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# News Analysis: Did You Really Mean to Hide Those Foreign Accounts?

by Lee A. Sheppard

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We don't need to collect taxes, other than in an amount of roughly 20 percent of GDP, which is enough to require people to hold the currency, so why are we chasing a relative handful of people with unreported foreign accounts?

Because we want wage earners, from whom tax is withheld, to think that the tax system -- and by extension the entire economic arrangement -- is fair. Taxes are the way people communicate with their government.

We can't have wage earners thinking that the system is unfair, even if they have gotten into the habit of voting the antitax party into office. We can't have them thinking that the whole United States is a giant plutocracy along the lines of Manhattan. Ordinary wage earners whose votes politicians need to earn shouldn't be made to feel like schmucks because hedge fund managers aren't paying taxes or their dentist is hiding money from his ex-wife in a Cook Islands trust.

That being said, punishments that are too harsh do not command respect either. The United States is reluctant to punish tax cheats too heavily. They generally don't go to prison unless something else is going on (e.g., *United States v. Simon*, 727 F.3d 682 (7th Cir. 2013)). So the IRS has developed a sliding scale of settlement options in the period since the UBS scandal first came to light. Nonetheless, the agency's best efforts to make penalties proportionate to taxpayer perceptions have not discouraged quiet disclosure.

At the June 5 New York University Tax Controversy Forum in New York, practitioners discussed with John McDougal, special trial attorney and division counsel with the IRS Small Business/Self-Employed Division, and David Horton, director (international individual compliance) in the IRS Large Business and International Division, how to navigate the now-perpetual IRS offshore voluntary disclosure program and the newer options. Larry A. Campagna of Chamberlain, Hrdlicka, White, Williams & Aughtry moderated a panel that included Megan L. Brackney of Kostelanetz & Fink LLP and Jeremy H. Temkin of Morvillo Abramowitz Grand Iason & Anello PC.

Practitioners have developed their own points of reference, given the IRS's statutory inability to issue published guidance on foreign bank account reports. IRS guidance must be couched in frequently asked questions on the IRS website, none of which has a formal document number (other than a Tax Analysts document number). So practitioners speak in terms of options 1 (OVDP), 2 (streamlined filing compliance), 3 (delinquent FBARs), and 4 (delinquent international information returns), outlined under "Options Available for U.S. Taxpayers With Undisclosed Foreign Accounts" on the IRS website. (Restated OVDP FAQs.)

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## Tax Settlements

OVDP is available to willful tax cheats, but not to those under audit or criminal investigation. Horton explained that the OVDP, now in its fourth iteration, is essentially unchanged. The most recent significant change was the increase in the penalty from 27.5 percent to 50 percent of the taxpayer's highest account balance when the taxpayer's bank has been placed on the naughty list, which now includes 21 banks, nine of which have signed deferred prosecution agreements. The enhanced penalty applies to all the taxpayer's foreign accounts, not just the one at the bad bank.

Participation in OVDP requires eight years of returns, a criminal clearance, and a closing agreement. An OVDP taxpayer essentially agrees to an audit. The penalties are regarded as onerous, but the program is great for those whose misdeeds have not come to IRS notice because it offers protection from criminal prosecution.

The streamlined filing compliance procedure, which is one year old, requires only three years of returns. It was designed to accommodate nonresidents with home-country bank accounts. For them, there are no section 6662 or FBAR penalties. As detailed in a separate FAQ, there is a substantial presence test to determine nonresidence that is keyed to section 911. (Prior coverage.)

Domestic residents who are not under audit or criminal investigation became eligible for the streamlined procedure last year, but must make an upfront payment of a miscellaneous offshore penalty of 5 percent of their highest foreign account balances, determined using a narrower definition of financial assets than is used for OVDP (Form 8938, "Statement of Specified Foreign Financial Assets"). Domestic residents effectively must file six years of returns because of the lookback period in the Internal Revenue Manual (http://goo.gl/X2euhA).

The streamlined procedure is available to taxpayers whose failure to file or pay may have been negligent but was not willful. Streamlined participants must swear under penalty of perjury that their noncompliance was not willful. Justice Department lawyers threaten that they will prosecute taxpayers who lie to get into the streamlined program, but there is no pre-clearance. (Prior coverage.)

