FBAR Examination, Appeals and Collection Procedures in the Post-Amnesty World

By Steven Toscher and Michel R. Stein

Steven Toscher and Michel R. Stein analyze FBAR examination, enforcement, appeals and collection in the post-amnesty world.

Introduction

Following the IRS's successful offshore voluntary compliance initiatives,[1] practitioners should expect an increase in IRS examination activity of taxpayers who did not enter into these compliance initiatives. Approximately 30,000 taxpayers entered into the initiatives, leaving many whom the IRS suspects are not in compliance.

The IRS has a fruitful source of leads to taxpayers who are not in compliance—from banks such as UBS who have turned over the identifying information regarding thousands of taxpayers pursuant to the "John Doe" summons, pending "John Doe" summonses with respect to other banks such as HSBC. Some other leads include:

- Requesting administrative assistance through the Swiss Federal Tax Administration for account holders at Credit Suisse and Bank Clariden Leu;
- Utilizing criminal enforcement initiatives by the Department of Justice, which will likely end in many banks being required to turn over information on U.S. taxpayers pursuant to Deferred Prosecution Agreements; or
- Employing the recent FATCA legislation, which will force many foreign banks to disclose their U.S. account holders or be subject to a potentially punitive withholding tax regime.

The writing is on the wall—information is flowing to the IRS and practitioners should be prepared for this increased examination activity. While most of the activity will focus on income tax returns and other Internal Revenue Code (the "Code") foreign information reporting requirements, there will also be a determined focus on compliance with the Foreign Bank Account Report (FBAR) form. Practitioners need to familiarize themselves with the special procedures which will be utilized in these types of examinations.[2]

The FBAR is not an income tax return, and special examination procedures have been adopted by the IRS. Appeal procedures for receipt and control, interim processing and closing of FBAR penalties within Appeals have recently been established.[3] Central to any FBAR examination are issues surrounding willfulness, which directly impacts the imposition of penalties in any case. Collection concerns also impact the potential examination and Appeals considerations, since the ability to collect assessed penalties can be a cumbersome procedure. Each of these topics has been set forth in this article.

IRS FBAR Examination Procedures

FBARs in General

The FBAR is a report filed with the Treasury stating that the person filing has a financial interest in, or signatory authority over, financial accounts in a foreign country with an aggregate value exceeding $10,000 at any time during the taxable year. As part of the FBAR reporting requirement, persons are instructed to indicate on their Form 1040, Schedule

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B, Part III, whether the individual has an interest in a financial account in a foreign country by checking "yes" or "no" in the appropriate box. The Schedule B then directs the taxpayer to file the FBAR, which is used to report a financial interest in or signatory authority over bank accounts in a foreign country. The deadline for filing an FBAR for each calendar year is on or before June 30th the following year—and this date cannot be extended.

The prescribed Department of Treasury form is known as the Report of Foreign Bank and Financial Accounts TD F 90-22.1 (last revised in November 2011) (otherwise referred to as "FBAR") and is available on the IRS website at *www.irs.ustreas.gov*. The instructions to the FBAR have been recently revised and explain how compliance with the statute is achieved and sets forth in detail the required information and those persons obligated to comply with the FBAR reporting requirements. Treasury Regulations were issued by Financial Crimes Enforcement Network (FinCEN) in 2011, which apply to FBARs filed for calendar year 2010 and future years.

Examination Procedure Guidelines

On January 1, 2007, the IRS revised the Internal Revenue Manual (IRM) provisions relating to the Bank Secrecy Act Chapter (IRM 4.26.17) to set forth FBAR examination procedures not previously formalized in writing. On May 5, 2008, the IRS revised IRM 4.26.17, modifying and superseding portions of IRM 4.26.17.

The manual provisions set forth the procedures to be followed by IRS examiners in the Small Business/Self Employed (SB/SE) division who are responsible for enforcing compliance with the reporting and record keeping requirements of the FBAR. These provisions also provide helpful guidance for tax professionals whose clients are under FBAR examination. The IRM provisions set forth procedures for initiating and closing FBAR investigations, investigation procedures and procedures for potential referrals of FBAR violations for criminal enforcement.

