

FBARs, Voluntary Disclosures and Foreign Accounts

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Dennis Brager



Dennis Brager is a California State Bar Certified Tax Specialist and a former Senior Trial Attorney for the Internal Revenue Service's Office of Chief Counsel. In addition to representing the IRS in court, he advised the Service on complex civil and criminal tax issues. He now has his own four attorney firm in Westwood, and has been named as a Super Lawyer in the field of Tax Litigation by Los Angeles Magazine. He has been quoted as a tax expert, by Business Week, the Daily Journal, the National Law Journal, The Daily Beast, USA Today, Palm Beach Daily News, Money Laundering, the Los Angeles Daily Journal and Tax Analyst.

Having worked for the IRS for six years, he gained valuable insight into the inner workings of that organization. This not only helps in developing the right strategies, but facilitates working with the system quickly and efficiently. Mr. Brager has limited his practice to representing clients having disputes with the IRS, the Franchise Tax Board, the State Board of Equalization and the Employment Development Department--both at trial and administrative levels.

He has appeared on ABC Television's Good Morning America show, Fox Business News, and TV One Access. He has also spoken before the California Continuing Education of the Bar, the California Society of CPAs, the UCLA Tax Controversy Institute, the California State Bar Tax Section, the Consumer Rights Litigation Conference, the California Trial Lawyers Association, the American Bar Association, the Warner Center Estate and Tax Planning Council, and the National Association of Enrolled Agents. Dennis Brager has been an instructor at Golden Gate University's Masters in Taxation Program and a guest speaker at the University of Southern California. Mr. Brager has testified as an expert witness on Federal tax matters.

His articles have appeared in the California Lawyer, Daily Journal, Taxation for Lawyers, Los Angeles Lawyer, The Consumer Advocate, Family Law News, California Tax Lawyer, Journal of Tax Practice and Procedure, and Journal of Taxation of Investments. They include "Offshore Voluntary Disclosure – The Next Generation," "Partial Offshore Tax Amnesty – Voluntary Disclosure 2.0," Anatomy of an OPR Case (Definitely Not R.I.P.), "FBAR and Voluntary Disclosure," "The Tax Gap and Voluntary Disclosure," "Circular 230: An Overview," "Recent Developments in Tax Procedure," "Damages, Rescission and Debt Cancellation as Client Income," "Ponzi Scheme Victims May Be Able to Mitigate Losses with Tax Deduction," "Prevailing Party-Recovering Attorneys Fees From the IRS," "The Taxpayer Bill of Rights--A Small Step Toward Reining in the IRS," "Challenging the IRS Requires a Cohesive Strategy," "The Innocent Spouse Defense," "IRS Guidelines for Installment-Payment Agreements," "Expert Advice: New Rules on 1099 Forms," "Tax Brakes: The Taxpayer Bill of Rights 2," and "Expert Advice: Avoiding Payroll Taxes."

Mr. Brager received his undergraduate degree from Pace University (B.B.A., magna cum laude, 1975, Accounting/Finance), and his law degree from New York University (J.D., 1978). He is a former chair of both the Tax Compliance, Procedure and Litigation Committee of the Los Angeles County Bar Association, and the California State Bar, Tax Procedure and Litigation Committee. He is admitted to practice before the U.S. Supreme Court, the Ninth Circuit Court of Appeals, U.S. Claims Court, U.S. Tax Court, U.S. District Court and the U.S. Bankruptcy Court.

The Problem

- U.S. Persons who have signatory authority over, or a financial interest in an offshore account must file an FBAR- Form TD F 90-22.1 for accounts with combined balances over 10k U.S. dollars.
 - U.S. Person = U.S. Citizen or U.S. “resident”
 - Currently a resident means:
 - a resident alien under IRC Section 7701(b) includes:
 - Green card test
 - substantial presence test
 - any entity including but not limited to, a corporation, partnership, trust, or limited liability company created, organized, or formed under the laws of the United States
 - Substantial presence test may not apply prior to the issuance of latest FINCEN regulations on March 28, 2011

The Problem (Continued)

