MSP #8

The IRS's Offshore Voluntary Disclosure Programs Discourage Voluntary Compliance by Those Who Inadvertently Failed to Report Foreign Accounts

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DEFINITION OF PROBLEM

The Bank Secrecy Act (BSA) requires U.S. citizens and residents to report foreign accounts on Form TD F 90–22.1, *Report of Foreign Bank and Financial Accounts* (FBAR) so the government can better detect "bad actors" engaged in tax evasion, terrorism, and money laundering.[1] Beginning in 2009, the IRS initiated a series of offshore voluntary disclosure (OVD) programs to settle with taxpayers who had failed to report offshore income and file any related information return such as the FBAR: the 2009 Offshore Voluntary Disclosure Program (OVDP), 2011 Offshore Voluntary Disclosure Initiative (OVDI), and the open-ended 2012 OVDP.[2] As discussed in prior reports, these programs applied a resource-intensive, burdensome, punitive, one-size-fits-all approach designed for "bad actors" to "benign actors" who inadvertently violated the rules.[3]

While an estimated five to seven million U.S. citizens reside abroad, and many more U.S. residents have FBAR filing requirements,[4] the IRS received only 741,249 FBAR filings in 2011, and as of September 29, 2012, it had received fewer than 28,000 OVD submissions from FBAR violators.[5] Thus, significant FBAR filing compliance problems likely remain unaddressed.

1 *See generally* 31 U.S.C. § 5321(a)(5); 31 C.F.R. § 1010.350; Internal Revenue Manual (IRM) 4.26.16 (July 1, 2008); Joint Committee on Taxation (JCT), JCS-5-05, *General Explanation of Tax Legislation Enacted in the 108th Cong*. 377-78 (May 2005).

2 IRS, *Voluntary Disclosure: Questions and Answers*, http://www.irs.gov/uac/Voluntary-Disclosure:-Questions-and-Answers (first posted May 6, 2009) [hereinafter "2009 OVDP FAQ"]; IRS, *2011 Offshore Voluntary Disclosure Initiative Frequently Asked Questions and Answers*, http://www.irs.gov/Businesses/International-Businesses/2011-Offshore-Voluntary-Disclosure-Initiative-Frequently-Asked-Questions-and-Answers (first posted Feb. 8, 2011) [hereinafter "2011 OVDI FAQ"]; *IRS, Offshore Voluntary Disclosure Program Frequently Asked Questions and Answers*, http://www.irs.gov/Individuals/International-Taxpayers/Offshore-Voluntary-Disclosure-Program-Frequently-Asked-Questions-and-Answers (first posted June 26, 2012) [hereinafter "2012 OVDP FAQ," or collectively the "OVD programs"].

3 National Taxpayer Advocate 2011 Annual Report to Congress 191-205; *Id*. at 206-72; National Taxpayer Advocate 2013 Objectives Report to Congress 7-8; *Id*. at 21-29. *See also* Taxpayer Advocate Directive 2011-1 (Aug. 16, 2011).

4 National Taxpayer Advocate 2009 Annual Report to Congress 144.

5 IRS response to TAS information request (July 27, 2012); IRS response to TAS information request (Sept. 23, 2012).

In addition to problems identified in prior reports, the National Taxpayer Advocate is concerned that the IRS has:

- Increased the cost and burden of correcting past violations, as well as the IRS resources required to process these corrections, by continuing to require benign actors to opt in and opt out of OVD programs — even though processing times are longer for those who opt out, averaging nearly 550 days for the 2009 program;
- Increased the burden of reporting foreign accounts in the future by requiring duplicative reporting on the FBAR and Form 8938, *Statement of Specified Foreign Financial Assets*; and
- Discontinued pilot programs to send information about the foreign account reporting requirements to people with foreign accounts.

However the IRS recently reduced the burden of correcting errors somewhat. It clarified that some taxpayers could opt out of the OVD programs without penalty. A new initiative also allows some nonresidents to correct errors outside of the OVD programs.

As the IRS receives an increasing amount of information from foreign financial institutions that will enable it to identify more FBAR noncompliance, however, it may need to devote more enforcement resources to address this noncompliance; expand its outreach and self-correction options for benign actors; or ignore the noncompliance altogether. The IRS should promote voluntary compliance by reducing compliance burdens and expanding its targeted outreach and self-correction options for benign actors.

ANALYSIS OF PROBLEM

IRS OVD programs discouraged taxpayers from self-correcting errors, burdening taxpayers and draining IRS resources.

Taxpayers may normally correct their own inadvertent violations without significant penalties or burdens.

The maximum civil penalty applicable to a bad actor for "willfully" failing to report foreign accounts on an FBAR is severe — the greater of 50 percent of the account or $100,000 per year.[6] However, the IRS does not generally apply a significant penalty to benign actors who inadvertently fail to report accounts, particularly if they voluntarily correct the violation(s) before the IRS contacts them.[7]

6 31 U.S.C. § 5321(a)(5)(C).

7 *See, e.g.*, IRM 4.26.16.4.7 (July 1, 2008). Unlike citizens of most other countries, U.S. citizens with income above certain thresholds are required to file returns with the IRS even if they reside abroad and have no net U.S. tax liability. *See, e.g.*, IRC § 6012(a)(flush) and (c). The FBAR and the new Form 8938 may help the government to detect potentially unreported income deposited in foreign accounts.

In addition, those who failed to report income could normally avoid accuracy-related penalties by filing "qualified amended returns" before being contacted by the IRS.[8] Thus, in the absence of any special IRS program, a taxpayer could correct a failure to report a foreign account and income from the account while avoiding most penalties by simply filing three (or six) years worth of returns (or amended returns) and FBARs.[9] This approach encourages voluntary compliance and self-correction, which is the IRS's stated goal.[10]

The IRS OVD programs discourage self-correction.

The IRS "strongly encouraged" everyone with an FBAR violation and unreported income (including benign actors) to participate in its OVD programs and initially discouraged them from opting out.[11] For example, IRS FAQs indicated:

> Those taxpayers making "quiet" disclosures should be aware of the risk of being examined and potentially criminally prosecuted for all applicable years. 2009 OVDP FAQ #10; 2011 OVDI FAQ #15; 2012 OVDP FAQ #15.
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> ***
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> Taxpayers who do not submit a voluntary disclosure run the risk of detection by the IRS and the imposition of substantial penalties, including the fraud penalty and foreign information return penalties, and an increased risk of criminal prosecution. 2009 OVDP FAQ #3; 2011 OVDI FAQ #4; 2012 OVDP FAQ #4.
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> Failing to file an FBAR subjects a person to a prison term of up to ten years and criminal penalties of up to $500,000. 2009 OVDP FAQ #14; 2011 OVDI FAQ #6; 2012 OVDP FAQ #6.
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> ***
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> [For those who opt out of the 2009 OVDP] All relevant years and issues will be subject to a complete examination. At the conclusion of the examination, all applicable penalties (including information return and FBAR penalties) will be imposed. Those penalties could be substantially greater than the 20 percent penalty. 2009 OVDP FAQ #34.
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8 *See* Treas. Reg. § 1.6664-2. Certain deductions and credits may be denied if returns from individuals who are not U.S. residents or citizens are more than 16 months late or if returns from foreign corporations are more than 18 months late, provided the taxpayer does not demonstrate reasonable cause for the delay. *See* IRC §§ 874(a) (applicable to individuals) and 882(c)(2) (applicable to corporations); Treas. Reg. §§ 1.874-1 and 1.882-4.

