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In this article, McCormick explores the background for the IRS's anticipated shift from voluntary disclosure to assessments in the international compliance area, and he details some of the assessment guidelines for failure to file the foreign bank account report.

Introduction

For close to a decade, retroactive offshore disclosures have served as a cornerstone of the IRS's efforts to ensure that U.S. taxpayers meet their reporting requirements for foreign assets. Curative programs for prior failures have long been seen as appropriate given the IRS's past lack of emphasis on international requirements, combined with the historical irrelevance of those requirements for most taxpayers. The traditional and most expansive program for those disclosures has been the offshore voluntary disclosure program.

The evolution of the international area has arguably made retroactive disclosure options less appropriate. The past several years have seen a heightened emphasis on international reporting, in part as a result of the publicity given to retroactive disclosure options. As the world has become increasingly global, these requirements have also applied to a far greater scope and variety of individuals. With those factors in mind, the IRS recently announced the pending closure of the OVDP.

Prospectively, alternate disclosure options will exist, albeit with a narrowed focus. Many taxpayers will be left without optimal options for disclosures. Those who cannot comfortably certify non-willfulness — which, for many reasons, is an increasing proportion of noncompliant taxpayers — will be affected. On a more macro scale, a growing expectation among practitioners is that the IRS's approach in the international compliance area will shift from disclosures to assessments.

In the assessment realm, there is likely to be a focus on failures to file Financial Crimes Enforcement Network Form 114 (the foreign bank account report) since those failures both receive the most attention and typically create the largest assessable penalties. It is vital to be aware that because the FBAR is required under Title 31 rather than Title 26, enforcement mechanisms can often be more limited than those for traditional tax penalties. This article explores the background for the anticipated shift to assessments and details some of the guidelines for assessments in the FBAR context.

OVDP: Background and Cessation

In 2009 the IRS introduced the first OVDP, then a three-month opportunity in the wake of the UBS scandal, for taxpayers to rectify prior failures to disclose international holdings. Based in part on the success of the 2009 program and in part on the continuing need for taxpayers to remedy past omissions, a second short-term program was announced in 2011. And in 2012 an open-ended version of the OVDP was announced. In that announcement, the IRS explicitly noted that the 2012 OVDP could be closed "at any time." Modifications to the 2012 OVDP were made in 2014. Since inception, the programs have generated more than $10 billion in payments made to the government, according to the IRS.

In lieu of the penalties that otherwise could be assessed for a failure to meet tax obligations related to foreign assets, taxpayers in the OVDP agreed to pay a 20 percent accuracy-related penalty (and pay failure-to-file and failure-to-pay penalties when applicable). The disclosing taxpayer also agreed to pay the miscellaneous Title 26 offshore penalty, a one-time penalty that under the 2012 and 2014 versions of the OVDP typically was 27.5 percent of the highest value of foreign income-generating assets during the eight-year disclosure period (although, in some circumstances, that penalty amount increased to 50 percent). The OVDP process was lengthy but offered legitimate levels of peace of mind to concerned taxpayers: Standard policy within the OVDP was that participating taxpayers would not be recommended to face criminal penalties (which could apply for FBAR failures), and a closing letter was received upon completion of the program indicating that all prior failures to properly report were resolved.

On March 13 the IRS issued IR-2018-52, publicizing its intention to close the OVDP effective September 28. The release noted that part of the rationale for the OVDP's closure was based on "advances in third-party reporting." Two primary mechanisms account for these advances: the Foreign Account Tax Compliance Act (which, through various means, essentially requires foreign financial institutions to disclose specific foreign assets held by U.S. taxpayers) and settlements between the IRS and prominent FFIs (UBS and Bank Leumi being two examples). Using different methods, both FATCA and the settlements have led to the IRS now being able to more easily access information on the overseas holdings of U.S. taxpayers. Functionally, this means that the IRS is no longer as reliant on taxpayers to voluntarily come forward, thus removing the incentive to offer voluntary options.

