Navigating the IRS Penalty Abatement Procedures for Foreign Information Reporting Noncompliance
Requesting Penalty Abatements for Failure to File Forms 5471, 5472, FATCA and FBAR

TUESDAY, SEPTEMBER 12, 2017
1pm Eastern  |  12pm Central  |  11am Mountain  |  10am Pacific

Today’s faculty features:

Dennis N. Brager, Esq., Brager Tax Law Group, Los Angeles

Joel N. Crouch, Managing Partner, Meadows Collier Reed Cousins Crouch & Ungerman, Dallas

The audio portion of the conference may be accessed via the telephone or by using your computer’s speakers. Please refer to the instructions emailed to registrants for additional information. If you have any questions, please contact Customer Service at 1-800-926-7926 ext. 10.

NOTE: If you are seeking CPE credit, you must listen via your computer — phone listening is no longer permitted.
**Tips for Optimal Quality**

**Sound Quality**
If you are 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, you may listen via the phone: dial 1-866-328-9525 and enter your PIN when prompted. Otherwise, please send us a chat or e-mail sound@straffordpub.com immediately so we can address the problem.

If you dialed in and have any difficulties during the call, press *0 for assistance.

**NOTE:** If you are seeking CPE credit, you must listen via your computer — phone listening is no longer permitted.

**Viewing Quality**
To maximize your screen, press the F11 key on your keyboard. To exit full screen, press the F11 key again.
In order for us to process your continuing education credit, you must confirm your participation in this webinar by completing and submitting the Attendance Affirmation/Evaluation after the webinar.

A link to the Attendance Affirmation/Evaluation will be in the thank you email that you will receive immediately following the program.

For CPE credits, attendees must participate until the end of the Q&A session and respond to five prompts during the program plus a single verification code. In addition, you must confirm your participation by completing and submitting an Attendance Affirmation/Evaluation after the webinar and include the final verification code on the Affirmation of Attendance portion of the form.

For additional information about continuing education, call us at 1-800-926-7926 ext. 35.
Mr. Crouch is Managing Partner of Meadows, Collier, Reed, Cousins, Crouch & Ungerman, L.L.P. He represents a broad range of clients, including individual taxpayers, closely-held business enterprises, estates, corporations and tax advisors in all stages of federal civil and criminal tax proceedings. In almost 30 years of practice, he has helped his clients resolve hundreds of civil and criminal tax matters, many of which involved sophisticated and complex legal and tax issues, both domestic and international.

Mr. Crouch is board certified in tax law by the Texas Board of Legal Specialization and has been recognized as one of the best in his field by Texas Monthly and Law and Politics Magazines by being named a Texas Super Lawyer from 2003 through 2017. He has also been named one of the Best Lawyers in Dallas by D Magazine for the year 2012-2017. He has been named to Best Lawyers in America for Tax Law and recognized as a Top Rated Lawyer in White Collar Criminal Defense Law by ALM as published in The American Lawyer, Corporate Counsel and The National Law Journal.

He is a frequent speaker on both substantive and procedural tax issues for both legal and accounting professionals. Topics include Tax Shelter Defense, IRS Examinations, Appeals, Litigation and Collection Strategies, IRS Criminal Investigations, IRS Offshore Activities, IRS Focus on Tax Professionals, Employment Classification, IRS penalties, and Litigating Partnership Tax Cases. Mr. Crouch has published various articles re: the IRS & tax procedures.
IRS Policy on Penalties

• Penalties exist to encourage voluntary compliance by supporting the behavioral standards expected by the Code. Although penalties also serve to bring additional revenue and indirectly fund enforcement costs, these results are not reasons for creating and imposing penalties. Nor should they be used as a bargaining point in resolving a taxpayer’s other tax adjustments.

• Voluntary compliance is achieved when taxpayers make a good faith effort to meet their tax obligations.

• To be fair and effective, penalties should be severe enough to deter noncompliance, encourage noncompliant taxpayers to comply, be objectively proportioned to the offense, and be used as an opportunity to educate taxpayers and encourage their future compliance.

• Penalty administration should ensure consistency, accuracy, and impartiality.
“Undisclosed foreign financial asset” means any asset which information was required to be provided under §§ 6038, 6038B, 6038D, 8938, 6046A or 6048 and was not disclosed.

In the case of any portion of an underpayment which is attributable any undisclosed foreign financial asset understatement, the penalty is 40% of the underpayment of tax.

No penalty will be imposed if the taxpayer can establish that the failure to comply was due to reasonable cause and the taxpayer acted in good faith.
Form 8938 – Statement of Foreign Financial Assets

- Reports the taxpayer’s interest in certain foreign financial assets, including financial accounts, certain foreign securities and interest in foreign entities as required by IRC Section 6038D.
- Penalty is $10,000 per return, with an additional $10,000 per month of delinquency beginning 90 days after the taxpayer is notified of the delinquency.
- Maximum of $50,000 per return.
- Failure to file a Form 8938 or failure to report a specified foreign financial asset required to report, will result in the statute of limitations remaining open for all or part of the tax return until 3 years after the date of the Form 8938 is filed.
- No penalty will be imposed if the taxpayer can establish that the failure to comply was due to reasonable cause and not due to willful neglect.
Form 3520 - Annual Return to Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts

• Includes creation of a foreign trust, transfers of property to a foreign trust, and receipt of distributions from a foreign trust.
  – Penalty is the greater of $10,000, or 35% of the gross reportable amount.

• Also used for receipt of gifts from a foreign entity, including a foreign estate.
  – Penalty is 5% of the value of the gift per month up to a maximum of 25% of the value of the gift.

