

USC Gould School of Law

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Foreign Financial Assets: You Can Run, But You Cannot Hide

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Presentation Overview

- **Current Enforcement Environment**
- **Foreign Accounts and Assets**
 - FBARs and International Tax Reports: Forms and Penalties
 - Zwerner Case Overview – When It All Goes Wrong
- **Options for Taxpayers with Undisclosed Foreign Financial Accounts and Assets**
 - 2014 OVDP and Common OVDP Issues
 - Streamlined Filing Compliance Procedures (Nonresidents and Residents)
 - Delinquent Submission Procedures: FBARs and International Information Returns
- **Historic Voluntary Disclosure Overview (IRS/DoJ)**

TAX ENFORCEMENT FOCUS ON UNDECLARED FOREIGN FINANCIAL 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

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

CURRENT IRS ENVIRONMENT

■ SEVERE BUDGET CONSTRAINTS

- Impacts hiring, training, etc. throughout

■ SIGNIFICANT, ONGOING CONGRESSIONAL SCRUTINY

- 501(c)(4)
- Affordable Care Act roles & responsibilities
- FATCA implementation

■ LEADERSHIP TRANSITION

- New Commissioner
- Deputy Commissioner(s)
- Appeals Chief
- General continuity issues throughout

FOREIGN ACCOUNTS & ASSETS

Who Has Money Abroad?

- Historical reasons
- War and persecution
- Families with international presence
- Americans living overseas for a time
- American business interests
- Inheritance, gifts
- Diversification
- Tax Cheats . . .
- People who don't know they have assets abroad . . .

“HOW WILL THEY FIND OUT?”

- In the old days (five years ago), advisors could not honestly tell clients that discovery was likely
- Today, governments have numerous 3rd party sources:
 - FATCA (information from foreign financial institutions directly or via their governments)
 - Growing automatic information exchanges between governments
 - DOJ program for Swiss banks – over 100 banks participating
 - Other government investigations (UBS, Credit Suisse, HSBC, etc.)
 - Data mining information from OVDPs and streamlined disclosures
 - Family and business associates – come one, come all
 - Whistleblowers
- IRS is paying attention to taxpayers’ own filings (Form 8938 required by FATCA, 5471s, 3520s, FBARs, etc.)
- As we shall see, although coming forward may be expensive, not coming forward may be ruinous

“HOW WILL THEY FIND OUT?”

THE DOJ PROGRAM FOR SWISS BANKS

- Department of Justice has 14 banks under investigation
 - other Swiss banks are eligible for a non-prosecution agreement or non-target letter
 - New tack on DOJ policy in prosecuting business entities
- Program requires substantial disclosures of U.S.-related account information (not names) dating back to Aug. 1, 2008, as well as potentially large penalties
 - U.S. will then use treaty to get the names
- Account holders under more pressure to come forward
 - they avoid prosecution, and bank gets reduced penalty

“HOW WILL THEY FIND OUT?”

- FATCA marks a sea change – not only because the United States has thrown its weight around and requires both third parties at home and abroad and taxpayers to provide information but also because other countries, through bilateral and multilateral (EU, OECD, etc.) initiatives, are also attacking the same problem with similar weapons, including tax amnesties, FATCA clones and derivatives, and a worldwide campaign for increased automatic exchange of tax information
- The message to your clients should be:

**YOU CAN'T HIDE HERE AND YOU
CAN'T HIDE THERE EITHER!**

FBAR Overview

Report of Foreign Bank and Financial Accounts

FinCEN Form 114 (Formerly Form TD F 90-22.1)

- U.S. citizens, residents or a person in and doing business in the U.S. must file an FBAR with the government if they have a financial account in a foreign country with a value exceeding \$10,000 at any time during the calendar year
- Not a tax form, with many consequences for examination and collection
 - E.g., due on or before June 30 of the following year; no extensions
 - Assessment, appeal and collection procedures differ

FBAR Overview

Who must file?

- **A United States person** must file an FBAR if that person has:
 - A financial interest in;
 - Signature authority over; or
 - Any other authority over any financial account(s) in a foreign country if their aggregate value exceeds \$10,000 at any time during the calendar year
- **A United States person** is:
 - Any entity created, organized or formed under the laws of the United States or its political subdivisions or territories
 - U.S. citizens and tax residents

FBAR Overview

Financial Interest and Signature Authority

■ Financial interest

- Account in which U.S. person is owner of record, even if only as agent, nominee or attorney
- Account of corporation, partnership or other entity in which U.S. person holds >50% interest
 - Note: No tax law-style family attribution rules
- Account of grantor trust with U.S. grantor or other trust if U.S. person holds >50% “present beneficial interest” or receives >50% of current income

■ Signature and other authority

- Individual has sole or joint authority to control financial account by direct written or unwritten communication to person with whom account is maintained.