9 The statutory period for assessing additional tax is generally limited to three or six years from the date the return is filed. *See* IRC § 6501.

10 IRS Policy Statement 6-11 (Nov. 4, 1977) ("[A]dministrative procedures and forms will be designed to promote voluntary compliance."); IRS Policy Statement 20-1 (June 29, 2004); H.R. Conf. Rep. No. 101-386 at 661 (1989) ("the IRS should develop a policy statement emphasizing that civil tax penalties exist for the purpose of encouraging voluntary compliance.").

11 2009 OVDP FAQ #10; 2011 OVDI FAQ #15; 2012 OVDI FAQ #12.

> [Q] Is the IRS really going to prosecute someone who filed an amended return and correctly reported all their income? ... [A] When criminal behavior is evident and the disclosure does not meet the requirements of a voluntary disclosure under IRM 9.5.11.9, the IRS may recommend criminal prosecution to the Department of Justice. 2009 OVDP FAQ #49.

Because of these threats, many taxpayers were concerned that the IRS would always seek the maximum FBAR penalties, regardless of the situation. As described in prior reports, some benign actors were so fearful of opting out that they accepted the IRS settlement and paid more than they owed.[12] Moreover, since the Deputy Commissioner partially rescinded a Taxpayer Advocate Directive (TAD) aimed at assisting these taxpayers, and the IRS Commissioner responded to the National Taxpayer Advocate's concerns with deafening silence, TAS has observed less flexibility among IRS examiners and OVD program managers in dealing with benign actors.[13] Under these circumstances, some taxpayers are likely to ignore their problems until the IRS offers them a reasonable way to correct inadvertent errors.[14]

IRS OVD programs were burdensome for benign actors and drained IRS resources.

The OVD programs require benign actors to opt in and then opt out. OVD program participants must file (or amend) eight years of returns; wait for the IRS to process the applications; and then either (1) pay various penalties plus an "offshore" penalty equal to 20, 25, or 27.5 percent of their unreported offshore assets;[15] or (2) "opt for an examination" by "opting out" and risk unreasonably large FBAR penalties.[16]

As shown below, OVD program processing times are longer for benign actors who opt out, averaging nearly 550 days for those opting out of the 2009 OVDP.

12 *See, e.g.*, National Taxpayer Advocate 2011 Annual Report to Congress 238-41.

13 *See* Memorandum for National Taxpayer Advocate from Deputy Commissioner for Services and Enforcement, *Taxpayer Advocate Directive 2011-1* (Oct. 14, 2011); Memorandum for Commissioner of Internal Revenue from National Taxpayer Advocate, *Recommendations Regarding Taxpayer Advocate Directive 2011-1* (Sept. 26, 2011). For further discussion of this issue, see National Taxpayer Advocate Fiscal Year 2013 Objectives Report to Congress 8-9.

14 *See e.g.*, Alison Bennett, *Tax Evasion: Taxpayers Fear Disclosing Offshore Assets As Deadline Approaches, Practitioners Say*, 157 DTR GG-1, 2011 (Aug. 15, 2011); Robert Wood, *Should You File FBAR for the First Time?*, Forbes (June 14, 2011), http://www.forbes.com/sites/robertwood/2011/06/14/should-you-file-fbar-for-the-first-time/; Steven Mopsick, *Tax Justice for Americans Abroad: No Penalties for Prospective Compliance*, 136 Tax Notes 189 (July 9, 2012).

15 Certain taxpayers could qualify for an offshore penalty rate of 5 percent or 12.5 percent. 2011 OVDI FAQ #52 and #53; 2012 OVDP FAQ #52 and #53.

16 *See* 2011 OVDI FAQ #42; 2012 OVDP FAQ #42; 2009 OVDP FAQ #34. *But see* Memorandum from Deputy Commissioner for Services and Enforcement, *Guidance for Opt Out and Removal of Taxpayers from the Civil Settlement Structure of the 2009 OVDP and the 2011 OVDI* (June 1, 2011) ("the taxpayer should not be treated in a negative fashion merely because he or she chooses to opt out . . ."; 2012 OVDP FAQ #51 (same).

TABLE 1.8.1, OVD Program Applications, Dispositions, and Processing Time as of September 29, 2012[17]

	2009 OVDP		2011 OVDI		2012 OVDP
	Number	Average Processing Time (closed cases)	Number	Average Processing Time (closed cases)	Number
Total applicants[18]	11,161		11,941		4,095
Closed after certification	10,723	307.3 days	1,463	116.6 days	0
Open certification	63		10,417		4,095
Opted out	280		30		0
Closed after opt out	235	548.4 days	8	176.5 days	0
Open after opt out	38	647.4 days	22	173.4 days	0
Removed	105		0		0
Closed after removal	79	583.9 days	0	n/a	0
Open after removal	24	711.1 days	0	n/a	0

Although the IRS has not closed very many opt-out cases, the average civil FBAR penalty assessed against those opting out of the 2009 OVDP is only $15,737.[19] Moreover, the IRS has not initiated any criminal prosecutions against those who opted out.[20] In other words, the IRS required benign actors with minor FBAR violations to spend the time to apply to the 2009 OVDP, incur significant fees for representation, and wait for about a year and a half for the IRS to process their cases (on average), all in an effort to collect very little FBAR penalty revenue.

While benign actors would normally have made "quiet" corrections, rather than participate in the OVD programs, the IRS warned them **not** to do so. This approach left the taxpayers with no good options — and discouraged voluntary compliance — while committing the IRS to use limited enforcement resources to process a potentially large number of submissions.[21]

People with Canadian retirement plans faced additional burdens.

People with certain Canadian retirement plans who wanted to file late or amended U.S. tax returns, as required for participation in an OVD program, faced additional burdens. The IRS issued conflicting guidance about how to make a late election to exclude undistributed

17 IRS response to TAS information request (Oct. 23, 2012).

18 The number shown for the 2009 OVDP and the 2011 OVDI counts an application from a husband and wife as one application, but the number shown for the 2012 OVDP counts them as two.

19 IRS response to TAS information request (Oct. 23, 2012) (noting that $1,255,567 in willful and nonwillful penalties plus $1,671,518 in negligence penalties were assessed against taxpayers who opted out of the 2009 OVDP in 186 closed cases). Moreover, a small number of taxpayers could account for most of these penalties.

20 *Id.*

21 Although the IRS has not processed very many opt out requests, the average civil FBAR penalty assessed against those opting out of the 2009 OVDP is only $15,737 ($1,255,567 in willful and nonwillful penalties plus $1,671,518 in negligence penalties, divided by 186 closed cases). IRS response to TAS information request (Oct. 23, 2012). Moreover, the IRS has not initiated any criminal prosecutions against those who opted out. *Id.*

income from those plans.[22] Under Revenue Procedure 2002-23, if taxpayers do not make these elections by attaching them to a timely-filed U.S. income tax return, they are late, and the IRS will not accept late elections unless the taxpayer obtains a private letter ruling (PLR).[23] Some taxpayers spent significant time and resources to obtain a PLR, as shown below.[24]

TABLE 1.8.2, PLR Requests Under Section 4.06 of Rev. Proc. 2002-23, FY 2009-2012[25]

Fiscal Year	2009	2010	2011	2012
Total Requests	18	6	134	35
Average User Fee	$ 4,500	$1,083	$ 728	$1,489
Average Processing Time[26]	149 days	133 days	165 days	120 days
Number Issued	18	6	17	4
Number Denied/Returned[27]	1	0	0	0
Number Withdrawn	0	0	0	0
Number Open[28]	0	0	117	31

However, the IRM suggested that the IRS would simply process late elections without a PLR.[29] Thus, the IRS treated similarly-situated taxpayers differently.

