* of such benefits, except those for which there is a statutory proscription against offset. 31 C.F.R. § 285.5(e)(2)(v). For example, administrative offsets include Social Security benefits, for which Congress provided that "none of the moneys paid or payable or rights existing under this title shall be subject to execution, levy, attachment, garnishment, or other legal process, or to the operation of any bankruptcy or insolvency law." 42 U.S.C § 407 (§ 207(a)).

Collections:
Federal Debt Collection Options

The federal government is required to take "all appropriate steps to collect [any] debt … owed to any executive, judicial, or legislative agency." 31 U.S.C. § 3711(g)(9).

The available debt collection methods include:

(1) Administrative offset
(2) Tax refund offset
(3) Federal salary offset
(4) Non-federal employee wage garnishment
(5) Debt referral to private collection contractors
(6) Debt referral to agencies operating a debt collection center
(7) Reporting of delinquencies to credit reporting bureaus
(8) Litigation or foreclosure

31 U.S.C. §§ 3711(g)(9)(A)-(H).

Collections:
Administrative Offset - Exemptions

I. Treasury regulations distinguish between statutes which proscribe execution, levy, attachment, garnishment or other legal process from those that specifically proscribe offset; only the latter class of benefits are exempt. *See* 31 C.F.R. § 285.4 (covered benefit payments include those payable under the Social Security Act (other than SSI payments), part B of the Black Lung Benefits Act or any law administered by the Railroad Retirement Board (other than payments that such Board determines to be tier 2 benefits") despite the fact that these statutes contain proscriptions against garnishment).

II. The only benefit explicitly *exempt* from administrative offset by statute is a benefit payable under the Higher Education Act of 1965. 31 U.S.C. § 3716(c)(1)(C).

III. The Department of Treasury further exempts (1) Black Lung Benefits Act Part C benefit payments, (2) Railroad Retirement Board tier 2 payments, (3) payments made under the tariff laws of the U.S., (4) Veterans Affairs benefit payments to the extent such payments are exempt from offset pursuant to 38 U.S.C. § 5301, and (5) federal loan payments other than travel advances. 31 C.F.R. § 285.5(e)(2).

Collections:
Administrative Offset – Exemptions (Cont.)

I. As to benefits payable pursuant to the Social Security Act, part B of the Black Lung Benefits Act, or any law administered by the Railroad Retirement Board, the first $9,000 that a debtor is entitled to receive within a 12-month period is exempt from offset. 31 U.S.C. § 3716(c)(3)(A)(ii).

II. The secretary of the Treasury may exempt payments under means-tested programs, or under other programs where justification is provided, when requested by the head of the respective agency. 31 U.S.C. § 3716(c)(3)(B); 31 C.F.R. § 285.5 (e)(7).

Collections: Administrative Offset (Cont.)

I. Administrative offset may be used only after there has been an attempt to collect the amount owed from the debtor directly. 31 U.S.C. § 3716(a).

II. If direct collection is unsuccessful, the agency must then provide the debtor: "(1) written notice of the type and amount of the claim, the intention of the head of the agency to collect the claim by administrative offset, and an explanation of the rights of the debtor under this section; (2) an opportunity to inspect and copy the records of the agency related to the claim; (3) an opportunity for a review within the agency of the decision of the agency related to the claim; and (4) an opportunity to make a written agreement with the head of the agency to repay the amount of the claim." 31 U.S.C. § 3716(a); *see also* 31 C.F.R. § 285.5 (g).

III. The offset amount from a monthly covered benefit payment will be the lesser of (1) the amount of the debt, with interest, penalties and administrative costs; (2) an amount equal to 15% of the monthly covered benefit payment; or (3) the amount, if any, by which the monthly covered benefit payment exceeds $750. 31 C.F.R. § 285.4(e)(1).

Collections:
Tax Refund Offsets

I. The federal government may offset federal tax refunds to collect any debt. 31 U.S.C. § 3720A(a); 31 C.F.R. § 5.11 (IRS may use federal tax refund offset to collect a debt; debts must be sent to FMS for collection by this method); 31 C.F.R. § 285.2 (FMS may collect debts by federal tax refund offset).

II. With joint tax returns where only one spouse is liable, the non-liable spouse may secure his proper share of a tax refund from which an offset was made. 31 C.F.R. § 285.2(f).

III. Tax refund offsets may be used only after an attempt to collect directly from the debtor. 31 U.S.C. § 3720A(b)(5); 31 C.F.R. § 285.2(d). If direct collection is unsuccessful, the agency must: (1) notify the debtor of its intent to collect the debt by tax refund offset, (2) provide at least 60 days to present evidence that all or part of the debt is not past-due or legally enforceable, and (3) consider any evidence presented by the debtor and determine that the debt is past due and legally enforceable. 31 U.S.C. § 3720A(b); 31 C.F.R. § 285.2(d).