FBAR Overview

Accounts in Foreign Countries

■ Account

- Includes bank, securities or other financial accounts
- “Other” accounts include
 - Accounts with brokers and dealers in futures or options
 - Insurance or annuities with cash value
 - Mutual fund with regular N.A.V.
 - Government has reserved on other investment funds
 - Pensions: Area of uncertainty – not reportable if general unsecured obligation of corporation or pension plan; reportable if individual savings or retirement account
- What matters is not whether financial institution is foreign but where account is maintained

Don't take chances –
if you aren't sure, go ahead and report!

FBAR Overview

Sanctions - Civil Penalties

- FBAR – penalties up to ***50% of account balances per year*** for willful failure to file
 - Six year statute of limitations, even for non-filers
 - Non-willful penalties – warning or \$10,000/per account
 - Need to reduce to judgment to enforce collection
 - Mitigation guidelines for smaller accounts in IRM
- Definition of **Willfulness**
 - ***Williams (4th Circuit), McBride & Zwerner*** opinions broaden test
 - What did the return preparer know?
 - Was the box on Form 1040 Sch. B, Line 7 checked “no”?
 - Badges of fraud – concealment, tax loss, etc.
 - But note seemingly more relaxed definition in streamlined programs discussed below (slides 30 and 42)

Tax Information Returns

Sanctions — Civil Penalties

Tax Form

- 3520 – Foreign trust distributions and foreign gifts
- 3520A – Foreign trusts with U.S. grantors
- 5471 – Various 10% interests in foreign corps.
- 8865 – Various 10% interests in foreign partnerships
- 8621 – PFICs
- 926 – Transfers to foreign corporation

Penalties

- 35% of trust transfers, 5%-25% of gifts
- 5% of the trust value
- \$10,000 per CFO, can double on notice and demand
- 10%, doubled after notice; 10% of property transferred to partnership up to \$100,000
- No direct penalty; coordinated with Form 8938 (next slide)
- 10% of property transferred up to 100K or unlimited

Tax Information Returns

New Kids on the Block

- **Form 8938** (effective 2011)
 - Report of foreign financial assets
 - Overlaps with FBAR but many differences
 - \$50,000 threshold (\$250,000 or more for nonresident U.S. persons)
 - If filing other foreign information forms, need only state number of forms filed
- **Form 8938 Penalties**
 - \$10,000, doubled after notice up to \$50,000/return
 - Form does not yet apply to entities, only individuals
- **Annual PFIC reporting on Form 8261** (effective 2013)

Tax Returns— Civil Penalties and Statute of Limitations

- Accuracy-related — 20% of the tax + interest
- Fraud — 75% of the tax + interest
- Failure to File/Failure to Pay – up to 25%
- Understatement due to omission of income from foreign sources— 40% (effective 2011)
- Expanded statute of limitations
 - Section 6501(c)(8) extends the statute indefinitely for failure to file most international forms (but not FBARs, which are not tax forms) until 3 years after forms filed
 - Extended for all income tax, not just tax relating to item that should have been included on international form

Meet Carl R. Zwerner

The Facts

- Lives in Florida – 86 years old
- Foreign account disclosed on timely filed 2007 Form 1040 – FBAR and 1040X filed - 10/13/2008
- Tax counsel contacted IRS CI – 02/10/2009
 - Non-client specific contact re 2004-2007
- CI letter “no criminal referral” – 02/17/2009
- FBARs and Forms 1040X filed for 2004, 2005 & 2006 – 03/27/2009

NO IRS EXAMINATION HAD BEGUN AS OF 03/27/2009

Meet Carl R. Zwerner

IRS Audit Begins in 2010

- Audit re tax years 2004-2007 but agent referenced extending audit to 1992 !
- **GOV'T** – Zwerner admitted to “willful misconduct” in failing to file FBARs in letter dated 08/09/10
- **ZWERNER** - letter of 08/09/10 was dictated by the agent as “the only way he would be able to obtain a reduction of the penalties that might otherwise apply”
- **GOV'T** – Even if unaware of FBAR reporting requirements, he was “reckless or willfully blind.”
 - *United States v. Williams* (4th Cir. 2012)
 - *McBride v. United States*, 908 F. Supp. 2d 1186 (D. Utah 2012) (D. UT 2012)

