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# Report of Foreign Bank and Financial Accounts: Preparing for 2011 Filings

Evaluating the Final FBAR Regs, Second Voluntary Compliance Offer and Other Developments

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WEDNESDAY, MAY 4, 2011

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

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Today's faculty features:

Dennis Brager, Founder, **Brager Tax Law Group**, Los Angeles

Brent Lipschultz, Partner, **EisnerAmper**, New York

Kevin Packman, Partner, **Holland & Knight**, Miami, Fla.

Steven Toscher, Principal, **Hochman Salkin Rettig Toscher & Perez**, Beverly Hills, Calif.

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# Report of Foreign Bank and Financial Accounts: Preparing for 2011 Filings Seminar

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May 4, 2011

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Brent Lipschultz, EisnerAmper  
[blipschultz@eisneramper.com](mailto:blipschultz@eisneramper.com)

Kevin Packman, Holland & Knight  
[kevin.packman@hklaw.com](mailto:kevin.packman@hklaw.com)

Steven Toscher, Hochman Salkin Rettig  
Toscher & Perez  
[ahlersa@pepperlaw.com](mailto:ahlersa@pepperlaw.com)

Dennis Brager, Brager Tax Law Group  
[dbrager@bragertaxlaw.com](mailto:dbrager@bragertaxlaw.com)

# Today's Program

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Material Terms Of Finalized FBAR Regs  
*[Brent Lipschultz and Kevin Packman]*

Slide 7 - Slide 36

Requirements Of FATCA Sect. 6038D Information Return  
*[Steven Toscher and Kevin Packman]*

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The 2011 Voluntary Disclosure Program  
*[Dennis Brager]*

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Potential Criminal Exposure And Cases  
*[Steven Toscher]*

Slide 69 - Slide 92

Brent Lipschultz, EisnerAmper

Kevin Packman, Holland & Knight

# **MATERIAL TERMS OF FINALIZED FBAR REGS**

# FBAR Overview

- FBAR (Form TD F 90-22.1) is a by-product of the Bank Secrecy Act (BSA) of 1970 (USC Title 31).
  - Congressional concern that tax haven financial centers were being used by U.S. taxpayers to conceal illegal activities or evade tax
  - A number of filings under the BSA including suspicious activity reports, currency transaction reports and FBARs
  - Information from these forms is entered into BSA computer, so that any government agency may access (including but not limited to IRS, Customs, DEA, FBI, etc.)
  - BSA is designed to fight fraud, money laundering, terrorist financing, tax evasion and other financial crimes.



## FBAR Overview (Cont.)

- Since FBAR is not a tax return and has a June 30 filing deadline in Detroit, Mich.:
  - ❖ Mailbox rule does not apply, and there are no extensions.
  - ❖ No CFC attribution rules
  - ❖ IRC Sect. 6103 confidentiality and disclosure rules do not apply.

# Authority To Administer FBAR

- Original authority to investigate possible FBAR compliance was delegated to the IRS, while authority for civil enforcement of FBAR violations was delegated to the Financial Crimes Enforcement Network (FinCEN), an arm of the Treasury.
- In 2003, FinCEN delegated its enforcement authority for FBARs to the IRS. Thus, the IRS now has authority to investigate FBAR non-compliance, assess and collect civil penalties associated with such non-compliance, and revise the FBAR form and instructions (10/08 and 3/11).
- FinCEN retains authority over FBAR regs and rules.
  - Final regs issued on 2/23/11, effective 3/28/11
  - Proposed regs issued on 2/26/2010

# Who Must File FBAR?

- Any **U.S. person** who has a **financial interest, signature authority, or other authority** over **foreign financial accounts**, if in the aggregate the accounts exceed **\$10,000** at any time during the year
- A person required to file an FBAR also must check the appropriate box of his income tax return.
  - Form 1040, Sch B, Part III
  - Form 1041, Sch G, Question 3
  - Form 1065, Sch B, Question 10
  - Form 1120, Sch N, Question 6
  - Form 3520 references FBAR filing obligation

# Who Is A U.S. Person?

- Individual
  - Citizen
  - Green card holder, even if under treaty tie-break deemed non-U.S.
  - Resident alien under IRC 7701(b) rules or elects to be treated as a resident under this section
  - “In and doing business in the U.S.” → Not relevant under final regs
- Domestic business entities (corporations, partnerships, limited liability companies)
  - Tax elections are irrelevant
  - Key: Must be formed under the laws of U.S., state, D.C., U.S. territory or possession, or Indian law

# Who Is A U.S. Person? (Cont.)

- Domestic trusts
  - Formed in the U.S., U.S. territories, possessions and Indian territory
  - Ignore IRC 7701(a)(30) → Formation key
    - E.g., a trust governed under U.S. laws with foreign trustees would be a domestic trust for FBAR filings and a foreign trust for federal income tax.
- Domestic estates
  - PR/executor files on behalf of estate; if non-compliance by decedent, no liability for PR/executor
  - If you are unable to obtain complete records, file with what you have and note the steps taken to gather information.

# Example: Who Is A U.S. Person?

Q. Is a single-member LLC, which is a disregarded entity for U.S. tax purposes, a U.S. person for FBAR purposes?

A. Yes, the tax rules concerning disregarded entities do not apply with respect to the FBAR reporting requirement. FBARs are required under Title 31, not under any provision of the Internal Revenue Code.

# Who Is Not A U.S. Person?

- Non-resident alien, unless substantially present
  - Count days of presence in the U.S., but focus on visa classifications
  - Consider closer connection and treaties

Foreign entity that elects to be treated as U.S.