Code Sec. 6103 Privacy Issues

The FBAR is not attached to the taxpayer's individual income tax return. It is therefore not subject to the stringent disclosure restrictions of Code Sec. 6013 (relating to confidentiality and disclosure of return information) and the information contained in the FBAR can be shared with other Federal, state and local agencies. A FBAR examination can be initiated independently of a BSA or tax examination, or can be initiated in the course of a tax or other BSA examination. IRM provisions are established to prevent the unauthorized use of information obtained by the IRS in a tax investigation for FBAR purposes.[4] If the source of the FBAR information is a tax examination, the information acquired is "return information" protected by Code Sec. 6103.[5] The examiner must obtain a "related statute determination," signed by an IRS Territory Manager, before using the return information in the FBAR case.[6] A related statute determination is necessary to allow the examiner to use the information obtained in the course of the tax investigation.[7] As part of the related statute determination, the Territory Manager should determine whether the potential FBAR violation is in furtherance of tax violations.[8] Without a related statute determination, the "return information" *cannot* be used in the FBAR examination and such use could subject the examiner to civil and criminal penalties for violating Code Sec. 6103.[9] If the examiner is conducting an examination solely under the BSA, however, a related statute determination is not needed to examine FBAR compliance, because no information from a tax examination or other Code Sec. 6103 protected information is involved.[10]

Power of Attorney

A person may authorize a representative to receive information with respect to the FBAR examination. In a case that involves both tax matters and FBAR matters, IRS Form 2848, power of attorney, may be used.[11] In an FBAR case that does not involve a related income tax case; a general power of attorney should be used.[12]

The FBAR Examination

If it is determined that if a taxpayer has an unreported foreign bank account, there can be a number of different consequences—depending on whether the IRS determines there was a violation, a violation which should not be penalized, a violation subject to a penalty or a violation which warrants a referral to the Criminal Investigation Division.

No FBAR Violation

If no FBAR violation is found, the examiner will complete a summary memorandum and a FBAR Monitoring Document (FMD) and close the FBAR case to the group manager, who will review the case

for technical and procedural issues.[13] The Detroit Computing Center (DCC) will record the information from the FMD into the FBAR database and note in the FBAR database if and when a follow-up FBAR examination is needed.[14]

FBAR Violation without Penalty

If a FBAR violation is found, but no penalty is warranted in view of the facts and circumstances, the examiner may issue a FBAR warning letter (Letter 3800).[15] In this situation, the examiner will issue the Letter 3800 to the person in violation of the FBAR requirements and a copy will be retained in the file.[16] The person in violation will be asked to return any delinquent or corrected FBARs and a copy of the warning letter to the examiner.[17] The examiner will retain the original and a copy of the FBAR in the FBAR case file, and mark the FBAR as secured through examination and note in the FBAR database if and when a follow-up FBAR examination is needed.[18]

FBAR Violation with Penalty

If the examiner determines it is appropriate to assert an FBAR penalty and that a referral to the Criminal Investigation Division is not appropriate or has been declined, the examiner will assert penalties in accordance with the FBAR penalty guidelines.[19] The examiner will submit the FBAR case file to a SB/SE Counsel Area FBAR Coordinator ("Counsel").[20] Counsel will render advice within 45 days or will work with the examiner to establish a shorter time frame if expedited review is needed.[21] Counsel will prepare a written memorandum of review of the FBAR case.[22] If counsel recommends imposition of the penalty, the review will assist Appeals in the event the case is appealed.[23] If Counsel does not recommend imposition of the penalty, the review will state the reasons for disagreement.[24] If disagreement is based upon inadequate factual development, the review should recommend areas for further examination.[25]

Taxpayer's counsel should carefully monitor the case and be actively engaged if it is determined the examiner is considering asserting penalties—including making appropriate submissions on whether there was a violation and, if so, whether there was reasonable cause for the violation. These submissions may not only convince the examiner, but could be influential with the examining agent's Group Manager and Area Counsel as to whether the penalty is warranted and if warranted, the appropriate amount of the penalty.

Meetings with the Group Manager or IRS Counsel should also be requested in appropriate circumstances—even if they might be resisted by the IRS. The penalty for willful failures carries a high burden of proof which the government must meet to sustain the penalty[26] and the amount of the penalty may depend on the taxpayer's degree of culpability under the IRS's penalty mitigation guidelines. There is substantial opportunity at the examination stage for counsel to influence a more favorable outcome of the examination.

If the IRS determines the FBAR penalty is appropriate, the examiner will issue Letter 3709, the FBAR 30-day letter, and transmit with that letter, the Form 13449, *FBAR Agreement to Assessment and Collection*, which sets forth the basis for the FBAR penalty.[27] No interest accrues on the FBAR penalty prior to assessment or if payment is made within 30 days after the date, a notice of penalty amount due is mailed to the taxpayer.[28] In addition to interest, a six percent delinquency penalty applies to amounts remaining unpaid 90 days from the date a notice of penalty amount due is first mailed to the taxpayer.[29]

