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# FBAR Penalty Investigation Workshop

OVDI Opt-out and Removal Cases  
Treaty Cases



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## FBAR Penalty Investigations

- The goal of the FBAR penalty investigation is to gathering evidence to arrive at a decision regarding the appropriate FBAR penalties
- Many investigations will result in non-willful penalties because the IRS cannot prove willfulness
- The evidence will guide the investigation:
  - If the evidence tends to show willful conduct by the person, continue to gather evidence to prove willfulness
  - If the evidence tends to show non-willfulness, then shift the focus of the investigation to reasonable cause



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The goal of an FBAR penalty investigation is to gather evidence to arrive at a decision regarding the appropriate FBAR penalties. Examiners should try to avoid starting a penalty investigation with the intent of proving a that a specific penalty applies. At the start of the investigation you may have some evidence that tends to show willfulness, or that that tends to show non-willfulness, but until you gather additional information you really do not know with any degree of certainty the appropriate penalty, if any, to assert.

Many FBAR penalty investigations will result in non-willful penalties, not because the person did not act willfully, but because we cannot meet our burden to prove that the person acted willfully.

You need to allow the evidence to guide the investigation. If the evidence tends to show willful conduct by the person, then continue to gather evidence to prove willful FBAR violations; however, if the evidence tends to show non-willfulness, then at some point during the investigation you will shift the focus to evaluating whether the person has reasonable cause for the FBAR violations. At what point you have gathered enough information to make a decision about the direction of the investigation heavily depends upon the facts of the case.

## Suggested Approach

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- Was there a duty to file?
- Did the taxpayer have reasonable cause for not filing?
- If no reasonable cause, was the violation willful or nonwillful?
- If willful, what amount of penalty is necessary to achieve compliance objectives
  - ♦ as to the taxpayer?
  - ♦ As to other non-filers?



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## Was there a Duty to file?

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- The examiner must prove each of the statutory requirements to file an FBAR:
  - ♦ A U.S. person
  - ♦ With a financial interest in, or signature or other authority over
  - ♦ Foreign financial accounts
  - ♦ The aggregate value of which exceeded \$10,000 at any time during the calendar year



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## Was there reasonable cause?

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- Did some event or condition prevent timely filing?
- Did the taxpayer consult a qualified professional?
  - ♦ The mere uninformed belief that no return is due, no matter how genuine, is not reasonable cause unless the taxpayer make inquiry
- Reasonable cause = no penalty
  - ♦ Consider need for warning letter



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## Was the Violation Willful?

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- United States v. Pomponio, 429 U.S. 19 (1976)
- Willfulness is a  
VOLUNTARY,  
INTENTIONAL,  
VIOLATION of a  
KNOWN LEGAL DUTY



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## Known Legal Duty

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- Direct evidence:
  - Taxpayer filed a current incomplete FBAR or previously filed FBARs or received a warning letter
- Circumstantial evidence
  - Preparer asked about foreign accounts and taxpayer lied
  - Taxpayer otherwise concealed account
  - Failure continued for many years without inquiry



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## Voluntary and Intentional

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- Bad motive is not required
  - Question is whether non-filing was deliberate choice
- A motive to hide the account tends to show not filing was deliberate and not accidental
- But absence of motive does not negate willfulness if other evidence failure was not inadvertent.



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## United States v. Williams

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- Lost in District Court, but parts of opinion are favorable.
  - 2010 U.S. Dist. LEXIS 90794 (E.D.Va. 2010)
  - On appeal to Fourth Circuit
- Defined Willfulness:
  - “[w]here willfulness is a statutory condition of civil liability, it is generally taken to cover not only knowing violations of a standard, but reckless ones as well.” Safeco Ins. Co. of Am. v. Burr, 551 U.S. 47, 57 (2007)
- Standard of Proof – Preponderance of the Evidence



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## United States v. Williams

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- Fourth Circuit reversed July 20, 2012
  - Unpublished opinion
- Did not disturb lower court definition of willfulness or standard of proof
- Approved rule that reckless disregard satisfies willfulness requirement for civil penalties
- Held that finding of lack of willfulness was clearly erroneous



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## United States v. Williams

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Basis for 4th Circuit clearly erroneous finding:

- Issue is intent – not motive
- Signature of return charges TP with knowledge of contents
  - “at a minimum” line 7a’s reference to Form TD F 90-22.1 put him on inquiry notice of filing requirement
- TP testimony that he never read the words on the returns shows a “conscious effort to avoid learning of filing requirements”
  - This, with false “no” on Schedule B = willful blindness



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## Determining Amount of Penalty

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- Agent and Manager have discretion
- Objective is to foster compliance
- Mitigation guidelines in IRM 4.26.16
- Here is where taxpayer's conduct after discovery becomes relevant
  - ♦ Cooperation in exam
  - ♦ Agreed vs unagreed



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## Willful or Non-Willful?