Collections:
Federal Salary Offsets

I. Federal salary offset is another available option for the federal government to collect any non-tax debt. 5 U.S.C. § 5514(a)(1); 31 C.F.R. § 5.12 (IRS may use federal salary offset to collect a debt; debts should be transferred to FMS for collection by this method unless centralized offset through FMS is not available or appropriate, in which case IRS may collect delinquent debt directly through salary offset); 31 C.F.R. § 285.7(a)(1) (FMS may collect debts by federal salary offset).

II. The salary deductions may be made from a federal employee's basic pay, special pay, incentive pay, retired pay, retainer pay or other authorized pay from federal employment. 5 U.S.C. § 5514(a)(1); 31 C.F.R. § 5.12 (requiring IRS to follow offset procedures enumerated in 5 U.S.C. § 5514; 31 C.F.R. § 285.7(d)(3)(iii) (requiring FMS to follow offset procedures enumerated in 5 U.S.C. § 5514).

III. The government may withhold up to 15% of the debtor's disposable pay, meaning the wages remaining after legally-mandated withholdings are deducted. 5 U.S.C. §§ 5514(a)(1) - (5)(A); 31 C.F.R. § 5.12(g)(3) (adopting same restrictions for salary offset by IRS); 31 C.F.R. § 285.7(g) (adopting same restrictions for salary offset by FMS).

Collections:
Federal Salary Offsets (Cont.)

The agency must provide the debtor with:

(1) 30 days written notice, informing such individual of the nature and amount of the indebtedness, the intention of the agency to collect the debt through deductions from pay, and an explanation of the individual's rights

(2) An opportunity to inspect and copy government records relating to the debt

(3) An opportunity to enter into a written agreement with the agency to establish a schedule for the repayment of the debt

(4) An opportunity for a hearing on the determination of the agency concerning the existence or the amount of the debt

5 U.S.C. § 5514(a)(2); 31 C.F.R. § 285.7(i).

Collections: Wage Garnishments

I. The federal government may garnish wages of non-government employees to collect any debt owed, pursuant to 31 U.S.C. § 3720D(a). 31 C.F.R. § 285.11(a) (FMS may collect debt by garnishing wages of non-federal employees); 31 C.F.R. § 5.13(a) (IRS may collect debt by garnishing wages of non-federal employees if all provisions of 31 C.F.R. § 285.11 are followed).

II. The non-federal employee wage garnishment provisions are similar to those for federal salary offset. The government may garnish up to 15% of the debtor's disposable pay. 31 U.S.C. § 3720D(a); 31 C.F.R. § 285.11(i).

III. In the case of financial hardship, the agency must decrease the amount garnished to reflect the debtor's financial condition. 31 C.F.R. § 285.11(k).

IV. The government may not garnish the wages of a debtor who has been involuntarily separated from employment until the debtor has been reemployed continuously for at least 12 months. 31 C.F.R. § 285.11(j).

Collections:
Private Collection Agencies And Credit Reporting

I. The government may also contract with a third party for collection services to recover any debt owed to the U.S. 31 U.S.C. § 3718(a); 31 C.F.R. § 5.15 (IRS may refer debts to private collection agencies; debts must be transferred to FMS for collection by this method); 31 C.F.R. § 285.12(c)(2) (FMS may transfer debts to private collection agencies)

II. A debt collection contract may provide for a fee payable to the collection agent from the amount recovered. 31 U.S.C. § 3718(d).

III. Delinquent debts are reported to credit bureaus pursuant to 31 U.S.C. 3711(e), 31 C.F.R. § 901.4, 31 C.F.R. § 285.12(c)(2) and 31 C.F.R. § 5.14.

IV. The government must send notice to the debtor at least 60 days prior to reporting a delinquent debt to a consumer reporting agency. 31 C.F.R. §§ 5.14, 5.4.

Collections:
Lawsuits To Collect The FBAR Penalty

I. The government may collect debts by judicial action. 31 U.S.C. § 3711(g)(9)(H). The IRS must refer debts to the Department of Justice for litigation when "aggressive collection activity" has been unsuccessful. 31 C.F.R. § 5.16(b).

II. Debts transferred to FMS are also referred to the Department of Justice for litigation, when other collection activities have failed. 31 C.F.R. § 285.12(c)(2).

III. The statutory provisions specific to FBAR penalties require that the government file suit to collect the FBAR penalties within two years of the penalty assessment date. 31 U.S.C. § 5321(b)(2); 28 U.S.C. § 1345; *see also* 31 C.F.R. § 285.12(c)(2) (In taking any action, including referral of a debt to the Department of Justice for litigation, FMS must comply with "the statutory and regulatory requirements and authorities *applicable to the debt* and the action.") (*emphasis added*).