Pursuant to 2012 OVDP FAQ #54, the IRS recently provided entirely different instructions for making late elections. Although FAQ #54 may reduce burden for some, it will confuse others, as the IRS has issued three conflicting statements about how to make a late election. This confusion is compounded by the fact that neither the taxpayer-friendly IRM nor FAQ #54 represent formal guidance. Moreover, those who have already paid to prepare a PLR submission may incur additional fees to make a different submission pursuant to FAQ #54.[30]

22 *See* Form 8891, *U.S. Information Return for Beneficiaries of Certain Canadian Registered Retirement Plans.*

23 Rev. Proc. 2002-23, 2002-1 C.B. 744.

24 To put these figures in context, a Westlaw search revealed the IRS issued only 1,487 PLRs in 2011.

25 IRS response to TAS information request (July 25, 2012).

26 Processing time reflects the days in inventory for rulings issued during the year.

27 One PLR request was returned because it was not necessary.

28 The open cases were suspended pending resolution of consistent treatment under the OVDI program. We understand the IRS is returning the user fees.

29 Rev. Proc. 2002-23, §§ 4.01 and 4.06, 2002-1 C.B. 744; Treas. Reg. §§ 301.9100-1 and -3; IRM 21.5.3.4.9.1 (Aug. 4, 2009) ("For retroactive elections... Process the amended return as normal."). The IRS does not track the number of Form 8891 submissions or the number processed late. IRS response to TAS information request (July 27, 2012).

30 *See* Marie Sapirie, *Frustration Grows for Canadians in OVDI*, 2012 Tax Notes Today 169-1 (Aug. 29, 2012).

The IRS has recently reduced the burden of correcting errors for some taxpayers.

The IRS issued a "fact sheet," clarifying that nonresidents who opt out of the OVD programs will not always face penalties.

In December 2011, the IRS clarified that, for nonresidents, it would not always impose FBAR penalties if the taxpayer could establish a "reasonable cause."[31] While this clarification was helpful, it provided little comfort to many with inadvertent violations, because establishing reasonable cause is sometimes difficult. For example, it is difficult to establish reasonable cause for failure to file an income tax return because the law assumes nearly every U.S. citizen knows about the obligation to file an income tax return.[32] By contrast, the FBAR filing requirement was relatively unknown until recently, but the IRS fact sheet does not explicitly make it easier for taxpayers to establish reasonable cause for failure to file an FBAR. For example, the taxpayer does not necessarily have reasonable cause if tax preparation software or a tax preparer failed to ask the taxpayer about foreign accounts.[33] The government expects the taxpayer to review the tax return that references FBAR reporting, expects this review to cause the taxpayer to file an FBAR, and may even assume that any failure to file an FBAR is thus due to willful blindness.[34] Even if a preparer affirmatively advised the taxpayer not to report a foreign account or the income from it, the taxpayer is likely to have difficulty getting the preparer to sign a statement acknowledging the inaccurate advice.[35] However, the IRS may require such a signed statement before it will make a reasonable cause determination. Thus, some people with inadvertent violations may not be able to establish reasonable cause.

The IRS recently established a process to allow nonresidents to make self-corrections outside of the OVD programs.

Under a new program, beginning September 1, 2012, nonresident nonfilers have the option of filing three years of delinquent returns (and six years of FBARs) without triggering penalties (the "Streamlined Nonresident Filing Initiative").[36] If each return reports less than $1,500 in additional tax due and the IRS deems them "simple," absent "high risk factors," the returns will be classified "low risk" and will not be examined. Participants are ineligible for the 2012 OVDP.

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31 IRS, FS-2011-13, *Information for U.S. Citizens or Dual Citizens Residing Outside the U.S.* (Dec. 2011), http://www.irs.gov/uac/Information-for-U.S.-Citizens-or-Dual-Citizens-Residing-Outside-the-U.S.

32 *See, e.g., United States v. Boyle*, 469 U.S. 241 (1985).

33 "Factors that might weigh in favor of a determination that an FBAR violation was due to reasonable cause include reliance upon the advice of a professional tax advisor **who was informed of the existence of the foreign financial account**, that the unreported account was established for a legitimate purpose and there were no indications of efforts taken to intentionally conceal the reporting of income or assets, and that there was no tax deficiency (or there was a tax deficiency but the amount was de minimis) related to the unreported foreign account." IRS, FS-2011-13, *Information for U.S. Citizens or Dual Citizens Residing Outside the U.S.* (Dec. 2011) [emphasis added]; Treas. Reg. § 1.6664-4 (reliance on tax advisor not reasonable if the taxpayer "fails to disclose a fact that it knows, or reasonably should know, to be relevant to the proper tax treatment of an item").

34 IRM 4.26.16.4.5.3 (July 1, 2008).

35 A benign actor with nothing to hide might have been less likely to question a preparer's advice or ask for a contemporaneous written opinion about the FBAR filing requirement.

36 IRS, *New Filing Compliance Procedures for Non-Resident U.S. Taxpayers* (first posted June 28, 2012), http://www.irs.gov/Individuals/International-Taxpayers/New-Filing-Compliance-Procedures-for-Non-Resident-U.S.-Taxpayers.

Because the IRS has provided little guidance about what makes a return "high risk," participants may still be subject to a full examination and potentially severe penalties, making the new program less attractive. Moreover, the IRS has not provided any similar self-service options for benign actors who are U.S. residents or owe more than $1,500.[37] The IRS should increase the threshold and allow U.S. residents to participate.[38] Nonetheless, this program is likely to reduce the burden on many nonresidents as well as on the IRS.

New duplicative reporting requirements make compliance more burdensome, and "stack" penalties.

Beginning in 2012, those with certain foreign financial assets in excess of $50,000 must report foreign account information (and certain other foreign financial asset information) on IRS Form 8938, *Statement of Specified Foreign Financial Assets*.[39] Form 8938 is sometimes called the "Tax FBAR" or "Super FBAR" because, as the Government Accountability Office (GAO) has observed, it duplicates much of the information required on the FBAR, though it is due with the return rather than on June 30, the due date for the FBAR.[40] In addition, a taxpayer who fails to report a single account on both forms could face two sets of penalties — the FBAR penalty under Title 31 and the Super FBAR penalty under Title 26.

Many benign actors still have not filed FBARs.

The IRS should be reducing (rather than increasing) the burden of correcting prior noncompliance and the burden of reporting foreign accounts in the future, given the existing compliance problem. While an estimated five to seven million U.S. citizens reside abroad and many U.S. residents also have FBAR filing requirements,[41] the IRS received only 741,249 FBAR filings in 2011.[42] In the face of what may be a serious FBAR compliance

37 For a description of some benign actors who are U.S. residents, see for example, Steve Mopsick, *Tax Justice II: No FBAR Penalties For Otherwise Compliant Recent Immigrants to the United States* (Aug. 2, 2012), http://mopsicktaxlaw.blogspot.com/2012/08/tax-justie-ii-no-fbar-penalties-for.html.