○ Financial Interest Definition

- Owner of record or holder of legal title
- A United States person has a financial interest in each foreign account for which the owner of record or holder of legal title is
 - a) A person acting as an agent, nominee, attorney or in some other capacity on behalf of the United States person with respect to the account,
 - b) A corporation in which the United States person owns directly or indirectly more than 50 percent of the voting power or the total value of the shares, a partnership in which the United States person owns directly or indirectly more than 50 percent of the interest in profits or capital, or any other entity (other than certain exempted entities) in which the United States person owns directly or indirectly more than 50 percent of the voting power, total value of the equity interest or assets, or interest in profits,
 - c) A trust, if the United States person is the trust grantor and has an ownership interest pursuant to Code Sections 671 to 679, or
 - d) A trust in which the United States person either has a present beneficial interest in more than 50 percent of the assets or from which such person receives more than 50 percent of the current income.

The Problem (Continued)

- Schedule B Question: At any time during 2012, did you have an interest in or a signature or other authority over a financial account in a foreign country, such as a bank account, securities account, or other financial account? See page B-2 for exceptions and filing requirements for Form TD F 90-22.1
 - Checking the box that says "No", subjects a taxpayer to a possible criminal charge of filing a false income tax return which is a felony.

FBARs Are Due June 30th



- They are not filed with the tax return, but must be filed electronically with the Financial Crimes Enforcement Network (FINCEN).
- Extensions of time to file federal income tax returns do not extend the time for filing FBARs. There is no statutory or regulatory provision granting an extension of time for filing FBARs.
- Statute of Limitations for the IRS to Assess the FBAR Penalty is 6 years from June 30th even though no FBAR was filed.

Criminal Penalties

- Willful Failure to File an FBAR. Up to \$250,000 or 5 years in jail or both.
- Willful failure to file an FBAR while violating another "law of the United States" or as part of a pattern of any illegal activity involving more than \$100k in a 12 month period. Up to \$500k or 10 years in jail or both.
- Filing a false return, IRC § 7206(1). Up to three years in jail or \$100,000 or both.
- Tax Evasion. IRC § 7201. Up to \$100,000 or 5 years in jail or both.

Civil FBAR Penalties

- Negligent Violation. Up to \$10k for each violation.
 - Applies only to violations occurring after Oct. 22, 2004.
 - The IRS takes the position that if there are multiple accounts then there are multiple violations
 - e.g. a taxpayer who has three different accounts would be liable for \$30,000 of penalty each year.

More Civil FBAR Penalties



- Willful Failure to File. Up to the **greater** of \$100,000, or 50 percent of the amount in the account at the time of the violation.
- Willful Failure to keep records of the account. Any person required to file the FBAR must keep certain records of the account for five years

Civil Title 26 Penalties

- Civil Fraud Penalty for Willful Failure to Report Income. 75% of the tax due.
- Accuracy Related Penalty for negligent failure to report. 20% of the tax due.
- Penalties for failure to file a Form 3520 reporting the transfer of funds to a foreign trust or receipt of a distribution from a foreign trust, which begins at 35% of the amount transferred to or received from the foreign trust.
- Penalties for failure to file a Form 3520 to report the receipt of a gift or inheritance from a foreign person or estate, or a gift received from a foreign corporation or partnership, which begins at 5% per month of the value of the gift and can reach as high as 25% of the value.
- Penalties for failure to report transfers of property to a foreign corporation (Form 926), which begin at 10% of the value of the property transferred to the corporation and which can reach a maximum of \$100,000 per return.

Civil Title 26 Penalties

(Continued)

- Penalties for failure to file foreign corporation information returns (Form 5471 and or Form 5472), which begin at \$10,000 and can run as high as \$50,000 per return.
- Penalties for failure to file Form 3520-A reflecting ownership of a foreign trust under the grantor trust rules, which consists of a penalty of 5% of trust assets.
- Penalties for failure to file foreign partnership information returns (Form 8865), which start at \$10,000 and can reach a maximum of \$50,000 per return, plus up to \$100,000 of the value of property transferred to the foreign partnership.
- There is no statute of limitations on the failure to file the various foreign information reporting forms.
- Interest.