- NRA electing to be a U.S. person under IRC 6013(g) or (h)

# What Is A Financial Interest?

- Owner of record - Legal title holder
  - U.S. beneficial owner of a bearer share entity or IBC
  - U.S. grantor of foreign trust with U.S. beneficiaries has filing requirement even if not a beneficiary (i.e. IRC 679). Grantor is the owner.
- Constructive ownership
  - Hold title as an agent, custodian, nominee, attorney in fact
  - Owns more than 50% of the shares by voting or value
  - Owns more than 50% of the capital or profits
  - Has a present beneficial interest in more than 50% of the assets or income in a trust
    - **Observation:** A beneficiary of a discretionary trust does not have an FBAR filing obligation simply by reason of being a beneficiary. Filing is required by a beneficiary if distribution is received. Under final rules, a remainder beneficiary does not have a current FBAR filing obligation.
    - Final regs eliminated automatic reporting requirement if a trust has a protector



# Only Foreign Accounts Must Be Reported

- Foreign: Anywhere outside of the U.S., its possessions and territory
  - Royal Bank of Canada in New York: **No requirement**
  - Bank of America in Toronto: **Requirement**
- Domestic account with foreign assets: **No requirement**
  - U.S. mutual fund, 401(k), 403B or IRA with foreign investments: **No requirement**
  - Foreign mutual fund with all U.S. investments: **Requirement**

# Which Foreign Accounts Must Be Reported?

- 2/26/10: Proposed regulations approved
- The focus is on the relationship taxpayers have with the financial institution.
- If a relationship is formalized, it is reportable, regardless of length.
  - Bank account
  - Securities account
  - Other financial accounts

# What Is A Financial Account?

- Savings deposit, demand deposit, checking or other account maintained with person engaged in banking
  - Includes time deposits and certificates of deposit
  - Definition never changed
- New definition of securities accounts created by proposed regulations does not change:
  - “Account maintained with a person in the business of buying, selling, holding or trading stock or other securities”
- Other financial accounts includes:
  - A deposit account with a person in the business of accepting deposits as a financial agency
  - An account with a person who acts as a broker or dealer for futures or option transactions in any commodity, or is subject to the rules of a commodity exchange or association

**Query: Is gold stored in a depository considered a financial account?**

# What Is A Financial Account? (Cont.)

- Mutual funds: Pooled investments open to the public, where shares have a net asset value and regular redemptions
- Hedge funds, private equity funds
  - Excluded from FBAR reporting but not from FATCA
  - FinCEN has reserved the right to issue regs in the future

# What Is A Financial Account? (Cont.)

- Foreign life insurance and annuity policies with a cash surrender value
  - Foreign life insurance product including unit life insurance policies: Requirement
  - Foreign life insurance company using foreign products: Requirement
  - Foreign life insurance company issuing U.S. product in the U.S.: No requirement
  - U.S. life insurance company with foreign sub issuing foreign life insurance product: Requirement

# Exempt Accounts

- If foreign account is in a U.S. military facility or operated by U.S. institution for the military
- Correspondent or nostro accounts maintained by banks for bank to bank transfers
- Account with an international financial institution of which the U.S. is a member
- Account of a department or agency of the U.S., an Indian tribe or any political subdivision of a state
- Assets held in an omnibus account maintained through a U.S. global custody bank, unless the arrangement permits U.S. person to access foreign holdings maintained in the account

# Signature Authority/Other Authority?

- “Authority of an individual (alone or in conjunction with another) to control the disposition of money, funds, or other assets held in a financial account by direct communication (whether in writing or otherwise) to the person with whom the financial account is maintained”
- FBAR obligation only if the person has the authority to directly deliver instructions to the financial institution
  - Could include e-mail, text, telephone call, fax, online transaction

# Signature Authority: Examples

- U.S. investment managers
  - Investment decisions do not require a filing, but moving money in and out of accounts may.
- U.S. trustee of foreign trust
- Power of attorney



# Signature Authority: Exceptions

- New FBAR regs broaden the reporting for employees/officers who have no direct financial interest, but have signature authority; only five exceptions:
  1. Banks examined by Office of Comptroller of Currency, Board of Governors of the Federal Reserve, FDIC, Office of Thrift Supervision or National Credit Union Assoc.; and federal banking agencies
  2. Financial institutions registered with and examined by the SEC or Commodity Futures Trading Commission
  3. An authorized service provider that maintains foreign financial accounts by an investment company registered under the Investment Company Act of 1940
  4. Companies that are listed on a U.S. national securities exchange, whether company is domestic or foreign
  5. Companies that have more than \$10 million in assets and over 500 shareholders
  6. Officers and employees of a U.S. subsidiary of a listed company (see 4 above), if U.S. subsidiary is named in a consolidated FBAR filing of the parent

Observation: The reporting exception is limited to foreign financial accounts directly owned by the entity that employs the officer or employee that has signature authority.

# Other Authority: Examples

- U.S. person can control the disposition of funds by verbal means (any means other than signing a paper).
  - E-mail? Text?
  - Telephone call?
  - Fax?
  - Online transaction?

# How Are Accounts Valued?

- The over \$10,000 is met if:
  - At any time of the year, **aggregate value of all** foreign accounts is in excess of \$10,000, regardless of whether accounts generated income or dividends
  - If non-liquid asset, 12/31 value
  - If asset sold during year, value at date of sale
  - All values must be converted for U.S. purposes
  - Periodic statements can be relied upon if the bona fide statements are prepared by the financial institution in the ordinary course of business.
  - New form (issued in March 2011) eliminates certain valuation instructions and seems to require the use of Treasury's financial service rate.

# Miscellaneous Filing Issues

- Individuals may file a simplified return if :
  - Financial interest in more than 25 accounts
  - Signature or other authority over more than 25 accounts
- U.S. entities may file a simplified return if:
  - Financial interest in more than 25 accounts
- U.S. entities may file consolidated returns if they own more than 50% in an entity that is otherwise required to file an FBAR.
- A U.S. beneficiary does not have an FBAR filing obligation if the trust, the trustee of the trust, or agents of the trust are U.S. persons who have filed FBARs with respect to the trust.