38 The National Taxpayer Advocate previously recommended increasing the $1,500 threshold to the "substantial understatement" threshold. National Taxpayer Advocate 2013 Objectives Report to Congress 24. Individuals who owe less than the greater of 10 percent of the tax required to be shown on the return or $ 5,000 may not have a "substantial understatement," and thus, may not be subject to an accuracy-related penalty, particularly if a negligence penalty does not apply. IRC § 6662(d). When the substantial understatement penalty applies due to an undisclosed foreign financial asset, the penalty rate increases from 20 to 40 percent. *See* IRC § 6662(j). Thus, there is precedent for using the combination of a substantial understatement and nondisclosure to distinguish minor omissions from those that may warrant more significant sanctions. Of course, we would still need to consider how to handle those who had not filed returns, as they would not have a substantial understatement.

39 IRC §§ 6038D and 1298(f); Notice 2011-55, 2011-29 I.R.B. 53 (July 18, 2011). An FBAR is due on June 30 if the aggregate value of the foreign accounts exceeded $10,000 during the prior calendar year. 31 C.F.R. § 1010.306(c).

40 GAO, GAO-12-403, *Reporting Foreign Accounts to the IRS, Extent of Duplication Not Currently Known, but Requirements Can Be Clarified* 2, 18 (Feb. 2012). Although the IRS met with GAO and provided technical information, neither the Financial Crimes Enforcement Network (FinCen) nor the IRS responded to GAO's recommendation to revise the Form 8938 and FBAR to address duplicative reporting. *Id*. at 3.

41 IRS website, *Reaching Out to Americans Abroad* (Apr. 2009), http://www.irs.gov/Businesses/Reaching-Out-to-Americans-Abroad; W&I Research Study Report, *Understanding the International Taxpayer Experience: Service Awareness, Use, Preferences, and Filing Behaviors* (Feb. 2010) (citing U.S. Department of State data). This number does not include U.S. troops stationed abroad. Moreover, the tax gap associated with offshore accounts could be significant. *See, e.g.*, James Henry, Tax Justice Network, *The Price of Offshore Revisited* 5 (July 2012), http://www.taxjustice.net/cms/upload/pdf/Price_of_Offshore_Revisited_120722.pdf ("at least $21 to $32 trillion" may be "invested virtually tax-free through . . . more than 80 'offshore' secrecy jurisdictions").

42 IRS response to TAS information request (July 27, 2012).

problem, the government opened only 3,220 civil FBAR examinations and 18 criminal investigations in calendar year (CY) 2011.[43]

While the OVD programs attracted over 27,000 applications (perhaps less than one percent of those who did not file FBARs) and collected almost $5.5 billion, a more effective initiative could prompt significantly more taxpayers to come into compliance voluntarily.[44] The OVD programs may be prompting them to renounce U.S. citizenship instead. The number of people renouncing citizenship has risen to an all-time high — nearly quadrupling over a four-year period — from 470 in 2007 to 1,788 in 2011.[45]

The IRS stopped sending letters to educate those with foreign accounts about the foreign account reporting requirements.

IRS officials generated significant publicity about the FBAR reporting requirements by giving speeches and posting information to the IRS website.[46] Perhaps as a result, FBAR filings have more than doubled between 2008 and 2011 — from 349,667 in 2008 to 741,249 in 2011.[47] However, as noted above, this may still be only a fraction of the filings the IRS should receive.

In addition, the IRS has not conducted in-person presentations about the FBAR filing requirements in foreign countries, even in countries where it has a tax attaché and a significant number of residents are required to file.[48] This approach sends the message that the IRS will spend resources to punish, but not to educate, U.S. citizens abroad.

The IRS has also discontinued an FBAR Compliance Initiative Project to educate those with foreign bank accounts who are most likely to have FBAR violations.[49] While the Postal Service returned 22 percent of the project's letters as undeliverable, address research could help to reduce that problem.[50] In addition, the IRS has stopped work on an initiative to develop the FBAR Stop Filer Program.[51] The Stop Filer Program would send letters to

43 *Id.* This figure does not include OVD "certifications," but it does include "examinations" resulting from OVD submissions.

44 *Id.* (reporting the dollar amount); IRS response to TAS information request (Sept. 23, 2012) (reporting the number of applications).

45 The figures above reflect the number of names of expatriates published in the Federal Register.

46 IRS response to TAS information request (July 27, 2012). The IRS also recently reorganized materials on its website.

47 *Id.* For a graphic representation of the dramatic rise in Internet searches for the term "FBAR" after 2009, see http://www.google.com/trends/?q=FBAR (last visited, Sept. 21, 2012).

48 IRS response to TAS information request (Aug. 17, 2012). Nor does it plan to do so. IRS response to TAS information request (July 27, 2012). For additional discussion of this issue, *see* Most Serious Problem: *Challenges Persist for International Taxpayers as the IRS Moves Slowly to Address Their Needs, supra/infra*; National Taxpayer Advocate 2011 Annual Report to Congress 137-272 (Most Serious Problems: *Foreign Taxpayers Face Challenges in Fulfilling U.S. Tax Obligations*), 166-75 (Most Serious Problem: *Small Businesses Involved in International Economic Activity Need Targeted IRS Assistance*).

49 U.S. Department of the Treasury, *A Report to Congress in Accordance With § 361(B) of The Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001* 5 (CY 2009) ("the project remains viable . . . [but] is currently closed."). Many foreign accounts are reflected in the Web-CBRS database. *Id.* at 5.

50 In response to 117 letters, 26 were returned as undeliverable, but the IRS received 73 responses and 15 FBAR filings. IRS response to TAS information request (Nov. 2, 2012). For suggestions to reduce undeliverable mail, see *Status Update: Underfunding of IRS Initiatives to Modernize Its Correspondence Systems Undermines Taxpayers' Statutory Rights and Impedes Efficient Resource Allocation, infra*.

51 IRS response to TAS information request (Aug. 8, 2012).

taxpayers who had filed an FBAR in the prior year, but not the current year, to remind them that they may still have a filing requirement. Thus, the IRS does not send letters to educate those for whom the requirements are the most relevant.

As information reporting on foreign accounts expands, a combination of targeted soft notices and expanded self-correction options could significantly improve voluntary compliance.

Over the next few years, foreign financial institutions will begin to report more foreign accounts to the IRS, enabling the IRS to identify many more FBAR violations.[52] New Form 8938 filings may also allow the IRS to identify more taxpayers who should have filed an FBAR.[53] Yet, the IRS is unlikely to have additional resources to address FBAR violations using enforcement tools or its OVD programs. As a result, it will increasingly have to ignore violations that it can detect unless it expands the self-correction options available to benign actors. If the IRS reinstated and expanded its soft notice programs and its Streamlined Nonresident Filing Initiative to encourage more benign actors to correct inadvertent violations without draining IRS resources, it could create a win-win situation — reducing the burden for them while freeing up IRS enforcement resources to address bad actors.