Meet Carl R. Zwerner

The Audit

- **Attempted to enter 2011 OVDI during audit**
 - **2009 OVDP**, 03/26/09 to 10/15/09 (20% Penalty)
 - **2011 OVDI**, 02/08/11 to 09/09/11 (25% Penalty)
 - **2012 OVDP**, 01/09/12 – present (27.5% Penalty)
- **Civil Fraud Penalty Assessed (75% of income tax)**
 - Conceded by IRS Appeals – 2004 and 2005
 - Abated by U.S. Tax Court – 2006
 - Not asserted – 2007

U.S.A. vs. Carl R. Zwerner

Case # 1:13-cv-22082-CMA (SD Florida, June 11, 2013)

■ FBARs Filed – Due June 30

- 2007 FBAR and 1040X filed 10/13/2008
- 2004, 2005 & 2006 FBARs and 1040X's filed 3/27/2009, (BEFORE the audit commenced)

■ 50% FBAR Penalties Assessed - 31 U.S.C. § 5321

- 2004 – \$723,762 (on June 21, 2011)
- 2005 – \$745,209 (on August 10, 2011)
- 2006 – \$772,838 (on August 10, 2011)
- 2007 – \$845,527 (on August 10, 2011)

U.S.A. vs. Carl R. Zwerner

Case # 1:13-cv-22082-CMA (SD Florida, June 11, 2013)

- **FBAR Liability - \$3,488,609.33** (as of June 6, 2013)
- **Highest Account Balance - \$1,691,054** (at any time between 2004 – 2007)
- **Criminal FBAR Cases** - one-year, 50% FBAR penalty
- **Eighth Amendment to the U.S. Constitution** - a civil penalty is unconstitutional if the penalty is at least in part “punishment” and such punishment is *grossly disproportionate to the conduct which the penalty is designed to punish*

U.S.A. vs. Carl R. Zwerner

Case # 1:13-cv-22082-CMA (SD Florida, June 11, 2013)

- **JURY** sustained 50% FBAR penalties for 2004, 2005 and 2006
- **SETTLED** while post-trial arguments pending
- **Zwerner agreed to:**
 - **50% FBAR penalties for 2004 and 2005** in the amounts of \$723,762 and \$745,209 respectively, interest thereon of \$21,336.11 and \$20,947.52, respectively
 - **Plus statutory interest and penalties that accrued under 31 U.S.C. § 3717(e)(2)** on the FBAR penalty assessments for 2004 and 2005 of \$128,016.64 and \$125,685.11, respectively

Effectively, the government exacted a 100% penalty from a man in his 80s who tried to come forward before he was known to the government

UNDECLARED FOREIGN ACCOUNTS – WHEN THE GOVERNMENT FINDS YOU FIRST

- If the initial contact is by the IRS, a purely civil tax resolution is no longer certain and, as the Zwerner case demonstrates, significant civil penalties are likely
- If the initial contact is by the Department of Justice, a purely civil tax resolution is anything but certain and is perhaps unlikely.

DoJ Letter re Investigation of Undeclared Foreign Financial Accounts

“The Department of Justice is conducting an investigation of U.S. taxpayers who may have violated federal criminal laws by failing to report they had a financial interest in, or signature authority over, a financial account located in a foreign country. We have reason to believe that you had an interest in a financial account in India that was not reported to the IRS on either a tax return or FBAR, Department of Treasury Form TD F 90-22.1, report of Foreign Bank and Financial Account. You are advised that the destruction or alteration of any document that may relate to this investigation constitutes a serious violation of federal law, including but not limited to obstruction of justice . . . You are further advised that you are a subject of a criminal investigation being conducted by the Tax Division [of the Department of Justice].”

