Correcting Foreign Information Reporting Noncompliance: Voluntary Disclosure Programs

TUESDAY, APRIL 30, 2019, 1:00-2:50 pm Eastern

IMPORTANT INFORMATION FOR THE LIVE PROGRAM

This program is approved for 2 CPE credit hours. To earn credit you must:

- Participate in the program on your own computer connection (no sharing) – if you need to register additional people, please call customer service at 1-800-926-7926 ext.1 (or 404-881-1141 ext. 1). Strafford accepts American Express, Visa, MasterCard, Discover.
- **Listen on-line** via your computer speakers.
- **Respond to five prompts during the program plus a single verification code.**
- To earn full credit, you must remain connected for the entire program.

WHO TO CONTACT DURING THE LIVE EVENT

For Additional Registrations:
-Call Strafford Customer Service 1-800-926-7926 x1 (or 404-881-1141 x1)

For Assistance During the Live Program:
-On the web, use the chat box at the bottom left of the screen

If you get disconnected during the program, you can simply log in using your original instructions and PIN.

Tips for Optimal Quality

FOR LIVE PROGRAM ONLY

Sound Quality

When listening via your computer speakers, please note that the quality of your sound will vary depending on the speed and quality of your internet connection.

If the sound quality is not satisfactory, please e-mail sound@straffordpub.com immediately so we can address the problem.

Correcting Foreign Information Reporting Noncompliance: Voluntary Disclosure Programs

TUESDAY, APRIL 30, 2019

Joshua Ashman, CPA, Partner
Expat Tax Professionals, New York
jashman@expattaxprofessionals.com

Nathan Mintz, Tax Counsel
Expat Tax Professionals, New York
nmintz@expattaxprofessionals.com

Notice

ANY TAX ADVICE IN THIS COMMUNICATION IS NOT INTENDED OR WRITTEN BY THE SPEAKERS' FIRMS TO BE USED, AND CANNOT BE USED, BY A CLIENT OR ANY OTHER PERSON OR ENTITY FOR THE PURPOSE OF (i) AVOIDING PENALTIES THAT MAY BE IMPOSED ON ANY TAXPAYER OR (ii) PROMOTING, MARKETING OR RECOMMENDING TO ANOTHER PARTY ANY MATTERS ADDRESSED HEREIN.

You (and your employees, representatives, or agents) may disclose to any and all persons, without limitation, the tax treatment or tax structure, or both, of any transaction described in the associated materials we provide to you, including, but not limited to, any tax opinions, memoranda, or other tax analyses contained in those materials.

The information contained herein is of a general nature and based on authorities that are subject to change. Applicability of the information to specific situations should be determined through consultation with your tax adviser.

Correcting Foreign Information Reporting Noncompliance

Joshua Ashman, CPA
(718) 887-9933 (ext. 102) • jashman@expattaxprofessionals.com

Nathan Mintz, Esq.
(718) 887-9933 (ext. 116) • nmintz@expattaxprofessionals.com

expat tax PROFESSIONALS

I. Foreign Information Noncompliance – An Introduction

Outline

- Introduction
- International Information Reporting

expatXtax PROFESSIONALS

Introduction

U.S. System of Citizenship Taxation and Its Implications

As a basic rule, U.S. citizens and green card holders, even those residing outside the United States, are considered to be U.S. residents for tax purposes and are therefore subject to U.S. tax reporting on their worldwide income.

There are over 9 million U.S. citizens believed to be residing outside of the United States.

Over the past several years, disclosure laws have been strengthened (e.g., FATCA) and international agreements have been expanded (e.g., IGAs) to increase global tax transparency of U.S. taxpayers with foreign concerns.

Taxpayers at risk range from the “willfully delinquent” American to the “accidental” American.

Introduction (cont.)

U.S. Government's Two-Pronged Approach ("Good Cop, Bad Cop") To Encourage Disclosure:

(1) Increased Reporting Requirements:

- Reporting of Foreign Accounts (FBAR)
- Reporting of Foreign Financial Interests (FATCA)
- More Detailed Reporting of Foreign Entities
- Increased Penalties for Violations that Touch Foreign Activities

(2) Increased Amnesty Opportunities (2014)

- More Amnesty Options
- More Lenient Entrance Requirements

expatXtax PROFESSIONALS

Introduction (cont.)