CONCLUSION

In conclusion, the National Taxpayer Advocate preliminarily recommends that the IRS:

1. Expand and clarify the Streamlined Nonresident Filing Initiative to encourage all benign actors (including U.S. residents and those owing more than $1,500) to correct past noncompliance using less burdensome procedures that do not unnecessarily drain IRS enforcement resources (*e.g.*, expand and clarify who qualifies for it and further explain who will be deemed to have reasonable cause for failure to file an FBAR).
2. Send "soft" notices to educate persons with foreign accounts about the FBAR and Form 8938 reporting requirements, encouraging them to self-correct inadvertent violations, as contemplated by the FBAR Compliance Initiative Project and the FBAR Stop Filer Program.
3. Clarify how beneficiaries of Canadian retirement plans can file late or amended returns that elect to exclude undistributed income from those plans by issuing formal guidance to consolidate the seemingly inconsistent guidance provided by Revenue Procedure 2002-23, 2002-1 C.B. 744 (requiring a PLR), IRM 21.5.3.4.9.1 (Aug. 4, 2009) (instructing employees to process late elections), and 2012 OVDP FAQ #54 (requiring a submission to an examiner) in a way that minimizes taxpayer burden.

52 Foreign financial intermediaries will soon be required to report more foreign accounts to the IRS. *See generally* IRC §§ 1471-1474; *Regulations Relating to Information Reporting by Foreign Financial Institutions and Withholding on Certain Payments to Foreign Financial Institutions and Other Foreign Entities*, 77 Fed. Reg. ¶ 9022 (Feb. 15, 2012) (notice of proposed rulemaking).

53 *See* IRC §§ 6038D and 1298(f).

4. Revise Forms 8938 and/or TD F 90–22.1 to reduce taxpayer burden and the duplicative reporting identified by the GAO.[54]

IRS COMMENTS

Global tax enforcement is a top priority at the IRS, and we have made significant progress on multiple fronts, including groundbreaking international tax agreements and increased cooperation with other governments. In addition, the IRS and Justice Department have increased efforts involving criminal investigation of international tax evasion. This combination of efforts helped support the 2009 OVDP, the 2011 OVDI, and the ongoing 2012 OVDP. The goal of these programs is to get individuals back into the U.S. tax system and to turn the tide against offshore tax evasion. The programs have given U.S. taxpayers with undisclosed assets or income offshore an opportunity to get compliant with the U.S. tax system, pay their fair share, and avoid potential criminal charges. The programs have so far resulted in the collection of more than $5.5 billion in back taxes, interest, and penalties from approximately 38,000 applicants. In addition, the programs provided the IRS with a wealth of information on various banks and advisors assisting people with offshore tax evasion, which the IRS is using to continue its international enforcement efforts.

Throughout the programs, taxpayers have had the opportunity to opt out of the settlement structure and request an examination if the taxpayer disagrees with the result provided for under the program. The opt-out procedures and additional guidance issued on June 1, 2011, clarify that, depending on the facts and circumstances, it may be preferable for a particular taxpayer to opt out of one of the programs. In addition, the IRS added frequently asked questions to provide examples of circumstances in which taxpayers may want to consider opting out of the civil settlement structure and examples of when it might be a disadvantage to opt out. The IRS also advised employees working cases that taxpayers opting out should not be treated in a negative fashion merely because he or she opted out.

The IRS has taken a number of additional steps to assist taxpayers seeking to come into compliance. Last year, to address questions from international taxpayers, the IRS issued a fact sheet[55] to assist U.S. citizens and dual citizens residing outside the U.S. understand the federal tax return and FBAR filing requirements and return to compliance. More significantly, to address additional feedback from taxpayers and stakeholders, including practitioners and organizations representing taxpayers located overseas, the IRS provided a new option — the Streamlined Filing Compliance Procedures — effective September 1, 2012, to help some nonresident U.S. taxpayers who have not been filing tax returns come

54 The National Taxpayer Advocate previously recommended increasing the FBAR filing threshold to make it consistent with the Form 8938 filing threshold. *See* National Taxpayer Advocate Fiscal Year 2013 Objectives Report to Congress 25 (noting the government could amend regulations under 31 C.F.R. § 1010.306(c) and/or change the FBAR form). She also recommended abating the penalty for the failure to file Form 8938 during the first year. *Id.* at 26. In addition, the IRS might reduce duplicative reporting by adding items reported on an FBAR to the existing list of items that taxpayers do not have to report on Form 8938. *See* Treas. Reg. § 1.6038D–7T.

55 http://www.irs.gov/uac/Information-for-U.S.-Citizens-or-Dual-Citizens-Residing-Outside-the-U.S.

into compliance. The option provides certain taxpayers who have resided outside of the U.S. since January 1, 2009, with a chance to catch up with their federal tax filing obligations if they owe little or no back taxes.

Situations of taxpayers with offshore compliance issues vary widely given the complexities of this area of tax law. While taxpayers should consult with their professional tax advisor to determine which option is the most appropriate given a taxpayer's specific facts and circumstance, the IRS did identify a number of common situations and potential solutions on IRS.gov to assist taxpayers.[56]

With regard to the recommendations in the report, the IRS notes the following.

As previously stated, in June 2012, the IRS announced new streamlined filing compliance procedures ("streamlined procedures"), effective September 1, 2012, for certain non-resident U.S. taxpayers who have failed to timely file U.S. federal income tax returns or FBARs but recently became aware of their filing obligations and now seek to come into compliance with the law. Under this program, taxpayers presenting low compliance risk will undergo an expedited review and the IRS will not assert penalties or pursue follow-up actions. In August 2012, the IRS issued streamlined procedural guidance, including submission instructions and a description of factors that, if present, suggest an increase in compliance risk level and therefore ineligibility for streamlined examination.[57] We will continue to evaluate the program and feedback received from taxpayers, practitioners, and other stakeholders to determine whether additional modifications to the program or guidance are necessary.

The IRS has taken a number of steps to educate persons with foreign accounts about the FBAR and Form 8938 reporting requirements. For example, the IRS created a comparison chart available on IRS.gov[58] to assist taxpayers in differentiating between FBAR and FATCA Form 8938 requirements. This chart has been publicized through several channels reaching U.S. filers located domestically and overseas, including the IRS Twitter account, communications by the IRS tax attachés located in U.S. consulates and embassies overseas with the assistance of the State Department, and the IRS National Public Liaison's practitioner email distribution list. The IRS will continue to share information with the public using IRS.gov and other communication vehicles to educate taxpayers regarding FBAR and FATCA filing requirements and will also continue to monitor whether additional outreach is appropriate.

In response to inquiries from taxpayers participating in one of the three voluntary disclosure programs with specified Canadian retirement plans, in June 2012, the IRS provided

56 http://www.irs.gov/Individuals/International-Taxpayers/Options-Available-to-Help-Taxpayers-With-Offshore-Interests.

57 http://www.irs.gov/uac/Instructions-for-New-Streamlined-Filing-Compliance-Procedures-for-Non-Resident-Non-Filer-US-Taxpayers.

58 http://www.irs.gov/Businesses/Comparison-of-Form-8938-and-FBAR-Requirements.

instructions for how taxpayers could make the retroactive deferral of income elections.[59] In addition, the new Streamlined Procedures incorporated instructions for addressing this issue in its submission requirements.[60] We will continue to review other available guidance to determine if additional clarification is necessary.