Agreed Case

If the taxpayer agrees to assessment of penalties, the taxpayer should return to the examiner the delinquent FBARs along with the signed and dated Form 13449.[30] The examiner places the signed Agreement Form 13449 in the FBAR case file, retains the original and a copy of the FBAR in the FBAR case file, and marks the FBAR as secured through examination. The examiner will complete a summary memorandum and a FMD and close the FBAR case to the group manager, who will review the case for technical and procedural issues.[31]

Unagreed Case

If the FBAR penalty is not agreed to, the taxpayer must mail a written protest to the examiner within 30 days.[32] The case is then transferred to the IRS Appeals Division.[33] The appeal is entered on the FBAR database at the DCC, which has responsibility to monitor the statute of limitations.[34] The DCC is to notify Appeals when the statute of limitations has less than a year to expire.[35] Placing responsibility for monitoring the statute of limitations in the DCC seems to be at odds with established procedures in tax cases which place responsibility on the examination and appeals personnel.

A Freedom of Information Act request can be helpful in an FBAR examination, and will reveal what

is in the administrative file. In a Bank Secrecy Act[36] investigation, the examiner is instructed to use the Title 31 FBAR lead sheet to commence the investigation. If the examiner finds an FBAR violation, he or she must establish a separate file (distinct from the Bank Secrecy Act file) since the FBAR penalties are imposed by the IRS, while non-FBAR related Bank Secrecy Act penalties are assessed by FinCEN. [37]An FBAR examination case file may include the following documents:[38]

- Agent activity record
- Related statute memorandum (Form 13535), if appropriate
- FBAR lead sheet and work papers
- Brief summary memorandum explaining any FBAR violation(s)
- Copy of any delinquent FBAR(s) annotated in red on the top "Secured by Examination"

FBAR Criminal Referrals

The IRS Criminal Investigation Division ("CI") has authority to examine criminal FBAR violations.[39] Acceptance by CI of an FBAR referral for criminal investigation depends on the evidence establishing willfulness.[40] A Fraud Technical Advisor (FTA) will assist an examiner in determining whether or not there is a willful violation and provide the examiner with information concerning referrals to CI.[41] If the examiner considers that the case warrants referral for possible criminal investigation, the examiner will involve a FTA as soon as possible.[42] If the FTA considers that criminal investigation is not appropriate, the FTA will so advise the examiner and provide a written explanation of the reason that criminal referral is not appropriate.[43] The examiner may then proceed with the FBAR case under FBAR civil procedures.[44]

If there are "firm indications" of willful FBAR violations that warrant referral to CI, the FTA will advise the examiner.[45] The examiner will prepare Form 2797, *Referral Report of Potential Criminal Fraud Cases*, with a detailed explanation of the FBAR violations.[46] If the referral of the FBAR case to CI is declined, the examiner follows procedures where material violations exist and civil penalties are asserted.[47] If the referral is accepted, the examiner will place a transmittal memorandum in file indicating acceptance, complete the FMD showing CI acceptance and forward the FMD to DCC, which will enter the information on the FBAR database and note on the FBAR database that a follow-up FBAR civil examination is needed and monitor the statute of limitations.[48] After completion of the criminal case, the examiner will forward any delinquent or corrected FBARs to DCC and commence any appropriate civil FBAR penalty action.[49]

In the past, criminal referrals and prosecutions were rare. In the post-IRS FBAR initiative world, we expect the most egregious violators will receive increased attention of IRS criminal enforcement efforts.

IRS Appeals Procedures

A new IRM provision confirms that FBAR penalty determinations by the examination function will be subject to pre-collection IRS Appeals review—like most other taxes and penalties administered by the IRS.

If the taxpayer does not agree with the FBAR penalty, the taxpayer has 30 days from the date of Letter 3709 to file an appeal. FBAR penalties come to Appeals as stand-alone cases or together with a related income tax or international penalty.[50]

The written protest is filed with the examiner and must be postmarked by the deadline set forth in Letter 3709.[51] The examiner forwards the file to his or her group manager, who then sends the file to Appeals.[52]

The appeals officer assigned to the case will contact the Appeals FBAR coordinator prior to scheduling the initial appeals conference with the taxpayer.[53] If the case involves both FBAR reporting violations and Title 26 offenses, the examiner, group manager and Appeals will discuss whether examination should hold the FBAR case until the tax issues are resolved.[54] The IRM cautions the examiner to monitor the period of limitations.