OPTIONS FOR TAXPAYERS WITH UNDISCLOSED FOREIGN FINANCIAL ASSETS

- Taxpayers who have not yet been contacted by the government now have several options
- 2014 Offshore Voluntary Disclosure Program
- Streamlined Filing Compliance Procedures
- Delinquent FBAR Submission Procedures
- Delinquent International Information Return Submission Procedures

2014 OFFSHORE VOLUNTARY DISCLOSURE PROGRAM

IR-2014-73 (June 18, 2014)

- Indefinite term, subject to change at any time
 - Effect of John Doe Summons or 18 USC 3506 ?
 - Letter from foreign institution?
 - Letter from foreign tax administrator?
- Eight years of amended returns and FBARs for which the due date has passed (N/A fully compliant tax years)
- After preliminary acceptance – 90 days to submit OVDP application & pay taxes, interest & accuracy-related penalties
 - If applicable - delinquency & failure-to-pay penalties
 - Misc. Title 26 Offshore Penalty equal to **27.5%** of highest year end balance in account in last eight years
 - Separate checks for each year and Offshore Penalty
- IRS Criminal Investigation Division to screen all cases

2014 OFFSHORE VOLUNTARY DISCLOSURE PROGRAM

Foreign Financial Institutions or Facilitators

■ Offshore Penalty increases to **50%** if before submission of pre-clearance request, it becomes public that financial institution is under IRS or DOJ investigation –

1. UBS AG
2. Credit Suisse AG, Credit Suisse Fides, and Clariden Leu Ltd.
3. Wegelin & Co.
4. Liechtensteinische Landesbank AG
5. Zurcher Kantonalbank
6. swisspartners Investment Network AG, swisspartners Wealth Management AG, swisspartners Insurance Company SPC Ltd., and swisspartners Versicherung AG
7. CIBC FirstCaribbean International Bank Limited, its predecessors, subsidiaries, and affiliates
8. Stanford International Bank, Ltd., Stanford Group Company, and Stanford Trust Company, Ltd.
9. The Hong Kong and Shanghai Banking Corporation Limited in India (HSBC India)
10. The Bank of N.T. Butterfield & Son Limited (also known as Butterfield Bank and Bank of Butterfield), its predecessors, subsidiaries, and affiliates

And, just announced:

11. Bank Leumi in Israel and affiliates in Luxembourg, Switzerland and U.S. (eff. 12/22/2014)
12. Sovereign Management and Legal, Ltd. (effective 12/19/2014)

2014 OFFSHORE VOLUNTARY DISCLOSURE PROGRAM

Submission Documents (OVDP FAQ #25)

- Offshore Voluntary Disclosure Letter (Form 14457) and
- Attachment to Voluntary Disclosure Letter (Form 14454)
- Foreign Account and Asset Statement (Form 14452)
- Penalty Computation worksheet (Form 14453)
- Power of Attorney for OVDP - includes authorization for analogous acts for Report of Foreign Bank and Financial Accounts (FBAR) matters

2014 OFFSHORE VOLUNTARY DISCLOSURE PROGRAM

Opting Out

- Taxpayers may opt out of OVDP at any time and IRS may remove for noncooperation or untimely submissions
- Opt out results in audit – not limited to international
- Why opt out? Usually, where non-willfulness and reasonable cause arguments are (very) strong and FBAR and information penalties high in relation to taxes
- Why choose OVDP instead of other available programs?
 - Ineligibility for other programs
 - OVDP followed by opt out still makes prosecution very unlikely; streamlined programs provide no protection if IRS audits and finds failures were willful
 - Successful opt-out theoretically may result in zero penalties

Warning: Opting out can lead to both better and worse results

Streamlined Filing Compliance Procedures (SFCP)

Non-Resident & Residents (Updated 10/9/14)

- Does not provide protection from criminal prosecution if the IRS and DOJ determine that the taxpayer's particular circumstances warrant such prosecution - IRS Voluntary Disclosure Practice might help avoid a criminal referral if the appropriate "bells and whistles" set forth in Internal Revenue Manual (IRM) 9.5.11.9 are followed - a "truthful, timely, complete" disclosure, "willingness to cooperate," "taxpayer makes good faith arrangements with the IRS to pay in full, the tax, interest, and any penalties determined by the IRS to be applicable," etc.
 - Once a taxpayer makes a submission under either Streamlined Procedure, OVDP is no longer available
 - Once a taxpayer makes a submission under the OVDP after July 1, 2014, the Streamlined Procedures are no longer available
 - Returns submitted under the streamlined procedures "may" be subject to IRS examination, additional civil penalties, and even criminal liability, if appropriate (**IRS will "spot check" returns**)

Streamlined Filing Compliance Procedures

Eligibility for Non-Resident & Residents

- Eligible if not currently under IRS examination, etc.
- Failed to report income from a foreign financial asset and pay tax as required by U.S. law, and
- May have failed to file an FBAR (FinCEN Form 114, previously Form TD F 90-22.1) with respect to a foreign financial account, and
- **MUST CERTIFY**, under penalties of perjury, that such failure resulted from “non-willful conduct” – non-willful conduct is specifically defined as 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
 - Is this intended to be significantly more user friendly than the historic definitions of “willfulness” and “willful blindness”?
 - If not, then why specifically define “non-willful” conduct?

