Undisclosed Foreign Accounts: IRS Investigations, Audits, OVDP and Streamlined Disclosures – The Lawyer’s Role in Guiding the Taxpayer through Perilous Waters

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As long as there are taxes, people will try to evade them . . . United States v Floyd 740 F.3d 22, 27 (1st Cir. 2014)

  • Resulted from concerns about U.S. people hiding behind foreign bank secrecy laws to evade U.S. tax

• 1992 – Treasury delegated to the IRS the authority to investigate FBAR violations and to identify cases to recommend for criminal prosecution or civil penalties

• 2003 – Financial Crimes Enforcement Network (“FinCEN”, the primary Treasury Agency responsible for administering and enforcing the BSA) delegated FBAR enforcement authority to the IRS, with the ability to assess civil penalties, employ summons power, etc.

• Historically low rates of compliance and enforcement—until recently
IRS Offshore Voluntary Disclosure Programs

- 2003 – Offshore Voluntary Compliance Initiative
- 2003 – Last Chance Compliance Initiative
- 2009 – Offshore Voluntary Disclosure Program
- 2011 – Offshore Voluntary Disclosure Initiative
- 2012 – Offshore Voluntary Disclosure Program
- 2014 – Streamlined Filing Procedures
DOJ Crackdown

- Since 2009 the Department of Justice has been aggressively pursuing information from foreign banks and prosecuting foreign banks and advisors and U.S. account holders and advisors.
  - “Swiss Bank Pleads Guilty in Manhattan Federal Court to Conspiracy to Evade Taxes” DOJ Press Release, January 3, 2013
  - “First Deadline Approaches for Participating in the Program for Non-Prosecution Agreements or Non-Target Letters for Swiss Banks” DOJ Press Release, Dec. 12, 2013
DOJ Crackdown

- Swiss Asset Management Firm and Related Companies Agree to Resolve Criminal Tax Investigation. The Swisspartners Group Is Paying $4.4 Million in Forfeiture and Restitution DOJ Press Release May 9, 2014
- Credit Suisse sentenced for conspiracy to help U.S. Taxpayers hide offshore accounts from Internal Revenue Service – November 21, 2014
- BSI SA of Lugano, Switzerland, is first bank to reach a non-prosecution agreement under DOJ Swiss Bank Program – March 30, 2015
Current FBAR Guidance

- FinCEN Introduces new forms
  - On September 30, 2013, FinCEN posted, on its internet site, a notice announcing FinCEN Form 114, Report of Foreign Bank and Financial Accounts (the current FBAR form). FinCEN Form 114 supersedes TD F 90-22.1 (the prior version of the FBAR form) and is only available online through the BSA E-Filing System website. The system allows the filer to enter the calendar year reported, including past years, on the online FinCEN Form 114.
FBAR Failure-to-File Penalties

- Negligent failure
  - Up to $10,000

- Willful failure
  - The greater of $100,000 or 50% of the highest balance in the account
  - Possible criminal exposure (up to $500,000 and up to 10 years of imprisonment) in addition to civil penalties

- Reasonable cause exception
  - If there is reasonable cause and the balance of the account is “properly reported” (presumably, on a late-filed FBAR), no penalty will be imposed
Collections: Lawsuits To Collect The FBAR Penalty and the Treasury Department Administrative Offset Program

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

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

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

Collections:
Statutes Of Limitations

- There are two statutes of limitation with respect to the collection of FBAR penalties. IRM § 8.11.6.3.1.1(2) (11-01-2011):
  - Two years to sue to collect from the later of the assessment date or the date any judgment becomes final in a criminal action involving the same transaction that resulted in the penalty. 31 U.S.C. § 5321 (6)(2)
  - Six years from the assessment date during which it, through FMS, can collect through certain offsets. 31 U.S.C. § 5321 (6)(1)

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

❖ If the IRS assesses a FBAR penalty, the Taxpayer may not seek relief in the Court. IRC § 7442 With the door to the Tax Court closed, those facing FBAR penalties appear to be left with two options to obtain judicial review: Either pay the penalty and file a refund lawsuit, or wait until the government files suit in district court to collect the penalty and challenge the assessment. 31 U.S.C. § 5321(b)(2); 28 U.S.C. §§ 1345 and 1346(a).

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

❖ In a government action to recover a FBAR penalty, there is a right a jury trial. See Tull v. United States, 481 U.S. 412, 425 (1987) (finding right to jury trial in suit by government to assess penalties under Clean Water Act).