FBAR penalty cases will usually be received in Appeals pre-assessment.[55] However, upon request, Appeals will also conduct post-assessment hearings as provided in Title 31 CFR 5.4 and 900 to consider FBAR penalty liability and collection.[56] The IRM provides that post-assessment FBAR penalty cases are priority cases that must be completed and approved within 60 days of the appeals officer-assigned date.[57] FBAR penalties are considered an Appeals-coordinated Issue (category of case) and require a referral to International prior to holding the first conference.[58]

Statute of Limitations

Appeals requires 180 days remaining on the FBAR assessment statute of limitations at the time the administrative file is received.[59] Married couples under FBAR examinations are treated as individual cases and extensions must be obtained from each individual under examination.[60] Title 31 sets forth

the dual FBAR requirement for those who maintain a relation with a foreign financial institution—both to file reports (filing requirement) and to keep specified records (record keeping requirement).[61] The IRS takes the position that differing statute of limitations exist for each separate requirement. With respect to the filing requirement, the IRM states that the IRS has six years to assess an FBAR civil penalty from the due date of the FBAR report.[62] With respect to the record keeping requirement, the IRM states the IRS has six years from the date the IRS first asks for the records.[63] The IRS's interpretation of the differing statutes of limitation is not apparent from the language of the statute.

Penalties

In an effort to improve FBAR compliance and enforcement, Congress, in Section 821 of the American Jobs Creation Act of 2004 (AJCA),[64] reorganized Title 31 USC Section 5321(a)(5) (the statute which contains the FBAR penalty) and enacted a new civil penalty for nonwillful violations of the FBAR reporting requirements and increased the existing penalty for willful violations.[65] Previously, the only significant penalty for failure to comply with the FBAR reporting requirements related to willful failures.[66]

Under changes made by the AJCA, which apply to violations after October 22, 2004 (the date of AJCA enactment), that is, FBAR forms due on or after June 30, 2005, the IRS may impose a civil monetary penalty not exceeding $10,000, on anyone who violates, or causes any violation, of the FBAR reporting requirement rules.[67] This new penalty eliminates the need for the IRS to prove willfulness—a main barrier to its ability to impose any FBAR civil penalty in the past. The penalty may be waived, however, if both of the following are met: (1) "such violation was due to reasonable cause" and (2) "the amount of the transaction or the balance in the account at the time of the transaction was properly reported."[68]

The AJCA increased the civil penalty for willful violations. Under the changes, the civil penalty for willful violations was increased to the greater of $100,000 or 50 percent of the amount of the transaction or the balance in the account at the time of the violation.[69] This is a significant increase from the penalty that applies to violations existing on or before October 22, 2004, where the civil penalty amount was limited to the greater of $25,000 or the balance in the account at the time of violation, up to a maximum of $100,000 per violation. A civil penalty can be imposed despite the fact that a criminal penalty is imposed with respect to the same violation.[70]

The IRS, in the IRM, takes the position that FBAR penalties are determined per account, not per unfiled FBAR, for each person required to file,[71] although this seems contrary to a plain reading of the statute. Penalties apply for each year of violation.[72] Examiners, however, are expected to exercise discretion, taking into account the facts and circumstances of the case, in determining whether penalties should be asserted and the total amount of penalties to be asserted.[73]

There may be multiple FBAR civil penalty assessments arising from one account.[74] There may be multiple penalty assessments if there is more than one account owner, or if a person other than the account owner has signature or other authority over the foreign account.[75] Each person can be liable for the full amount of the penalty.[76]

Penalty Mitigation Guidelines

Recognizing its discretionary authority, and in order to promote consistency by IRS employees in exercising this discretion, the IRS has adopted Penalty Mitigation Guidelines for the calculation of FBAR civil penalties for its personnel, as set forth in IRM 4.26.16.4.6 (07-01-08).[77]

In exercising discretion, examiners should consider whether the issuance of a warning letter and the securing of delinquent FBARs, rather than the assertion of a penalty, will achieve the desired result of improving future compliance.[78] The IRS recognizes that penalties should be asserted only to promote compliance with the FBAR reporting and record keeping requirements.[79]

The examiner has discretion to determine the amount of the penalty, if any, because the total amount of penalties that can be applied under the statute can greatly exceed an amount that would be appropriate in view of the violation.[80] Examiners are expected to exercise discretion, taking into account the facts and circumstances of each case, in determining whether penalties should be asserted and the total amount of penalties to be asserted.[81] The IRS has developed penalty mitigation guidelines to assist examiners in the exercise of their discretion in applying these penalties, and the mitigation guidelines are intended as an aid for the examiner in determining an appropriate penalty amount.

The Willful Standard

Practitioners should expect penalty considerations in many cases where income from foreign financial accounts or assets have been failed to be reported. A finding of willfulness can change what otherwise would be a manageable penalty, to something that could result in the confiscation of the entire amount of the foreign assets for a multi-year assessment. Understanding what makes failure to file an FBAR willful is therefore critical to any practitioner.