The IRS also pointed out in IR-2018-52 that the number of disclosures made through the OVDP peaked in 2011 at roughly 18,000. Disclosure numbers have reduced steadily since then, with 600 disclosures made in 2017. This reflects a long-standing (and logical) belief in the offshore disclosure realm: that as time goes on, diminishing returns come from voluntary programs. Given the amount of publicity given to both the offshore disclosure programs and to the foreign reporting requirements, there is a general belief that in the significant majority of circumstances, those who are willing to voluntarily come forward have already done so.

Alternate Disclosure Options

Although the OVDP will be closing, there will still be options for disclosures. A few, such as the delinquent FBAR submission procedures and the delinquent international information return procedures, are designed for taxpayers whose failures do not create additional taxes owed. As one would suspect, these programs have a narrow application. The most popular disclosure program remaining available is the streamlined filing compliance procedure; however, there may be growing concerns about participating in this program — concerns that are intertwined with the reasons for the OVDP's cessation.

Under the streamlined program for U.S. resident taxpayers, a 5 percent penalty is imposed on the highest balance of a taxpayer's foreign financial assets subject to penalty (assets reportable on either the FBAR or Form 8938) over the covered six-year period, along with taxes and interest on tax amounts. Compared with the OVDP, the terms of the streamlined program are more basic but offer fewer assurances: Although there are far fewer submission obligations, the taxpayer receives no closing letter or any type of affirmative statement from the IRS — not even an acknowledgement of receipt — upon submission and processing of the disclosure package.

The streamlined program requires that taxpayers' prior failures to file FBARs, include income from foreign assets on their Form 1040, or to pay tax on that income were non-willful. Importantly, this standard must apply to all aspects of the prior failures. For example, if a taxpayer's failures to file information returns were non-willful but his failures to include income were willful, he will not qualify for participation in the program.

For these purposes, the IRS defines non-willful as conduct "due to negligence, inadvertence, or mistake or conduct that is the result of a good faith misunderstanding of the requirements of the law."[1] Determinations of non-willfulness are made at the IRS's discretion, based primarily on a certification statement submitted by the taxpayer detailing relevant information. If a submission is denied based on a failure to meet the non-willfulness standard, the taxpayer is subject to the full array of applicable penalties.

As awareness of international reporting requirements becomes more widespread, the ability for a taxpayer's failures to be certified as non-willful arguably decreases. Before knowledge of the requirements was widespread, taxpayers could credibly claim ignorance; however, an increasingly small number of individuals can now assert they were fully unaware of them. Taxpayers who could not prove their non-willfulness under traditional voluntary disclosure methods have used the OVDP for their disclosures. The end of the OVDP eliminates that option for those taxpayers.

IR-2018-52 mentions that the more traditional voluntary disclosure program maintained by the IRS Criminal Investigation division — a program that existed long before the OVDP and shifted to a primarily domestic focus once the OVDP became available — will remain open after the closure of the OVDP. However, far fewer assurances are offered through this program than were offered through the OVDP.

Assessments for FBAR Failures

As noted, part of the rationale for the OVDP's cessation is that information now available to the IRS allows it to identify U.S. taxpayers who have not complied with reporting requirements. Although there are penalties both for failures to report income and for failures to file required information forms, the penalty range (and the IRS's discretion) are generally highest for willful failure to file the FBAR. It is critical to understand the standards for the assessment of penalties for FBAR failures. Although the statutory authority for assessing FBAR penalties is broad, the IRS has implemented significant limitations.

[1]Internal Revenue Manual section 4.26.16.4.5.3.

As brief background, U.S. persons with financial interests in, or signature authority over, foreign financial accounts must disclose covered accounts on the FBAR if the aggregate value of those accounts exceeds $10,000 at any time during the calendar year.[2] Reportable accounts include savings accounts, deposit accounts, demand deposit accounts, checking accounts, securities accounts, and any other account maintained with a person engaged in the business of banking or securities.[3] In determining whether the value of reportable accounts exceeds $10,000, aggregated values are used for all accounts in which any interest is maintained (including solely owned accounts, jointly owned accounts, and signature authority accounts).[4]

Although the FBAR requirement is maintained under Title 31, the IRS has been granted authority to enforce civil FBAR matters.[5] However, as discussed later, that authority generally does not extend to the collection of assessed penalties. For individuals, assessable penalty amounts hinge on whether a failure is determined to be willful or non-willful. Warning letters (in lieu of financial penalties) can be issued for failures to meet FBAR requirements.[6] There is a six-year statute of limitations for failures to file required FBARs.