Increased Efforts and Global Tax Reach of the IRS

Cooperation with foreign governments and financial institutions

- FATCA / IGAs with dozens of countries
- Foreign banks requiring US citizens to sign W-9 or similar forms
- Justice Department Swiss Bank program

Cooperation with other governmental departments

- Treasury Department giving FBAR information to the IRS
- IRS giving delinquency information to the State Department to enforce passport revocation penalty

expatXtax PROFESSIONALS

Introduction (cont.)

Audit Focus on international returns

Audit Chances Increase

- 2017 Audit Percentage: 0.5% - overall / 5.2% - international returns

International Compliance Issues Added to IRS Audit Campaigns (2018)

- Individual Foreign Tax Credit
- FATCA Filing (Form 8938) Compliance
- Foreign Company (Form 1120-F) Compliance
- Foreign Trust (Form 3520) Compliance
- Tax Withholding (Form 1042) Compliance
- Transition Tax (New IRC Section 965) Compliance
- Exemptions, Deductions, and Credits Claimed by Nonresident Aliens

expatXtax PROFESSIONALS

International Information Reporting – Examples of Forms

FBAR: Any U.S. account holder (person or entity) with a financial interest in or signature authority over one or more foreign financial accounts, with more than $10,000 in aggregate value in a calendar year, must file the FBAR annually with the Treasury Department.

Form 5471: annual information return of U.S. persons with respect to certain foreign corporations

New Forms 8992/8993: Calculation of Global Intangible Low-Taxed Income (GILTI) and Deduction

Form 3520: annual information return to report transactions with foreign trusts (including certain foreign pensions) and receipt of certain foreign gifts

Form 8938: FATCA Reporting - Statement of specified foreign financial assets

Form 8621: filed by certain shareholders of passive foreign investment companies (“PFICs”) (such as foreign mutual funds)

Form 8865: filed for each controlled foreign partnership when taxpayer is a 10% or more partner

Form 8858: filed for each wholly owned foreign entity for which a "check the box" election (i.e., an entity classification election) has been made

International Information Reporting – Delinquency

U.S. filing tax delinquency can manifest in a number of ways. Delinquency can result from any the following:

- Tax return is filed late
- Omitted or late filed information returns (e.g., FBAR, Form 5471, Form 3520)
- Returns are incorrect or incomplete – most common is the failure to report worldwide income

In our most recent experience, we have seen a particular focus by the IRS on late-filed Forms 3520-A, the deadline of which is a month earlier than the general return filing deadline of April 15. Several clients have received penalty letters from the IRS.

expatXtax PROFESSIONALS

International Information Reporting – Examples of Penalties

- **Failure to file penalty** – 5% of the taxes owed for each month outstanding (capped at 25% of the total tax liability).
- **Failure to pay penalty** – 0.5% of the taxes due for each month outstanding (no cap).
- **Accuracy-related penalty** – depending on the particular facts, an additional 20% penalty may apply if your income is substantially understated or if your underpayment was due to negligence or disregard of rules or regulations.
- **Form 5471/8865/8858 Civil Penalties** – $10,000 penalty per year per entity (up to $50,000 if the delinquency continues after IRS notice).
- **Form 5472 Civil Penalty** – Increased to $25,000
- **Form 3520 Civil Penalties** – Penalty is equal to the greater of $10,000, or 35% of the gross value of any property transferred to or distributed from a foreign trust, or 5% of the gross value of the portion of the trust's assets (penalties increase if the delinquency continues after IRS notice).
- **Criminal Penalties** – A willful violation can result in the imposition of criminal penalties, including imprisonment for up to 10 years and a fine of up to $500,000.

Penalty Abatement

The IRS may grant penalty abatement of some of the above civil penalties in the case of:

- A first time violation
- Reasonable cause explanation

expatXtax PROFESSIONALS

International Information Reporting – Examples of Penalties (cont.)