Willfulness Standard

The willfulness penalty applies to any person who has willfully violated the FBAR reporting or record keeping provisions.[82] The test for willfulness is whether there was a voluntary, intentional violation of a known legal duty.[83] The burden of establishing willfulness is on the IRS.[84] If it is determined that the violation was due to reasonable cause, the willfulness penalty will not be asserted.[85]

Willfulness is shown by the person's knowledge of the reporting requirements and the person's conscious choice not to comply with the requirements.[86] The only thing that a person need know is that he or she had an FBAR reporting requirement.[87] 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.[88]

IRM Examples of Willfulness

The IRS offers its view of what constitutes willfulness in the context of the FBAR reporting requirements**.** The following examples set forth in IRM 4.26.16.4.5.3.8 (07-01-08) illustrate situations in which willfulness may be present:

> 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.
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> 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.
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> 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. According to the IRS, a determination that the violation was willful likely would be appropriate in this case.
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> 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.

The IRM offers some concrete examples of what the IRS examining agent might or might not determine to be willful. However, the real world is more complex, and often time present a mixed bag of facts, requiring a more nuanced and sophisticated analysis to willful determinations.

Chief Counsel Office Memorandum

Recognizing clarification was necessary in context of FBARs, IRS Chief Counsel's Office, in a partially redacted legal memorandum (CCA 200603026, with Release Date September 1, 2005) ("CCA") offered significant guidance with respect to the civil FBAR penalty for willful violations. While the CCA offers guidance relating specifically to OVCI and LCCI cases, the Chief Counsel's views should be applicable to all FBAR reporting situations.

With respect to the willful standard, the CCA queried whether the willful violation in the civil penalty statute has the same meaning and interpretation as

under the criminal penalty statute. The CCA concludes that it does, citing that the same word willful is used in both sections and statutory construction rules suggest that the same word used in related sections should be consistently construed.

There are few cases construing "willful" in the civil penalty context. The CCA looked to Justice Blackman's dissent in *W. Ratzlaf*[89] in which the Supreme Court addressed the standard for willfulness in the context of a criminal violation of a structuring provision of the BSA as requiring "a voluntary intentional violation of a known legal duty."[90] The CCA concludes that the known legal duty means the account holder would merely have to have knowledge of the duty to file the FBAR, since knowledge of the duty to file an FBAR would entail knowledge that it is illegal not to file the FBAR.[91] The CCA admits that the corollary of this principal would also apply—that is, there is no willfulness if the account holder has no knowledge of the duty to file the FBAR.

The CCA next queried whether the criteria for assertion of the of the civil FBAR penalty is the same as the burden of proof that the IRS has when asserting the civil fraud penalty under Code Sec. 6663. The CCA states that although there are no cases that address this issue, the CCA expects the answer to be that the same standard will apply. That is, to assert the civil penalty, the IRS will have to prove willful by the "clear and convincing standard" rather than the mere "preponderance of the evidence."

The CCA goes on to state that the burden that the IRS carries with respect fraud cases represents an exception to the general presumption of correctness that the courts have afforded to tax assessments. However, because the FBAR penalty is neither a tax nor a tax penalty, the presumption of correctness with respect to the tax assessments would not apply to an FBAR penalty assessment for a willful violation—another reason that the IRS will need to meet the higher clear and convincing standard.[92]

The CCA further states that, in criminal cases, the government would have to establish willfulness "beyond a reasonable doubt." Although the same definition for willfulness applies ("a voluntary intentional violation of a known legal duty") the IRS would have a lesser burden (*i.e.*, clear and convincing) to meet with respect to the civil FBAR penalty than the criminal penalty.

The CCA also queries whether it is possible to shift the burden of proof for uncooperative witnesses, but answers this in the negative, acknowledging that there is no provision in Title 31 for shifting the burden for willfulness. Failure to cooperate would be a factor reflecting on willfulness together with other circumstantial evidence in favor of imposing an FBAR penalty. In cases where it is known that a violation occurred, but the amount in the foreign account is unknown, the maximum dollar limitations under 31 USC §5321 (*i.e.*, $25,000 for violations before October 21, 2004, and $100,000 after that date) will apply. This might present taxpayers with some difficult choices during an investigation vis-à-vis providing account information to the IRS, which the IRS could not otherwise obtain, and which could have the effect of substantially increasing the penalty amount.

Judicial Considerations

There are very few court cases addressing willfulness in the context of the FBAR reporting requirements**.** In one recent case, a District Court Judge, in *Williams*,[93] found that willfulness was lacking. In this nonpublished case, the Government sought to enforce its assessments of two FBAR penalties against Williams for willfully failing to report his interest in two Swiss bank accounts for tax year 2000. The Court concluded the Government fell short of meeting its burden in establishing that Williams willfully failed to disclose offshore assets in violation of that statute. The Court in citing to *H.V. Mohney*[94] (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.