For non-willful failures, the statute authorizes penalties of up to $10,000 per account per year. Individuals holding numerous accounts overseas can thus face significant penalties regardless of the accounts' aggregate value.[7] However, the Internal Revenue Manual (incorporating a May 2015 IRS memorandum[8]) generally limits the assessment to one non-willful penalty per open year, with the penalty not to exceed $10,000. The IRM also provides that in some cases, a single

[2]31 C.F.R. section 1010.350(a).

[3]31 C.F.R. section 1010.350(c).

[4]IRM section 4.26.16.3.6.3.

[5]IRM section 4.26.16.2.3.

[6]31 U.S.C. section 5321(a).

[7]31 U.S.C. section 5321(a)(5)(B)(i).

[8]SBSE-04-0515-0025.

$10,000 penalty will be the most appropriate assessment (despite FBAR failures covering multiple years).[9] And it says that in no case should the non-willful penalty exceed 50 percent of the highest aggregated balance of all accounts to which the violations relate during the years at issue.[10]

For willful violations, the penalties permissible under the statute are striking: an annual penalty of the greater of $100,000 or 50 percent of the amount of the balance of unreported accounts at the time of the violation (for each year a failure occurs).[11] Here too, however, the IRS has significantly limited the penalties. In typical cases, the total penalty amount for all years will be no more than 50 percent of the highest aggregated account balance, and the IRM states that in no case should the penalty exceed 100 percent of the highest balance.[12]

Importantly, the IRM notes that examiners have discretion in penalty application, so lower penalties can be imposed when that result is appropriate under the facts.[13] The IRM says that examiners should ensure that "the amount of the penalty is commensurate to the harm caused by the FBAR violation."[14]

As one can glean, markedly higher penalties are generally assessable for willful failures, particularly when the taxpayer maintains high account values. So a vital question is what types of action constitute willfulness for these purposes. For FBAR violations, willfulness mirrors the willfulness concept under criminal tax law: a voluntary, intentional violation of a known legal duty.[15] The IRM states as follows regarding willfulness in the FBAR context:

> Willfulness is shown by the person's knowledge of the reporting requirements and the person's conscious choice not to comply with the requirements. In the FBAR situation, the person only need know that a reporting requirement exists. If a person has that knowledge, the only intent needed to constitute a willful violation of the requirement is a conscious choice not to file the FBAR.[16]

Willful blindness — when a person makes a conscious effort to avoid learning of FBAR requirements — also constitutes willfulness for these purposes.[17]

Case law directly dealing the willfulness concept is limited and largely unfavorable to taxpayers. The case most often cited is *Williams*.[18] J. Bryan Williams was assessed penalties for willful FBAR violations. On Schedule B of his Form 1040, Williams (through his accountant, who prepared the return) checked "no" in response to the question whether he had a reportable interest in a foreign financial account. Williams said he never reviewed that portion of his return. Reversing a judgment in favor of Williams, the Fourth Circuit said that by signing his return, Williams had certified the truth of the return and had constructive knowledge of its contents. In the court of appeals' estimation, Williams's failure to review the FBAR question on Schedule B constituted a conscious effort to avoid learning of reporting requirements, with the "no" answer itself being conduct meant to mislead or conceal. After considering other indicia of willfulness, the Fourth Circuit determined that Williams had acted willfully under the facts involved.

The IRS takes a less aggressive position regarding Schedule B. The IRM states that the failure to learn of the FBAR requirement after seeing the Schedule B inquiry regarding foreign accounts may provide evidence of willful blindness but that the "mere fact that a person checked the wrong box, or no box, on a Schedule B" will not alone be sufficient to establish willfulness.[19] Because willfulness is a state of mind and thus not subject to direct proof, typically inferences are drawn from available facts. Factors

[9] IRM section 4.26.16.6.4.1.1.