Collections: Lawsuits To Collect The FBAR Penalty A Way To Challenge ....

I. With the door to the Tax Court closed, those facing FBAR penalties appear to be left with two options to obtain judicial review: Either pay the penalty and file a refund lawsuit, or wait until the government files suit in district court to collect the penalty and challenge the assessment. 31 U.S.C. § 5321(b)(2); 28 U.S.C. §§ 1345 and 1346(a).

II. A person assessed with the FBAR penalty may challenge liability in a suit to collect. *See United States v. Williams*, 2010 WL 3473311 (E.D. Va. Sept. 1, 2010) (reviewing penalty *de novo* and requiring government to prove Williams was properly assessed with the penalty); *United States v. Simonelli*, 614 F. Supp. 2d 241 (D. Conn. 2008).

III. For those who are permitted to challenge liability, it appears that there is a right a jury trial. *See Tull v. United States*, 481 U.S. 412, 425 (1987) (finding right to jury trial in suit by government to assess penalties under Clean Water Act).

IV. Where the FBAR penalty was assessed after a criminal conviction under 31 U.S.C. § 5322 for willful failure to file an FBAR penalty, it appears clear that the person against whom the penalty is assessed would be estopped from challenging liability.

Dischargeability: *Simonelli*

In *United States v. Simonelli,* 614 F. Supp. 2d 241 (D.Conn. 2008), the government filed a complaint seeking a judgment for the FBAR penalty, accrued interest and the failure to pay penalty that arises under 31 U.S.C. § 3717(e)(2). Simonelli conceded liability for the FBAR penalty but argued that the liability was discharged in his bankruptcy.

> The government moved for summary judgment, arguing that the penalty is a civil penalty and therefore excepted from discharge under 11 U.S.C. § 523(a)(7), which provides that a debtor will not be discharged from any debt "for a fine, penalty, or forfeiture payable to and for the benefit of a governmental unit, and is not compensation for actual pecuniary loss, other than a tax penalty."
>
> The court agreed, noting that § 523(a)(7), "creates a broad [exception to discharge in bankruptcy] for all penal sanctions, whether they be denominated fines, penalties, or forfeitures. Congress included two qualifying phrases; the fines must be both 'to and for the benefit of a governmental unit,' and 'not compensation for actual pecuniary loss.'" 614 F. Supp. 2d at 242 *(quoting Kelly v. Robinson,* 479 U.S. 36, 52 (1986)).

Dischargeability: *Simonelli* (Cont.)

Two types of tax penalties are specifically excluded from this broad exception to discharge: Certain kinds of "tax or customs dut[ies]" listed at § 523(a)(1), and penalties for taxes that are "imposed with respect to a transaction or event that occurred before three years before the date of the filing of the petition." 11 U.S.C. §§ 523(a)(7)(A), (B).

I. Simonelli argued that the FBAR penalty was a tax penalty "imposed with respect to a transaction or event that occurred before three years before the date of the filing of the petition." 11 U.S.C. § 532(a)(7)(B). He asserted the FBAR penalty was assessed "in lieu of assessing taxes on him because his failure to file the FBAR deprived the IRS of any information about his foreign bank transactions, making it impossible for the IRS to know how much tax to assess on him." 614 F. Supp. 2d at 243. He maintained that "the FBAR penalty is a tax penalty because the IRS uses it to penalize persons who fail to file FBARs, frustrating the IRS's ability to track, assess and collect their would-be taxes." *Id.*

II. The court disagreed, finding that the FBAR penalty is a civil penalty under the BSA, not a tax or tax penalty; and nothing ties the amount of the FBAR penalty to an amount of tax due. 614 F. Supp. 2d at 244 (*citing* 29 C.F.R. § 103.56(g) (authorizing the IRS "to assess and collect civil penalties under 31 U.S.C. § 5321 ... [and] investigate possible civil violations of these provisions")).

IRS Bankruptcy Procedures For FBAR Penalties: I.R.M. 5.9.4.19 (03-01-2007)

I. ***Delegated authority***: Delegation Order 4-35 effective Jan. 15, 2004 authorizes bankruptcy specialists grade 9 and above to prepare and file proofs of claim for FBAR penalties and to take appropriate action to protect the government's interest in bankruptcy, state and federal receiverships, and other state and federal insolvency actions.

II. ***Systemic tracking***: FBARs are filed with the Detroit computing center (DCC), and information reported on FBARs is entered in a database known as the currency and banking retrieval system (CBRS). FBAR penalties can only be checked by IRS personnel with passwords to CBRS. *FBAR cases are not loaded onto AIS or IDRS because FBAR cases are not tax cases*.