In a recent Tax Court case, *P.W. Browning*,[95] the taxpayer was the president and CEO of a manufacturing corporation he founded. In 1995, he entered an arrangement with an off-shore employee leasing company in Ireland, whereby he would be an employee of the Irish company, which would lease his services to a U.S. employee-leasing company, which would sublease his services to his manufacturing corporation. His role in his manufacturing corporation

did not change. The manufacturing company paid a salary, benefits and the applicable payroll taxes to the petitioner, and paid a fee to the Irish company, which the Irish company used to fund an unqualified deferred compensation account in Texas, held in the name of a subsidiary of the Irish corporation and for the benefit of the taxpayer.

In 1998, the taxpayer was issued a credit card by a Bahamas bank (Leadenhall Bank), and a checking account was opened at Leadenhall Bank to pay the credit card charges. The checking account was funded by the deferred compensation account in Texas and was also held in the name of the Irish company. The taxpayer then used this credit card to access the funds in the deferred compensation account, a substantial portion of which were used for personal expenses.

The court held that there was an understatement of income, because the taxpayer was in constructive receipt of the funds placed in the deferred compensation account (finding that he had unrestricted control over the amount deposited into the account and unrestricted access to the funds in the account through the credit card). The Tax Court found fraud because of the following indicia: (1) concealment of assets, (2) intent to mislead, (3) lack of credibility of the petitioner's and his tax advisor's testimony, and (4) intentional understatement of income. The Court found that he concealed the existence of the Leadenhall account by answering "no" to question 7a on Schedule B of Form 1040, and by failing to provide the revenue agent with information about the foreign credit card in response to an IDR requesting a list of all foreign and domestic credit cards. The court did not find the taxpayer credible when he testified that he thought "no" was proper for question 7a because he was not a signatory on the account and did not intend to hide that account. The taxpayer's incomplete answer to the revenue agent in response to her question regarding his foreign and domestic credit cards was also clear and convincing evidence of an intent to mislead the revenue agent.

In the FBAR context, this decision indicates that marking "no" on Schedule B can be an indicia of fraud, when considered with the surrounding circumstances. In this case, the taxpayer had testified that he believed "no" was proper, but the Tax Court did not find his testimony credible. The other factor the court relied on relating to concealment of the foreign accounts was the failure to reveal the foreign credit card in response to an IDR and a direct question from the revenue agent. The case does not mention anything about the FBAR penalty or the requirement to file an FBAR.

Many practitioners continue to wonder whether the IRS would really assert these draconian penalties. While the IRS may have a considerable burden of proof in sustaining "willful" penalties and asserting these very large penalties implicates constitutional limitations,[96] the answer is "yes." The leadership of the IRS appears committed to vigorously enforcing the laws relating to these foreign information reporting penalties.

Giving the heightened enforcement in the area of foreign bank accounts and assets, we are certain to see increased litigation in the area of willfulness and more guidance from the courts on this issue.

Collecting the FBAR Penalty

Unlike a tax or penalty assessed in the Code, which is subject to broad administrative collection remedies of liens and levies, the FBAR penalty assessment is made under Title 31 and is not subject to these administrative collection remedies. Remedies available to collect the penalty would be similar to any other creditor and enforced collection would require a lawsuit in federal court. This limitation on the IRS's ability to administratively collect the FBAR penalty should provide an inducement to the IRS to resolve FBAR penalty determinations in a manner which includes payment of the penalty. Collection on FBAR penalties is made that more difficult with respect to overseas financial accounts and assets, which generally are beyond the reach of the government. Upon assessment, the IRS makes notice and demand for payment by sending Letter 3708 to the taxpayer and power of attorney on file, and forwards collection information to the Department of Treasury's Financial Management Services (FMS).[97]

There are two separate collection limitation periods with respect to FBAR penalties: (1) two years from the later of the assessment date and (2) 10 years from the assessment date during which it can collect through certain offsets.[98] FBAR penalties constitute debts owed to an U.S. executive agency, and the IRS is authorized to collect debts using any of the methods enumerated in 31 USC §3711 (2008).[99]

IRS bankruptcy procedures for FBAR penalties are contained in IRM 5.9.4.19. IRS Delegation Order 4-35, effective January 15, 2004, authorizes bankruptcy specialists to prepare and file proofs of claim for FBAR penalties and to take appropriate action to

protect the government's interest in bankruptcy and other insolvency actions

At least one court case has held that FBAR penalties are nondischargeable. In *Simonelli*,[100] the Government filed a complaint seeking a judgment for the FBAR penalty, accrued interest and the failure to pay penalty that arises under 31 USC §3717(e)(2). The taxpayer conceded liability for the FBAR penalty, but argued that the liability was discharged in his bankruptcy. The court held that the FBAR penalty is a civil penalty under the BSA (not a tax or tax penalty) and therefore was excepted from discharge under Bankruptcy Code Sec. 523(a)(7).