• No penalty will be imposed if the taxpayer can demonstrate that the failure to comply was due to reasonable cause and not willful neglect.
A foreign trust with a U.S. owner must file form §3520-A in order for the U.S. owner to satisfy his or her annual information report requested under IRC§ 6048(b).

Each U.S. person treated as an owner of any portion of a foreign trust under §§671-679 is responsible for ensuring that their foreign trust files Form §3520-A and furnishes the required annual statements to it’s U.S. owners and U.S. beneficiaries.

Penalty is the greater of $10,000 or 5% of the gross value of trust assets determined to be owned by the U.S. person.

No penalties will be imposed if the taxpayer can establish that the failure to comply was due to reasonable cause and not willful neglect.
• Certain United States persons who are officers, directors or shareholders in certain foreign corporations (including International Business Corporations) are required to report information about their ownership interest.
• Penalty 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. Maximum of $50,000 per return.
• Reduction of the foreign tax available for credit under §§901, 902, & 960.
• **Subject to Reasonable Cause Defense.**
• Pursuant to IRC § 6038B, taxpayers are required to report transfers to foreign corporations and other information.
• Penalty is 10% of the value of the property transferred, up to $100,000.
• No limit for an intentional failure to report a transfer.
• The penalty will not apply if the failure for comply is due to reasonable cause and not to willful neglect.
• The period of limitations for assessment of tax is extended to the date that is 3 years after the date of which the information required to be reported is provided.
Pursuant to IRC §§ 6038, 6038B and 6046A, U.S. persons with certain interests in foreign partnerships must report interest in and transactions of foreign partnerships, transfers of property to the foreign partnerships and acquisitions, dispositions and changes in foreign partnership interests.

Penalty for failure to file 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.

Penalty also includes 10% of the value of any transferred property that is not reported, up to a maximum of $100,000.

Penalty does not apply if it is shown that the failure to comply was due to reasonable cause.
First-Time Penalty Abatement

• First-Time Penalty Abatement-IRM 20.1.1.3.6.1
• Administrative waiver.
• Applies to penalties for failure to file, pay on time, and / or to deposit taxes.
• Conditions:
  – Taxpayer didn’t previously have to file a return or had no penalties for the 3 tax years prior to the tax year in which a penalty applies.
  – Taxpayer filed all currently required returns or filed an extension of time to file.
  – Taxpayer paid, or arranged to pay, any tax due.
<table>
<thead>
<tr>
<th>FORM</th>
<th>REQUIRED BY</th>
<th>PENALTY</th>
<th>STANDARD</th>
</tr>
</thead>
<tbody>
<tr>
<td>5472</td>
<td>IRC 6038A</td>
<td>IRC 6038A(d)</td>
<td>Reasonable cause</td>
</tr>
<tr>
<td>5471</td>
<td>IRC 6046(a)</td>
<td>IRC 6679(a)</td>
<td>Reasonable cause</td>
</tr>
<tr>
<td>8865</td>
<td>IRC 6046A</td>
<td>IRC 6679(a)</td>
<td>Reasonable cause</td>
</tr>
<tr>
<td>3520</td>
<td>IRC 6048</td>
<td>IRC 6677(d)</td>
<td>Reasonable cause + no willful neglect</td>
</tr>
<tr>
<td>3520-A</td>
<td>IRC 6048</td>
<td>IRC 6677(d)</td>
<td>Reasonable cause + no willful neglect</td>
</tr>
<tr>
<td>8938</td>
<td>IRC 6038D</td>
<td>IRC 6038D(g)</td>
<td>Reasonable cause + no willful neglect</td>
</tr>
<tr>
<td>926</td>
<td>IRC 6038B</td>
<td>IRC 6038B(c)</td>
<td>Reasonable cause + no willful neglect</td>
</tr>
<tr>
<td>FBAR</td>
<td>31 USC 5314</td>
<td>31 USC 5321(a)(5)(B)(i)</td>
<td>Reasonable cause + no willful neglect</td>
</tr>
</tbody>
</table>

FBAR
Former TD F 90-22.1
Now Fin CEN Report 114
Reasonable Cause

• The “reasonable cause” standard draws on a broad range of potentially applicable guidance, including the I.R.C., Treasury Regulations, the IRS’s Penalty Handbook contained in the I.R.M. (I.R.M. 20.1), and case law. “Reasonable cause is based on all the facts and circumstances. . . .” I.R.M. 20.1.1.3.2 (Nov. 25, 2011).

• “Reasonable cause relief is generally granted when the taxpayer exercised ordinary business care and prudence in determining their tax obligations but nevertheless failed to comply with those obligations.” Id.

• Mistake,” “forgetfulness,” or ignorance of the law typically will not establish reasonable cause and are sometimes pointed to as indicating a lack thereof.
• The determination of reasonable cause may involve the following:

• *IRM Section 20.1.1.3.2 paragraph (6)* further provides that reasonable cause does not exist where, after the facts that caused the noncompliant behavior cease to exist, the taxpayer fails to comply with the tax obligation within a reasonable time.

• *IRM Section 20.1.1.3.2.2.6. paragraphs (1) and (2)* states that the "ordinary care prudent business standard requires that taxpayer makes reasonable efforts to determine their tax obligations" and “reasonable cause may be established if the taxpayer shows ignorance of the law in conjunction with other facts and circumstances."

• *IRM Section 20.1.1.3.2.2.6 paragraph (2)(E)* provides that when considering various factors as a basis for whether a taxpayer is ignorant of the law, the IRM provides "the level of complexity of a tax or compliance issue” is another factor that should be considered in evaluating reasonable cause because of ignorance of the law."
The Internal Revenue Manual (IRM) explains several key criteria for relief from penalties, including reasonable cause. IRM Section 20.1.1.3.2, paragraph (5) provides that the following inquiries are relevant to the question of reasonable cause:

- What happened and when did it happen?
- During the period of time the taxpayer was non-compliant, what facts and circumstances prevented the taxpayer from filing a return, paying a tax, and/or otherwise complying with the law?
- How did the facts and circumstances prevent the taxpayer from complying?
- How did the taxpayer handle the remainder of their affairs during this time?
- Once the facts and circumstances changed, what attempt did the taxpayer make to comply?
Reasonable Cause – Important Factors

• The taxpayer’s compliance history.