Not Just For Tax Cheats

- Client a U.S. Citizen decides to buy a flat in London so that he will have a place to stay while on vacation, and he might retire there. Opens an account in England and wires \$500k to an account at the Bank of Scotland to use as a down payment. Two weeks later he turns that money over to his solicitor to close the purchase. The client is required to file an FBAR.
- Client born in the U.S. moved to Australia to live and work. As a natural consequence he has accounts in Australia. FBAR required.
- Client was born in India; he has lived in this country for 20 years, but still maintains accounts in India in order to provide for family members there, and to invest a portion of his assets in the growing Indian economy. FBAR required.
- Client is the vice president of a company with a division in France. The vice-president is a signer on the corporate accounts in France. The VP must file his own FBAR, in addition to any corporate FBARs.
- Client has a Canadian Retirement Account. FBAR required.
- Client fled the Iranian revolution in the mid-70s, moved to the United States, and placed money in Israeli banks for safety. FBARs are required.

How Will the IRS Find Out? Let Me Count the Ways

- FATCA (Foreign Account Tax Compliance Act of 2009)
- *IRS Investigations*
 - *Credit Suisse*
 - *Julius Baer*
 - *HSBC*
 - *Basler Kantonalbank*
 - *Bank Leumi*
 - *Bank Hapoalim*
- *Agreements with Swiss Banks*

FATCA

- Jan. 1, 2014 FATCA withholding begins.
- FATCA requires a 30 percent withholding tax on any "withholdable payment" made either to an FFI (e.g. an offshore bank) or certain other entities if it fails to comply with new reporting, disclosure, and related requirements.
- FFIs are required to:
 - Obtain information from each account holder as is necessary to determine which accounts are "U.S. accounts"
 - Comply with verification and due diligence procedures with respect to the identification of U.S. accounts

FACTA (Continued)

- Report annually certain information related to any U.S. account maintained by such institution
- Deduct and withhold 30 percent on certain pass thru payments made to the benefit of an account holder that refuses to provide the required information (a "recalcitrant account holder")
- Attempt to obtain a waiver in any case in which any foreign law would (but for a waiver) prevent reporting of information under the provision related to any U.S. account maintained by such institution and, if a waiver is not obtained, to close the account.
- File a 1099 with the IRS, or provide detailed information about the foreign account. E.g.
 - Name and address
 - Account Balance
 - Gross Receipts and Gross withdrawals

More Exposure



- Whistle Blowers
 - Disgruntled Bank Employees
 - Bank Employees Under Indictment
 - We're Just in it for the Money
 - Ex-Spouses
 - Ex-employees
 - Ex-business partners
- Foreign Banks. Most foreign financial institutions are closing accounts of U.S. persons who refuse to fill out Form W-9, and agree to information reporting to the IRS.
- IRS Activity
 - HSBC Summons
 - Interview Pool of 33,000 taxpayers participating in OVDP/OVDI
 - Sometime in 2012 Credit Suisse turned over client information to IRS pursuant to a treaty request
 - Indictment against Wegelin Bank
 - Swiss Bank Clariden Leu turned over client information to IRS in late 2011
 - Ongoing negotiations with the Swiss government and Fourteen Swiss Banks

Tax Amnesty - Offshore Voluntary Disclosure Program (OVDP)

- Eligibility not for:
 - Taxpayers under audit **whether or not** related to offshore issues
 - Taxpayers under investigation by CI (Criminal Investigation)
 - Taxpayers with illegal source of income
 - Taxpayers who have reported and paid tax on all their taxable income for prior years but did not file FBARs
 - Taxpayers who reported all income, but failed to file offshore information forms such as Form 3520, or 5471

OVDP Extended

- OVDP Provided for a 20% Penalty for Disclosures Prior to Oct. 16, 2009
 - OVDP Permitted a Taxpayer to argue for less than a 20% penalty without “opting out”
- OVDI 2011 Provided for a 25% Penalty for Disclosures Prior to Sept 10, 2011
- OVDP 2012 Provides for a 27.5% Penalty
 - Announced Jan. 9, 2012. IRS Notice 2012-5
 - Currently there is no ending date.