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### Factors tending to support a willful penalty

- Opened the foreign bank account
- Owner of, or a financial interest in, the foreign bank account
- Participated in an abusive tax avoidance scheme

### Factors tending to show non-willful conduct

- Inherited the foreign bank account
- Only signature authority over the foreign bank account
- Did not participate in an abusive tax avoidance scheme



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## Willful or Non-Willful?, cont'd.

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### Factors tending to support a willful penalty

- Tax non-compliance
- Did not seek advice, or relied upon the advice of a promoter, foreign banker, or other unqualified tax professional

### Factors tending to show non-willfulness

- Tax compliance
- Relied upon the advice of a tax return preparer, a CPA, an attorney, or another qualified tax professional



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## Willful or Non-Willful?, cont'd.

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### Factors tending to support a willful penalty

- Violations persist after notification of FBAR reporting requirements
- Foreign account **not** disclosed to return preparer
- An offshore entity owns the account

### Factors tending to show non-willfulness

- Full compliance after notification of FBAR reporting requirements
- Foreign account disclosed to return preparer
- Person owns the account in his name



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## Willful or Non-Willful?, cont'd.

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### Factors tending to support a willful penalty

- No business reason for the foreign account
- No family or business connection to the foreign country

### Factors tending to show non-willfulness

- Business reason for the foreign account
- Family or business connection to the foreign country



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## Willful or Non-Willful?, cont'd.

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### Factors tending to show willfulness

- Previously-filed FBARs do not include all foreign accounts
- Illegal income in the foreign account

### Factors tending to show non-willfulness



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## FBAR Penalty Memorandum

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- Counsel reviews all FBAR penalty proposals to determine whether the evidence supports the penalty the proposed penalty
- Examiner prepares a memorandum for Counsel to summarize the evidence that support the proposed FBAR penalty (bullet or narrative form)
- For unagreed FBAR penalty cases, Appeals also will refer to this memorandum
- For cases where the person contests the FBAR penalty assessment, may be used in the court proceedings



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At the conclusion of all FBAR penalty investigations where the examiner proposes an FBAR penalty, either the willful penalty or the non-willful penalty, Counsel needs to review to the proposed FBAR penalties to determine whether the evidence gathered by the examiner is sufficient to sustain the proposed FBAR penalties.

To assist Counsel in this task, the examiner should prepare a memorandum to summarize the evidence that supports the penalty assessment. This memorandum can be in either bullet or narrative form, or a combination of the two forms. Often it is often better to summarize the evidence using bullets, and then use a narrative to explain how the evidence supports the proposed penalty assessments.

For unagreed FBAR cases where the person protests the penalties, the FBAR penalty memorandum will provide Appeals with a summary of the penalty case.

In the event the IRS assesses the FBAR penalties, and the person contests the assessments, the FBAR penalty memorandum will assist with preparing the case for the court.

## FBAR Penalty Case Workpapers

- FBAR penalty case separate from the income tax cases
- Where appropriate, include copies of relevant Title 26 information, including information to show tax deficiencies
- Organized and indexed workpapers are easier to follow, particularly if the penalty assessment goes to trial
- Must address each element of the penalty



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The FBAR penalty case file is separate from the related income tax examinations or Title 26 penalty cases. The FBAR penalty case and the income tax cases may follow separate processing paths so it is important to include in the FBAR penalty case copies of all the relevant information from the Title 26 case files, including information to show the amounts of the tax deficiencies.

As with all cases, well organized and indexed workpapers are easier to follow. Also keep in mind that, if the FBAR penalty assessment goes to trial, the workpapers in the FBAR penalty case file will be an important part of the government's FBAR penalty case.