• Length of time.

• Circumstances beyond the taxpayer’s control.
IRS’s Position on Reasonable Cause

- The IRS will not address a penalty abatement request until it confirms that the taxpayer is in compliance with the filing requirements for all open years that are not on extension.
- Reasonable cause determinations can only be made by the unit that asserted the penalty (e.g., campus cannot allow reasonable cause for a penalty asserted by LB&I, TE/GE, or SB/SE Field Office Examination).
- A taxpayer’s repeated failure to file does not support testimony that the taxpayer demonstrated normal business care or prudence for the older, late-filed years.
- A taxpayer’s testimony that records were not available year after year has no merit.
- Reasonable cause is not available after a taxpayer receives notification from the IRS that he has 90 days to file the unfiled return. Treas. Reg. § 1.6038-2(k)(3)(i).
When Reasonable Cause Does Not Exist

- A foreign country’s imposition of penalties on the taxpayer for disclosing the information;
- A foreign trustee refuses to provide the information for any reason, including difficulty in producing the required information; or
• Taxpayer’s education, sophistication and business experience are relevant in determining whether the taxpayer’s reliance on the advice was reasonable and in good faith.
REASONABLE CAUSE - Reliance

• Leading case *U.S. v Boyle*, 469 U.S. 241 (1985)

  – “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. (citation omitted) Ordinary business care and prudence" do not demand such actions.”

  – “By contrast, one does not have to be a tax expert to know that tax returns have fixed filing dates and that taxes must be paid when they are due. In short, tax returns imply deadlines. Reliance by a lay person on a lawyer is of course common; but that reliance cannot function as a substitute for compliance with an unambiguous statute.”
• *Estate of J. H. Thouron v U.S.*, 752 F.3d 311 (3rd Cir 2014)
• Form 706 late payment penalty (6651(a)(2)) case.
• Third Circuit interpreted *Boyle*
  – *Boyle* created three types of reliance on an agent
    • Reliance in ministerial task of paying taxes and filing returns
    • Reliance in which return is filed after due date but within time erroneously advised by tax professional
    • Reliance on tax professional’s advice about a matter of tax law
  – *Thouron* confines *Boyle*’s holding to the first type
  – *Thouron* holds that reliance on a qualified tax professional (types 2 and 3) may be constitute reasonable cause for 6651(a)(1) and (a)(2) penalties
• *Peter Knappe v U.S.* 713 F.3d 1164 (9th Cir 2013)
• Form 706 late filing penalty (6651(a)(1)) case.
  – Taxpayer personally filed the return after the actual deadline, but within the time that the CPA erroneously told him was available. The Supreme Court in *Boyle* expressly declined to address this precise question.
  – Ninth Circuit found determining the filing deadline of a tax return, and when the estate tax return was due once an extension had been obtained are non-substantive tax advice issues.
• Of interest *Thouron* doesn’t mention *Knappe* even though it was decided well before the *Thouron* opinion was issued
The undisputed facts of this case indicate that the executors were endeavoring to exercise care in the administration of the estate, and relied upon the advice of counsel to aid them in that effort. These facts reflect that the executors applied for an extension of the payment and filing deadlines, in accordance with the advice of counsel. This advice and the executors' reliance on it was eminently reasonable and prudent under the circumstances, where inexperienced executors were buffeted by and contending with intra-family disputes over asset valuations and other matters that hampered their ability to fulfill their legal obligations. Moreover, nothing in the record remotely suggests that the executors were cavalier in their attention to the tax rules, or were seeking to do anything other than ensure that the estate paid its taxes faithfully.

The record thus strongly supports the executors' assertion that they reasonably relied upon the advice of their legal counsel, and that they took the steps they reasonably believed were required of them to pay the estate's taxes and file its return in accordance with the law. On these undisputed facts, we find that the executors exercised ordinary business care and prudence in relying upon their counsel's erroneous assertion that the deadline for filing the return and paying the taxes owed had been extended for 12 months, and the Court is not persuaded that Boyle or other binding authority compel a contrary finding.
Reliance

• Was the advisor a competent professional who had sufficient expertise to justify reliance?
• Did the taxpayer provide necessary and accurate information to the advisor?
• Did the taxpayer rely in good faith on the advisor’s judgment?

– Neonatology Assoc. v. Comm’r 115 T.C. 43 (2000), affd’d, 299 F.3d 221 (3rd Cir. 2002)
• The Tax Court rejected penalties and additions to tax in the case based on the taxpayer’s reliance on a tax professional.

• The court rejected an IRS argument that the company should have conducted a deeper investigation of its long-time adviser’s competency.
How to Request

• For I.R.C. § 6038 penalties, the taxpayer must submit a written statement signed under penalties of perjury that makes an affirmative showing of all of the facts which support the claim that the failure to file resulted from reasonable cause. Treas. Reg. § 1.6038-2(k)(3)(ii).

• For the I.R.C. § 6038 penalty, if the taxpayer demonstrates that he substantially complied with the filing requirements, any omissions or errors will not be considered a failure to file and the penalty does not apply.
On June 19, 2017, IRS released an International Practice Unit (IPU) on the meaning of “substantial compliance” for purposes of determining whether certain international information returns are sufficiently complete to avoid penalties.