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

❖ For recent litigation regarding government lawsuits to recover FBAR penalties see: (1) United States v Zwerner No. 1:13 cv-22082 – CMA (S.D. Fla 2013) and (2) Moore v United States No. 2:13-cv-02063 (W.D. Wash 2015)
FBAR Due Date

- Must be **received** by June 30
- **No extension** available
- **Mandatory e-filing** of FBARs
FBAR – Disclosure on Income Tax Return

- 2011 Revision of Schedule B, Part III, of Form 1040 added a specific question that asks whether the taxpayer is required to file an FBAR (under penalties of perjury) whether or not they are required to file the FBAR.

- Previously, Schedule B, Part III only asked whether the taxpayer had a foreign account but not whether an FBAR filing was required.
FBAR – Disclosure on Income Tax Return (cont’d.)

Previous Schedule B (Form 1040):

<table>
<thead>
<tr>
<th>Part III</th>
<th>Foreign Accounts and Trusts</th>
</tr>
</thead>
<tbody>
<tr>
<td>7a</td>
<td>At any time during 2010, did you have an interest in or a signature or other authority over a financial account in a foreign country, such as a bank account, securities account, or other financial account? See instructions on back for exceptions and filing requirements for Form TD F 90-22.1 . . . . .</td>
</tr>
<tr>
<td>b</td>
<td>If “Yes,” enter the name of the foreign country ▶</td>
</tr>
<tr>
<td>8</td>
<td>During 2010, did you receive a distribution from, or were you the grantor of, or transferor to, a foreign trust? If “Yes,” you may have to file Form 3520. See instructions on back . . . . .</td>
</tr>
</tbody>
</table>
FBAR – Disclosure on Income Tax Return (cont’d.)

Current Schedule B (Form 1040):

You must complete this part if you (a) had over $1,500 of taxable interest or ordinary dividends; (b) had a foreign account; or (c) received a distribution from, or were a grantor of, or a transferor to, a foreign trust.

<table>
<thead>
<tr>
<th>Part III</th>
<th>Foreign Accounts and Trusts</th>
</tr>
</thead>
<tbody>
<tr>
<td>7a</td>
<td>At any time during 2012, did you have a financial interest in or signature authority over a financial account (such as a bank account, securities account, or brokerage account) located in a foreign country? See instructions.</td>
</tr>
<tr>
<td>7a</td>
<td>If “Yes,” are you required to file Form TD F 90-22.1 to report that financial interest or signature authority? See Form TD F 90-22.1 and its instructions for filing requirements and exceptions to those requirements.</td>
</tr>
<tr>
<td>7b</td>
<td>If you are required to file Form TD F 90-22.1, enter the name of the foreign country where the financial account is located.</td>
</tr>
<tr>
<td>8</td>
<td>During 2012, did you receive a distribution from, or were you the grantor of, or transferor to, a foreign trust? If “Yes,” you may have to file Form 3520. See instructions on back.</td>
</tr>
</tbody>
</table>

Revision not yet made to:

- Form 1041, Page 2, Other Information
- Form 1102 & 1120S, Schedule N
- Form 1065, Schedule B, Line 10
- Form 990, Part V, Line 4
FBAR Filing Requirement

A U.S. person with a **financial interest** in, or **signature authority** over, one or more **foreign financial accounts**, if **aggregate** value of accounts exceeds $10,000 at any time during the calendar year.

For example, if a taxpayer has 10 foreign accounts, each with only $1,001, they must be reported.
Department of Justice Efforts to Combat Offshore Tax Evasion
The Problem

- The 2008 Senate Report estimated that the use of unreported offshore accounts to evade U.S. taxes cost the Treasury approximately $100 billion annually.
Prosecution Efforts: Foreign Banks

- Charge: conspiracy (18 U.S.C. § 371)
- UBS
- Wegelin Bank
- Swisspartners Group
- Credit Suisse
- Bank Leumi
- Commerzbank
- BSI Sa Lugano Switzerland
Prosecution Efforts: U.S. Account Holders

- Charges
  - Tax evasion (IRC § 7201)
  - False tax returns (IRC § 7206 (1))
  - Conspiracy (18 U.S.C. § 371)
  - Willful failure to file FBARS (31 U.S.C. § 5322)
Efforts to Obtain Information: Treaty Requests

- Bank Julius Baer
- Liechtensteinische Landesbank
Efforts to Obtain Information: John Doe Summons

- UBS
- HSBC
- First Caribbean International Bank
- Zurcher Kantonalbank
- The Bank of NP Butterfield & Son Limited
IRS Offshore Voluntary Disclosure Programs
2012 Offshore Voluntary Disclosure Program “OVDP”

- IRS reports that under the 2009 and 2011 Voluntary Disclosure Programs, each of which was open for a six month period, 45,000 taxpayers have come forward, and Treasury has collected $6 billion