The workpapers must address each element of the FBAR reporting requirements. We will discuss these elements shortly. Examiners should consider organizing their workpapers according to these elements.

## Step 1: Prove a Violation Exists

- To assert any FBAR penalties, the examiner must prove that there was an FBAR violation
- The examiner must prove each of the statutory requirements to file an FBAR:
  - A U.S. person
  - With a financial interest in, or signature or other authority over
  - Foreign financial accounts
  - The aggregate value of which exceeded \$10,000 at any time during the calendar year



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The FBAR penalty investigation is a two-step process. First, the examiner needs to prove that the person failed to file the report mandated by the statute. Second, the examiner must prove the appropriate penalty to assert.

To prove that a person failed to comply with the law, the examiner must prove that the person had a reporting requirement under the statute and that the person failed to comply with the statute.

To prove that the person had filing requirement, the examiner must:

Prove the person is a U.S. Person.

Prove the person had a financial interest in, or signature or other authority over one or more accounts.

Prove that each account was a foreign financial account.

Prove the aggregate balance of the foreign financial accounts exceeded \$10,000 at any time during the calendar year.

## Step 2: Prove the Appropriate Penalty

- Once the examiner proves there is a statutory violation, the examiner must determine the appropriate penalty to assert, if any
- The burden of proof is on the government
  - To assert a willful penalty, the examiner must prove the person knew of the requirement to file an FBAR and voluntarily, intentionally, failed to file an FBAR
  - To assert a non-willful penalty, the examiner must determine whether the person had reasonable cause for failing to file the FBAR
- The evidence must support the penalty



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Once the examiner proves the person had a statutory reporting requirements and that the person failed to file the FBAR, the examiner must then determine the appropriate penalty to assert, if any.

In all penalty cases, the burden of proof is on the government.

To assert a willful penalty, the examiner must prove the person knew of the requirement to file an FBAR and voluntarily, intentionally, failed to file an FBAR.

To assert a non-willful penalty, the examiner must determine whether the person had reasonable cause for failing to file the FBAR.

The evidence gathered by the examiner must support the proposed penalty assessment.

## FBAR Case Study

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Read XYZ Case – Summary of Facts

- Are there leads to other sources of information?



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## FBAR Case Study

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### Read XYZ Case: Revenue Agent Unagreed Report – Key Points

- ◆ Do you believe the agent gathered sufficient evidence to support the following statements:
  - “It is determined that TP had knowledge of the reporting requirements.”
  - “TP’s conscious choice not to comply with the known FBAR requirements.”



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## FBAR Case Study

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Read XYZ Case – Counsel Response #1

- Do you agree with Counsel's Opinion?



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## U.S. Person

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### Must prove the person is a U.S. Person

- United States passport with photo and passport number
- Statement by person that shows he is a U.S. citizen
- IDRS CC DDBKD has citizenship indicator (code “A”)
- Statement by person that he was U.S. resident for each year
- Proof of presence inside the United States for each year
  - Driver’s license address
  - Addresses on IDRS
  - Voting registration records
  - Witness interviews (return preparer, family members, etc.)



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We need to prove that the person had a requirement to file an FBAR for a specific calendar year. Although this may seem obvious, you need to secure proof that the person was either a U.S. citizen or a resident of the United States during the calendar year. This should not be difficult to prove, but you need something in the case file to prove this simple fact.

A copy of the person’s United States passport, with a photograph of the person and the passport number, is good proof of citizenship. It is better if you made the copy of the passport, but a copy made by a third party may be sufficient.

A statement by the person that shows he is a U.S. citizen, either an admission of citizenship, or a statement about the location of the person’s birth, is acceptable.

IDRS command code DDBKD contains information from the Social Security Administration about the citizenship of the person associated with the Social Security Number; citizenship code “A” means the person is a U.S. citizen.

If the person is not a U.S. citizen, or we cannot prove the person is a U.S. citizen, then we need to prove that the person was a resident of the United States during each year for which there is an FBAR violation. A direct statement by the person about residency status is the best evidence, but other ways to show residency are addresses on a driver’s license, IDRS addresses, voting registration records, and statements by other witnesses, such as the return preparer or family members, about their knowledge of the where the person lived during the relevant years.

