Practice

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Revised IRS Appeals Procedures re: FBAR Penalties

On October 28, 2013, the IRS revised the Internal Revenue Manual (IRM) providing guidance and clarification regarding the administrative review of FBAR penalties by the IRS Office of Appeals.[1] The IRM is essentially the operational manual providing guidance and procedures for the various functions carried out by the IRS. The Office of Appeals serves as the administrative dispute resolution forum for any taxpayer contesting an IRS compliance action. It has long been Appeals' mission to "resolve tax controversies, without litigation, on a basis that is fair and impartial to both the Government and the taxpayer in a manner that will enhance voluntary compliance and public confidence in the integrity and efficiency of the Service."[2]

The Financial Crimes Enforcement Network (FinCEN) delegated its enforcement authority for penalties imposed under Title 31, Sections 5314–5321 for the failure to file Form 114, Report of Foreign Bank and Financial Accounts (FBAR) to the IRS. This delegation was effective April 8, 2003, by memorandum of agreement between FinCEN and the IRS. With respect to FBAR penalties being considered for resolution by IRS Appeals, the *revised* IRM 8.11.6 provisions reference:

1. New FBAR. FinCEN Form 114 and 114(a). FinCEN Form 114 has replaced the *former* Report of Foreign Bank and Financial Account (FBAR), Form TD F 90-22.1 (Form TD F 90-22.1 is now obsolete). FinCEN Report 114, *Report of Foreign Bank and Financial Accounts,* is used to electronically report a financial interest in or signature authority over a foreign financial account. New FinCEN Form 114(a), *Record of Authorization to Electronically File FBARs,* is for filers who submit FBARs jointly with spouses, or desire to submit them via third-party preparers.

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Effective July 1, 2013, the FBAR *must* be filed electronically through the Bank Secrecy Act E-File System and must be received by on or before June 30 of the year immediately following the calendar year being reported. The June 30 filing date may not be extended. The reference to FBAR Form TD F 90-22.1 has been replaced with a reference to FinCEN Form 114 on Schedule B, Line 7b of Form 1040 for tax year 2013.

2. IRS FBAR Administrative File. The IRS administrative file provided to Appeals will contain a brief summary memorandum explaining the FBAR violation(s) containing statistical information which will include a discussion of the FBAR violations, the number of penalty assessments, the dollar amounts involved, and the FBAR case disposition; A Form 13535, Foreign Bank and Financial Accounts Report Related Statute Memorandum, signed by the designated Program Manager affirming that the information shows the FBAR violations were committed in furtherance of income tax violations, when appropriate; A copy of any delinquent FBAR(s) secured during the examination; FBAR issue workpapers; the FBAR 30-Day Letter (Letter 3709 for pre-assessment; Letter 3708 for post-assessment); the Taxpayer's protest; the representatives FBAR/Title 31 Power of Attorney Form 2848, if applicable; an IRS Counsel Opinion memo for FBAR penalties larger than $10,000 (for willful penalties only).

3. Limited Jurisdiction for Post-Assessed FBAR Penalties. Post-assessed FBAR penalties in excess of $100,000 cannot be compromised by Appeals without approval of the Department of Justice (DOJ). *See* 31 U.S.C. § 3711(a)(2) and 31 CFR §902.1(a) and (b). Once assessed, the FBAR penalty becomes a claim of the U.S. Government. Typically, the FBAR penalty case will usually be received in Appeals pre-assessment. 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 issues.

Post-assessment FBAR penalty cases will be handled by Appeals on a priority expedited basis. Appeals now requires these cases be completed and approved within 120 days of the date the Appeals Officer is assigned to the date the Appeals Team Manager (ATM) approves the case for closing. Previously, such cases were to be completed within 60 days. Appeals will require 180 days remaining on the applicable Title 31 assessment statute of limitations at the time the administrative file is received.

Appeals Cases with less than 180 days remaining on the assessment statute of limitations at the time the case is received by Appeals will be returned to the examining function as a premature referral so an extension of the statute of limitations may be secured. If no statute extension is secured then the FBAR penalty can be assessed and the taxpayer will be given post-assessment appeal rights. However, an Appeals Officer has the authority to execute a Title 31 FBAR statute extension. See IRM 1.2.52.14, Delegation Order 25-13 (formerly DO 4-35, Rev. 1). Also, *see* IRM 8.11.6.3.1 for information on the statute of limitations for FBAR cases.