Conclusion

Almost 10 years ago, when we first wrote about FBAR enforcement issues, few practitioners and even fewer taxpayers knew anything about FBARs. Today, given the globalization of the world economy and the IRS's commitment to international compliance, we all must familiarize ourselves with the procedures the IRS will employ in administering its enforcement and compliance program. FBAR enforcement is here to stay and we all need to get prepared.

Endnotes

1 These recent initiatives included the 2009 Offshore Voluntary Disclosure Program, the 2011 Offshore Voluntary Disclosure Initiative, which closed on September 9, 2011, and the 2012 Program, recently announced IR-2012-5, Jan. 9, 2012. The IRS announced that it collected $4.4 billion from taxpayers in the 2009 and 2011 Programs. Previous IRS initiatives included the 2003 Offshore Voluntary Compliance Initiative and the Last Chance Compliance Initiatives. The State of California just ran its own Voluntary Compliance Initiative 2, which concluded on October 31, 2011.

2 For more in depth analysis of the substantive requirements and history of FBAR enforcement, *see* Toscher and Stein, *FBAR Enforcement is Coming!,* Journal of Tax Practice & Procedure (December–January 2004); Toscher and Stein, *FBAR Enforcement–an Update,* Journal of Tax Practice & Procedure (April–May 2006); Toscher and Stein, *FBAR Enforcement–Five Years Later,* Journal of Tax Practice & Procedure (June–July 2008).

3 *See* IRM 8.11.6 (11-01-2001).

4 IRM 4.26.17.2 (01-01-07).

5 IRM 4.26.17.2.1.D (01-01-07).

6 IRM 4.26.17.2.1.D (01-01-07).

7 IRM 4.26.17.2.1.F (01-01-07).

8 IRM 4.26.17.2.1.3.A (01-01-07).

9 *See* Code Sec. 7431 (civil) and Code Sec. 7213 (criminal).

10 IRM 4.26.17.2.3 (05-05-08).

11 IRM 4.26.17.5.2.1 (01-01-07).

12 Along the same line, BSA summons, TF F 90-22.31, rather than a summons under Code Sec. 7602, must be used if information that is purely BSA information is sought. IRM 4.26.17.5.3 (01-01-07).

13 IRM 4.26.17.4.1 (05-05-08).

14 IRM 4.26.17.4.1.3 (05-05-08).

15 IRM 4.26.17.4.2 (05-05-08).

16 IRM 4.26.17.4.2.2 (05-05-08).

17 *Id.*

18 *Id.*

19 IRM 4.26.17.4.3 (05-05-08)

20 IRM 4.26.17.4.3.2 (05-05-08).

21 IRM 4.26.17.4.3.5.A (05-05-08).

22 *Id.*

23 *Id.*

24 *Id.*

25 *Id.*

26 The IRS must prove willfulness by "clear and convincing" evidence and a general presumption of correctness afforded to tax assessments does not apply. *See* CCA 200603026 (September 1, 2005). *See* also *United States v. Williams (Civil Action No. 1:09-cv-437, E.D. Virginia 2010).*

27 IRM 4.26.17.4.3.6 (05-05-08).

28 31 USC §3717(b); IRM 4.26.17.4.3.6.E (05-05-08).