## Miscellaneous Filing Issues (Cont.)

- Participants and beneficiaries in retirement plans governed under IRC sections 401(a), 403(a) and 403(b), including owners and beneficiaries of IRAs (or Roth IRAs), are not required to file an FBAR with respect to foreign accounts held by the plan.
- Trustees and administrators of qualified plans are not exempt from FBAR reporting.
- Filing reminder: IRS granted persons with signature authority with no direct interest in an account to file back FBAR reports by June 30, 2011 under Notice 2010-23. Under OVDI, this deadline is apparently extended through Aug. 31, 2011.

# Effects Of IRS Enforcement

- **From 2004 to 2009**
- The number of FBARs filed with the IRS increased 145%, from 217,699 to 534,043.
- FBAR-related examinations increased 96%, from 334 to 656.
- FBAR penalty assessments increased nearly four-fold, from \$4.2 million to \$20.5 million.
- Treasury inspector general for tax administration, reference number 2010-30-125: New legislation could affect filers of the Report of Foreign Bank and Financial Accounts, but potential issues are being addressed (Sept. 29, 2010)

# Enforcement: Civil Penalties

- Prior to 10/2004: Penalties only for willful violations
  - Minimum \$25,000, maximum \$100,000
- Non-willful: Penalty of up to \$10,000
- Willful: Maximum penalty is the greater of \$100,000 or 50% of the balance of the account at the time of the violation.
  - IRS has discretion when imposing penalties. Thus, penalties may differ based on the taxpayer's particular facts and circumstances.
  - If check the box on Form 1040, incorporate foreign income on Form 1040 and otherwise forget to file FBAR, facts and circumstances (reasonable cause may exist)

# Enforcement: Civil Penalties (Cont.)

- Because FBAR is Title 31, IRC cannot use a lien or levy to collect on a penalty. The Service is limited to Title 31 collection methods. [civil suit to collect monetary fine - 31 USC §5321(b)(2)]
- Tax Court/Bankruptcy
  - Tax Court has no jurisdiction over FBAR penalties
    - Williams, 131 TC No. 6 (10/2/08)
  - FBAR not discharged in bankruptcy
    - Simonelli, 1-2 AFTR 2d 2008-6577 (D.Conn. Sept. 30, 2008)



# Enforcement: Criminal Penalties

- **Requires willfulness**
- Up to \$250,000 fine, imprisonment for up to five years, or both
- Up to \$500,000 fine, imprisonment for up to 10 years, or both
  - Failure to file must have been part of a criminal activity (i.e., it occurs during the violation of another law or is part of an illegal activity involving more than \$100,000 in a 12-month period)

# Enforcement: Statute Of Limitations

- Title 26 statute of limitations does not apply.
- Civil: Six years to assess penalty from date of violation; two years following assessment to collect
  - 31 USC 5321(b)(1) and (b)(2)
- Criminal: Five years to assess penalty
  - 18 USC 3282(a)

# Enforcement: Judicial

- FBARs: Constitutional (U.S. Supreme Court)?
  - California Bankers Assn. v Schultz, 416 US 21 (1974)
- Failure to check the box – an affirmative act in tax evasion, SOL remains open, continuing violation
  - U.S. Dept. of Justice Criminal Tax Manual: Saying no on the Form 1040 can be basis for a tax evasion prosecution. 12.08(6)(g)
  - Concealing the existence of a foreign account is evidence of fraud.
  - U.S. v Olenicoff, (C.D. California, 3/31/08): Said no on Schedule B for 1998-2004 tax returns reflecting no foreign accounts, despite transferring well over \$100 million into such accounts during those years. Avoided jail but paid \$52 million to resolve civil tax liabilities

# FBAR Assistance

- FBAR frequently asked questions  
<http://www.irs.gov/businesses/small/article/0,,id=148845,00.html>
- IRS FBAR hotline: (800) 800-2877, option 2
- IRS FBAR e-mail: [FBARquestions@irs.gov](mailto:FBARquestions@irs.gov)

Steven Toscher, Hochman Salkin Retting Toscher & Perez  
Kevin Packman, Holland & Knight

# **REQUIREMENTS OF FATCA SECT. 6038D INFORMATION RETURN**

# Foreign Account Tax Compliance Act (FATCA)

On March 18, 2010, President Obama signed the Hiring Incentives to Restore Employment Act (Pub.L No. 111-14) (HIRE Act). The HIRE Act created tax breaks for businesses hiring new workers through a payroll tax holiday and other measures.

To pay for these tax breaks, the HIRE Act set forth provisions that have far reaching implications for foreign institutions that may have U.S. clients **and** broadens reporting requirements for foreign assets, through incorporation (with some modifications) of the Foreign Account Tax Compliance Act of 2009 (FATCA).

# FATCA

- The FATCA provisions affect (1) increased reporting for individuals with foreign assets, and (2) disclosure and compliance issues for foreign financial institutions.
- We will address only the increased reporting and disclosure for persons with foreign assets.
- The compliance and reporting issues for foreign financial institutions has been subject to much controversy and is beyond the scope of the program today. Suffice it to say that it expands information exchanges between foreign banks and the U.S. government and will severely limit bank secrecy for US taxpayers.

# New Foreign Asset Disclosure

Beginning with the 2011 tax year (that is, for tax years beginning after March 18, 2010), **in addition to the existing FBAR reporting requirements**, U.S. individuals who hold any interest in a specified foreign financial asset during the tax year must attach to their tax returns for the year certain information with respect to each asset if the aggregate value of all assets exceed \$50,000 (or a higher dollar amount prescribed by the secretary of the Treasury).



# Foreign Financial Assets

Specified foreign financial assets include (1) depository, custodial accounts or other financial accounts maintained at a foreign financial institutions; or (2) to the extent not held in an account at a financial institution, generally (A) any foreign issued stock or securities, any interests in a foreign investment fund or derivatives with a foreign counterparty; or (B) any interest in a foreign entity.