Streamlined Filing Compliance Procedures

Non-Resident Defined

- **U.S. Persons** - In any one or more of the most recent three years for which the U.S. tax return due date (or properly applied for extended due date) has passed the person did not have a U.S. abode and the individual was physically outside the United States for at least 330 full days (See FAQ #1 re SFOP Non-Resident)
- **Non-U.S. Persons** - in any one or more of the last three years for which the U.S. tax return due date (or properly applied for extended due date) has passed, the individual did not meet the substantial presence test of IRC section 7701(b)(3)
- **Joint Return Filers** - both spouses must meet the applicable non-residency requirement

Streamlined Filing Compliance Procedures

Non-Resident Procedures

- File delinquent or amended tax returns, together with all required information returns (e.g., Forms 3520, 5471, and 8938) for each of the **3 most recent years** for which the U.S. tax return due date (or properly applied for extended due date) has passed
- For each of the most recent **6 years** for which the FBAR due date has passed, **electronically** file any delinquent FBARs (FinCEN Form 114, previously Form TD F 90-22.1)
- **Pay** the full amount of tax and interest due when submitting the foregoing delinquent or amended returns

Streamlined Filing Compliance Procedures

Non-Resident Procedures

- Complete and sign a **Certification by U.S. Person Residing Outside of the U.S.** certifying, under penalties of perjury:
 - eligibility for the Streamlined Foreign Offshore Procedures;
 - that all required FBARs have now been filed
 - statement why the failure to report all income, pay all tax, and submit all required information returns, including FBARs, **resulted from non-willful conduct**

Streamlined Filing Compliance Procedures

Effect of Non-Resident Procedures

- **NO** failure-to-file, failure-to-pay penalties, accuracy-related penalties, information return penalties, or FBAR penalties will be applicable to the information set forth on the returns submitted
- **UNLESS** a subsequent examination of such returns results in a determination that the original tax noncompliance was fraudulent and/or that the FBAR violation was willful
- If the IRS determines an additional tax deficiency for a return submitted, the IRS may assert applicable additions to tax and penalties relating to that additional deficiency
 - **Retroactive relief** for failure to timely elect income deferral on certain retirement and savings plans where deferral is permitted by the applicable treaty

Streamlined Filing Compliance Procedures

Resident Eligibility

- **Fail to meet the applicable non-residency requirement** described above (for joint return filers, one or both of the spouses must fail to meet the applicable non-residency requirement)
- **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
- Failed to report gross income from a foreign financial asset and pay tax as required by U.S. law, and may have failed to file an FBAR (FinCEN Form 114, previously Form TD F 90-22.1) and/or one or more international information returns (e.g., Forms 3520, 3520-A, 5471, 5472, 8938, 926, and 8621) with respect to the foreign financial asset, and such failures resulted from non-willful conduct

Streamlined Filing Compliance Procedures

Resident Procedures

- 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 (the “covered tax return period”), **file amended tax returns, together with all required information returns** (e.g., Forms 3520, 3520-A, 5471, 5472, 8938, 926, and 8621)
- For each of the most recent **6 years** for which the FBAR due date has passed (the “covered FBAR period”), **electronically file any delinquent FBARs** (FinCEN Form 114, previously Form TD F 90-22.1)
- Pay the full amount of tax, interest and a **5% miscellaneous offshore penalty** (based on highest aggregate year end balance/value of foreign financial assets – defined as assets required to be reported on an FBAR or Form 8938 or, if reported, the gross income from such asset was not reported)

Streamlined Filing Compliance Procedures

Resident Procedures (cont'd)

- Complete and sign a **Certification by U.S. Person Residing in the U.S.** certifying, under penalties of perjury:
 - eligibility for the Streamlined Domestic Offshore Procedures
 - that all required FBARs have now been filed
 - that the failure to report all income, pay all tax, and submit all required information returns, including FBARs, resulted from non-willful conduct; and
 - that the 5% misc. offshore penalty amount is accurate
- If the IRS determines an additional tax deficiency for a return submitted, the IRS may assert applicable additions to tax and penalties relating to that additional deficiency