## Financial Interest/Signature Authority

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- Statements made in OVDI disclosures are likely sufficient to prove ownership
- For cases with UBS records, the records should show ownership, although we need to support the UBS records with other evidence
  - Verify signatures on UBS bank documents
- Transfers between the foreign account and a U.S. account may be evidence of a financial interest in the account



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## Foreign Financial Account

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- Is the account located outside the United States?
- What is the address of the bank shown on the bank statements or bank documents?
- Are the bank statements and other documents in a foreign language?
- Format of the date
  - DD-MM-YYYY as in Europe?
  - MM-DD-YYYY as in the United States?
- Location of banker



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Yes, this is a serious issue that you must address. UBS has a branches located throughout the United States. The fact that a person has a bank account with UBS is not proof that the bank account is a foreign bank account subject to reporting on an FBAR.

The easiest way to verify the location of the bank account is to inspect the UBS bank records. Is the bank address in bank records, or on the bank statements, located outside the United States?

Are the bank statements or bank documents in a language other than American English?

What is the format of the date? Is the format Day-Month-Year, as used in Europe, or Month-Day-Year as used in the United States?

If there are banker notes or other notes in the case file, can you determine the location of the parties who wrote the notes? Are the notes in American English? If the notes were written in a foreign language, or the person who wrote the notes is located outside the

United States, it is highly likely that the associated account is a foreign bank account.

## Aggregate Balance Exceeds \$10,000

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- Compute the maximum balance of each foreign bank accounts
- Where necessary, convert the maximum balance to U.S. Dollars using the appropriate conversion rate
- When proposing to assess the willful penalty, compute the balance of each account on the due date of the FBAR



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The final statutory requirement that you must prove is that the aggregate balance of the foreign accounts exceeded \$10,000 during the calendar year.

Based upon the bank statements you should be able compute the maximum balance of each foreign bank account in the currency of that account and, where necessary, the maximum balance of each account converted into U.S. Dollars.

Add together the maximum balances of all accounts to show that the aggregate balance of the foreign accounts exceeds \$10,000.

Also, for any account subject to FBAR reporting where you intend to assert the willful FBAR penalty, you need to show the balance of that account on June 30 of the year following the reporting year. Just to refresh your memory, the willful FBAR penalty is based upon the value in the account on the date of violation.

## Propose an FBAR Penalty

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- The examiner and group manager have discretion to propose an appropriate penalty based upon the facts of the case
- Explain deviations from the FBAR mitigation guidelines
- Compute the proposed FBAR penalties



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Once you have shown both that the person had a requirement to file an FBAR and that the person failed to file the FBAR, you need to determine the appropriate penalty. Under the FBAR penalty mitigation guidelines, the examiner and group manager have the discretion to propose an appropriate penalty based upon the specific facts of the case.

Where it is appropriate to deviate from the FBAR mitigation guidelines, the examiner and group manager need to explain the reasons for the deviations, regardless of whether the proposed penalty is an amount that is greater than, or less than, the amount penalty under the FBAR mitigation guidelines.

The examiner must also compute the amount of the proposed penalty.

The rest of this presentation discusses what type of evidence is necessary to sustain both willful and non-willful FBAR penalties.

## Willful FBAR Penalties

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- The primary difference between willful and non-willful FBAR penalties is the degree of fault by the person
- Willful is a voluntary, intentional violation of a known legal duty
  - Had knowledge of the requirement to file an FBAR
  - Chose not to file the FBAR
- To elevate the violation to willful, need affirmative acts by the person to conceal the account



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There are two FBAR penalties, one for willful violations and one for non-willful violations. The primary difference between willful conduct and non-willful conduct is the degree of fault of the person who failed to file the FBAR.

The general definition for willful is the voluntary, intentional violation or disregard of a known legal duty. Notice that the two important concepts in the definition of willfulness are knowledge and intent.

With respect to FBAR filing requirements, a person acted willfully if he had knowledge of the requirements to file an FBAR and chose not to file the FBAR.

Absent direct proof that the person knew he had to file an FBAR, you will need to identify affirmative acts by the person to conceal the foreign account to elevate the FBAR penalty from non-willful to willful. There mere fact that a person failed to file an FBAR is, by itself, not an indication of willfulness.