In exploring IRS rulings and court decisions defining the substantial compliance doctrine, the IPU emphasizes the distinction between income tax returns and informational returns.

- Information reported on income tax returns is necessary to determine tax liability. As such, if a taxpayer omits information that is not necessary to determine tax liability, the return may be considered complete notwithstanding the omission.
- Information returns are required so that the IRS can properly administer the revenue laws. If material information is left off an information return, such omission can impede the IRS’ ability to perform the duties placed on it by Congress.
- Because income tax and information returns serve different functions, the IPU notes that different rules should apply.

A court might apply the generally applicable substantial compliance doctrine to international information returns, including Forms 8865, 8858, 926, 3520, 3520-A and 5471.

A return that is incomplete is no return at all, potentially exposing the taxpayer to penalties.
The IPU provides several examples where an international return was not “substantially complete” and penalties applicable. Among the noteworthy examples are:

- A taxpayer filed a Form 5471 that “accurately reported the majority of the information, but it failed to accurately report major transactions with related parties.” The IRS rejected an “aggregate approach,” under which a taxpayer would be considered to be in substantial compliance if it accurately reported a certain percentage of the information required to be reported on the Form 5471.

- A taxpayer filed separate Forms 5471 for a large number of Controlled Foreign Corporations (CFCs). Each Form 5471 reported much of the required information and included numerous pages of detailed financial information regarding financial condition, corporate stock structure, shareholders and results of operations. However, the Service identified significant understatements of purchases from and/or sales to some CFCs and related third parties (reported on Schedule M, Transactions Between Controlled Foreign Corporation and Shareholders or Other Related Persons) and significant inconsistencies in the reported earnings and profits of some CFCs.

- A taxpayer filed Form 5471 that reported amounts on Schedules C, Income Statement, and F, Balance Sheet that were not in accordance with GAAP and failed to attach Schedule O, Organization or Reorganization of Foreign Corporations and Acquisitions and Dispositions of Its Stock. In concluding the Form 5471 was incomplete, the IRS declared that “failure to include Schedule O, by itself, is likely to cause the taxpayer to fail the substantial compliance test.”
The CCA provides a list of seven factors that should be considered in a facts and circumstances analysis:

1. The magnitude of the underreporting, or of the over-reporting, of the erroneous reported transaction(s) in relation to the actual total amount of that reported type of transaction(s).

2. Whether the reporting corporation has reportable transactions other than the erroneous reported transaction(s) with the same related party and correctly reported such other transactions.

3. The magnitude of the erroneous reported transaction(s) in relation to all of the other reportable transactions as correctly reported.

4. The magnitude of the erroneous reported transaction(s) in relation to the reporting corporation’s volume of business and overall financial situation.

5. The significance of the erroneous reported transaction(s) to the reporting corporation’s business in a broad functional sense.

6. Whether the erroneous reported transaction(s) occur(s) in the context of a significant ongoing transactional relationship with the related party.

7. Whether the erroneous reported transaction(s) is (are) reflected in the determination and computation of the reporting corporation’s taxable income.
Procedures for Challenging at the Conclusion of the Examination

• Deficiency procedures do not apply.
• Only the examination function that assessed the penalty has the authority to abate the penalty. I.R.M., pt. 20.1.9.2.4(3) (Mar. 21, 2013).
• The examiner assigned to the case must confirm the taxpayer has satisfied all filing requirements for all open years before considering an abatement request. I.R.M., pt. 20.1.9.2.4(1) (Mar. 21, 2013).
Requests for Abatements

• Form 843, Claim for Refund and Request for Abatement, is filed when a taxpayer seeks abatement of a penalty due to reasonable cause or other reason.

• The Form 843 must be filed with the IRS center where the taxpayer would be required to file the current year’s tax return. Once the Form 843 is filed, the case will be transferred to the Examination group that made the initial assessment for review.

• The filing of Form 843 will not automatically stay the collection process. The taxpayer should communicate with the collection group to ensure that no enforced collection action is taken while the request for penalty abatement is pending.

  – Whenever a taxpayer presents information that raises a reasonable doubt as to the correctness or validity of an assessment, the IRS should exercise reasonable forbearance in its collection efforts. I.R.M., pt. 1.2.14.1.4 (Mar. 1, 1984) (formerly Policy Statement 5-16).

  – Even if there is a stay in enforced collection activity, interest will continue to accrue while the request for an abatement of the penalties is pending.
1. Is the taxpayer’s request based on a frivolous position?
   If Yes – Deny
   If No – Continue

2. Is the taxpayer claiming they are first time filer and were unaware of the filing requirement?
   If Yes- Deny
   If No – Continue

   (IRM notes – don’t confuse with FTA on primary return)

   (IRM notes – Ordinary business care and prudence requires the taxpayer to determine their tax obligations when establishing a business in a foreign country)

3. Is the taxpayer requesting that the penalty be waived because of financial problems?
   If Yes – Deny
   If No – Continue

Exhibit 21.8.2-1  Form 5471 Decision Tree
4. Is the taxpayer claiming that the return was filed late because the transactions, laws or business structure was complicated?
   If Yes – Deny
   If No – Continue

5. Is the taxpayer claiming that because the corporation was involved in multiple layers of ownership, it prevented them from filing timely?
   If Yes – Deny
   If No – Continue

6. Is the taxpayer claiming that the return was filed late because of difficulty in obtaining foreign information?
   If Yes – Deny
   If No – Continue

7. Is the taxpayer asserting that Form 5471 is not required to be filed for the foreign corporation?
   If yes – Refer to Exam
   If No – Continue
10-20. Cover

Assessment Error
Bankruptcy
Casualty or Disaster
Death, Serious Illness or Absence
Extension
Ignorance Of The Law
IRS Error
Mail Problems
OVDI, OVDP or FAQ 18
Records Unobtainable
Reliance Error
## RELIANCE ERROR

Who did the taxpayer rely on?

