Practice

OVDP and Streamlined Procedures: Am I Non-Willful?

By Charles P. Rettig

The IRS recently announced Streamlined Filing Compliance Procedures in an effort to encourage "non-willful" U.S. taxpayers to come into compliance with their reporting and filing requirements associated with varying interests in foreign financial accounts and assets.[1] The streamlined procedures require the filing of original or amended tax returns reporting not only whatever foreign source income was generated in each of the applicable tax years but also properly reporting any U.S. source income and deductions for each of the applicable tax years.

Once a taxpayer makes a submission under the Streamlined Procedures, the taxpayer may not participate in the IRS Offshore Voluntary Disclosure Program (OVDP). Similarly, a taxpayer who submitted an OVDP voluntary disclosure letter pursuant to OVDP FAQ 24 on or after July 1, 2014, is not eligible to participate in the streamlined procedures. Those directly involved in creating and managing the foreign account and assets are the only ones capable of determining whether determining non-willful status. If such status is not supported by sufficient objective facts, consider other methods of coming into compliance, including the OVDP.

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The government may have or subsequently receive information that does not support such status. All relevant facts and circumstances must be carefully analyzed before making a determination regarding the submission of a "non-willful" certification requesting participation in the streamlined procedures.

For eligible U.S. taxpayers residing *outside* the United States, all penalties will be waived under the streamlined procedures. For eligible U.S. taxpayers residing *in* the United States, the only penalty under the streamlined procedures will be a miscellaneous offshore penalty equal to five percent of the foreign financial assets that gave rise to the tax compliance issue (all income tax related penalties associated with the non-U.S. source income will be waived).

The streamlined procedures do not limit the civil penalties otherwise associated with the reporting of U.S. source income. OVDP Frequently Asked Question 7.1 provides, "The offshore penalty structure only resolves liabilities and penalties related to offshore noncompliance. Domestic portions of a voluntary disclosure are subject to examination." The original OVDP was created in 2009 around

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the theory that those who failed to report an interest in a foreign financial account did so with the intent to evade a U.S. tax obligation. This theory ignores the realities of life for most residing outside the United States as well as for many recent immigrants.

Audits of Streamlined Submissions

Returns submitted under the streamlined procedures will not automatically be subject to IRS audit, but they may be selected for audit under the existing audit selection processes applicable to any U.S. tax return and may also be subject to verification procedures in that the accuracy and completeness of submissions may be checked against information received from banks, financial advisors and other sources. As such, returns submitted under the streamlined procedures may be subject to IRS examination resulting in additional tax and penalties with respect to any audit related adjustments.

The purpose of seeking experienced counsel is to learn the seriousness of the situation at hand and to be guided into the best possible resolution at the least overall cost. If looking for a friend, get a dog.

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No Criminal Protection

The streamlined procedures do not provide protection from a possible criminal prosecution referral. However, the IRS Voluntary Disclosure Practice set forth in IRS Internal Revenue Manual (IRM) 9.5.11.9 would seem to provide a pass from a criminal referral if the appropriate "bells and whistles" set forth in IRM 9.5.11.9 are followed—a "truthful, timely, complete" disclosure, "willingness to cooperate," "taxpayer makes good faith arrangements with the IRS to pay in full, the tax, interest, and any penalties determined by the IRS to be applicable," *etc.*

IRM 9.5.11.9 further provides the following:

1. It is currently the practice of the IRS that a voluntary disclosure will be considered along with all other factors in the investigation in determining whether criminal prosecution will be recommended. This voluntary disclosure practice creates no substantive or procedural rights for taxpayers, as it is simply a matter of internal IRS practice, provided solely for guidance to IRS personnel. Taxpayers cannot rely on the fact that other similarly situated taxpayers may not have been recommended for criminal prosecution.
2. A voluntary disclosure will not automatically guarantee immunity from prosecution; however, a voluntary disclosure may result in prosecution not being recommended. This practice does not apply to taxpayers with illegal source income.

Am I "Non-Willful"?