4. Limited Availability of Alternative Dispute Resolution (ADR) Rights. ADR rights are not available for post-assessment FBAR penalty cases. However, Fast Track Settlement (FTS) is available for pre-assessed FBAR penalties only if the 30-Day Letter (Letter 3709) has not been issued. In FTS, the IRS Appeals Officer uses mediation techniques to focus issues and lead examiner and the taxpayer to determine the outcome of the dispute. If resolution is not reached through mediation, the Appeals mediator will propose a resolution, but such proposal is not imposed on either party. If FTS is unsuccessful in reaching a resolution, a taxpayer is not precluded from requesting traditional Appeals consideration.

Fast Track Mediation (FTM) is also available for pre-assessed FBAR penalties. In FTM, Appeals personnel trained in mediation help the examiner and the taxpayer discuss the issues in dispute, and possible ways to resolve it. The goal is to reach a jointly agreeable solution, consistent with relevant law, although the mediator will not require either party to accept a certain outcome. Post Appeals Mediation (PAM) is not available on any FBAR penalty case.

5. Mitigation Threshold Conditions Survive. The revised guidance for the IRS Office of Appeals references the historic FBAR penalty mitigation provisions set forth in IRM 4.26.16.4.6. Given recent IRS Offshore Voluntary Disclosure Programs (OVDP), the continued viability of the IRM FBAR mitigation guidelines has been subject to question. It should not be overlooked that the October 28, 2013, revisions to IRM 8.11.6 relating to FBAR penalty cases under consideration by the IRS Office of Appeals specifically reference these mitigation guidelines. For smaller foreign financial accounts, the mitigation guidelines might provide relief from the assessment of otherwise significant potential FBAR penalties of 31 U.S.C. § 5321(a)(5).

6. Joint and Several FBAR Penalty Liability. There is no joint and severable liability with FBAR penalty cases. FBAR penalties apply and are assessed individually and not jointly (there should only be one individual under examination per FBAR case file).

Married couples under FBAR examination are treated as individual cases.

7. Interest Does Not Accrue Until the FBAR Penalty Is Assessed. Interest on FBAR penalties does not accrue until the penalty is actually assessed by the IRS. As such, some might consider executing an extension of the applicable FBAR statute of limitations to avoid a pre-mature assessment of a penalty with an accompanying interest accrual.

8. Expedited Closings of Unagreed FBAR Penalty Cases. If the Appeals Officer and the taxpayer cannot agree upon a resolution the assessment is to occur immediately without issuance of a Notice of Deficiency.

9. No Chapter 11 Relief. Title 11 of the U.S. Bankruptcy Code does not provide relief from an assessed FBAR penalty.

10. FBAR Penalties Are an Appeals Coordinated Issue (ACI). Under existing procedures, Appeals resolutions involving coordinated issues must be approved by the Appeals FBAR Coordinator for that issue. The Appeals FBAR Coordinator serves as a resource person for the Office of Appeals. The purpose of the required coordination is to ensure that resolutions of FBAR penalties are consistent nationwide. A referral to IRS International Operations is required prior to holding the first Appeals conference regarding the FBAR penalty. Such coordination might make it difficult for certain taxpayers to obtain relief in Appeals from an FBAR penalty being considered by an otherwise understanding Appeals Officer.

11. Litigation Forum. Litigation regarding FBAR penalties is within the jurisdiction of the U.S. District Court (rather than the Tax Court).

"Willfulness" in the FBAR Context

Section 5321(a)(5) of Title 31 does not define how to assess whether an individual acted willfully in his failure to comply with the FBAR reporting requirements. "'[W]illfully' is a 'word of many meanings whose construction is often dependent on the context in which it appears.'"[3] In order to prevail in assertion of a "willful" FBAR penalty, the United States must prove the following elements: (a) the person being penalized was a citizen of the United States, or a resident or a person doing business in the United States during the year(s) involved; (b) the person had a financial interest in, or signatory or other authority over, a bank, securities or other financial account during the year(s) involved; (c) the bank, securities or other financial account had a balance that exceeded $ 10,000 during the year(s) involved; (d) the bank, securities or other financial account was in a foreign country; (e) the person failed to disclose the bank, securities or other financial account; (f) the failure to report was willful; and (g) the amounts of the penalties were proper.