<table>
<thead>
<tr>
<th>Option</th>
<th>Action</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Responsible Officer/partner</td>
<td>Continue</td>
</tr>
<tr>
<td>2. CPA or Accountant</td>
<td>Continue</td>
</tr>
<tr>
<td>3. Attorney</td>
<td>Continue</td>
</tr>
<tr>
<td>4. IRS Employee</td>
<td>Go to IRS – Error</td>
</tr>
<tr>
<td>5. Bookkeeper</td>
<td>Deny</td>
</tr>
<tr>
<td>6. Person assisting in establishment of Foreign Corporation</td>
<td>Deny</td>
</tr>
<tr>
<td>7. Information in tax plan or promotion</td>
<td>Deny</td>
</tr>
<tr>
<td>8. Financial advisor</td>
<td>Deny</td>
</tr>
<tr>
<td>9. Business Associate</td>
<td>Deny</td>
</tr>
<tr>
<td>10. Someone else</td>
<td>Deny</td>
</tr>
</tbody>
</table>
Was the taxpayer’s reliance reasonable?
1. Reliance involved avoidance of substantial income
   Deny
2. Reliance was based on frivolous positions
   Deny
3. Taxpayer substantially changed filing positions
   Deny
4. Taxpayer did not take reasonable steps to investigate
   Deny
5. Taxpayer did not request a 2nd opinion
   Deny
Protesting the Examiner’s Conclusions

- Request a conference with the examiner and his manager to discuss the determination that the taxpayer is liable for penalties.
- If there is still disagreement, the taxpayer has a right to file a protest to have the IRS Office of Appeals (“Appeals”) review the determination. The protest must be filed within the time period set forth in the IRS’s correspondence to the taxpayer.
- If the examination period concluded and the period for filing a protest expired, then the procedures outlined above are not applicable.
Appeals’ Review of Penalty Assessments

- Appeals has the authority to review penalties after they have been assessed by the examination function. I.R.M. 8.11.5.1(7)(Dec. 18, 2015).

- Appeals has the authority to consider the applicable statutory, regulatory and judicial guidance related to the penalty and may consider “hazards of litigation” to resolve the case. I.R.M., pt. 8.11.5.1(12) (Dec. 18, 2015).

- If Appeals determines the penalty should be partially abated, Appeals will give the taxpayer an additional 30 days to provide additional information. If no information is provided, the taxpayer will receive an additional 15 days to provide additional information. I.R.M. 8.11.4.1.6(6)(Nov. 20, 2014).

- Appeals should resolve the case as expeditiously as possible, generally within 90 days. I.R.M., pt. 8.11.4.1.6(1) (Nov. 20, 2014).

- The taxpayer should communicate with the Collection group and inform the group of the status of the appeal. I.R.M., pt. 8.11.5.1(9) (Dec. 18, 2015).
- Taxpayer’s untimely filing of Forms 5472 for each of the tax years was due to reasonable cause.
  - Appeals settles cases based on hazards of litigation. Based on the information in the file, the government would have substantial litigating hazards, but Taxpayer would have hazards as well. Reasonable cause is based on all the facts and circumstances in each situation, and is generally present when the taxpayer exercised ordinary business care and prudence in determining his or her tax obligations but nevertheless was unable to comply with those obligations.
  - Under the Boyle standard, in order to establish reasonable cause, the Taxpayer must demonstrate that the late filing was beyond its control. The information in the file indicates that while Taxpayer made a good faith effort to comply once he became aware of the filing requirements, he did not seek advice regarding the requirement until 2 or 3 tax returns were past due. Based on the information in the file, this was not beyond Taxpayer’s control, and it does not demonstrate ordinary business care and prudence. Therefore, Taxpayer does have some litigating hazards.
  - Appeals reduced penalty from $80,000 to $4000.
Audit Reconsideration Requests

• The audit reconsideration process is used to reevaluate the results of a prior audit if the taxpayer disagrees with the original determination and there is new information that was not considered during the original examination. I.R.M., pt. 4.13.1.2 (Dec. 16, 2015).

• The IRS will grant an audit reconsideration request when:
  – The taxpayer did not appear for the audit;
  – The taxpayer moved and did not receive IRS correspondence; or
  – The taxpayer has new documentation that is pertinent to the issues presented.
The IRS will not consider a request for audit reconsideration if:

(a) The taxpayer has already been afforded an audit reconsideration request and did not provide any additional information with his/her current request that would change the audit results;
(b) The assessment was made as a result of a closing agreement entered into under I.R.C. § 7121 using Form 906, Closing Agreements on Final Determination Covering Specific Matters, or Form 866, Agreement as to Final Determination of Tax Liability, or some combination of the two forms;
(c) The assessment was made as a result of a compromise under I.R.C. § 7122. These agreements are final and conclusive. A final compromise determination can be identified on IDRS by the posting of a TC 788;
(d) The assessment was made as the result of final TEFRA administrative proceedings;
(e) The assessment was made as a result of the taxpayer entering into an agreement on Form 870-AD, Offer to Waive Restrictions on Assessment and Collection of Tax Deficiency and to Accept Overassessment;
(f) The Tax Court has entered a decision that has become final, or a District Court or the United States Court of Federal Claims has rendered a judgment on the merits that has become final; or
(g) The Tax Court has dismissed a case for lack of prosecution.
Audit Reconsideration Requests