Taxpayers pursuing resolution of a foreign account issue within the streamlined procedures are required to certify, under penalties of perjury, that their conduct was "non-willful." For purposes of the streamlined procedures, non-willful conduct is defined as conduct that is "due to negligence, inadvertence, or mistake or conduct that is the result of a good faith misunderstanding of the requirements of the law."[2]

The IRM defines "willfulness" in the FBAR context as a determination of whether there was "a voluntary, intentional violation of a known legal duty."[3] The burden of establishing willfulness is on the IRS and may be demonstrated by the person's knowledge of the reporting requirements and the person's conscious choice not to comply with the requirements.[4] In the FBAR context, the IRM provides that the only thing that a person need know is that he has a reporting requirement.[5] If a person has that knowledge, the IRM asserts that the only intent needed to constitute a willful violation of the requirement may a conscious choice not to file the FBAR.[6]

Taxpayers and their representatives must be cautious when certifying non-willful status to the government. The vast majority of taxpayers having previously undisclosed interests in a foreign financial account or asset likely believe they are more "non-willful" than not. The issue at hand in the streamlined procedures is whether the IRS will agree. Feel lucky?

The certification requires that the taxpayer "provide specific reasons for your failure to report all income, pay all tax, and submit all required information returns, including FBARs. If you relied on a professional advisor, provide the name, address, and telephone number of the advisor and a summary of the advice. If married taxpayers submitting a joint certification have different reasons, provide the individual reasons for each spouse separately in the statement of facts."

How does a taxpayer actually provide "specific reasons" in his certification confirming that he did not know of the FBAR filing requirements? The ability to prove something

that simply did not exist is difficult, at best. Will the government discount statements by the taxpayer attempting to disprove knowledge as self-serving unless accompanied by objective supporting evidence? What objective evidence might exist to appropriately demonstrate a lack of personal knowledge by the taxpayer about their foreign reporting requirements?

"Willful Blindness" Pushing Back on OVDP Transitional Taxpayers

Taxpayers recently attempting to transition from the OVDP into the streamlined procedures are receiving some degree of pushback from the government. Transitional treatment has been denied for many on the basis of "willful blindness" where the government believes the return preparer "likely" inquired about the existence of a foreign account or where the taxpayer simply failed to advise their return preparer of the existence of an interest in a foreign financial account (whether or not the preparer inquired about such an account).

Under the concept of "willful blindness," willfulness may be attributed to a person who has made a conscious effort to avoid learning about the FBAR reporting and recordkeeping requirements.[7] Should the taxpayer have inquired of his return preparer about the need to report an interest in a foreign financial account? Should the preparer have gone beyond providing a tax organizer that recites the Schedule B reference relating to an interest in a foreign financial account and perhaps explained what types of foreign interests are reportable?[8] In defining willful blindness in this context, the IRM states:

> An example that might involve willful blindness would be a person who admits knowledge of and fails to answer a question concerning signature authority at foreign banks on Schedule B of his income tax return. This section of the return refers taxpayers to the instructions for Schedule B that provide further guidance on their responsibilities for reporting foreign bank accounts and discusses the duty to file [the FBAR]. These resources indicate that the person could have learned of the filing and recordkeeping requirements quite easily. It is reasonable to assume that a person who has foreign bank accounts should read the information specified by the government in tax forms. The failure to follow-up on this knowledge and learn of the further reporting requirement as suggested on Schedule B may provide some evidence of willful blindness on the part of the person. For example, 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. The mere fact that a person checked the wrong box, or no box, on a Schedule B is not sufficient, by itself, to establish that the FBAR violation was attributable to willful blindness."[9]

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Will a return preparer actually step up and confirm they knew of the existence of a reportable interest in a foreign financial account and to some degree erroneously advised the taxpayer that the FBAR was not required to be filed? Will the IRS somehow punish the preparer who steps up and admittedly gave the wrong advice … or no advice … or looked the other way … when faced with facts that would objectively lead an observer to inquire about the possible existence of a foreign financial account? Are OVDP taxpayers seeking transitional treatment in the streamlined procedures being held to a different "non-willful" standard than taxpayers entering the streamlined procedures directly? Would that even make sense? The government should treat similarly situated taxpayers in a similar manner.