- IRS reopened the program on January 9, 2012 and it was amended in 2014

- Similar to the 2011 program, but with a few significant differences:
  - Open for an indefinite period of time until otherwise announced; terms of OVDP could change at any time
  - Requires individuals to pay an FBAR penalty of 27.5% (compared to 25% in the 2011 program and 20% in the 2009 program), may be increased to 50% in certain circumstances
  - 8 year “rolling” look-back period with exclusion of compliant years
2012 Offshore Voluntary Disclosure Program “OVDP” (cont’d)

- The 2014 Amendments to the 2012 OVDP requires taxpayers to submit: (1) full payment for tax, interest, and accuracy related, failure to file, and failure to pay penalties (if applicable); (2) copies of previously filed original federal income tax returns for the taxable years included in the voluntary disclosure period; (3) amended federal income tax returns reporting previously unreported income; (4) a foreign account or asset statement; and (5) a taxpayer account summary with penalty calculation.

- In addition, taxpayers participating in the 2014 amendment to the 2012 OVPPD must also submit: (1) payment in full of the Offshore Penalty by separate check;
(2) copies of filed FBARs; (3) copies of statements for all foreign financial accounts (without regard to balances); (4) a statement identifying all foreign entities held during the disclosure period (whether held directly or indirectly); (5) complete and accurate information returns for any foreign entities holding OVDP assets; (6) estate and gift tax returns for estates of deceased taxpayers participating in the OVDP; (7) a statement addressing PFIC issues; and (8) if applicable, the documentation required under the FAQs for Canadian Registered Retirement Savings Plans and Registered Retirement Income Funds for those taxpayers wishing to make late election to defer U.S. income tax on earnings by filing Form 8891.
More stringent eligibility requirements

- U.S. government receipt of taxpayer information from “John Doe” summons, treaty request, or similar action is disqualifying event
- Taxpayers who appeal foreign tax administrator’s decision to release account information must notify U.S. Attorney General or be disqualified
- IRS may in its discretion designate certain classes of taxpayers ineligible
- IRS has issued a list of 55 questions and answers (Q&A) regarding the Voluntary Disclosure Program
Streamlined Filing Compliance Procedures

The streamlined filing compliance procedures are available to taxpayers who certify that their failure to report foreign financial assets and pay the tax due with respect to those assets did not result from willful conduct on their part.

❖ Eligibility

The streamlined procedures are available only for individual taxpayers, including estates of individual taxpayers. There are separate procedures for U.S. individual taxpayers residing outside the United States and U.S. individual taxpayers residing in the United States.
Streamlined Filing Compliance Procedure (cont’d.)

- The streamlined procedures are not available to taxpayers who are under civil examination, regardless of whether the examination relates to undisclosed foreign financial assets, and are not available to taxpayers under criminal investigation by IRS Criminal Investigation.

- Taxpayers who have previously filed delinquent or amended returns regarding offshore foreign financial assets, i.e., taxpayers who made “quiet disclosures” outside of the OVDP or its predecessor programs may use these streamlined procedures, but any penalty assessment previously made with respect to those filings will not be abated.
Streamlined Filing Compliance Procedures (cont’d.)

- Taxpayers who want to participate in streamlined procedures need to obtain a valid taxpayer identification number. For U.S. citizens and resident aliens, this number would be their social security number. For entities, their number would be the appropriate EIN.

The non-willful certification

- The IRS requires the taxpayer to certify that the non compliance was due to non-willful conduct. The certification defines non willful conduct 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.” The U.S. Supreme Court has defined willfulness in criminal tax cases as “Voluntary, intentional violation of a known legal duty.” Cheek v. United States 498 US 192.
2012 OVDP: “Opt Out” Option

- An opt out is an election made by a taxpayer to have his or her case handled under the standard audit process.
- IRS recognizes that in certain cases, the opt out option may reflect a preferred approach. That is, there may be instances in which the results under the voluntary disclosure program appear too severe given the facts of the case.
- Full scope examinations will occur if opt out is initiated.
- If issues are found upon a full scope examination that were not disclosed by the taxpayer, those issues may be the subject of review by IRS Criminal Investigation.
Risks of “Quiet Disclosure”

- FAQ 15: “Taxpayers are strongly encouraged to come forward under the OVDP to make timely, accurate, and complete disclosures. Those taxpayers making ‘quiet’ disclosures should be aware of the risk of being examined and potentially criminally prosecuted for all applicable years.”

- FAQ 16: “The IRS is reviewing amended returns and could select any amended return for examination. The IRS has identified, and will continue to identify, amended tax returns reporting increases in income. The IRS will closely review these returns to determine whether enforcement action is appropriate. If a return is selected for examination, the 27.5 percent offshore penalty would not be available. When criminal behavior is evident and the disclosure does not meet the requirements of a voluntary disclosure under IRM 9.5.11.9, the IRS may recommend criminal prosecution to the Department of Justice.”
That’s all folks!