Examples of FBAR delinquency penalties include the following:

FBAR Civil Penalties – "**Non-willful**" delinquency can result in a penalty of $10,000 per account per year unless there is "**reasonable cause**" for failing to file. A "**willful"** failure to file could be subject to civil penalties equal to the greater of $100,000 or 50% of the balance in each unreported account.

(We will further discuss the concepts of "reasonable cause" and "willful versus non-willful" delinquency in later slides on the disclosure amnesty programs).

FBAR Criminal Penalties – A willful violation can result in fines of up to $250,000 in fines and 5 years of jail time.

The IRS has issued interim guidance to examiners for implementing procedures to improve the administration of the FBAR. In it, examiners are advised that it may be appropriate to apply one penalty for each open year, regardless of the number of unreported foreign financial accounts. In such case, the penalty for each year would be limited to $10,000. For even less egregious cases, the facts may indicate that asserting non-willful penalties for each year of delinquency may not be appropriate. In such case, the examiner may assert a single penalty for all years of delinquent FBARs, which is not to exceed $10,000.

II. Streamlined Disclosure Program

Outline

- ❑ Introduction
- ❑ Determining Residency
- ❑ Domestic and Foreign Offshore Procedures
- ❑ Non-Willful Standard
- ❑ Non-Willful Certification
- ❑ Challenges and Future of Streamlined Program

expatXtax PROFESSIONALS

Introduction

The IRS Streamlined Procedures were first introduced as an amnesty program for individuals in 2012 with strict entrance requirements. The Streamlined Procedures were significantly modified in 2014 to have more lenient requirements. Among other things, the revised 2014 program eliminated a requirement under the 2012 program that the taxpayer have $1,500 or less of unpaid tax per year.

Effective July 1, 2014, the IRS began to offer two types of Streamlined Procedures:

(1) Streamlined Foreign Offshore Procedures ("SFOP")

- For U.S. taxpayers residing outside the United States

(2) Streamlined Domestic Offshore Procedures ("SDOP")

- For U.S. taxpayers residing within the United States

According to the latest IRS announcement on the amnesty programs, about 65,000 taxpayers have thus far participated in the program.

expatXtax PROFESSIONALS

Determining Residency for Streamlined Programs

Taxpayers who are U.S. citizens or lawful permanent residents (e.g., Green Card Holders) are considered to reside outside the United States if:

For at least one of the three Streamline years, the individual:

(1) did not have a U.S. “abode” (generally, one’s home, habitation, residence, domicile, or place of dwelling); and

(2) was physically outside the United States for at least 330 full days (meaning, the taxpayer did not spend more than 35 days in the United States).

expatXtax PROFESSIONALS

Determining Residency for Streamlined Programs (cont.)

Taxpayers who are not U.S. citizens or lawful permanent residents are considered to reside outside the United States 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.

Under the substantial presence test, one must be physically present in the United States on at least: (a) 31 days during the current calendar year; and (b) a total of 183 days during the current year and the 2 preceding years, counting all the days of physical presence in the current year, but only one-third the number of days of presence in the first preceding year, and only one-sixth the number of days in the second preceding year.

expatXtax PROFESSIONALS

Determining Residency for Streamlined Programs (cont.)

Case Study - Residency:

Facts:

The most recent 3 years for which the taxpayer's U.S. tax return due dates have passed are 2015, 2016, and 2017.

Taxpayer is not a U.S. citizen or green card holder. Taxpayer was born in the UK and resided in the UK until March 15, 2016, when she was transferred by her employer to its U.S. office. Taxpayer was physically present in the U.S. for more than 183 days in both 2016 and 2017. While Taxpayer did meet the substantial presence test for 2016 and 2017, she did not meet it for 2015.

Outcome:

Taxpayer meets the non-residency requirement for purposes of the Streamlined Foreign Offshore Procedures.

expat X tax PROFESSIONALS

Streamlined Foreign Offshore Procedures

Under the Streamlined Foreign Offshore Procedures (taxpayers residing outside the United States), the taxpayer is required to submit:

- 3 years of tax returns and information returns
- 6 years of FBARs
- Non-willful certification (US Resident - Form 14653, Non-US - Form 14654)

Note: A taxpayer cannot participate if the IRS has already initiated a civil examination.