# Information Required

The information required to be disclosed must include the maximum value of the asset during the tax year. Moreover, for financial accounts, the taxpayer must disclose the name and address of the financial institution, and the account number. For stocks or securities, the taxpayer must disclose name and address of the issuer and such other information as is necessary to identify the class or issue of stock. In the case of any other instrument, contract or interest, a taxpayer must provide any information necessary to identify the instrument, contract or interest; along with the names and addresses of all issuers and counterparties.

# Form 8938, Statement of Foreign Financial Assets

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|   |   |   |
|---|---|---|
| <b>Form 8938</b><br>Department of the Treasury Internal Revenue Service | <b>Statement Of Foreign Financial Assets</b><br>• See separate Instructions. • Attach to your tax return. (Attach additional sheets if you need more space) | OMB. No. 1545-2195<br><br>Attachment sequence No. 175 |
|---|---|---|

All information must be in English. Show all amounts in U.S. dollars. Show currency conversion rates in Part V.

For tax year beginning \_\_\_\_\_, and ending \_\_\_\_\_.

Type of filer:

- a.  Individual b.  Joint c.  Amended d.  Partnership  
 e.  Corporation f.  Consolidated  
 g.  Fiduciary or Other--\_\_\_\_\_

|   |                    |
|---|--------------------|
| Name of U.S. person filing return                                     | Identifying number |
| Number, street, and room or suite no. (if P.O. box, see instructions) |                    |
| City or town, province or state, and country (including postal code)  |                    |
| Name of joint filer   | Identifying number |
| Number, street, and room or suite no. (if P.O. box, see instructions) |                    |
| City or town, province or state, and country (including postal code)  |                    |

**Part I Interests in Foreign Financial Account(s). See instructions.**

|   |  |  |                              |
|---|--|--|------------------------------|
| Maximum value of account during taxable year                          | Type of account(s) a. <input type="checkbox"/> Bank b. <input type="checkbox"/> Securities d. <input type="checkbox"/> Other (enter type in space below) |  |                              |
| Name of Financial Institution in which account is held                |  | Account number or other designation                                  |                              |
| City or town, province or state, and country (including postal code)  |  |  |                              |
| Income/(loss)   | Type of income/(loss)  | Where reported   |                              |
| \$ _____  | <input type="checkbox"/> Dividends<br><input type="checkbox"/> Interest<br><input type="checkbox"/> Capital gain<br><input type="checkbox"/> Other _____ | Form _____<br>Line _____   | Schedule _____<br>Line _____ |
| If account held jointly. Name   |  |  | Identifying number           |
| Number, street, and room or suite no. (if P.O. box, see instructions) |  | City or town, province or state, and country (including postal code) |                              |

... repeat for additional accounts

# Form 8938, Statement of Foreign Financial Assets

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## Part II Interests in Stock or Securities. See instructions.

| Interests in Stock or Securities. See instructions. Description of Stock or Security (common/preferred stock, bonds, etc.) | Number of Shares | Name of issuer | Check if PFIC | TIN (if known by filer) | Check if stock or security were acquired during the taxable year | Check if stock or security disposed of during taxable year | Maximum Value During Taxable Year |
|--|------------------|----------------|---------------|-------------------------|--|--|-----------------------------------|
|--|------------------|----------------|---------------|-------------------------|--|--|-----------------------------------|

|   |  |                          |                             |
|---|--|--------------------------|-----------------------------|
| Income/(loss)   | Type of income/(loss)  | Where reported           |                             |
| \$ _____  | <input type="checkbox"/> Dividends<br><input type="checkbox"/> Interest<br><input type="checkbox"/> Capital gain<br><input type="checkbox"/> Other | Form _____<br>Line _____ | Schedule ____<br>Line _____ |
| If account held jointly. Name   | Identifying number   |                          |                             |
| Number, street, and room or suite no. (if P.O. box, see instructions) | City or town, province or state, and country (including postal code)   |                          |                             |

... repeat for additional interests

# Form 8938, Statement of Foreign Financial Assets

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## Part III Interests in foreign financial instruments and contracts held for investment.

Description of Interest      Name(s) of issuer(s), counterparties, etc.      TIN (if known by filer)      Check this box if the interest acquired during taxable year      Check box if interest disposed of during taxable year      Maximum Value During Taxable

|   |   |                          |                              |
|---|---|--------------------------|------------------------------|
| Income/(loss)   | Type of income/(loss)   | Where reported           |                              |
| \$ _____  | <input type="checkbox"/> Dividends<br><input type="checkbox"/> Interest<br><input type="checkbox"/> Capital gain<br><input type="checkbox"/> Other<br>_____ | Form _____<br>Line _____ | Schedule _____<br>Line _____ |
| If account held jointly. Name   | Identifying number  |                          |                              |
| Number, street, and room or suite no. (if P.O. box, see instructions) | City or town, province or state, and country (including postal code)  |                          |                              |

... repeat for additional interests.

# Form 8938, Statement of Foreign Financial Assets

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## Part IV Interests in foreign entities not described in Part II. (See instructions)

|                |                              |                         |  |   |
|----------------|------------------------------|-------------------------|--|---|
| Name of Issuer | Type/description of Interest | TIN (if known by filer) | Check if interest acquired during taxable year | Check if interest disposed or during taxable year |
|----------------|------------------------------|-------------------------|--|---|

| Income/(loss)              | Type of income/(loss)  | Where reported           |
|----------------------------|--|--------------------------|
| \$ _____<br>_____<br>_____ | <input type="checkbox"/> Dividends<br><input type="checkbox"/> Interest<br><input type="checkbox"/> Capital gain<br><input type="checkbox"/> Other _____ | Form _____<br>Line _____ |

### Schedule

|   |  |
|---|--|
| Line _____  |  |
| If account held jointly. Name   | Identifying number   |
| Number, street, and room or suite no. (if P.O. box, see instructions) | City or town, province or state, and country (including postal code) |

... repeat for additional interests

## Part V Foreign Currency Conversion (See instructions)

|                                   |      |        |
|-----------------------------------|------|--------|
| Asset Number<br>(as listed above) | Rate | Source |
|-----------------------------------|------|--------|

# Failure-To-Disclose Penalty

Individuals who fail to make the required disclosures are subject to a penalty of \$10,000 for the tax year, and this penalty may increase to \$50,000 if the failure continues for more than 90 days after notification by the IRS. The failure-to-disclose penalty may not be imposed on any individual who can show that the failure is due to reasonable cause and not willful neglect. The fact that a foreign jurisdiction would impose a civil or criminal penalty on the taxpayer for disclosing is not reasonable cause.