29 IRM 4.26.17.4.3.6.E (05-05-08).

30 IRM 4.26.17.4.4.1 (05-05-08).

31 IRM 4.26.17.4.4.2 & 3 (05-05-08).

32 IRM 4.26.17.4.6.2 (01-01-07).

33 IRM 4.26.17.4.7.3 (01-01-07).

34 IRM 4.26.17.4.7.4 (01-01-07).

35 *Id.*

36 Bank Secrecy Act of 1970 (P.L. 91-508).

37 IRM 4.26.17.2.3(4) (05-05-2008).

38 IRM 4.26.17.3(1) (05-05-2008).

39 IRM 4.26.17.5.4 (05-05-08),

40 IRM 4.26.17.5.4.3 (05-05-08).

41 IRM 4.26.17.5.4.1.1 (05-05-08).

42 IRM 4.26.17.5.4.1.2 (05-05-08).

43 IRM 4.26.17.5.4.1.6.A (05-05-08).

44 IRM 4.26.17.5.4.1.6.B (05-05-08).

45 IRM 4.26.17.5.4.1.7 (05-05-08).

46 IRM 4.26.17.5.4.1.8 (05-05-08).

47 IRM 4.26.17.5.4.2.1 (05-05-08).

48 IRM 4.26.17.5.4.2.2 (01-01-07).

49 IRM 4.26.17.5.4.3 (01-01-07).

50 IRM 8.11.6.1(4) (11-01-2011).

51 IRM 4.26.17.4.6.2 (01-01-2007).

52 IRM 4.26.17.4.7(2) (01-01-2007).

53 *Id.*

54 IRM 4.26.17.4.7(6) (01-01-2007).

55 IRM 8.11.6.1 (6) (11-01-2011).

56 *Id.*

57 IRM 8.11.6.1(6) (11-01-2011).

58 IRM 8.11.6.1(5) (11-01-2011).

59 IRM 8.11.6.2 (1) (11-01-2011).

60 IRM 8.11.6.3 (4) (11-01-2011).

61 31 USC §5314.

62 31 USC §5321(b)(1) ("The Secretary of the Treasury may assess a civil penalty under subsection (a) at any time before the end of the 6-year period beginning on the date of the transaction with respect to which the penalty is assessed") ; IRM 8.11.6.3.1 (1) (11-01-2011).

63 *Id.*

64 American Jobs Creation Act of 2004 (AJCA) (P.L. 108-357).

65 *See* 31 USC §5321(a)(5), as amended by the AJCA. *See* also American Jobs Creation Act of 2004, Law, Explanation and Analysis, ¶655.

66 The statute did contain a small penalty of $500 for negligent failures to comply. 31 USC §5321(a)(6)(A).

67 31 USC §5321(a)(5)(A) & (B)(i).

68 31 USC §5321(a)(5)(B)(ii).

69 *See* 31 USC §5321(a)(5); *See* also American Jobs Creation Act of 2004, Law, Explanation and Analysis, ¶655.

70 31 USC §5321(d).

71 IRM 4.26.16.4.7 (07-01-08).

72 *Id.*

73 *Id.*

74 IRM 4.26.16.4 (07-01-08).

75 *Id.*

76 *Id.*

77 The Penalty Mitigation Guidelines for cases closed under the Last Chance Compliance Initiative (LCCI) are different from the general mitigation guidelines. For guidelines applicable to LCCI cases, *see* IRM 4.26.16.4.6.4 and 5 (07-01-08).

78 IRM 4.26.16.4.5 (07-01-08).

79 IRM 4.26.16.4.4 (07-01-08).

80 *Supra* note 78.

81 IRM 4.26.16.4.6 (07-01-08).

82 IRM 4.26.16.4.5.2 (07-01-08).

83 IRM 4.26.16.4.5.3.1 (07-01-08).

84 IRM 4.26.16.4.5.3 (07-01-08).

85 IRM 4.26.16.4.5.4 (07-01-08).

86 IRM 4.26.16.4.5.5 (07-01-08).

87 *Id.*

88 *Id.*

89 *W. Ratzlaf*, SCt, 94-1 USTC ¶50,015, 510 US 135, 114 SCt 6. This is the long established definition for criminal tax violations. *See P. Pomponio*, SCt, 76-2 USTC ¶9695, 429 US 10.

Endnotes

[90] CCA 200603026.
[91] *Id.*
[92] *Id.* The CCA refers to the 31 USC §5321 penalty in effect prior to the changes reflected in the AJCA (see Note 1 to the CCA) and, therefore, it is unclear who must carry the burden with respect to the nonwillful penalty or its reasonable cause exception.
[93] *Williams*, *supra* note 26.
[94] *H.V. Mohoney*, CA-6, 92-1 USTC ¶50,081, 949 F2d 1397.
[95] *P.W. Browning*, 102 TCM 460, Dec. 58,803(M), TC Memo 2011-261.
[96] *See* Toscher and Lubin, *When Penalties Are Excessive–The Excessive Fines Clause As a Limitation on the Imposition of the Willful FBAR Penalty*, Journal of Tax Practice & Procedure, December 2009–January 2010.
[97] IRM 4.26.17.4.4(4)(e-f) (05-05-2008).
[98] IRM 8.11.6.3.1.1(2) (11-01-2011).
[99] *See* 31 CFR § 5.4(a)(6) (authorizing "treasury entities" to collect debts by offset of tax refunds or benefits, private collection agency, credit bureau reporting, administrative wage garnishment or litigation); *see* also 31 CFR § 5.1 ("treasury entity" includes the IRS).
[100] *United States v. Simonelli,* 614 F. Supp. 2d 241 (D. Conn. 2008).