OVDP Documentation



- The following information must be submitted as part of the complete OVDP package after both pre-clearance, and:
 - Copies of previously filed original (and, if applicable, previously filed amended) federal income tax returns for tax years covered by the voluntary disclosure;
 - Amended federal income tax returns with applicable schedules detailing the amount and type of previously unreported income from the account or entity;
 - A completed “Foreign Account or Asset Statement” for each previously undisclosed foreign account or asset during the voluntary disclosure period (available on the IRS website);
 - For taxpayers disclosing offshore financial accounts with an aggregate highest account balance in any year of \$1 million or more, a completed “Foreign Financial Institution Statement” for each foreign financial institution with which the taxpayer had undisclosed accounts or transactions during the voluntary disclosure period (available on the IRS website);

OVDP Documentation

(Continued)



- “Taxpayer Account Summary With Penalty Calculation” (available on the IRS website);
- A check in full payment of the total tax, interest and all applicable penalties except the “in-lieu” penalty;
 - “Collection alternatives” may be available
- For taxpayers disclosing offshore financial accounts with an aggregate highest account balance in any year of \$500,000 or more, copies of offshore financial account statements reflecting all account activity for each of the tax years covered by the voluntary disclosure;
- For those taxpayers disclosing offshore financial accounts with an aggregate highest account balance of less than \$500,000, copies of offshore financial account statements reflecting all account activity for each of the tax years covered by the voluntary disclosure must be readily available upon request; and
- Waivers extending the time for the IRS to assess Title 26 tax, interest, and penalty as well as FBAR penalties.

OVDP Penalties

- 27.5% of the highest account balance at any time during the prior 8 years.
 - The penalty base is not limited to foreign financial accounts required to be reported on an FBAR. Instead the 27.5% (or 12.5% or 5%) penalty applies to all of the taxpayer's offshore holdings that are related in any way to "tax non-compliance"
 - An accuracy related penalty of 20% of the tax due pursuant to IRC Section 6662
 - If applicable, the failure to file and failure to pay penalties under IRC Section 6651(a)(1) and (a)(2)
- The taxpayer may not argue lack of willfulness
- No reasonable cause exception

Relief for Non-Citizen Non Filers



- Streamlined Compliance Procedure Announced Aug. 31, 2012
- Who is Eligible?
 - Must have resided outside of the U.S. since Jan. 1, 2009
 - Cannot have filed a U.S. tax return during the same period; and
 - Must present a "low level compliance risk."
- The Benefits
 - Only three years of tax returns need to be filed vs. eight for OVDP
 - No FBAR or other penalties
 - Less documentation

How is Compliance Risk Determined?

- The tax due for the prior three years must be less than \$1,500 in each year. However, even if the tax due meets this low level if any of the following factors are present then the compliance risk rises, and the taxpayer may not be eligible to participate. The factors are:
 - If any of the returns submitted through this program claim a refund;
 - If there is material economic activity in the United States;
 - If the taxpayer has not declared all of his/her income in his/her country of residence;
 - If the taxpayer is under audit or investigation by the IRS;

Compliance Risk

(Continued)

- If FBAR penalties have been previously assessed against the taxpayer or if the taxpayer has previously received an FBAR warning letter;
- If the taxpayer has a financial interest or authority over a financial account(s) located outside his/her country of residence;
- If the taxpayer has a financial interest in an entity or entities located outside his/her country of residence;
- If there is U.S. source income; or
- If there are indications of "sophisticated tax planning or avoidance."

Downsides of Streamlined Compliance Procedure

- The new procedure provides no protection from the risk of criminal prosecution
- Once a submission is made if the IRS determines that the Streamlined Compliance Procedure is not appropriate, the taxpayer may not participate in the Offshore Voluntary Disclosure Program (OVDP)
- It is not a DIY project, and will require substantial legal and accounting fees to produce:
 - 3 years of tax returns and 6 years of FBARs
 - An analysis to determine whether or not the client has criminal exposure which makes the streamlined procedure problematic
- Does not appear to be available to participants in earlier programs

Limited OVDP Relief

- For accounts that do not exceed \$75,000 the penalty is 12.5% of the highest aggregate balance
 - All other terms remain the same
 - Non-financial assets are taken into account for determining the \$75,000 threshold
- 5% Penalty
 - Category 1 “Inherited” Accounts
 - Taxpayer did not open the account
 - Minimal Infrequent Contact
 - Did not withdraw more than \$1k in any one year
 - Prove that all taxes were paid on the principal balance going back to Jan. 1, 1991.
 - Category 2. The Brain Dead Citizen
 - Taxpayers who are foreign residents and who were unaware they were U.S. citizens.