# Underpayment Penalty: Undisclosed Foreign Assets

- A 40% accuracy-related penalty (double the otherwise applicable penalty) can be imposed for the underpayment of tax that is attributable to an undisclosed foreign financial asset understatement. For this purpose, an “undisclosed foreign financial asset understatement” for any tax year is the portion of the understatement for the year that is attributable to any transaction involving undisclosed foreign financial assets.
- The new 40% penalty is subject to the same defenses that are otherwise available for §6662 penalties. The penalty applies starting with tax year 2011 (tax years beginning after March 18, 2010.)



# **Six-Year Statute Of Limitations For Omitted Income**

- The statute of limitations for assessment of tax has been extended to six years if there was an omission of gross income in excess of \$5,000 relating to a foreign financial asset.
- The new statute applies not only to returns filed after March 18, 2010, but also to returns filed before that date if the statute of limitations was still open on that date.
- A 2006 tax return filed on April 15, 2007 would be subject to the new six-year statute of limitations.

# In Conclusion

- In terms for foreign tax compliance and enforcement, this is really not the end.
- Nor is it the beginning of the end.
- As a famous statesman once said: “*This is merely the end of the beginning.*”

Dennis Brager, Brager Tax Law Group

# **THE 2011 VOLUNTARY DISCLOSURE PROGRAM**

# OVDI Penalties



- 25% of the highest account balance at any time from 2003 to 2010 (FAQ No. 7)
  - The penalty base is not limited to foreign financial accounts required to be reported on an FBAR. Instead the 25% (or 12.5% or 5%) penalty applies to all of the taxpayer’s offshore holdings that are related in any way to “tax non-compliance.”
  - An accuracy related penalty of 20% of the tax due pursuant to IRC § 6662
  - If applicable, the failure to file and failure to pay penalties under IRC § 6651(a)(1) and (a)(2)

# Penalty Example 1

- Taxpayer has two offshore accounts, with a \$100,000 high balance between 2003 through 2010. He also owns a vacation property with a FMV of \$1,000,000. The property is rented out two months per year for a total of \$20,000. Neither the income nor the expenses are reported on a tax return. Had it been reported, there would be no increase in tax, because the expenses exceed the income.

## Penalty Examples 2, 3

- Same as # 1, except that it was not rented out
- Same as # 2, except that although the property was not rented out, it was initially purchased in 1999 with funds that were skimmed from the taxpayer's business and not reported.

# Pre-Clearance With CI

## FAQ 23



- Highly recommended
  - Avoids nasty surprises
- All pre-clearance requests are faxed to (215) 861-3050.
- CI responds by fax.
- Pre-clearance questions may be discussed with local CI office or by calling (215) 861-3759.

# Tax Amnesty - The Next Generation Offshore Voluntary Disclosure Initiative (OVDI)



- Eligibility; not for:
  - Taxpayers under audit, regardless of whether related to offshore issues
  - Taxpayers under investigation by CI (Criminal Investigation)
  - Taxpayers with illegal source of income (?)
  - Taxpayers who have reported and paid tax on all their taxable income for prior years but did not file FBARs
  - Taxpayers who reported all income but failed to file offshore information forms such as 3520 or 5471



# OVDI Deadlines



**ALL** required documents must be provided to the IRS **NO LATER** than Aug. 31, 2011 (FAQ No. 1)

- Copies of previously filed original (and, if applicable, previously filed amended) federal income tax returns for tax years covered by the voluntary disclosure
- Amended federal income tax returns with applicable schedules detailing the amount and type of previously unreported income from the account or entity
- A completed “Foreign Account or Asset Statement” for each previously undisclosed foreign account or asset during the voluntary disclosure period (available on the IRS Web site)
- For taxpayers disclosing offshore financial accounts with an aggregate highest account balance in any year of \$1 million or more, a completed “Foreign Financial Institution Statement” for each foreign financial institution with which the taxpayer had undisclosed accounts or transactions during the voluntary disclosure period (available on the IRS Web site)

# OVDI Deadlines (Cont.)



- “Taxpayer Account Summary With Penalty Calculation” (available at on the IRS Web site)
- **A check in full payment of the total tax, interest and all applicable penalties**
  - If everything can’t be paid in full, then submit Form 433A with a proposed payment arrangement.
- For taxpayers disclosing offshore financial accounts with an aggregate highest account balance in any year of \$500,000 or more, copies of offshore financial account statements reflecting all account activity for each of the tax years covered by the voluntary disclosure
- For those taxpayers disclosing offshore financial accounts with an aggregate highest account balance of less than \$500,000, copies of offshore financial account statements reflecting all account activity for each of the tax years covered by the voluntary disclosure must be readily available upon request.
- Waivers extending the time for the IRS to assess Title 26 tax, interest and penalty as well as FBAR penalties (FAQ No. 25)

# Limited OVDI Relief

- The taxpayer may not argue lack of willfulness.
- No reasonable cause exception
- There is no *de minimis* non-compliance.
- For accounts that do not exceed \$75,000, the penalty is 12.5% of the highest aggregate balance.
  - All other terms remain the same.
- 5% penalty
  - Category 1: Inherited accounts
    - Taxpayer did not open the account.
    - Minimal, infrequent contact
      - No mail hold
    - Did not withdraw more than \$1k in any one year
    - Prove that all taxes were paid on the principal balance
  - Category 2: The brain-dead citizen
    - Taxpayers who are foreign residents and who were unaware they were U.S. citizens