• To request the audit reconsideration, the following items must be present:
  – The taxpayer filed the tax return for the disputed item;
  – The assessment remains unpaid or the IRS reserved credits that the taxpayer is disputing;
  – The taxpayer must identify the adjustments that are in dispute;
  – The taxpayer must provide new information that was not considered during the original audit; and
  – There was a computational or processing error in assessing the tax.
Litigation of Penalty Cases

- **Tax Court:**
  - In a deficiency proceeding, the Tax Court does not have jurisdiction over the assessment of the monetary penalties.
  - In a deficiency proceeding, the Tax Court has jurisdiction over a reduction in a taxpayer’s foreign tax credits pursuant to I.R.C. § 6038.
  - In *Flume v. Commissioner*, T.C. Memo. 2017-21, the Tax Court held the taxpayer could challenge the imposition of a penalty for failure to file a Form 5471 where the taxpayer did not otherwise have an opportunity to challenge the imposition of that penalty. Notably, the IRS did not assert in *Flume* that the opportunity to go to Appeals was a prior opportunity for purposes of I.R.C. § 6330(c)(2)(B).
• U.S. District Court
  – A U.S. district court lacks jurisdiction to hear a case where a taxpayer seeks an injunction to remove a lien or prevent a levy in connection with the collection of a penalty, except where the taxpayer can demonstrate:
    • The IRS cannot prevail on the merits, when the facts and laws are viewed in the light most favorable to the IRS; and
    • The taxpayer meets the standard prerequisites for relief such as the absence of a remedy at law.
  – The District Court has jurisdiction over a taxpayer’s refund suit to seek a refund of a penalty.
Dennis Brager

- Ex-IRS Trial Lawyer
- State Bar Certified Tax Specialist
- 30+ Years Tax Dispute Experience with IRS, EDD, BOE, FTB Problems
- Nationally Recognized Tax Litigation Attorney
Dennis Brager is a California State Bar Certified Tax Specialist and a former Senior Trial Attorney for the Internal Revenue Service's Office of Chief Counsel. In addition to representing the IRS in court, he advised the Service on complex civil and criminal tax issues. He now has his own five attorney firm in Westwood, and has been named as a Super Lawyer in the field of Tax Litigation by Los Angeles Magazine. He has been quoted as a tax expert, by Business Week, the Daily Journal, the National Law Journal, The Daily Beast, USA Today, Palm Beach Daily News, Money Laundering, the Los Angeles Daily Journal and Tax Analyst.

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

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


Mr. Brager received his undergraduate degree from Pace University (B.B.A., magna cum laude, 1975, Accounting/Finance), and his law degree from New York University (J.D., 1978). He is a former chair of both the Tax Compliance, Procedure and Litigation Committee of the Los Angeles County Bar Association, and the California State Bar, Tax Procedure and Litigation Committee. He is admitted to practice before the U.S. Supreme Court, the Ninth Circuit Court of Appeals, U.S. Claims Court, U.S. Tax Court, U.S. District Court and the U.S. Bankruptcy Court.
Fin CEN Report 114

• **Generally.** US citizens, residents and certain other persons must annually report their direct or indirect financial interest in, or signature authority over a financial account that is maintained with a financial institution located in a foreign country, if, for any calendar year, the aggregate value of all foreign accounts exceeded $10,000 at any time during the year.
Increased FBAR Civil Penalties

- Assessed After Jan 15, 2017
  - Nonwillful $12,663. Up from 10k
    - Subject to reasonable cause defense.
  - Willful. Minimum $126,626 per violation. Up from a minimum of $100,000

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

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

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

• IRS examiners are instructed to use their best judgment when preparing FBAR penalties, taking into account all the available facts and circumstances of each case.

• in “most cases” the non-willful penalty will be limited to one $10,000 (12,663?) per year regardless of the number of accounts.

• The examiner, with group manager approval, and after consultation with the an Operating Division FBAR Coordinator may assert a single $10,000 (12,663?) penalty in a multi-year case.

• In no event will the total amount of the penalties for non willful violations exceed 50% of the account balances.
IRM Guidelines for Willful FBAR Violations (post May 12, 2015)

• In “most cases”, the total penalty amount for all years under examination will be limited to 50% of the highest aggregate balance of all unpaid foreign financial accounts during the years under examination. Examiners may recommend an amount which is higher or lower than 50%.

• The total penalty should not exceed 100% of the highest aggregate balance.
Best Practices in Drafting Penalty Abatement Requests

• Understand the law including recent case law, and IRS guidelines if any
• Make sure you carefully question your client about the facts. See our “willfulness factor questions” below
• Each year of a multiple year case must be addressed
• Consider SOL issues
• Consider including a declaration from your client signed under penalty of perjury
• If you’re client states that she relied on a third party—interview that person (usually the tax preparer)
• Obtain a declaration from the third party if possible
• Set forth those cases and guidelines which you believe support your client’s case
• Distinguish any cases that are not helpful to your cause
Best Practices in Drafting Penalty Abatement Requests (cont.)

- Determine if there are any documents supporting your request, and include copies. E.g. emails between your client, and the tax preparer
- Obtain copies of any organizers that your client filled out, and sent back to the tax preparer
- Include a request that the IRS contact you before any decision is made
- File a Freedom of Information Act (FOIA) Request if an appeal is necessary
Willfulness

- 31 U.S.C. § 5321 (a)(5)(C) imposes upon any person who "willfully violat[es]" or "willfully caus[es] any violation of ... section 5314," a penalty equal to the greater of $100,000 or 50% of the balance in the account(s) at the time of the violation. 31 U.S.C. §§ 5321 (a)(5)(C) and (D).

- Willfulness is “a voluntary, intentional violation of a known legal duty.” United States v. Sturman, 951 F.2d 1466 (6th Cir. 1991), quoting Cheek v. United States, 111 S. Ct. 604, 610 (1991); IRM 4.26. 16.4.5.3(1)
Willfulness (Cont.)