Limited OVDP Relief (Continued)



- Category 3. Foreign Residents Who Meet All of the Following Conditions:
 - Taxpayer resides in a foreign country
 - Has made a “good faith showing” that she has timely complied with all tax reporting and payment requirements in the country of residence; and
 - Has \$10,000 or less of U.S. source income each year
- Category 3 taxpayers may exclude the value of non-financial assets from the penalty base.
- Category 3 did not exist under the 2009 OVDP, and therefore qualifying taxpayers may reopen their cases with the IRS.

Alternatives to Entering OVDP. Just Say No?

- Filing a quiet disclosure
- Filing accurate 2013 tax returns, and/or FBARs, but not self correcting prior years
- Enter OVDP followed by Opt-out
 - In June 2011 IRS published an “opt-out” guide for its agents instructing them on procedures to follow in the case of an opt-out.
- Stick head in sand, and do nothing (Not Recommended!)
- Potential Risks
 - Full Blown Audit
 - Potential Penalties Exceeding the Value of Offshore Assets
 - Pay special attention to failure to file “information returns” e.g. 5471, 3520 etc.
 - Possible criminal exposure including jail time
 - Loss of green card status
- Potential Rewards
 - No Taxes
 - No Penalties
 - No Audit

Penalty Process Outside of OVDP



- FBAR penalty imposed under the Bank Secrecy Act (BSA) not the Internal Revenue Code
- Appeals Review Available- Rubberstamp?
- The Tax Court does not have jurisdiction over the penalty. *Williams v. Commissioner*, 131 T.C. 54 (2008).
- FBAR penalties are not dischargeable in bankruptcy. *U.S. v. Simonelli*, 102 AFTR 2d 2008-6577
- No FBAR penalty can be collected unless the taxpayer agrees, or the IRS brings suit in federal district court and proves that the penalty applies.
- FBAR Penalties can not be collected through summary IRS Collection Procedures

Malpractice Avoidance Tactics



- Consider Circular 230 Section 10.34(d). A practitioner may generally rely, in good faith and without verification, on information furnished by a client. A practitioner may rely on information provided by a client in good faith. However, a practitioner may not ignore the implications of any information provided to or actually known by the practitioner. If the information furnished by the client appears to be incorrect, inconsistent with other known facts, or incomplete, the practitioner is required to make further inquiry. Good faith reliance contemplates that a practitioner will make reasonable inquiries when a client provides information that implies possible participation in overseas transactions/accounts subject to FBAR requirements

Malpractice Avoidance Tactics (Continued)



- Obtain written affirmative representations from clients about the non-existence of foreign assets before failing to file Form 8938, or checking the “no” box on Schedule B. Stating the taxpayer has no financial interest in, or signatory authority over a foreign financial account.
 - Clients have short and selective memories
- Advise the client of the need to file an FBAR in writing.
 - The preparer is not required to prepare the FBAR

Malpractice Avoidance Tactics (Continued)



- Considerations Upon Discovery of Undisclosed Accounts
 - The Preparer as IRS witness
 - Federal Practitioner Privilege v. Attorney Client Privilege
 - Circular 230, Section 10.34(c). The practitioner has a duty to advise a client of any potential penalties likely to apply to a position taken on a return
 - Statement on Standards for Tax Services No. 6, Knowledge of Error: Return Preparation
 - If a member is requested to prepare the current year's return and the taxpayer has not taken appropriate action to correct an error in a prior year's return, the member should consider whether to withdraw from preparing the return and whether to continue a professional or employment relationship with the taxpayer. If the member does prepare such current year's return, the member should take reasonable steps to ensure that the error is not repeated.
 - While performing services for a taxpayer, a member may become aware of an error in a previously filed return or may become aware that the taxpayer failed to file a required return. The member should advise the taxpayer of the error and the measures to be taken. Such recommendation may be given orally. If the member believes that the taxpayer could be charged with fraud or other criminal misconduct, the taxpayer should be advised to consult legal counsel before taking any action.
 - Potential Conflict of Interest. Can the client claim reliance on the preparer?

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