With respect to the perceived duplicate reporting required on Forms 8938 and TD F 90-22.1, it is important to recognize that there are two separate reporting requirements under the law with different requirements. The FBAR (TD F 90-22.1) is required under Title 31 for law enforcement purposes in addition to tax administration. As a consequence, different policy considerations apply to FBAR and other information reporting, such as the Form 8938. These are reflected in the law defining differing categories of persons required to file Form 8938 and the FBAR, different filing thresholds for Form 8938 and FBAR reporting, and differing assets (and accompanying information) required to be reported on each form. These differing policy considerations were recognized during the passage of the HIRE Act and the enactment of section 6038D, and Congress's intention to retain FBAR reporting notwithstanding the enactment of section 6038D was specifically noted in the technical explanation of the revenue provisions contained in Senate amendment 3310, The "Hiring Incentives to Restore Employment Act," Under Consideration by the Senate (Staff of the Joint Comm. On Taxation, JCX-4-10 (February 23, 2010)) (Technical Explanation) accompanying the HIRE Act. The Technical Explanation states that "[n]othing in this provision [section 511 of the HIRE Act enacting section 6038D] is intended as a substitute for compliance with the FBAR reporting requirements, which are unchanged by this provision." (Technical Explanation at p. 60.) The IRS is committed to ensuring that taxpayers understand the different reporting requirements and will continue to explore whether further coordination of the requirements is possible provided the existing legal framework.

59 *See* 2012 OVDP FAQ 54 at http://www.irs.gov/Individuals/International-Taxpayers/Offshore-Voluntary-Disclosure-Program-Frequently-Asked-Questions-and-Answers.

60 *See* instruction 7 at http://www.irs.gov/uac/Instructions-for-New-Streamlined-Filing-Compliance-Procedures-for-Non-Resident-Non-Filer-US-Taxpayers.

Taxpayer Advocate Service Comments

The National Taxpayer Advocate fully supports the IRS's goal to design initiatives and offer settlements to "get individuals back into the U.S. tax system and to turn the tide against offshore tax evasion." Its new Streamlined Nonresident Filing Initiative is a significant step in the right direction. The National Taxpayer Advocate commends the IRS for addressing tax evasion and for its web-based efforts to educate taxpayers about little-known FBAR reporting requirements that, if overlooked, can trigger massive and disproportionate civil penalties.

However, the combination of the FBAR statute and the way the IRS administers it creates the potential for such draconian penalties that many taxpayers agree to pay unwarranted amounts to avoid the possible risk of being bankrupted several times over (as described below).[61] The IRS may believe that taxpayers have the choice to opt out of its OVD programs, but many do not feel that way.

Specifically, the FBAR statute authorizes a maximum penalty of up to 50 percent of the maximum balance in each overseas account for each year of non-reporting (or, if greater, $100,000 per violation).[62] Because the statute of limitations period is six years, the maximum penalty for large accounts is essentially 300 percent of the maximum account balances (assuming a relatively constant balance).[63]

> **Example:** Assume an individual with dual U.S.-Canadian citizenship who has lived his entire life in Canada has a $1 million account in a Canadian bank. To simplify, assume further that the balance has been $1 million for each of the past six years. Because this individual has violated the FBAR reporting requirements by failing to file Form TD F 90-22.1, the amount of the penalty could be as high as $3 million — three times his total savings! The penalty may be an even greater percentage of his savings if the account value has fallen since the end of the sixth year.

The National Taxpayer Advocate is concerned that such a disproportionate civil penalty amount, particularly in the absence of clear limits on the situations in which it can be applied, is excessive to the point of possibly violating the U.S. Constitution.[64] In any event, it is certainly a scary prospect for taxpayers.

61 Research suggests the IRS's current approach may be more likely to reduce voluntary compliance and increase tax evasion. *See e.g.*, TAS Research Study, *Factors Influencing Voluntary Compliance by Small Businesses: Preliminary Survey Results*, vol. 2, *infra* (finding a correlation between tax compliance and trust in government and the views of other members of local organizations toward the IRS and the U.S. tax system).

62 31 U.S.C. § 5321(a)(5)(C).

63 A six-year statute of limitations applies to the civil FBAR penalty. *See* 31 U.S.C. § 5321(b)(1). Criminal penalties of up to $500,000 and 10 years in prison may also apply. 31 U.S.C. §§ 5321(a)(5)(C) and 5322; 31 C.F.R. § 1010.840(b).

64 *See* Steven Toscher and Barbara Lubin, *When Penalties Are Excessive – The Excessive Fines Clause as a Limitation on the Imposition of the Willful FBAR Penalty*, J. Tax Prac. & Proc. 69-74 (Jan. 2010).

Far from allaying taxpayer concerns about this statute, the IRS OVD programs magnify them. In general, the OVD programs attempted to entice taxpayers to make voluntary disclosures by offering to cap the FBAR penalty and other penalties for failure to file information returns at 20 percent (or 25 or 27.5 percent for the 2011 and 2012 OVD programs, respectively) of the highest account value during the past six years (called the "offshore penalty"). For taxpayers who believe the IRS can prove they deliberately violated the disclosure statute, this is a good deal. But what about other taxpayers for whom penalties would be negligible?

The existing FBAR statute offers such taxpayers a better deal, capping the maximum penalty at $10,000 per violation if the IRS cannot prove the violation was willful and eliminating the penalty altogether if the taxpayer can show "reasonable cause" for his or her failure to report the account(s).[65] As discussed in prior reports, 2009 OVDP FAQ #35 provided seemingly clear assurances that "[u]nder no circumstances will a taxpayer be required to pay a penalty greater than what he would otherwise be liable for under existing statutes."[66] So if a taxpayer makes a voluntary disclosure under the 2009 OVDP and argues that his failure was nonwillful or due to reasonable cause, the IRS will consider that. Right?

Not really. The IRS now says that, notwithstanding FAQ #35, those who seek to pay a lower penalty must opt out of the OVD programs and submit to a full-blown examination.[67] That examination could yield a lesser penalty — but it also could yield a greater FBAR penalty, potentially the maximum.

A big disconnect exists between the way the IRS and taxpayers view the decision to opt out. From the IRS perspective, a taxpayer who believes his failure to report the account was nonwillful or subject to the reasonable cause exception can opt for an examination where he or she can demonstrate it. "If the taxpayer really has nothing to hide, why would the taxpayer hesitate?" the IRS reasons.

But that is not how many taxpayers react. Because of the IRS's aggressive statements and enforcement measures in the foreign bank account reporting area, many taxpayers start out scared to death about criminal prosecution and the possibility of losing 300 percent or more of the value of their accounts. Most are distrustful of the IRS and are not confident

65 31 U.S.C. § 5321(a)(5)(B).

66 National Taxpayer Advocate 2011 Annual Report to Congress 191-205; *Id.* at 206-72; National Taxpayer Advocate 2013 Objectives Report to Congress 7-8; *Id.* at 21-29. *See also* Taxpayer Advocate Directive 2011-1 (Aug. 16, 2011).