Most disputes revolve around whether the person "willfully" failed to disclose their interest in the foreign financial account. In *McBride,*[4] the District Court determined that the applicable definition of willfulness is that which has been used in other civil contexts, including civil tax collection matters and compliance with reporting requirements. Where willfulness is a condition of civil liability, it covers "not only knowing violations of a standard, but reckless ones as well."[5] Therefore, according to *McBride*, "willfulness" may be satisfied by establishing the individual's reckless disregard of a statutory duty, as opposed to acts that are known to violate the statutory duty at issue.[6] An improper motive or bad purpose is not necessary to establish willfulness in the civil context.[7] In *McBride*, the District Court determined that an individual's actions may be deemed willful if the individual recklessly ignores the risk that conduct is illegal by failing to investigate whether the conduct is legal.

The Supreme Court has confirmed that acting with "willful blindness" to the obvious or known consequences of one's action also satisfies a willfulness requirement in both civil and criminal contexts.[8] Under the "willful blindness" standard, "a willfully blind defendant is one who takes deliberate actions to avoid confirming a high probability of wrongdoing and who can almost be said to have actually known the critical facts."[9] Where a taxpayer makes a "conscious effort to avoid learning about reporting requirements," evidence of such willful blindness is a sufficient basis to establish willfulness.[10]

In civil contexts involving a requirement to report or disclose certain information to the IRS, willfulness has been defined as conduct which is voluntary, rather than accidental or unconscious.[11] Conduct that evidences "reckless disregard of a known or obvious risk" or a "failure to investigate ... after being notified [of the violation]" also satisfies the civil standard for willfulness in such contexts.[12] Willfulness may also "be proven through inference from conduct meant to conceal or mislead sources of income or other financial information."[13] Moreover, willful intent may be proved by circumstantial evidence and reasonable inferences drawn from the facts because direct proof of the taxpayer's intent is rarely available.[14]

In *Williams*, the Fourth Circuit held that a taxpayer was willful in failing to comply with FBAR requirements

when he signed a federal tax return that failed to disclose the existence of foreign accounts, "thereby declaring under penalty of perjury that he had 'examined this return and accompanying schedules and statements' and that, to the best of his knowledge the return was 'true, accurate, and complete.'"[15] The Fourth Circuit reversed the district court's findings of fact as "clearly erroneous," on the grounds that the district court failed to consider the taxpayer's signature on his returns sufficient evidence of his knowledge of his failure to comply with the FBAR requirement. "A taxpayer who signs a tax return will not be heard to claim innocence for not having actually read the return, as he or she is charged with constructive knowledge of its contents."[16] The Fourth Circuit in *Williams* determined that "line 7a's directions to '[s]ee instructions for exceptions and filing requirements for Form TD F 90-22.1'" puts a taxpayer "on inquiry notice of the FBAR requirement."[17]

The Fourth Circuit held that Williams's explicit statement that he never consulted Form TDF 90-22.1 or its instructions, never read line 7a, and "never paid any attention to any of the written words on his federal tax return" constituted a "conscious effort to avoid learning about reporting requirements," and his false answers on his federal tax return "evidence conduct that was 'meant to conceal or mislead sources of income or other financial information.'"[18] A taxpayer's signature on a return is likely sufficient proof in most cases of a taxpayer's knowledge of the instructions contained in the tax return form and in other contexts. "In general, individuals are charged with knowledge of the contents of documents they sign—that is, they have 'constructive knowledge' of those contents."[19] In *In re Crawley,*[20] the debtors contended that they did not read and review the information in their tax returns, which were prepared for them by their accountant, so they could not have failed to pay their taxes willfully. Despite not reviewing the returns, the court charged the debtors with knowledge of the contents of their returns, stating:

> [P]eople who sign tax returns omitting income or overstating deductions often blame their accountant or tax preparer. But these arguments never go anywhere. People are free to sign legal documents without reading them, but the documents are binding whether read or not.[21]

Summary

Significantly, the revised IRM added that IRS Counsel memo is needed for willful penalties over $10,000. The involvement of IRS Counsel in determining appropriate elements of willfulness could be significant. A nonwillful civil penalty not to exceed $10,000, may be imposed on any person who violates or causes any violation of the FBAR filing and recordkeeping requirements of 31 U.S.C. §§5314 and 5321(a)(5)(A). A civil penalty equivalent to the greater of $100,000 or 50 percent of the balance in the account at the time of the violation may be imposed on any person who "willfully" violates or causes any violation of any provision of 31 U.S.C. §§5314 and 5321(a)(5)(A).

The test for willfulness is generally whether there was a voluntary, intentional violation of a known legal duty and the burden of establishing willfulness is on the IRS. 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 needs to know is that they have a reporting requirement. 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.