Under this program, the taxpayer avoids all of the penalties normally associated with delinquency (e.g., failure-to-file and failure-to-pay penalties, accuracy-related penalty, information return penalties, FBAR penalties).

The participant is required to pay only the following:

- Unpaid taxes
- Interest

expat X tax PROFESSIONALS

Streamlined Domestic Offshore Procedures

The Domestic Offshore Procedures (for taxpayers residing in the United States) have the same submission requirements as the Foreign Offshore Procedures, namely 3 tax returns, 6 FBARS, and the non-willful certification.

The Domestic Offshore Procedures differ from the Foreign Offshore Procedures in two main ways:

(1) A domestic resident taxpayer that has failed to file a U.S. income tax return in any of the three most recent tax years cannot participate in the domestic offshore procedures (while a foreign resident taxpayer that has been similarly delinquent can participate in the foreign offshore procedures).

(2) Further, even if the taxpayers qualifies, the domestic offshore procedures bear a **5% miscellaneous penalty** on the highest aggregate balance/value of one's foreign financial assets during the FBAR period (while the foreign offshore procedures have no such penalty).

Non-Willful Standard

The language of the certification forms seems to offer a broader range of conduct that will be considered non-willful for purposes of the Streamlined program.

In the form, the taxpayer must certify the following:

“My failure to report all income, pay all tax, and submit all required information returns, including FBARs, was due to non-willful conduct. I understand that non-willful conduct is conduct that is due to **negligence, inadvertence, or mistake or conduct that is the result of a good faith misunderstanding of the requirements of the law**.”

Further insight into the willful standard can be gleaned from the FBAR penalty regime, which we will discuss later in the FBAR amnesty program.

expatXtax PROFESSIONALS

Non-Willful Standard (cont.)

Examples of Facts Evidencing Non-Willfulness

- Taxpayer always lived abroad (e.g., “accidental American”) or at least lived abroad as adult or during years of employment
- Taxpayer living abroad has diligently filed and paid taxes in foreign country
- Taxpayer has a close connection to the foreign country (family, employment, etc.)
- Taxpayer has no post-secondary school education, and either no degree or an undergraduate degree in the arts or sciences and not one in taxation or finance
- Taxpayer works in a non-skilled job
- Taxpayer inherited the account from a parent who lives in the foreign country
- The funds in the account originated offshore
- Taxpayer has limited income and owes no tax or little tax
- The person is not a sophisticated investor whose investments consist solely of an employer 401(k) and IRA

expatXtax PROFESSIONALS

Non-Willful Standard (cont.)

Examples of Facts Evidencing Non-Willfulness (cont.)

- Taxpayer living abroad has bank accounts only in his or her country of residence
- Taxpayer has during the filing period suffered severe emotional, medical, family or business hardships
- The person's tax return preparer was a store-front operator who did not inquire about offshore bank accounts or provide a tax organizer to clients
- Taxpayer lives in rural area with limited access to accountants or US tax assistance
- For US resident, the person has recently immigrated to the U.S. and has been preoccupied with adapting to the new country, culture, lifestyle, language or a new spouse
- For US resident, the person recently immigrated to the U.S came from a country that does not tax its citizens on world-wide income

Non-Willful Certification

Prior to 2016, the Certification form required that taxpayers include a general narrative of facts which lead to the failure to timely report all income, pay all tax, and submit all required information returns, including FBARs. In January of 2016, the form was significantly revised to require that the taxpayer's explanation of non-willfulness include the following:

- Specific reasons for your past failure, whether favorable or unfavorable to you, including your personal background, financial background, and anything else you believe is relevant to your failure.
- An explanation as to the source of funds in all of your foreign financial accounts/assets. For example, explain whether you inherited the account/asset, whether you opened it while residing in a foreign country, or whether you had a business reason to open or use it.
- An explanation of your contacts with the account/asset including withdrawals, deposits, and investment/ management decisions.
- A complete story about your foreign financial account/asset.
- If you relied on a professional advisor, provide the name, address, and telephone number of the advisor and a summary of the advice (this requirement was previously included).
- If married taxpayers submitting a joint certification have different reasons, provide the individual reasons for each spouse separately in the statement of facts (this requirement was also previously included).