67 IRS guidance says it will consider accepting a lower penalty inside the 2009 OVDP if "discussions concerning the assertion of an offshore penalty lower than 20 percent have taken place with a TA, Territory Manager, Group Manager, Counsel, or member of the national team (*i.e.* during a case assistance visit) and the discussions **have been documented in the agents case file prior to Feb 8, 2011**." Memorandum from Director, SB/SE Examination, and Director, International Individual Compliance, for all OVDI Examiners, *Use of Discretion on 2009 OVDP Cases* (Mar. 1, 2011), http://www.irs.gov/pub/irs-drop/ovdi_memo_use_of_discretion_3-1-11.pdf. When the IRS does consider a lower penalty under FAQ #35, however, it reverses the burden of proof – requiring the taxpayer to prove nonwillfulness before considering the nonwillful penalty. Moreover, in TAS's view, even when a taxpayer proves nonwillfulness inside the 2009 OVDP, in some cases the IRS does not actually consider the facts they have presented. Rather, it asserts, without providing any explanation, that the taxpayer has not proved nonwillfulness and must opt out before the IRS will consider the facts.

it will be reasonable.[68] The fact that the IRS seemed to say through FAQ #35 that it would consider lesser penalties within the 2009 OVDP regime and is now backtracking increases taxpayer concerns about whether they will get a fair shake if they opt out.

TAS has encountered some examiners who, seeking to close OVD cases, suggested that the taxpayer would likely pay more if he or she opted out. Such statements are believable because the OVD examiner — the very same examiner who recommended against reducing the penalty within the OVD program — is required to make an *ex parte* recommendation to the opt-out committee about how to resolve the case if the taxpayer opts out.[69] Moreover, some taxpayers in this position come from countries with totalitarian regimes, where the government often enforces its laws in arbitrary ways. Thus, even where taxpayers feel strongly that their FBAR noncompliance was due to reasonable cause or was not willful, faced with the choice of accepting the IRS's proposed penalty (which, in our example, comes to $200,000 or 20 percent of $1 million) or opting for a full examination — with the hope of avoiding the penalty but with the knowledge that opting out could result in a potential penalty of far more than their net worth ($3 million in our example) — many will not want to risk opting out.

From a taxpayer's perspective, this may feel like extortion. In the opinion of the National Taxpayer Advocate, it is a significant intrusion on taxpayer rights.

More broadly, the National Taxpayer Advocate is concerned extreme penalties are sometimes enacted to combat extreme abuses, but the penalties inadvertently affect "benign actors" whose actions technically fall within the over-broad definition of the extreme conduct. In 2004, for example, Congress enacted IRC § 6707A, which imposed a strict liability penalty for failing to report participation in specified "listed transactions."[70] The penalty amount was $100,000 per individual per year and $200,000 per entity per year.[71] The penalty was intended to apply to those who engaged in egregious tax shelters. However, it soon became apparent that the penalties were affecting a range of small businesses, including some that created insurance programs to benefit their employees and did not know the transactions fit within the technical definition of a particular listed transaction. In some cases, individuals operated their businesses through wholly owned Subchapter S corporations, meaning that they were subject to penalties of $300,000 per year ($100,000 at the individual level and $200,000 at the entity level). After the National Taxpayer Advocate and

68 As the IRS's own characterization of these taxpayers in its response suggests, it starts with the misperception that it is giving people a great deal because it assumes it is giving people "an opportunity to get compliant with the U.S. tax system, pay their fair share, and avoid potential criminal charges." Most taxpayers who make inadvertent mistakes would not view the IRS offer as a good deal because they would not be subject to penalties at all. Rather, they would be alarmed by the implication that the IRS considers them potential targets of a criminal prosecution for inadvertently failing to file an information return. As discussed above, nobody who has opted out has been subject to criminal prosecution.

69 Memorandum for Commissioner, LB&I Division and Commissioner, SB/SE Division, from Deputy Commissioner for Services and Enforcement, *Guidance for Opt Out and Removal of Taxpayers from the Civil Settlement Structure of the 2009 OVDP and the 2011 OVDI* (June 1, 2011), http://www.irs.gov/pub/newsroom/2011_ovdi_opt_out_and_removal_guide_and_memo_june_1_2011.pdf.

70 American Jobs Creation Act, Pub. L. No. 108-357, § 811(a), 118 Stat. 1418 (2004); H.R. Rep. No. 108-548, pt. 1, at 261 (2004).

71 *See id.*

others raised concerns that the penalty was both disproportionate and applicable to a much wider swath of taxpayers than intended, Congress reduced the penalty.[72]

A similar situation arises here. The FBAR penalties generally are designed to apply to taxpayers who are intentionally evading U.S. tax by hiding significant untaxed assets in offshore accounts (the "bad actors"). But they are also affecting taxpayers with modest account balances and/or who did not intentionally evade tax, including those with assets in higher-tax jurisdictions where no tax evader would reasonably plan to hide assets. In administering this law, the IRS needs to do a better job of recognizing the distinction, and a key part of what is needed is to remove the fear of opting out of the OVD programs.

The National Taxpayer Advocate has suggested a three-category approach to improving the OVD programs to encourage voluntary compliance among those who failed to file FBARs and similar information returns. To encourage voluntary compliance, these taxpayers, who are coming forward before being contacted by the IRS, should be given reasonable options for correcting violations without having to opt out and risk disproportionate penalties.[73]

Category 1. Full relief from FBAR and information reporting penalties. Taxpayers whose underpayment is below a reasonable threshold amount — such as the IRC § 6662(d) threshold (*i.e.*, the greater of $5,000 or ten percent of the tax required to be shown) — should be permitted to file delinquent returns without penalty, regardless of whether they are residents.[74] They should not be subject to the threat of being deemed "high risk" and potentially hit with the maximum penalties, as is the case under the new Streamlined Nonresident Filing Initiative.[75]

Category 2. Taxpayers who have reasonable cause or who acted non-willfully. Taxpayers whose underpayment is greater than the threshold, but who believe they have reasonable cause or who acted non-willfully should provide an explanation of their circumstances, file delinquent returns, pay tax due, interest, accuracy-related penalties, and Title 26 information reporting penalties. Depending on the circumstances and explanation, these taxpayers should be required to pay either the non-willful FBAR penalty or no penalty under the

72 See National Taxpayer Advocate 2008 Annual Report to Congress, vol. 2, 24 (recommending legislation to make the penalty proportional to the decrease in tax, establish a "reasonable cause" exception, and to eliminate the potential for stacking); National Taxpayer Advocate 2008 Annual Report to Congress 419, 422 (same). Congress subsequently changed the law. *See* Creating Small Business Jobs Act of 2010, Pub. L. No. 111-240, Title II, § 2041(a), 124 Stat. 2506, 2560 (2010) (limiting the penalty to 75 percent of the decrease in tax shown on the return as a result of such transaction). For an analysis of continuing problems with the penalty, including the lack of a reasonable cause exception, see Toni Robinson and Mary Ferrari, *Congress Eases a Penalty, but Squanders Reform Opportunity*, 2011 Tax Notes Today 13-7 (Jan. 17, 2011).

73 See National Taxpayer Advocate Fiscal Year 2013 Objectives Report to Congress 23-25.

74 Under the 2009 OVDP FAQ #9, persons who failed to file FBARs and did not report all of their income are required to pay the offshore penalty, even if they have no tax liability. Under 2011 OVDI FAQ #18 and FAQ #19, those with no unreported tax liability for periods before 2011 were permitted to file corrected returns outside of the program without penalty. Under 2012 OVDP FAQ #18, those with no unreported tax liability are permitted to file corrected returns outside of the program without penalty.