Streamlined Filing Compliance Procedures

Effect of Resident Procedures

- Pay a Title 26 miscellaneous offshore penalty equal to 5% of the highest aggregate year-end balance/value of the foreign financial assets (FFA) that are subject to the miscellaneous offshore penalty during the years in the covered tax return period (3 years) and the covered FBAR period (6 years)
- FFA is subject to the 5% penalty in a given year in the covered FBAR period if the asset should have been, but was not, reported on an FBAR (FinCEN Form 114) for that year (See FAQs of 10/8/14)
- FFA is subject to the 5% 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, or
 - was properly reported for that year, but gross income in respect of the asset was not reported in that year

Streamlined Filing Compliance Procedures

Effect of Resident Procedures

- **NO** accuracy-related penalties, information return penalties, or FBAR penalties will be applicable to the information set forth on the returns submitted
- **UNLESS** a subsequent examination of such returns results in a determination that the original tax noncompliance was fraudulent and/or that the FBAR violation was willful
- If the IRS determines an additional tax deficiency for a return submitted, the IRS may assert applicable additions to tax and penalties relating to that additional deficiency
 - Retroactive relief for failure to timely elect income deferral on certain retirement and savings plans where deferral is permitted by the applicable treaty

DELINQUENT FBAR SUBMISSION PROCEDURES

(Updated 10/9/14)

■ Taxpayers who do not need the OVDP or the SFCPs

- have not filed a required FBAR (FinCEN Form 114, previously Form TD F 90-22.1),
- have **reasonable cause** for not timely filing the information returns,
- are not under a civil examination or a criminal investigation by the IRS, and
- have not already been contacted by the IRS about the delinquent FBARs

■ **Should electronically file the delinquent FBARs** according to the FBAR instructions and include a statement explaining why the FBARs are filed late - select the reason for filing late on the cover page of the electronic form

■ **No Penalty** will be applied for the failure to file the delinquent FBARs if taxpayer properly reported on U.S. tax returns, and paid all tax on, the income from the foreign financial accounts reported on the delinquent FBARs and has not previously been contacted regarding an income tax examination or a request for delinquent returns for the years for which the delinquent FBARs are submitted

■ May be selected for audit through the existing audit selection processes that are in place for any tax or information returns

DELINQUENT INTERNATIONAL INFORMATION **RETURN SUBMISSION PROCEDURES**

(Updated 10/9/14)

■ **Taxpayers who do not need the OVDP or the SFCPs**

- have not filed one or more required international information returns,
- have **reasonable cause** for not timely filing the information returns,
- are not under a civil examination or a criminal investigation by the IRS, &
- not yet contacted by the IRS about the delinquent information returns
- *even if some unreported income* (FAQ#1 – Oct 8, 2014)

■ **File the delinquent information returns with a statement of all facts establishing reasonable cause for the failure to file**

- Delinquent Forms 3520 and 3520-A should be filed according to the applicable instructions for those forms
- All other delinquent international information returns (5471's, etc.) should be attached to an amended return and filed according to the applicable instructions for the amended return

■ **May be selected for audit through the existing audit selection processes that are in place for any tax or information returns**

SO WHAT DOES WILLFULNESS MEAN?

- The government through litigation has established a standard for willfulness that is so low that very few people can safely risk arguing that they were not willful (see cases on slide 13)
- But – IRM position and especially the language used in the streamlined procedures is more favorable to taxpayers
“Non-willful conduct is conduct that is due to negligence, inadvertence, or mistake or conduct that is the result of a good faith misunderstanding of the requirements of the law.”
- The IRS says it will examine certifications of non-willfulness in streamlined disclosures, but it is not clear to what extent this is actually happening
- The IRS has so far not giving additional guidance – and this may be deliberate

WHAT ARE AGENTS ASKING IN PRACTICE?

1. Did a preparer have a part in preparing the returns?
2. If so, what did preparer ask? What was said by taxpayer and preparer to each other? Did preparer ask about offshore accounts? FBARs? What were the responses? Anything written re these questions?
3. Did taxpayer have knowledge of offshore income? Was taxpayer knowledgeable about taxes, finance? What is taxpayer's level of education? What was taxpayer's knowledge of the rules re offshore income and FBAR reporting?
4. Why was there offshore income?
5. Why were the accounts opened?
6. Does taxpayer have a connection to the country where the accounts were located? What was it?
7. What were the sources of the funds in the accounts?
8. What type of activities did the accounts have: deposits? Withdrawals? Frequency of same? If trades, who managed those trades?