Responding to a question from Brackney, McDougal explained that the taxpayer has the burden of proof of non-willfulness. What is non-willful is what satisfies an IRS examiner and persuades him to accept the taxpayer's certification. Otherwise, concepts of willfulness track the 1988 penalty reform, which raised the intent requirements for fraud and negligence to levels above what they are under common tort law. To be negligent after penalty reform, a taxpayer must be nearly willful (section 6662(c)).

The streamlined program requires no criminal clearance but also offers no protection from criminal prosecution should the taxpayer's assertions prove false. There is no guarantee that the IRS will review the taxpayer's certification, but there is no guarantee that it won't. Horton characterized the streamlined process as purely procedural.

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Horton explained that the purposes of the streamlined procedure are to discourage quiet disclosure and to collect profiles of clients. Campagna commented that it is difficult for taxpayers with shell companies to argue that they were not willful, although he has seen cases in which clients put themselves entirely in the hands of a tax adviser.

Clients read the IRS website and ask their advisers for the streamlined procedure. Some lawyers put on placeholders while developing their client's case. Temkin likes to request OVDP pre-clearance while evaluating evidence of willfulness. If he is satisfied that the client turns out not to have been willful, he puts the client into the streamlined program and the OVDP request is withdrawn.

Why enter any voluntary program? Like Justice Department speakers at the conference, Horton emphasized that the IRS is gleaning information from cooperating bank and bank employee disclosures of everything but account holder identities and that agents know which banks have sent letters encouraging participation in the IRS's voluntary programs.

Caroline Ciraolo, acting assistant attorney general in the DOJ Tax Division, interjected that banks with deferred prosecution agreements have to agree to continuing cooperation with auditing. Temkin noted that not only are Swiss banks pushing for participation in OVDP, they are coming back to account holders asking for proof of participation and disclosure in the form of documentary evidence (which the banks can use to reduce their penalties). (Prior coverage .)

Some Swiss banks are so anxious to reduce their penalties that they offer lump sums to assist their former depositors with professional fees incurred in entering voluntary compliance programs. Lawyers at the forum debated whether that assistance would be income to the former customers. Clearly it is income, but the customer would be entitled to an offsetting section 212 deduction for the professional fees.

Clients, of course, got in the trouble they're in because of greed and disbelief that the IRS would ever be able to process information it receives about them. They continue in that disbelief even after their Swiss banks are caught. They access their accounts. They sign waivers for disclosure of their identities by their Swiss banks. They create paper trails.

Apparently, the sort of person who hates government and refuses to pay his taxes also persists in the belief that the government is incompetent at processing information. "It's unbelievable that huge numbers of taxpayers haven't come in from the cold," Charles P. Rettig of Hochman, Salkin, Rettig, Toscher & Perez PC said earlier in the day. "Information can be matched."

## FBAR

The IRS also offers delinquent FBAR filing procedures and delinquent international information return procedures for taxpayers whose only sins were failure to file FBARs or forms such as Form 5471, "Information Return of U.S. Persons With Respect to Certain Foreign Corporations," or Form 3520, "Annual Return to Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts."

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McDougal suggested that U.S. residents with de minimis tax deficiencies file delinquent FBARs with reasonable cause statements if the streamlined procedure penalty was off-putting. But he acknowledged lawyer complaints that clients who do that never hear from the IRS, even though their checks are cashed. (Delinquent FBAR submission procedures .)

Foreign bank account reporting penalties used to be bupkes. Now they're perceived as too high. Recent immigrants who kept their home-country bank accounts are not keen on having to give a chunk of their funds to the IRS as an extra fee for a green card. So in its most recent guidance (SBSE-04-0515-0025 ), the IRS effectively capped FBAR penalties, to the relief of immigrants and lawyers representing die-hard tax cheats as well.

Why should the latter be happy? Brackney explained that multiyear non-willful FBAR penalties can actually exceed willful FBAR penalties, especially for smaller accounts. So for smaller accounts and non-willful failure to file, the new guidance caps the FBAR penalty at $10,000 for one year. Under the new guidance, there will be no more stacking of non-willful penalties.

For willful FBAR nonfiling, the new guidance states that the penalty will be 50 percent of the highest account balance and will not exceed 100 percent of the highest account balance because of Eighth Amendment concerns. (See also the explanation in the IRS FBAR reference guide .)

Brackney wanted to know whether 50 percent was a floor, or would it still be possible to negotiate a penalty of less than 50 percent in a willful case? McDougal responded that 50 percent is the default amount but that case managers have discretion to lower it. Brackney said that the default amount aided decision-making.

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