IRS Evaluation of Streamlined Submission

The IRS does not send successful applicants an acceptance or closing letter. In this sense, “no news is good news.”

If the IRS does not receive adequate information in the Streamlined submission, it will often follow up with the taxpayer and ask for that information. It may ask for:

- More detailed account information
- More detailed foreign entity information
- More information about the professional whose advice you relied upon
- A further explanation to support your claim of non-willful conduct

The IRS will also compare the information given in the Certification form to the tax returns and FBARs filed. It now also has the ability to compare the information you provide to account data received from foreign financial institutions under the FATCA regime.

Streamlined Program Challenges

- Entities (corporations, partnerships, trusts) are not allowed to participate.
- If the IRS receives or discovers evidence of willfulness or criminal conduct on the part of the taxpayer (e.g., information received from foreign governments or financial institutions), 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. Entrance to the Streamlined program does not guarantee immunity from criminal prosecution.
- Tax years outside years covered in the Streamlined submission are open to examination and audit by the IRS.

Future of Voluntary Disclosure Programs

Recent IRS Announcement:

"A separate program, the Streamlined Filing Compliance Procedures, for taxpayers who might not have been aware of their filing obligations, has helped about 65,000 additional taxpayers come into compliance.

The Streamlined Filing Compliance Procedures will remain in place and available to eligible taxpayers. As with OVDP, the IRS has said it may end the Streamlined Filing Compliance Procedures at some point."

expatXtax PROFESSIONALS

III. New Voluntary Disclosure Program

Outline

- Introduction
- Requirements and Penalty Structure

expatXtax PROFESSIONALS

Introduction

The long-standing tax amnesty program for willful non-compliance, the Offshore Voluntary Disclosure Program ("OVDP"), was officially closed on Sept. 28, 2018.

The popularity of the OVDP had decreased significantly in recent years. It peaked in 2011, when about 18,000 participated, but then steadily declined through the years, falling to only 600 disclosures in 2017.

In its place, the IRS opened a new **Voluntary Disclosure Program** ("VDP"), which is available for taxpayers to make either domestic or offshore voluntary disclosures.

The new program replicates the OVDP in certain ways, but also has significant differences. Details of the program are set out in a memorandum that was published by the IRS in November of 2018.

The memorandum can be found here: https://www.irs.gov/pub/spder/lbi-09-1118-014.pdf

The IRS has not yet published additional guidance on the program.

expatXtax PROFESSIONALS

Requirements and Penalty Structure

Requirements

In general, voluntary disclosures under the program include a six-year disclosure period (a longer period can be negotiated if advantageous to the taxpayer). Taxpayers must submit all required returns and FBARs for the disclosure period.

Penalty Structure

i. The civil penalty under I.R.C. § 6663 for fraud *or* the civil penalty under I.R.C. § 6651(f) for the fraudulent failure to file income tax returns (together, the "civil fraud penalty") will apply to the one tax year with the highest tax liability. This penalty can be as high as 75 percent of the underpayment of tax.

ii. In limited circumstances, examiners may apply the civil fraud penalty to more than one year in the six-year scope (up to all six years) based on the facts and circumstances of the case, for example, if there is no agreement as to the tax liability.

iii. Examiners may apply the civil fraud penalty beyond six years if the taxpayer fails to cooperate and resolve the examination by agreement.

Requirements and Penalty Structure (cont.)