Aside from the above, any other elements of non-willful conduct (per IRM), such as no prior audits, no penalties, etc.

Common OVDP Issues

- “It’s not my money” (or only some of it is)
- Domestic Disclosures w/offshore issues
- Opt Outs – one size does not fit all . . . (see slide
- Anecdotal experience
 - Initial submissions, Committee
 - Audit? FBAR Penalty Collection Suit?
- Role of Non-Program (“Quiet”) Disclosures
- Role of Streamlined Procedures
- Follow up interviews of taxpayers
- Relationship to enforcement efforts

OFFSHORE VOLUNTARY DISCLOSURE PROGRAMS

Data Mining the Optional Intake Letters

The IRS is asking for information it can use to detect patterns and locate other non-compliant taxpayers:

“For accounts or assets where you have control or are a beneficial owner of the account or asset, **list any and all financial institutions and the country where the institution is located.** For accounts, please also list the dates the accounts were opened and/or closed. **Provide your point of contact at each financial institution.**”

“**Explain all face to face meetings, and any other communications you had regarding the accounts or assets with the financial institution(s).** Also include face to face meetings or communications regarding the accounts or assets with independent advisors/investment managers not from the financial institution(s) where the funds are held. **Provide the names, locations and dates of these meetings and/or communications.**”

TRIGGERS FOR CONSIDERING A VOLUNTARY DISCLOSURE OR OTHER ALTERNATIVES

- Patriotic or a triggering event on the horizon?
- Seeking reduced income tax and foreign account reporting penalties (and no criminal referral) in exchange for voluntarily coming into compliance before the IRS is aware of the prior tax and financial account reporting indiscretions
- Incentive to come into compliance often depends on perception of fair treatment coupled with the perception of heightened future civil and criminal tax enforcement efforts – IRS, including its Commissioner, believes June 2014 changes represent a reasonable effort to bring more balance to offshore enforcement, so don't expect much more liberalization

OFFSHORE VOLUNTARY DISCLOSURES

Now What?

- **Whatever the trigger, taxpayers with previously undisclosed interests in foreign financial accounts **MUST** get into compliance –**
 - **If unreported tax incidental & strong reasonable cause** – consider delinquent FBAR or international information return procedures
 - **If unreported tax a bit more than incidental & not strong on reasonable cause** – consider OVDP or Streamlined procedures
- Waiting to determine whether civil penalties will be reasonable is not a viable option
- Civil penalties may not seem reasonable – but will likely be less than if the taxpayer is contacted by IRS before coming into compliance – once the IRS knows about you, it is much harder to secure a reasonable result
- Criminal prosecutions of taxpayers with previously undisclosed interests in foreign accounts will continue

OFFSHORE VOLUNTARY DISCLOSURES

Now What?

- The vast majority of 45,000+ taxpayers participating in the 2009, 2011, 2012 and 2014 IRS Offshore Voluntary Disclosure programs previously filed returns prepared by preparers – preparers the IRS might believe were complicit in the non-compliance or possibly less than diligent in preparing the original returns
- Practitioners must exercise due diligence in preparing returns and documents and in determining the correctness of representations to the client and to the IRS – Circular 230 §10.22
- Clients have to be more diligent in choosing preparers

IRS VOLUNTARY DISCLOSURE PRACTICE

IRM 9.5.11.9 (12-02-2009)

- **Informal – an issue to be considered** in decision re criminal prosecution referral by IRS to the Department of Justice
- No substantive or procedural rights for taxpayers
- Cannot rely on the fact that other similarly situated taxpayers may not have been recommended for criminal prosecution
- Requires truthful, timely and complete disclosure

IRS VOLUNTARY DISCLOSURE PRACTICE

IRM 9.5.11.9 (12-02-2009)

- IRS practice since 1952 - encourage voluntary compliance
 - Legal source income
 - **Timely** – disclosure before IRS has initiated an examination or otherwise has information re taxpayer (Informant?)
 - **Truthful and complete**
- Taxpayer must
 - Fully cooperate with IRS
 - Make good faith arrangements to pay any tax, interest, and penalties determined by the IRS to be due
 - **Disclose every aspect of noncompliance**

IRS VOLUNTARY DISCLOSURE PRACTICE

IRM 9.5.11.9 (12-02-2009)

- Will not automatically guarantee immunity from prosecution - however, a voluntary disclosure may result in prosecution not being recommended by IRS (no “referral” the Department of Justice for prosecution)
- IRS representatives to refrain from offering opinions or discussing hypothetical investigations with anonymous taxpayers or his/her representatives – may inquire as to reasons why they are making the voluntary disclosure

IRS VOLUNTARY DISCLOSURE LETTERS

- **Domestic Voluntary Disclosure (DVD) Letter**
- **Offshore Voluntary Disclosure (OVD) “Optional Intake Letter”**

“By signing this document, I certify that I am willing to continue to cooperate with the Internal Revenue Service, including in assessing my income tax liabilities and making good faith arrangements to pay all taxes, interest, and penalties associated with this voluntary disclosure.