• A finding of willfulness under the Bank Secrecy Act must be supported by evidence of willfulness. IRM 4.26.16.4.5.3(2)

• Willfulness is shown by the person's knowledge of the reporting requirements and the person's conscious choice not to comply with the requirements. In the FBAR situation, the only thing that a person need know is that she has a reporting requirement. If a person has that knowledge, the only intent needed to constitute a willful violation of the requirement is a conscious choice not to file the FBAR. IRM 4.26.16.4.5.3(5).

• An example of a situation in which willfulness may be present is where: 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. A determination that the violation was willful likely would be appropriate in such a case. IRM 4.26.16.4.5.3(8.A.)(emphasis added)]
What is Willful Blindness, and Why Do You Care?

• Under the theory of “willful blindness,” willfulness may be attributed to a person who has made a conscious effort to avoid learning about the FBAR reporting requirements.

• “Willful blindness” requires proof that:
  o a person subjectively believed that there was a high probability that a fact exists and

• “Willful blindness” is more than recklessness or negligence. A willfully blind person is one who takes deliberate actions to avoid confirming a high probability of wrongdoing and who can almost be said to have actually known the critical facts. A defendant must subjectively believe that there is a high probability that a fact exists and the defendant must take deliberate actions to avoid learning of that fact." Global Tech id at 2070.

• Cf. *McBride*, (Willful blindness found based on the failure to review Schedule B of the tax return) but see, IRM 4.26.16.4.5.3(6) ("The mere fact that a person checked the wrong box, or no box, on a Schedule B is not sufficient, by itself, to establish that the FBAR violation was attributable to willful blindness").
Willful Blindness – Williams

  o Non-precedential
  o Split panel
• Criminal Conviction -- Mr. J. Bryan Williams pled guilty to a two-count superseding criminal information, charging him with conspiracy to defraud the IRS, in violation of 18 U.S.C. § 371, and criminal tax evasion, in violation of 26 U.S.C. § 7201.
  o Unreported Income of $800,000 on $7,000,000 in deposits
  o Lied to the accountant on the organizer
  o Checked the “No” box
• “I also knew that I had the obligation to report to the IRS and/or the Department of the Treasury the existence of the Swiss accounts, but for the calendar year tax returns 1993 through 2000, I chose not to in order to assist in hiding my true income from the IRS and evade taxes thereon, until I filed my 2001 tax return.”
Willful Blindness – Williams (cont.)

• “Unfortunate” aspects of Williams
  o Court focused on willful blindness despite ample evidence of willfulness
  o The Court stated that the fact that Williams admitted he never read, the FBAR form or line 7a of the tax return, and "never paid any attention to any of the written words on his federal tax return," constituted a "conscious effort to avoid learning about reporting requirements."
  o The Court equated “reckless conduct” with willful blindness— an approach rejected by the Supreme Court.
Willful Blindness - McBride

  - Preponderance of Evidence standard
  - Adopted Williams willful blindness standard repeating the assertion that recklessness equates to willful blindness
  - McBride adopted the determination in Williams that Schedule B, line 7a's direction to "[s]ee instructions for exceptions and filing requirements for Form TDF 90-22. 1" placed the taxpayer "on inquiry notice of the FBAR requirement."
- Evidence of willfulness should have been sufficient without relying on willful blindness
  - McBride lied about key details to the IRS during the course of an audit, withheld information, and made contradictory statements.
  - McBride read some of the marketing materials which informed him of the duty to report foreign accounts.
  - McBride used nominee entities to move U.S. revenue offshore
  - His stated purpose of entering the financial plan was to make it appear that he did not have a financial interest in foreign accounts that he had established by creating nominee corporations to hold the accounts.
  - His initial reaction to the promoter when told about the details was “This is tax evasion.”
  - McBride’s partner’s accountant expressed concerns about the plan, but McBride did not discuss the plan with his own accountant.
Recklessness = Willfulness

- Recklessness is a lower standard than willful blindness.
- “Recklessness" is an objective standard that looks to whether conduct entails "an unjustifiably high risk of harm that is either known or so obvious that it should be known." Safeco Ins. Co. of Am. v. Burr, 551 U.S. 47, 68 (2007).
Willfulness-Standard of Proof


• Willfulness can rarely be proven by direct evidence, since it is a state of mind. It is usually established by drawing a reasonable inference from the available facts. The government may base a determination of willfulness in the failure to file the FBAR on inferences from conduct meant to conceal sources of income or other financial information. For FBAR purposes, this could include concealing signature authority, interests in various transactions, and interests in entities transferring cash to foreign banks. IRM 4.26.16.4.5.3(7).
Non-Willfulness: Will You Know It When you See It?

• Presumably non-willful means the absence of willfulness, actual or constructive, but...
• “Non-willful conduct” for the Streamlined Program 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.”
Willfulness Factors/Questions

• Who Prepared the return?
  o Self
  o Tax Preparer

• Did the tax preparer use an organizer?
  o Was it filled out, and sent back?

• Were you asked about the existence of any offshore accounts or assets or about any foreign source income by the tax preparer?
  o If yes, what did you say?

• Was the preparer informed about foreign assets/income?
  o Why not?

• When did you first become aware of the foreign source income, foreign accounts or foreign assets?
Willfulness
Factors/Questions (Cont.)