Penalty Structure (cont.)

iv. Willful FBAR penalties will be asserted (for each year) in accordance with existing IRS penalty guidelines (i.e., greater of $100,000 or 50% of account balances).

v. A taxpayer is not precluded from requesting the imposition of accuracy related penalties under I.R.C. § 6662 instead of civil fraud penalties, or non-willful FBAR penalties instead of willful penalties. Given the objective of the voluntary disclosure practice, granting requests for the imposition of lesser penalties is expected to be exceptional. Where the facts and the law support the assertion of a civil fraud or willful FBAR penalty, a taxpayer must present convincing evidence to justify why the civil fraud penalty should not be imposed.

vi. Penalties for the failure to file information returns will not be automatically imposed. Examiner discretion will take into account the application of other penalties (such as civil fraud penalty and willful FBAR penalty) and resolve the examination by agreement.

vii. Penalties relating to excise taxes, employment taxes, estate and gift tax, etc. will be handled based upon the facts and circumstances with examiners coordinating with appropriate subject matter experts.

viii. Taxpayers retain the right to request an appeal with the Office of Appeals.

IV. Delinquent Information Return Programs

Outline

- Introduction
- Delinquent International Information Return Submission Procedures ("DIIRSP")
- Delinquent FBAR Submission Procedures ("DFSP")

expatXtax PROFESSIONALS

Introduction

The delinquent information return programs offer two alternatives to the main tax amnesty programs. These two alternatives are:

(1) Delinquent International Information Return Submission Procedures

(2) Delinquent FBAR Submission Procedures

In general, these are penalty-free disclosure solutions for taxpayers who are only delinquent with respect to international forms or FBARS and therefore do not need a comprehensive program.

(1) Delinquent International Information Return Submission Procedures ("DIIRSP")

U.S. taxpayers with foreign concerns may be required to attach certain international information forms to their federal income tax returns.

Such forms include, for instance:

Form 5471 – ownership interest in a foreign corporation

Form 8865 – ownership interest in a foreign partnership

Form 8858 – ownership in interest in a foreign disregarded entity

Form 3520 – dealings with a foreign trust and the receipt of large gifts from nonresidents

expatXtax PROFESSIONALS

DIIRSP Requirements

The DIIRSP are available to those who do not need to use the OVDP or Streamlined Procedures to file delinquent or amended tax returns to report and pay additional tax, but who:

- have not filed one or more required international information returns
- are not under a civil examination or a criminal investigation by the IRS
- have not already been contacted by the IRS about the delinquent information returns
- have "**reasonable cause**" for not timely filing the information returns

The taxpayer must file the delinquent information returns with a statement of all facts establishing reasonable cause for the failure to file. Assuming the taxpayer meets these criteria, the IRS will not impose a penalty for failure to file the delinquent information returns.

expat X tax PROFESSIONALS

What constitutes “reasonable cause”?

IRS FAQ:

“The longstanding authorities regarding what constitutes reasonable cause continue to apply, and existing procedures concerning establishing reasonable cause, including requirements to provide a statement of facts made under the penalties of perjury, continue to apply. See, for example, Treas. Reg. § 1.6038-2(k)(3), Treas. Reg. § 1.6038A-4(b), and Treas. Reg. § 301.6679-1(a)(3)”

IRS Internal Revenue Manual 20.1.9.1.1(4)

“…taxpayers who conduct business or transactions offshore or in foreign countries have a responsibility to exercise ordinary business care and prudence in determining their filing obligations and other requirements. It is not reasonable or prudent for taxpayers to have no knowledge of, or to solely rely on others for, the tax treatment of international transactions.”

expatXtax PROFESSIONALS

What constitutes “reasonable cause”? (cont.)

Court Decisions

Congdon v. U.S. [108 AFTR 2d 2011-6343 (E.D. Texas 2011)]

Taxpayer held a partnership that formed offshore entities for clients. The partnership owned a controlled foreign corporation (CFC). Taxpayer filed Form 5471 and did report the income from the CFC on the Form 1040, but he did not report the income on the Form 5471. The IRS imposed a $10,000 penalty for filing a substantially incomplete Form 5471.

Taxpayer argued reasonable cause, arguing that he was not a tax expert and he misunderstood the instructions for Form 5471. The government argued that neither ignorance of the law nor complexity of the tax laws constituted reasonable cause.

The Court held for the Taxpayer, concluding that although ignorance of the law alone is not sufficient to constitute reasonable cause, inexperience in tax matters, the complexity of the law, and a good record of compliance can show reasonable cause.

See also Nance v Commissioner [111 AFTR 2d 2013-1616 (W.D. Tenn. 2013)].