75 Those who owe more than $1,500 per year or are U.S. residents are ineligible for the Streamlined Nonresident Filing Initiative. IRS, *Instructions for New Streamlined Filing Compliance Procedures for Non-Resident, Non-Filer U.S. Taxpayers* (Aug. 31, 2012), http://www.irs.gov/uac/Instructions-for-New-Streamlined-Filing-Compliance-Procedures-for-Non-Resident-Non-Filer-US-Taxpayers. Moreover, those deemed "high risk" may still be subject to a full examination and maximum penalties, even if they otherwise qualify. *Id*.

reasonable cause exception.[76] Because they are required to cooperate, the IRS should have little difficulty evaluating their circumstances without requiring them to opt out.

Category 3. Taxpayers not included in Category 1 or 2. Taxpayers who do not assert that their violations were nonwillful but still voluntarily come forward to correct them should be required to file delinquent or amended returns, and pay tax, interest, accuracy-related penalties, and the offshore penalty, as currently required under the OVD programs.

With regard to Category Two, in order to determine whether there are valid arguments to claim a reasonable cause exception, the facts and circumstances involving non-compliance would have to be carefully reviewed by practitioners. Anti-abuse rules could discourage Category Three taxpayers from self-selecting into Category Two. This reasonable three-category approach could prevent the IRS from being viewed as extorting unjustified penalties from innocent taxpayers and ultimately improve voluntary compliance. As the Internal Revenue Manual acknowledges,

> Examiners should consider whether the issuance of a warning letter and the securing of delinquent FBARS, rather than the assertion of a penalty, will achieve the desired result of improving compliance in the future... Discretion is necessary because the total amount of penalties that can be applied under the statute can greatly exceed an amount that would be appropriate in view of the violation.[77]

Having taken this important discretion away from OVD program examiners, IRS policymakers should consider how collecting the offshore penalty from benign actors who owe less under existing statutes might affect future compliance.

In addition, the IRS comments do not fully address the National Taxpayer Advocate's preliminary recommendations.

- The IRS has not stated whether it might implement the National Taxpayer Advocate's preliminary recommendation to expand the OVD programs and the Streamlined Nonresident Filing Initiative to prevent its procedures from collecting the proceeds of what many are likely to view as extortion.
- The IRS has not addressed whether it will send letters to people who have likely overlooked the information reporting requirements.

76 The IRS should publish guidance to expressly define what constitutes "reasonable cause" for the purposes of FBAR and provide examples about the difference between willful and nonwillful violations, based on the taxpayer's background, education level, cultural concerns, etc. In developing a broader "reasonable cause" standard to apply to FBAR violations, the *Ratzlaf* standard of "a voluntary intentional violation of a known legal duty" is a good starting point. *See Ratzlaf v. U.S.*, 510 U.S. 135 (1994) (U.S. Supreme Court case discussing Bank Secrecy Act violations; however, not dealing with FBAR directly). The *Ratzlaf* analysis involves both the "knowledge of the reporting requirement" and a "specific intent," *i.e.*, "a purpose to disobey the law." *Ratzlaf*, 510 U.S. at 141 (internal citations omitted). *See also Cheek v. U.S.*, 498 U.S. 192 (1991) (holding that an airline pilot did not have the requisite "willfulness" for criminal tax evasion because he had a sincere belief that his income was not taxable, no matter how unreasonable that belief might be).

77 IRM 4.26.16.4(4)-(5) (July 1, 2008).

- The IRS does not dispute that it has provided and continues to provide beneficiaries of Canadian retirement plans with conflicting information about how they can file a late return that excludes undistributed income from the plan. As noted above, Revenue Procedure 2002-23, 2002-1 C.B. 744 (requiring a PLR), and IRM 21.5.3.4.9.1 (Aug. 4, 2009) (instructing employees to process late elections) both remain in force and conflict with 2012 OVDP FAQ #54 (requiring a submission to an examiner) and the instructions to the Streamlined Nonresident Filing Initiative. Yet, the IRS does not commit to combine or clarify this conflicting guidance.
- The IRS does not dispute that it is difficult for taxpayers to determine whether their violations are nonwillful or qualify for the reasonable cause exception, or that taxpayers cannot rely on statements on the IRS website. Yet, it does not commit to provide any clarifying guidance.

Finally, the IRS seems to justify its failure to minimize duplicative reporting that it is requiring on Forms 8938 and the FBAR (TD F 90-22.1), in part, on the basis of a Technical Explanation by Joint Committee on Taxation, which describes the new reporting requirement that Form 8938 seeks to implement. The IRS quotes a portion of the Technical Explanation, which states "[n]othing in this provision is intended as a substitute for compliance with the FBAR reporting requirements, which are unchanged by this provision." This language does not require FBAR reporting to remain unchanged, but simply explains that the legislation itself does not change the FBAR reporting requirements. Moreover, the Technical Explanation goes on to state that "regulatory exceptions to avoid duplicative reporting requirements are anticipated."[78] This seems to undercut any implication that Congress intended for Forms 8938 and TD F 90-22.1 to require duplicative reporting of the same information, as the GAO has identified. Further, a review of the entire Technical Explanation suggests that the reason the legislation did not eliminate FBAR reporting is because law enforcement components outside of the IRS, which do not have ready access to tax information, may need the information on an FBAR (TD F 90-22.1), which would not be possible if the information were instead collected on Form 8938 — a tax form subject to the confidentiality provisions of IRC § 6103. For its part, however, the IRS has access to FBAR (TD F 90-22.1) information. Thus, the Technical Explanation does not prevent the IRS from eliminating the requirement for taxpayers to report duplicative information on Form 8938. The National Taxpayer Advocate is encouraged that the IRS has committed to "explore whether further coordination of the [reporting] requirements is possible provided the existing legal framework."

78 JCT, JCX-4-10, *Technical Explanation of the Revenue Provisions Contained in Senate Amendment 3310, The "Hiring Incentives to Restore Employment Act," Under Consideration by the Senate* 60-61 (Feb. 23, 2010).

Recommendations

The National Taxpayer Advocate recommends the IRS take the following actions:

1. Adopt the three-category approach (described above), which does not require benign actors to opt out of the OVD program(s). Alternatively, the IRS could significantly expand and clarify the Streamlined Nonresident Filing Initiative to encourage all benign actors (including U.S. residents and those owing more than $1,500) to correct past noncompliance using less burdensome procedures (*e.g.*, expand and clarify who qualifies for it and further explain who will be deemed to have reasonable cause for failure to file an FBAR).
2. Send "soft" notices to educate persons with foreign accounts about the FBAR and Form 8938 reporting requirements, encouraging them to self-correct inadvertent violations, as contemplated by the FBAR Compliance Initiative Project and the FBAR Stop Filer Program.
3. Update Revenue Procedure 2002-23, 2002-1 C.B. 744 to clarify how beneficiaries of Canadian retirement plans can file late or amended returns that elect to exclude undistributed income from those plans.
4. Incorporate all OVD FAQs and the Streamlined Nonresident Filing Initiative (or the three-category approach, described above) into a Revenue Procedure (or similar guidance published in the Internal Revenue Bulletin) that incorporates comments from internal and external stakeholders.
5. Revise Forms 8938 and/or TD F 90–22.1 to reduce taxpayer burden and the duplicative reporting identified by the GAO.[79]

[79] The IRS might reduce duplicative reporting by adding items reported on an FBAR to the existing list of items that taxpayers do not have to report on Form 8938. *See* Treas. Reg. § 1.6038D–7T.