- Level and type of education?
- Work experience?
- Was the account opened with a U.S. passport? If not, why not?
- What were/are the sources of the funds in the accounts?
- Were the accounts held in an offshore structure?
- What is the source of the funds?
  - Legal vs. illegal
  - Taxed vs. untaxed
- How were funds withdrawn?
- Were the funds moved from one offshore bank to another?
- What did the client do when he was asked by a foreign bank to close his account?
OVDP- The Short Version

• 27.5% of the highest account balance at any time during the prior 8 years.
  o The penalty base is not limited to foreign financial accounts required to be reported on an FBAR. Instead the 27.5% penalty applies to all of the taxpayer’s offshore holdings that are related in any way to “tax non-compliance”
  o An accuracy related penalty of 20% of the tax due pursuant to IRC Section 6662
  o If applicable, the failure to file and failure to pay penalties under IRC Section 6651(a)(1) and (a)(2)

• The taxpayer may not argue lack of willfulness
• No reasonable cause exception
The 27.5% penalty is increased to 50% for taxpayers who have or had an account, or a facilitator who helped the taxpayer establish or maintain an offshore arrangement that has been publicly identified as being under investigation or as cooperating with an IRS investigation.

As of August 29, 2016 that list consists of 97 financial institutions.

Once the 50% penalty applies to one account it applies to all accounts, and assets wherever located.

It may take a few days for the IRS to update its published list, but if the event has already occurred the fact that the IRS hasn’t updated the list doesn’t avoid the 50% penalty if the public disclosure has occurred.

Practice tip: Make sure to tell each of your new clients that if they don’t file a pre-clearance today it may be significantly more expensive tomorrow.
Streamlined Procedures

- **General Eligibility Requirements**
  - Only for individual taxpayers, including estates of individual taxpayers
  - The failure to file FBARs, the failure to report all income, and the failure to submit all required information returns must be “non-willful.”
  - Not available to taxpayers who are currently under audit, or criminal investigation by the IRS
  - Taxpayers who have submitted full voluntary disclosure letters after June 30, 2014 are not eligible
  - Taxpayers who have finalized form 906 under prior OVDPs are not eligible
Streamlined Procedures (Cont.)

• The Benefits
  o Only three years of tax returns need to be filed vs. eight for OVDP
  o 5% offshore penalty for domestic taxpayers
  o No offshore penalty for non-resident taxpayers
  o No accuracy related penalty
  o No FBAR penalties
Streamlined Foreign Offshore Procedures (SFOP)

- Eligibility:
  - Must meet the general eligibility provisions for all taxpayers
  - Meet the applicable non-residency requirements
    - For joint filers both spouses must meet the non-residency requirements
- Non-residency requirements applicable to U.S. citizens and green card holders.
  - In any one of the 3 most recent prior years for which the return due date (or extended return due date) has passed, the individual did not have a U.S. abode, AND
  - The individual was outside of the U.S. for at least 330 full days
    - IRC Section 911 applies for the purposes of these procedures
Streamlined Domestic Offshore Procedures (SDOP)

• Eligibility:
  o Must meet the general eligibility provisions for all taxpayers
  o Have “previously” filed a U.S. tax return (if required) for each of the most recent 3 years for which the U.S. tax return due date (or properly applied for extended due date) has passed.
    • Thus non-filers are ineligible for the SDOP (unlike SFOP or OVDP)
Streamlined Domestic Offshore Procedures (cont.)

- **Scope and effect**
  - A 5% one-time miscellaneous offshore penalty
  - Qualifying taxpayers will not be subject to FBAR penalties, late filing penalties, accuracy penalties, information return penalties.
  - Qualifying taxpayers will be provided retroactive relief for failure to timely elect income deferral on certain foreign retirement accounts if otherwise permitted by applicable treaty.
    - Generally Canadian retirement plans
  - Qualifying taxpayers must:
    - File amended or original tax returns for the past 3 years including all required information returns such as Form 5471, 3520, and 8938
      - The full amount of the tax and interest due must be submitted with the returns
      - The full amount of the 5% offshore penalty must also be submitted with the returns
      - There is no apparent provision for payment arrangements unlike under OVDP
      - If the taxpayer has PFICs the modified mark to market method of calculating tax is not available as it would be under the OVDP
    - Electronically file 6 years of FBARs
    - Complete the Certification by U.S. Person Residing in the U.S. for SDOP on a form provided by the IRS
    - The Certification must include a statement that the failure to report all income, pay all tax, and submit all required information returns including FBARs was due to non-willful conduct
    - The Certification must set forth “specific reasons” for the failure to report etc.
SDOP: Calculating the 5% Penalty

• The penalty is 5 percent of the highest aggregate balance/value of the taxpayer’s foreign financial assets that are subject to the miscellaneous offshore penalty during the years in the covered tax return period and the covered FBAR period
• The highest value is calculated using year end values
• A foreign financial asset is included in a given year in the covered FBAR period if the asset should have been, but was not, reported on an FBAR
• A foreign financial asset is subject to the 5-percent miscellaneous offshore penalty in a given year in the covered tax return period if the asset should have been, but was not, reported on a Form 8938 for that year.
• A foreign financial asset is also subject to the 5-percent miscellaneous offshore penalty in a given year in the covered tax return period if the asset was properly reported for that year, but gross income in respect of the asset was not reported in that year.
Tax Litigation & Tax Controversy

Services We Provide

• Criminal Tax Defense
• FBAR and Offshore Account Problems
• Office of Professional Responsibility (OPR) Defense
• Tax Audits & Tax Appeals
• Tax Fraud Defense
• Tax Preparer Penalty Defenses
• Innocent Spouse Defenses
• California Sales Tax Problems
• IRS and California Payroll Tax Problems
• Offers in Compromise
• Installment Payment Agreements

Los Angeles
11400 W. Olympic Blvd., Suite 750
Los Angeles, CA 90064
Phone: 310.208.6200
Toll Free: 800.380.TAX LITIGATOR
Fax: 310.478.8030

www.bragertaxlaw.com
www.taxproblemattorneyblog.com

@TaxProblemEsq