Those who are now eligible to transition into the streamlined procedures but came forward to enter the OVDP before the streamlined procedures were revised should be treated in a similar manner to those who now enter the streamlined procedures directly. The streamlined procedures clearly define the term for "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."[10] The relatively more culpable standard of "willfulness" or "willful blindness" is not referenced in the streamlined procedures.

Does the definition of "non-willful" conduct set forth in the streamlined procedures apply … or not? If that definition is not intended to be significantly more user friendly than the historic definitions of "willfulness" and "willful blindness" then why was it included in the streamlined procedures? Can taxpayers rely upon the streamlined procedures if their return preparer declines to confirm a lack of inquiry to the taxpayer about the existence of an interest in a foreign financial account? Can taxpayers rely

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upon the streamlined procedures if they simply failed to advise their return preparer of the existence of an interest in a foreign financial account? The IRS IRM affirmatively concludes that, "The mere fact that a person checked the wrong box, or no box, on a Schedule B is not sufficient, by itself, to establish that the FBAR violation was attributable to willful blindness."[11] Does a common sense definition of "non-willful" conduct apply ... or not? Still feel lucky?

Determining Non-Willful Conduct

The IRS has indicated it will review each certification of non-willful status seeking participation in the streamlined procedures. Disclosure of the account to the return preparer or others will be an important factor. Another factor is the source of funds held in the foreign account. If the source of funds in the account was from unreported income, the situation can become somewhat problematic. However, having inherited funds in a foreign financial account, without more, might not be considered deserving of non-willful status by the IRS. The IRS has expressed an intention to treat taxpayers consistently and numerous individuals having inherited funds in an undeclared foreign account have been subjected to the stated OVDP penalty.

Deposits and withdrawals to the foreign account can reveal intentions and knowledge of various individuals involved. In reviewing the "non-willful" certification, the government can be expected to inquire about the manner in which deposits and/or withdrawals were made to/from the foreign account(s); the mechanics of how deposits/withdrawals were made; the form in which deposits/withdrawals occurred (*i.e.,* cash, check, wire, travelers' check, *etc.*); amounts of each withdrawal/deposit; when such deposits/withdrawals occurred; where such deposits/withdrawals occurred; whether there were there limitations on the amounts that could be deposited/withdrawn; and documents received when a deposit/withdrawal occurred (*i.e.,* receipt, credit memo, debit memo, *etc.*)?

Additional considerations regarding someone being "non-willful" often include whether the account was at some point moved to another foreign financial institution; whether the taxpayer's advisors had some degree of knowledge about the account; the perceived degree of financial and business sophistication and education of the taxpayer; whether foreign entities were involved as accountholders; documents provided to open the account (*i.e.,* U.S. or foreign passport(s), identification card, *etc.*—note that it might not be a good fact for a taxpayer having dual passports to open an account with their non-U.S. passport); communications, if any, with others that occurred regarding bank secrecy, taxation, and/or disclosure of any foreign accounts; failure to seek independent legal advice about how to properly handle the foreign bank account and instructions or advice received regarding holding or receiving mail from the bank, *etc.* Further questions often lay within the responses to each of the foregoing questions.

Lastly, in reviewing the non-willful certification under the streamlined procedures, resident taxpayers should anticipate the government inquiring as to whether the foreign accounts remain open and if not, where the funds were transferred when the account(s) were closed. Some resident taxpayers closed accounts and transferred the funds directly to a domestic account. Others closed accounts and transferred the funds through various means to other foreign accounts. Further questions often lay within the responses to each of the foregoing questions. An interview by an IRS agent (in person or by phone) should be anticipated and is more likely with respect to resident taxpayers.