# OVDP Is Dead, Long Live OVDI



- In-lieu-of penalty increased from 20% to 25%
- Small account penalty 12.5%
  - Available to OVDP participants, too
- Late-filing and late-payment penalties under IRC §6651(a)(1) and (2) are applicable.
- Taxpayer may not argue lack of willfulness .
- 5% penalty expanded
  - Available to OVDP participants, too

# Lessons Learned From OVDP



- Expect no mercy
- Assume that the most unfavorable possible interpretation of the FAQs will be applied

# Circular 230 Issues

- **§10.22 diligence as to accuracy. *Practitioners must exercise due diligence.***
  - (a) In preparing or assisting in the preparation of, approving and filing returns, documents, affidavits and other papers relating to Internal Revenue Service matters
  - (b) In determining the correctness of oral or written representations made by him to the Department of the Treasury; and
  - (c) In determining the correctness of oral or written representations made by him to clients with reference to any matter administered by the Internal Revenue Service

# Circular 230 And Updated FAQ 47



- FAQ 47 reiterates the practitioner's responsibilities under Circular 230
- Cautions against:
  - Making false or misleading statements to the IRS
  - Giving a false or misleading opinion to the taxpayer
- Practitioner must:
  - Exercise due diligence in advising the taxpayer about OVDI and about the implications of going forward
  - If the taxpayer chooses not to participate in OVDI, advise the taxpayer of the consequences of non-compliance.
- Makes clear that a practitioner can continue to represent a client who has not made a voluntary disclosure, as long as the current filings are correct

# Alternatives To Entering OVDI: Just Say No? Quiet Disclosure



- Internal Revenue Manual (IRM) § 9.5.11.9 (12/2/2009)
  - The communication must be truthful, timely and complete
  - A disclosure is timely only if it is received by the IRS before the IRS has:
    - Started a civil or criminal investigation (whether or not the taxpayer is aware of it) or has notified the taxpayer that it intends to start an exam
    - Received information from a third party alerting it to the specific taxpayer's non-compliance
    - Initiated a civil or criminal exam directly related to the specific liability of the taxpayer



# OVDI Alternatives (Cont.)



- Acquired information directly related to the specific liability of the taxpayer from a criminal enforcement action such as a grand jury subpoena
- The taxpayer must cooperate with the IRS in determining his correct tax liability.
- The taxpayer must also pay the liability or make arrangements for payment of the liability.
- Applies only to legal source income (IRM § 9.5.11.9.5)
- Taxpayers who are under investigation by **ANY** law enforcement agency do not qualify to make voluntary disclosures,

# Just Say No?

## Alternative 2



- Filing accurate 2010 tax returns and/or FBARs, but not self-correcting prior years
  - No protection against criminal prosecution
  - No fig leaf

# Just Say No?

## Risks And Rewards



- Potential risks
  - Full-blown audit
  - Potential penalties exceeding the value of offshore assets
  - Potential criminal exposure if no quiet disclosure, or the quiet disclosure is deemed not to be a “true” voluntary disclosure
- Potential rewards
  - No taxes
  - No penalties
  - No audit
  - The right to a hearing before IRS Appeals
  - The right to litigate the merits of the case

# Penalty Process Outside Of OVDI



- FBAR penalty imposed under the Bank Secrecy Act (BSA), not the Internal Revenue Code
- Appeals review available
  - Rubber-stamp?
- The Tax Court does not have jurisdiction over the penalty. *Williams v. Commissioner*, 131 T.C. 54 (2008).
- FBAR penalties are not dischargeable in bankruptcy. *U.S. v. Simonelli*, 102 AFTR 2d 2008-6577
- No FBAR penalty can be collected unless the taxpayer agrees, or the IRS brings suit in federal district court and proves that the penalty applies.

Steven Toscher, Hochman Salkin Retting Toscher & Perez

# **POTENTIAL CRIMINAL EXPOSURE AND CASES**

# The War On Secret Foreign Accounts

**“If you are a U.S. individual holding overseas assets, you must report and pay your taxes or we will be increasingly focused on finding you.”**

Douglas H. Shulman,

Commissioner of Internal Revenue

AICPA National Conference on Federal Taxation

Washington, D.C. , Oct. 26, 2009

HOCHMAN  
SALKIN  
RETTIG  
TOSCHER  
& PEREZ, P.C.

**Douglas H. Shulman,  
Commissioner Of Internal Revenue  
Nov. 16, 2010**

*“The VDP and UBS matters are significant, but there is obviously more to come. We have been scouring the vast quantity of data we received from the VDP applicants and from various other sources. Although more data mining is still to be done, this information has already proved invaluable in supplementing and corroborating prior leads, as well as developing new leads, involving numerous banks, advisors and promoters from around the world. And this remains just the start. As I have said from the beginning, this has never been about one bank or one country. We’ve produced results and will continue to produce results.”*

HOCHMAN  
SALKIN  
RETTIG  
TOSCHER  
& PEREZ, P.C.

# Douglas H. Shulman, Commissioner Of Internal Revenue Nov. 16, 2010 (Cont.)

*“To conclude, we are sending a clear message to taxpayers that we are serious about tax compliance. We will tirelessly pursue anyone who tries to use international borders to their advantage and cheat honest taxpayers. As I’ve said throughout my tenure as Commissioner, combating international tax evasion will continue to be a top priority. **We have additional cases and banks in our sights right now.** This issue is not going away, and those who try to skirt U.S. tax laws by hiding assets and income offshore, and the banks and advisors who help them do it, will find themselves increasingly at risk due to our efforts in this area.”*



# Criminal Penalty For FBAR Violations: Not Just A Civil Matter

- A willful failure to comply with the FBAR reporting requirements is a felony that can subject a taxpayer to a fine of not more than \$ 250,000 or **five years in prison** or both.
- While most criminal tax violations involving a willful failure to file a require tax forms are misdemeanors, a willful failure to file the FBAR form is a **felony**.
- Where the failure to file an FBAR is part of a pattern of illegal activity, the statute provides for a fine of up to \$500,000 and imprisonment of up to **10 years**, or both.
- A civil penalty can be imposed despite the fact that a criminal penalty is imposed with respect to the same violation.