Under penalties of perjury, I declare that I have examined this document and accompanying statements, and to the best of my knowledge and belief, they are true, correct, and complete.”

VOLUNTARY DISCLOSURE COMMUNICATIONS

IRM 9.5.11.9.6 (11-01-2011)

- **No specified format required** – information may be provided either verbally or in writing - must identify taxpayer and provide a brief description of all omitted income, the tax scheme used by the taxpayer, and a dollar estimate of the total taxes owed
- **Statement must be made by the taxpayer** (either verbally or in writing) that they are willing to cooperate with the IRS in determining the correct tax liability and make good faith arrangements to pay in full, the tax, interest, and any penalties determined by the IRS to be applicable in full. This is critical
- **taxpayer may submit amended returns** with their voluntary disclosure communication or wait to submit amended returns until after Criminal Investigation evaluates the communication and makes a recommendation to SB/SE Planning and Special Programs Unit (PSP) or LB&I Offshore Identification Unit (POIU)

IRS VOLUNTARY DISCLOSURES

Disqualifying Factors IRM 9.5.11.9.5 (12-02-2009)

- Are you currently the subject of a criminal investigation or civil examination? (If yes, specify)
- Has the IRS notified you that it intends to commence an examination or investigation? (If yes, specify)
- Are you under investigation by any law enforcement agency? (If yes, specify)
- Is the source of any of your income from illegal activity? (The IRS voluntary disclosure practice does not apply to taxpayers with illegal source income) (If yes, specify)
- Do you have any reason to believe that the IRS has obtained information concerning your tax liability? (If yes, specify)

IRS VOLUNTARY DISCLOSURE PRACTICE

Examples of timely voluntary disclosures include . . .

IRM 9.5.11.9 (12-02-2009)

“(6) **Examples of timely voluntary disclosures include:**

(A). A **letter from an attorney which encloses amended returns** from a client which are complete and accurate (reporting legal source income omitted from the original returns), which offers to pay the tax, interest, and any penalties determined by the IRS to be applicable in full and which meets the timeliness standard set forth above.

This is a voluntary disclosure because all of the elements of a voluntary disclosure have been met”

Department of Justice

VOLUNTARY DISCLOSURE POLICY

Section 4.01, Criminal Tax Manual, U.S. Department of Justice (2008)

Whenever a person voluntarily discloses that he or she committed a crime before any investigation of the person's conduct begins, that factor is considered by the Tax Division along with all other factors in the case in determining whether to pursue criminal prosecution.

If a putative criminal defendant has complied in all respects with all of the requirements of the Internal Revenue Service's voluntary disclosure practice, the **Tax Division may consider that factor in its exercise of prosecutorial discretion.** It will consider, inter alia, the timeliness of the voluntary disclosure, **what prompted the person to make the disclosure,** and whether the person fully and truthfully cooperated with the government by paying past tax liabilities, complying with subsequent tax obligations, and assisting in the prosecution of other persons involved in the crime.

Department of Justice

POLICY DIRECTIVES AND MEMORANDA

Section 3, Policy Directives and Memoranda
Tax Division, U.S. Department of Justice (02/17/1993)

. . . the Service's voluntary disclosure policy remains, as it has since 1952, an exercise of prosecutorial discretion that does not, and legally could not, confer any legal rights on taxpayers.

If the Service has referred a case to the Division, it is reasonable and appropriate to assume that the Service has considered any voluntary disclosure claims made by the taxpayer and has referred the case to the Division in a manner consistent with its public statements and internal policies. As a result, our review is normally confined to the merits of the case and the application of the Department's voluntary disclosure policy set forth in Section 4.01 of the Criminal Tax Manual

**Be Prepared . . .
For Heightened IRS Enforcement . . .
To Continue . . .
In this Target Rich Environment!**

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