If, as some believe, the streamlined procedures are being used to entice unsuspecting taxpayers into placing their heads onto the FBAR chopping block, the government should be held accountable. However, if, as most believe, the streamlined procedures were designed to provide not quite willful taxpayers an opportunity back into compliance through a simplified and expedited process, the IRS should respect the vast majority of streamlined submissions (and requests for transitional treatment) and move on.

Long-term, the overall integrity of government announcements and programs is far more important than searching through the forest to find that overly aggressive taxpayer(s) who dared falsely certify their knowledge (or lack thereof) of their foreign reporting obligations, under penalties of perjury. Those who dare consider taunting the government should be aware that the government possesses considerable information and may be able to relatively quickly determine submission of misleading or false certifications. Setting forth false or misleading information in a streamlined procedures certification in an effort to minimize a distasteful civil FBAR penalty could lead to an even more distasteful criminal investigation or prosecution.

What to Do?

Taxpayers currently participating in an IRS OVDP who meet the eligibility requirements for the Streamlined Filing Compliance Procedures should consider requesting transitional treatment if they are comfortable and have a sufficient factual basis to certify their "non-willful" status. They are not required to affirmatively opt out of the OVDP and will retain the ability to resolve their issues within the OVDP or opt out at a later date if the IRS does

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not agree with their non-willful certification.

Taxpayers not currently participating in an OVDP who meet the eligibility requirements for the streamlined procedures should likewise consider requesting streamlined treatment if they are comfortable and have sufficient factual basis to certify their "non-willful" status.

Non-resident taxpayers might be better positioned to achieve their goal of a non-willful, no penalty resolution under the streamlined procedures. Their "foreign" account is actually in their own neighborhood; it is only "foreign" in the sense that it is located outside the territorial boundaries of the United States. The existence of the account does not, by itself, somehow represent an acknowledgment of tax noncompliance by the nonresident taxpayer. The streamlined procedures seem to represent the first attempt by the government to acknowledge that at some point, nonresident taxpayers become residents of their home state, emotionally even if perhaps not technically.

The IRS has recently assessed multiple year, 50-percent FBAR penalties against various taxpayers around the country who, for various reasons, were unable to achieve a more meaningful resolution during an examination or who opted out of the OVDP. Depending on the actual facts involved, recent case law favors the government in many of these situations. If unable to convince the government of the taxpayers "non-willful" conduct within the streamlined procedures, the taxpayer might consider litigation. However, in litigation the "jury of your peers" may look more like the 99 percent of the population who have trouble understanding why anyone would maintain an interest in a financial account located in a foreign country.

If there are any uncertainties or potentially difficult factual scenarios involved, consult with experienced counsel. In this environment, such counsel may well provide advice that seems anything but user friendly. The purpose of seeking experienced counsel is to learn the seriousness of the situation at hand and to be guided into the best possible resolution at the least overall cost. If looking for a friend, get a dog.

ENDNOTES

1 *IRS Makes Changes to Offshore Programs; Revisions Ease Burden and Help More Taxpayers Come into Compliance*, IR-2014-73, June 18, 2014.
2 *Id.*
3 FBAR Willfulness Penalty—Willfulness, IRM 4.26.16.4.5.3 (July 1, 2008).
4 *Id.*
5 *Id.*
6 *Id.*
7 *Id.*
8 For 2013, Schedule B, Line 7a states "At any time during 2013, 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. … If 'Yes,' are you required to file FinCEN Form 114, Report of Foreign Bank and Financial Accounts (FBAR), formerly TD F 90-22.1, to report that financial interest or signature authority? See FinCEN Form 114 and its instructions for filing requirements and exceptions to those requirements." Further, Schedule B, Line 7b states, "If you are required to file FinCEN Form 114, enter the name of the foreign country where the financial account is located."
9 *Id.*
10 *IRS Makes Changes to Offshore Programs; Revisions Ease Burden and Help More Taxpayers Come into Compliance*, IR-2014-73, June 18, 2014.
11 FBAR Willfulness Penalty—Willfulness, IRM 4.26.16.4.5.3 (July 1, 2008).

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