# Related Tax Charges Under Internal Revenue Code

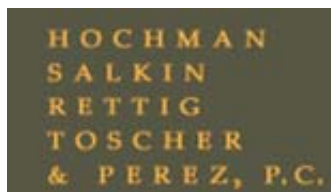
- Most of the criminal prosecutions with respect to foreign bank accounts in the past arose with respect to non-FBAR criminal statutes. For example, a taxpayer who provides a false answer to the foreign bank question on Schedule B of the for Form 1040 can be prosecuted pursuant to IRC §7206(1). That section criminally punishes a taxpayer who willfully makes and subscribes any return under penalties of perjury which he does not believe to be true and correct as to every material matter.
- A person *may not avoid* criminal prosecution by failing to provide an answer to the foreign bank account question. *Failing to answer “yes” or “no” could be considered knowingly signing a return that is not true and correct as to every material matter under IRC §7206(1).*

# Criminal FBAR Violations Require Willfulness

A criminal violation of the FBAR reporting requirement requires that the taxpayer act “**willfully.**”

The test for willfulness is whether there was a voluntary, intentional violation of a known legal duty.

In a criminal prosecution, the government must establish willfulness beyond a reasonable doubt.



# “Willfulness” Defined

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

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

# *Williams*: A Civil FBAR Case

- There are very few court cases addressing willfulness in the context of the FBAR reporting requirements. One recent case in District Court Judge , United States v. Williams, Civil Action No.: 1:09-cv-437 (E.D.Va. Sept 1, 2010), found that willfulness was lacking.
- In the case, the government sought to enforce its assessments of two FBAR penalties against defendant Williams for willfully failing to report his interest in two Swiss bank accounts for tax year 2000, as required by 31 USC §5314. The court concluded that the government fell short of meeting its burden (clear and convincing evidence in a civil case) in establishing that Williams willfully failed to disclose offshore assets in violation of that statute.

# Williams' Testimony Was Credible

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

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& PEREZ, P.C.

# Internal Revenue Manual

## Examples Of Willfulness

The following examples of willfulness are set forth in Internal Revenue Manual 4.26.16.4.5.3.8 (07-01-08) and are instructive of the government's approach in determining willfulness (at least in the civil penalty context) for criminal cases and normally requiring much stronger proof :

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



# IRM Example

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



## IRM Example (Cont.)

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

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## IRM Example (Cont.)

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

# **FBAR Criminal Referrals From Civil Examination Division**

The IRS Criminal Investigation Division (CI) has authority to examine criminal FBAR violations. Acceptance by the CI of an FBAR referral for criminal investigation depends on the evidence establishing willfulness. A fraud technical advisor (FTA) will assist the civil examiner in determining whether there is a willful violation and provide the examiner with information concerning referrals to CI. If the examiner considers that the case warrants referral for possible criminal investigation, the examiner will involve a FTA as soon as possible.

# Criminal Prosecutions Of FBAR Violations

While in the past, criminal enforcement relating to persons failing to comply with FBAR reporting requirements has been rare, the IRS (now the agency principally responsible for FBAR compliance) has geared up to investigate and prosecute willful violators. Increased emphasis, together with the IRS' ever-increasing ability to obtain once-secret information from foreign jurisdictions, suggests there will be more investigations and prosecutions in this area.

# ***U.S. v. Simon: Civil Administrative Relief?***

## **“Only Congress Can Forgive The Crime”**

- In U.S. v. Simon, 3:10-CR-0056-RLM (N.D. Ind., 2010), a court considered the impact of administrative relief on a criminal prosecution.
- The notice (and the defendant)
  - Notice 2010-23
    - If there is signature authority only (but no financial interest), then U.S. persons have until June 30, 2011 to file FBARs in 2010 and prior years.
    - Such taxpayers should check “No.”
- The DOJ (and the court)
  - Congress, not an agency, creates the crime. Only Congress can forgive the crime.
  - Later regulatory amendments cannot absolve a defendant of a crime without retroactive modification by Congress.

\* An earlier notice, Notice 2009-62, also provided relief.

## *U.S. v. Simon* (Cont.)

- Creation of uncertainty
  - If conduct is arguably not subject to civil penalties, how can it be criminal?
  - Can one rely on notices, other administrative guidance, FAQs or the Internal Revenue Manual?
  - Do you follow the broader statute, or the more lenient guidance and face possible prosecution?
- Possible limits of the orders and opinion in Simon
  - Taxpayers received large sums of money in years at issue.
  - Procedural notes
    - Change of the defense theory mid-trial regarding non-taxability of income
    - Late jury instructions
- Can a taxpayer risk following the administrative guidance?

# Criminal Prosecutions: The Old Days

Between 1996 and 1998, Justice Department statistics reveal that only nine indictments were filed charging failure to comply with the FBAR disclosure requirements, and for 1999 and 2000, no one was charged. During the period 1995 to 2002, there were only three convictions.

The reasons stated by the Treasury for these low prosecutorial statistics are strict banking secrecy laws making it difficult to obtain admissible evidence with respect to undisclosed foreign bank accounts, and prosecutorial selection of violations for criminal conduct associated with the concealment of foreign accounts such as tax evasion, fraud, money laundering, and false statements on a tax return for failing to check the box on Schedule B (which have greater jury appeal), in lieu of failure to comply with the FBAR disclosure requirements.