The court ruled that if Taxpayer could show that his accountant had advised him that he did not need to file Form 3520 and that he reasonably relied on that advice, he would have reasonable cause.

(2) Delinquent FBAR Submission Procedures (“DFSP”)

The Bank Secrecy Act (BSA) gives the Department of Treasury the authority to collect information from United States persons, including expats, who have financial interests in or signature authority over financial accounts maintained with financial institutions located outside of the United States.

The BSA requires that a **FinCEN Report 114**, Report of Foreign Bank and Financial Accounts (**FBAR**), be filed if the maximum values of the foreign financial accounts exceed $10,000 in the aggregate at any time during the calendar year.

FBAR Penalties

Examples of FBAR delinquency penalties include the following:

FBAR Civil Penalties

Negligent or "**non-willful**" delinquency can result in a penalty of $10,000 per account per year unless there is reasonable cause for failing to file.

A "**willful**" failure to file could be subject to civil penalties equal to the greater of $100,000 or 50% of the balance in each unreported account.

FBAR Criminal Penalties

A willful violation can result in fines of up to $250,000 and 5 years of jail time.

Note: Monetary penalties are subject to inflation.

Willful versus Non-Willful in the FBAR Penalty Context

Courts' Approach

Consistent with the Supreme Court's interpretation of the word "willful" in the civil context, courts in recent years have consistently held that the standard for "willfulness" for civil FBAR violations includes **recklessness** and **willful blindness**.

Theses courts rejected the stricter "intentional violation" threshold used in the criminal context.

As is the case with the standard for willfulness, the courts have been uniform with regard to the burden of proof for civil FBAR penalties; the government bears the burden of proving liability for the civil FBAR penalty by a **preponderance of the evidence** (the event was more likely than not to have occurred).

Case Citations

U.S. v. Garrity, 2018 U.S. Dist. LEXIS 56888 (D. Conn. 2018)

Bedrosian v. US, 2017 U.S. Dist. LEXIS 56535 (ED PA 2017))

US v. August Bohanec et ux, USDC CD Ca., No. 2:15-cv-04347 (December 2016))

expatXtax PROFESSIONALS

Willful versus Non-Willful in the FBAR Penalty Context

The Horowitz Case – 2019

(2019 U.S. Dist. LEXIS 9484 (D. Md. 2019))

Peter and Susan Horowitz maintained a Swiss account with a balance of almost $2 million. The account was originally opened when the taxpayers lived abroad in Saudi Arabia, but they kept the account open when they moved back to the US. The Horowitzes did not disclose the account to their U.S. tax preparer. They signed their tax returns each year answering “No” to the 1040, Schedule B, question about whether they had money in an account overseas or filed the FBAR to disclose the foreign account.

In 2010, they finally disclosed the account as part of entering the OVDP tax amnesty program, but they opted out of the program some time afterwards. In 2014, the IRS assessed penalties of $247,030 against each of them for the 2007 and 2008 tax years.

The Horowitzes appealed the proposed enhanced FBAR penalties, and the Appeals officer actually partially sided with them and requested that the IRS Appeals FBAR coordinator remove and reverse the FBAR penalties as prematurely assessed. The IRS then sued to collect the enhanced penalties.

The Court held, among other things, that the willfulness penalty should apply with respect to both Peter and Susan for 2007 and with respect to Peter only for 2008 (because Susan did not have a financial interest in the account in that year).

Willful versus Non-Willful in the FBAR Penalty Context

The Horowitz Case – 2019 (cont.)

It then brought case law precedent that “willful blindness” is an appropriate standard for determining whether enhanced FBAR penalties should apply. The Court argued that the standard was violated when the Horowitzes answered “No” to the 1040, Schedule B, question about whether they had money in an account overseas or filed a file the FBAR to disclose the foreign account.

The Horowitzes testified that friends in Saudi Arabia advised Peter that the FBAR was not required because the money in the account was earned overseas. Susan testified that she did not know about the FBAR at the time of the filing. They also argued that their U.S. tax accountants did not ask about their overseas bank accounts, and that they did not explain to the Horowitzes exactly what was being asked on the tax return about foreign accounts.