## Proving Willfulness

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- Direct evidence is the best proof of willfulness
  - Person admits to the agent that he knew of the filing requirement but did not file anyway
  - Person admits to a third party that he knew of the filing requirement but did not file anyway
- Circumstantial evidence may infer knowledge
  - Previous FBAR filing, warning letter, penalty assessment
  - Reporting only foreign accounts with low balances or located in non-secrecy countries
  - Need to address other motives for concealing the account
- Not necessary to prove an improper motive



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## Willful Blindness

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- Willful blindness is a voluntary, intentional, reckless failure to discover a legal duty (willful ignorance, intentional avoidance, blatant ignorance)
  - Rely upon circumstantial evidence
  - Evidence subject to different interpretations
- Show the person was in a position to acquire knowledge
- Weakness: Person argues he did not know or have reason to know that he had to report the account



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## Willful Blindness, continued

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- Key factors
  - Extra-ordinary acts or complexity to conceal the account
  - A desire not to contradict strong beliefs or desires
  - Bad faith
- In the FBAR penalty memorandum, the examiner must make the case for willful blindness
  - Link the facts
  - Tell a story
  - Argue weight of evidence
  - Failing to report was necessary to carry-out the plan



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The success of a willful blindness case will depend upon three basic factors: first, did the person take extra-ordinary or complex actions to conceal his ownership of the foreign account; second, would disclosing the existence of the account either violate the person's stated reasons for having the account or conflict with strongly-held beliefs; third, taking into account all of the actions of the person, did the person act in bad faith with respect to the foreign account. We are going to discuss these factors in the next few slides. Keep in mind that not all these factors will apply in every case.

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## Willful Blindness – Extraordinary Acts

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- Purpose of the account
  - Why not a U.S bank account
  - Equivalent of a cash hoard
- **Probe any statements by the person about financial privacy**
- Source of the funds on the account
- Steps to conceal the account
  - Create foreign entities (tiered entity structure); Why?
  - Who provided the advice
  - How did the person access the account (travel, wire transfers)
- Passive beneficiaries have comparably less willfulness



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## Willful Blindness – Contradict Beliefs

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- If the person is not a natural-born U.S. citizen
  - Tax system in the country of origin
  - Steps to take to become familiar with U.S. laws
- Does business in foreign countries?
- Compliance with state or local laws
- Other indications that indicate the person disagrees with disclosing information to the government



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## Willful Blindness – Contradict Beliefs

- Conclusions on taxability of income
  - Basis for belief
  - Who consulted (is foreign person qualified)
  - Compare and contrast source of advice with other sources of advice in other areas
  - Second opinions
- Disclose foreign account to return preparer or other tax professional
  - U.S. bank accounts, but not foreign accounts
  - Did return preparer ask about foreign accounts
  - Foreign accounts question on Sch. B, Form 1040



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The slide deals with the basic relationship between the person and the tax return preparer, from the point of view of the person. Later in this presentation we are going to discuss importance of gathering evidence from the tax return preparer to explore the relationship from the point of view of the tax return preparer.

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## Willful Blindness – Bad Faith

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- May be related to other reasons to conceal account
- May be able to impeach the person and reduce credibility
- Civil or criminal fraud
- Less than full disclosure of facts to professionals who would be in a position to advise the person of his reporting requirements
  - The professional's knowledge of a filing requirement is not relevant
  - The reason for the person to consult the professional is relevant
- Length of time of failure to report the account



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## Helpful Treaty Records

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- Identify treaty documents
- Try to verify documents created by UBS
- Form A



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Where you have bank records secured under the tax treaty, it is important that you identify all treaty documents that you attach to the FBAR penalty memorandum that you send to Counsel. Although all of the documents have a stamp to identify them as treaty records, some do not have any other indication that they came from UBS. The penalty memorandum should identify the source of all documents attached to it.

If you are using documents created by UBS, for example the monthly balances summary, to support the FBAR penalty computation, you should try to verify the accuracy of the document. A bank statement is better evidence to show the balance in the account than a document created by UBS. Of course, if UBS did not provide all of the bank statements, then the UBS-created document becomes the best evidence available.

Form A, if present, is a very good document to show that the person added a layer of anonymity to an already secret arrangement.



# Return Preparer Interview

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# Taxpayer Interview

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## SB/SE Offshore Resources

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SB/SE has three senior program analysts within the Abusive Transactions and Technical Issues function, ATTI for short, who specialize in offshore issues, including FBAR penalty investigations:

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