Taxpayers should carefully review the recent court decisions in *Williams*[22] and *McBride*[23] on the issue of determining "willfulness" for assertion of the more significant FBAR penalties (of up to 50 percent of the account balance, per year). Although the underlying facts in each case were not the best, the courts might not lightly view those with considerable financial resources who fail to inquire about their potential reporting requirements associated with various interests in foreign financial accounts.

The failure to learn of the filing requirements coupled with other factors, such as the efforts taken to conceal the existence of the accounts and the amounts involved may lead to a conclusion that the violation was due to willful blindness. However, IRM 4.26.16.4.5.3 provides that the mere fact that a person checked the wrong box, or no box, on a Form 1040, Schedule B is not sufficient, by itself, to establish that the FBAR violation was attributable to willfulness.

The involvement of IRS counsel lawyers familiar with the sometimes difficult task of demonstrating a person's "voluntary, intentional violation of a known legal duty" could prove to be beneficial review in considering the difference between assertion of "nonwillful" versus "willful" FBAR penalties. Time will tell.

Endnotes

1 *See www.irs.gov/irm/part8/irm_08-011-006.html.*
2 *See* IRM 8.1.1.1(1).
3 *Safeco Insurance Co. of America v. Burr,* SCt, 551 US 47, 57 (2004) (quoting *Bryan,* 524 US 184, 191 (1998)).

[4] *J. McBride,* DC-UT, 2012-2 USTC ¶50,666, 908 FSupp2d 1186.
[5] *Safeco Insurance Co.,* SCt, 551 US, at 57; cf. *Illinois Central R. Co.,* SCt, 303 US 239, 242–43 (1938) ("willfully" includes "conduct marked by careless disregard whether or not one has the right to so act") (citation omitted).
[6] *See Safeco Insurance Co., id.,* 551 US, at 57.
[7] *American Arms Int'l v. Herbert,* CA-4, 563 F3d 78, 83 (2009); *Prino v. Simon,* CA-4, 606 F2d 449, 451 (1979).
[8] *See Global-Tech Appliances, Inc. v. SEB S.A.,* SCt, 131 SCt 2060, 2068–69 (2011) ("persons who know enough to blind themselves to direct proof of critical facts in effect have actual knowledge of those facts") (citing *Jewell,* CA-9, 532 F2d 697, 700 (1976) (*en banc*)).
[9] *Global Tech Appliances, id.,* at 2070–71.
[10] *Williams,* CA-4, Case No. 10-2230, 2012 WL 2948569, at *4 (July 20, 2012) (internal quotations omitted).
[11] *G.B. Lefcourt,* CA-2, 97-2 USTC ¶50,648, 125 F3d 79, 83 (defining "willfulness" in the context of a civil penalty for willfully failing to disclose required information to the IRS as conduct that "requires only that a party act voluntarily in withholding requested information, rather than accidentally or unconsciously."); *accord J.O. Denbo,* CA-10, 93-1 USTC ¶50,177, 988 F2d 1029, 1034–35 (defining "willful" conduct as a "voluntary, conscious and intentional decision") (quoting *J.S. Burden,* CA-10, 73-2 USTC ¶9547, 486 F2d 302, 304, *cert. denied,* SCt, 416 US 904, 94 SCt 1608 (1974)).
[12] *Denbo, id.,* 988 F2d, at 1033.
[13] *Sturman,* CA-6, 951 F2d 1466, 1476–77 (1991).
[14] *See id.* (citing *M.R. Spies,* SCt, 43-1 USTC ¶9243, 317 US 492, 499, 63 SCt 364).
[15] *See Williams, supra* note 10.
[16] *Id.* (quoting *W.L. Greer,* CA-6, 2010-1 USTC ¶50,228, 595 F3d 338, 347 n. 4).
[17] *Id.*
[18] *Id.* (quoting *Sturman,* supra note 13, at 1476).
[19] *Consolidated Edison Co. of New York, Inc.,* CA-2, 2000-2 USTC ¶70,151, 221 F3d 364, 371.
[20] *R.J. Crawley,* BC-DC-IL, 2000-1 USTC ¶50,461, 244 BR 121, 130.
[21] *Id.,* at 130 (quoting *Novitsky v. American Consulting Engineers, L.L.C.,* CA-7, 196 F3d 699, 702 (1999)).
[22] *See Williams, supra* note 10.
[23] *McBride, supra* note 4.