[10] IRM section 4.26.16.6.4.1.

[11] 31 U.S.C. section 5321(a)(5)(D).

[12] IRM section 4.26.16.6.5.3.

[13] IRM section 4.26.16.6.6.1.

[14] IRM section 4.26.16.6.7.4.

[15] *See* IRM section 4.26.16.6.5.1.

[16] IRM section 4.26.16.6.5.1.3.

[17] IRM section 4.26.16.6.5.1.5.

[18] *United States v. Williams*, No. 10-2230 (4th Cir. 2012) (unpublished).

[19] IRM section 4.26.16.6.5.1.5.

such as efforts to conceal an account (for example, by holding the account in names of parties other than the beneficial owner) and lack of a rationale for holding the account in the foreign jurisdiction are evidence of willfulness.[20]

Enforcement of FBAR Assessments

The fact that FBAR requirements are provided under Title 31 rather than Title 26 is critical in the collection context. FBAR penalties are debts owed to the U.S. government, and the standards for the collection of FBAR penalties are provided by regulations under Title 31.[21]

For FBAR penalties, notices of penalties are sent before collection action begins.[22] Installment options for payment are available, and debts can be deemed uncollectible (in which case collection activity may be suspended or terminated).[23] When debts have a principal balance exceeding $100,000, however, the Justice Department must approve any compromise or any suspension or termination of collection activity.[24]

FBAR penalties are primarily enforced through government offsets and the commencement of civil actions to collect assessed penalties.[25] The government's collection methods through offset are (1) administrative offset, (2) tax refund offset, (3) federal salary offset, (4) referral to private collection contractors, (5) referral to agencies operating a debt collection center, (6) reporting delinquencies to credit reporting bureaus, (7) garnishing the wages of delinquent debtors, and (8) litigation or foreclosure.[26] There is no limitations period for offsets.[27]

As for civil actions, delinquent debts are referred to the Justice Department after "aggressive collection activity" has been taken and when compromise of the penalties (or the suspension of collection action) is inappropriate.[28]

Any action to enforce FBAR penalties must be filed within two years, with the applicable period typically beginning on the date of penalty assessment.[29] If suit is filed and an enforceable judgment ultimately results, collection options increase substantially.

It is critical to understand how the collection mechanisms for FBAR penalties differ from those for tax penalties imposed under Title 26. FBAR penalties are not classified as tax penalties.[30] Therefore, a multitude of options that are available without court approval for tax penalties (such as liens and levies) are unavailable, at least until there is an enforceable judgment. Awareness of these differences is important, both in advising taxpayers of collection options available to the government and in ensuring that no government actions undertaken to collect overstep the existing limitations.

Conclusion

The pending closure of the OVDP offers no guarantees of what the IRS will focus on in the international reporting realm. However, inferences can be drawn about what comes next. It appears increasingly likely that there will be a shift toward assessments, particularly in the FBAR context.

For taxpayers subject to FBAR penalties, there is an expectation that the assessments will be aggressive, given the prior options to voluntarily cure their failures. When those assessments occur, taxpayers and their advisers should be familiar with the IRS's standards to ensure that all feasible options to challenge the assessments are used. ■

[20] *See* IRM section 4.26.16.6.5.2.2.

[21] *See* 31 C.F.R. section 5.1.

[22] 31 C.F.R. section 5.4.

[23] 31 C.F.R. sections 5.6 through 5.8.

[24] 31 C.F.R. section 5.16.

[25] IRM section 8.11.6.3.1.1.2.

[26] 31 U.S.C. section 3711(g)(9).

[27] 31 U.S.C. section 3716(e)(1).

[28] 31 C.F.R. section 5.16(b).

[29] 31 U.S.C. section 5321(b)(2).

[30] *See United States v. Simonelli*, 614 F. Supp.2d 241 (D. Conn. 2008).