# Criminal Enforcement After UBS

- It is a new world following the UBS enforcement initiative, which has been ongoing since 2008.
- Criminal prosecutions of FBAR violations have increased dramatically over the last two years.
- There have been approximately 20 criminal convictions relating to the UBS investigation (mostly plea bargains), approximately 10 pending actions, and 60-70 UBS related criminal investigations nationwide.
- Recent criminal filings such as the *Jackson* case in New Jersey reflect that the government will prosecute UBS-type cases with tax losses that are very small (tax losses between \$5,000 and \$12,500 under sentencing guidelines).





***United States Attorney  
District of New Jersey***

FOR IMMEDIATE RELEASE  
November 18, 2010  
[www.justice.gov/usao/nj](http://www.justice.gov/usao/nj)

CONTACT: Rebekah Carmichael  
Office of Public Affairs  
(973) 645-2888

**NEW JERSEY UBS CLIENT PLEADS GUILTY TO FAILING TO REPORT  
OVER \$750,000 IN SWISS BANK ACCOUNT**

NEWARK, N.J. – A Hillsdale, N.J. woman pleaded guilty today to a federal charge of willfully subscribing to a false tax return, admitting she concealed over \$750,000 in a Swiss bank account, United States Attorney Paul J. Fishman and Acting Assistant Attorney General John A. DiCiccio of the Justice Department's Tax Division announced.

Lucille Abrahamsen Jackson made her first appearance and pleaded guilty before United States District Judge Dennis M. Cavanaugh in Newark federal court.

According to court documents filed in this case and statements made during today's guilty plea proceeding:

Jackson admitted that she signed and filed a false tax return for 2005 that failed to disclose her UBS account and income generated from the account's assets. Jackson also failed to file a Report of Foreign Bank or Financial Accounts (FBAR) with respect to the UBS account. The account, originally opened in 1992, was transferred in 2000 into the name of Primrose Properties, S.A., a nominee Panamanian corporation. Jackson and her father, Harry Abrahamsen, established Primrose in 2000 with the assistance of a foreign lawyer and a Swiss banker, in order to hide this account from the IRS. On April 12, 2010, Harry Abrahamsen pleaded guilty to a federal charge of failing to file an FBAR, admitting he concealed over \$1 million in Swiss bank accounts.

United States citizens who have an interest in, or signature or other authority over, a financial account in a foreign country with assets in excess of \$10,000 are required to disclose the existence of such account on Schedule B, Part III of their individual income tax returns. Additionally, U.S. citizens must file an FBAR with the United States Treasury disclosing any financial account in a foreign country with assets in excess of \$10,000 in which they have a financial interest, or over which they have signature or other authority.

Jackson admitted that her failure to file the FBAR and her failure to disclose the existence of the UBS account on her personal income tax returns allowed her to underreport personal income for the years 2000 through 2007. In 2003, the account reached a high balance of over \$759,376.

On April 12, 2010, Jackson's father, Harry Abrahamsen, pleaded guilty to a federal charge of failing to file an FBAR, admitting he concealed over \$1 million in Swiss bank

accounts.

In July 2010, another New Jersey resident and UBS client, Leonid Zaltsberg, of Milltown, pleaded guilty to subscribing to a false tax return.

In September 2009, UBS client Juergen Homann of Saddle River, N.J., also pleaded guilty to failing to file an FBAR.

UBS entered into a deferred prosecution agreement in February 2009, pursuant to which the bank admitted to helping U.S. taxpayers hide accounts from the IRS. As part of their agreement, UBS provided the United States government with the identities of, and account information for, certain U.S. customers of UBS' cross-border business.

"The IRS and Justice Department continue to work cooperatively to combat international tax evasion," said IRS Deputy Commissioner Steven T. Miller. "Individuals who hide income and assets offshore, and those banks and advisors who help them cheat, will find themselves increasingly at risk."

At sentencing, Jackson faces a maximum sentence of three years in prison and a maximum fine of \$250,000, or twice the amount of financial gain to the defendant or loss to the IRS. Additionally, Jackson has agreed to pay a 50 percent civil FBAR penalty based on the highest balance in the UBS account for the years 2000 through 2007. Judge Cavanaugh released the defendant on a \$250,000 bond pending sentencing, which is scheduled for February 28, 2011.

U.S. Attorney Fishman and Acting Assistant Attorney General DiCicco commended special agents of IRS – Criminal Investigation, under the direction of Special Agent in Charge Victor W. Lessoff, for the investigation leading to today's guilty plea.

The government is represented by Assistant United States Attorney Stacey A. Levine of the U.S. Attorney's Office Criminal Division and Trial Attorney Michael C. Vasiliadis of the Department of Justice's Tax Division.

10-331

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Defense counsel: Robert A. Mintz, Esq., Newark, N.J.

# Recent FBAR Conspiracy Indictment (Non-UBS)

- On Jan. 26, 2011, a grand jury indicted a New Jersey businessman for conspiring to conceal offshore bank accounts from the IRS.
- Background in indictment:
  - Accounts in BVI and India were with large international bank (not UBS).
  - Banker advised him to send five checks (each in the amount of \$10,000) in order to “stay below the radar.”
  - Banker told him that funds would not be transferred through U.S. banking system.
  - Following news of UBS DPA, he considered repatriation, and banker replied that he had nothing to worry about, because the bank would not be issuing Forms 1099.
  - Banker said IRS was looking at the Caribbean, not the Far East.
- Continued crackdown on non-UBS foreign bank accounts
- U.S. attorney in New Jersey: “Bankers should encourage their clients to comply with the law, not advise them how to break it.”

# Sentencing Under Advisory Federal Sentencing Guidelines

- Although a criminal conviction generally carries a statutory maximum sentence of five years of imprisonment, the actual sentence is determined under the now-advisory Federal Sentencing Guidelines and the Title 18 United States Code Sect. 3553.
- The applicable guideline provision is Sect. 2S1.3. In most tax cases, the guidelines will look to the “tax loss” involved to determine the advisory sentencing range.
- For example, the advisory guideline range of an individual convicted of an FBAR violation who avoided tax of more than \$80,000 would be **27 to 33 months**, assuming a “sophisticated means” adjustment.