III. ***Interagency agreement***: The IRS has entered into an agreement with FMS to prepare proofs of claim in cases when a debtor with an FBAR penalty assessment has filed bankruptcy. When debtors report FBAR penalties as debts in their bankruptcy petition and schedules, clerks of bankruptcy courts send notices to FMS in Birmingham, Ala. FMS forwards bankruptcy notices to the DCC.

IRS Bankruptcy Procedures For FBAR Penalties: I.R.M. 5.9.4.19 (03-01-2007), Cont.

I. ***DCC duties***: When the DCC receives bankruptcy notices, it inputs the bankruptcy indicator on CBRS. All FBAR penalty cases are processed by and assigned to the Los Angeles Field Insolvency office. DCC provides the following account information to the FBAR penalty bankruptcy specialist in the Los Angeles Insolvency office:

A. Debtor name
B. Debtor address
C. Debtor SSN
D. Balance(s) due for both the penalty and statutory additions
E. Assessment date
F. CSED

IRS Bankruptcy Procedures For FBAR Penalties: I.R.M. 5.9.4.19 (03-01-2007), Cont.

I. ***CSED***: The IRS has no current procedures for soliciting a waiver of the two-year statute of limitations for filing a civil action to recover an FBAR penalty. Filing a bankruptcy petition does not suspend the running of the CSED. However, if the FBAR collection statute has not expired upon the date of filing of the bankruptcy petition, 11 USC §108(c) extends the time to file an FBAR suit until the later of:

   A. The end of the two-year collection period, or

   B. 30 days after notice of the termination or expiration of the stay under 11 USC §§ 62, 922, 1201 or 1301 with respect to the claim.

II. ***Note***: Los Angeles Insolvency must coordinate any FBAR CSED issues closely with counsel, since the government may have only a short period of time in which to initiate a collection suit after the termination of the bankruptcy case.

III. ***Insolvency's duties***: Insolvency specialists or advisors in Territory 14 must verify the bar date has not expired, verify the FBAR CSED has not expired and prepare and distribute the proof of claim (Form B10) for FMS.

IRS Bankruptcy Procedures For FBAR Penalties: I.R.M. 5.9.4.19 (03-01-2007), Cont.

I. ***Creditor name***: IRS Insolvency prepares manual FBAR proofs of claim listing the creditor as the Financial Management Service at the following address:

US Treasury
Financial Management Services
P.O. Box 830794
ATTN: Debit Services Branch
Birmingham, AL 35283-0794

II. **Caution:** *An FBAR penalty cannot be included on a claim naming the IRS as the creditor.*

III. ***Claim calculations***: FBAR claims are always classified as unsecured general, and include the FBAR penalty amount and interest. Insolvency may have to coordinate with FMS or the DCC to determine the appropriate interest to report on a claim, because the interest rate on these penalties is subject to change. Also, a late payment penalty may be assessed under Title 31, and collection costs may be assessed.

IRS Bankruptcy Procedures For FBAR Penalties: I.R.M. 5.9.4.19 (03-01-2007), Cont.

I. ***Claim distribution***: The FBAR bankruptcy caseworker files the FBAR proof of claim with the Bankruptcy Court and must provide copies of the FBAR claim to the DCC, the Insolvency territory manager, FMS, the debtor and debtor's counsel. In addition, all FBAR cases must be referred to the local Counsel's office along with a copy of the proof of claim.

II. ***FBAR plan review***: Associate area counsel is responsible for reviewing bankruptcy plans as to the treatment of the unsecured general claim for the FBAR penalty. If the IRS is a creditor for unpaid federal taxes or statutory additions to taxes under the same docket number as the FBAR penalty, then the Field Insolvency specialist or advisor assigned to that case will process the non-FBAR assessments, following established procedures for the chapter under which the bankruptcy has been filed.

III. ***Payments on FBAR accounts***: FBAR payments received from the bankruptcy proceedings must be mailed for processing to FMS.

IRS Bankruptcy Procedures For FBAR Penalties: I.R.M. 5.9.4.19 (03-01-2007), Cont.

I. ***FBAR case monitoring***: The DCC will:

   A. Record payments if the bankruptcy indicator is on the account
   B. Process abatements
   C. Process full payment of the debt
   D. Reverse the bankruptcy indicator
   E. Return the account to regular collection status if appropriate

II. If a taxpayer is under an FBAR examination at the time it files for bankruptcy, the Service will notify the IRS Insolvency Unit and then complete the FBAR examination. The Insolvency Unit will file the proof of claim. and collection will be handled by the Financial Management Service (FMS). I.R.M. §4.26.17.5.6 (01-01-2007)