The Court concluded that the Horowitzes were “willfully blind” with respect to their FBAR requirements, and therefore the IRS correctly imposed the enhanced FBAR penalty. The Court reasoned that the fact they did not have a conversation about their accounts with their tax preparers, despite being aware enough to ask the advice of their friends on the matter, showed a conscious effort on their part to avoid properly learning what their obligations were at the time, which amounts to willful blindness.

Willful versus Non-Willful in the FBAR Penalty Context

IRS's Approach – Program Manager Technical Advice 2018-013

ISSUES

1. Section 5321(a)(5)(C) of Title 31 provides the maximum penalty amount for civil willful violations of the foreign bank and financial account reporting and recordkeeping requirements under 31 U.S.C. 5314 (FBAR requirements). What is the standard for willfulness?
2. What is the burden of proof for establishing that a civil violation of the FBAR requirements is willful?

CONCLUSIONS

1. The standard for willfulness under 31 U.S.C. 5321(a)(5)(C) is the civil willfulness standard, and includes not only knowing violations of the FBAR requirements, but **willful blindness** to the FBAR requirements as well as **reckless violations** of the FBAR requirements.
2. The burden of proof for establishing that a civil violation of the FBAR requirements is willful is **preponderance of the evidence**.

expatXtax PROFESSIONALS

Willful versus Non-Willful in the FBAR Penalty Context (cont.)

Factors Weighed by IRS (IRS Internal Documents):

Factors supporting a willful FBAR penalty:

Opened the foreign bank account

Owner of, or a financial interest in, the foreign account

Tax non-compliance

Did not seek advice, or relied upon the advice of an unqualified tax professional

Violations persist after notification of FBAR requirements

Foreign account not disclosed to return preparer

No business reason for the foreign account

No family or business connection to the foreign country

An offshore entity owns the account

Previously-filed FBARs don't include all foreign accounts

Illegal income in the foreign account

Participated in an abusive tax avoidance scheme

Factors not supporting a willful FBAR penalty:

Inherited the foreign bank account

Only signature authority over the foreign bank account

Tax compliance

Relied upon the advice of a tax return preparer, a CPA, attorney, or other qualified tax professional

Full compliance after notification of FBAR reporting requirements

Foreign account disclosed to return preparer

Business reason for the foreign account

Family or business connection to the foreign country

Person owns the account in his name

expatXtax PROFESSIONALS

DFSP Requirements

Under the DFSP, a taxpayer is required to submit missing FBARs going back six years and include a brief statement explaining why the FBARs were filed late (note that reasonable cause is not required, just a statement of explanation – of course, the more convincing the explanation the better, but there's no specific threshold that has to be met).

In order to be eligible for the program, you need to meet the following criteria:

- the taxpayer is not required to submit missing or amended tax returns (because all income was reported on the taxpayer's original returns);
- the taxpayer is not under a civil examination or a criminal investigation by the IRS; and
- the taxpayer has not already been contacted by the IRS regarding their delinquent FBARs.

Assuming the taxpayer meets the above criteria, the IRS has stated that it will not impose a penalty for failure to file the delinquent FBARs.

(So these procedures, like the DIIRSP, are a great way to catch up with the IRS, and avoid penalties completely.)

V. Alternative Disclosure Approaches

expatXtax PROFESSIONALS

Alternative Disclosure Approaches

While the current amnesty programs can offer beneficial results for many delinquent U.S. taxpayers, they do not necessarily allow taxpayers completely off the hook. For instance, under each program, taxpayers must still pay tax due with interest. Further, the Streamlined domestic procedures bear a 5% penalty, and the new Voluntary Disclosure Program has significant penalties as well.

These disadvantages have led some delinquent taxpayers to abandon the amnesty programs and instead try their luck with the following alternative approaches.

(1) "Noisy" Disclosure – Under this approach, the taxpayer files past delinquent returns with a statement explaining the reasons for the delinquency.

(2) "Quiet" Disclosure – Under this approach, the taxpayers files delinquent returns without any statement of explanation.

Thank you!