A NEW DAY

Voluntarily Disclosing Non-U.S. Accounts and Assets: Delivering Value for Your Clients

BY CAROLYN M. LEE, ESQ.

It's tax season. Do you know whether your clients have non-U.S. financial accounts and other assets? If they do, this ownership impacts their income tax reporting in many ways.

Failure to accurately report non-U.S. financial account items and ownership exposes a taxpayer to a riot of penalties, each a minimum of $10,000. The IRS has actively enforced these reporting requirements since 2009, with an escalating effect.

Currently, willful failure to properly file a complete and correct foreign bank account report (FBAR, aka FinCEN Report 114) may result in an inflation-adjusted penalty that is the greater of $124,588 or 50 percent of the account balance at the time of the violation—for each violation—according to published IRS FBAR guidance on Jan. 28.

For non-willful violations of the FBAR filing obligation that are not due to reasonable cause, the inflation-adjusted civil penalty may be $12,459—serious money, by any standard. Of course, proper reporting means no failure-to-report penalties, but that message has not gained significant traction.

As enforcement actions and penalties increased, return preparation software expanded fact-finding features to assist with proper reporting. Nonetheless, the compliance gap is significant. Approximately 9 million U.S. tax persons hold non-U.S. accounts, yet fewer than 2 million FBARs are filed. The compliance gap with respect to failure to file required information reports pertaining to non-U.S. accounts, assets and business interests (e.g., forms 8938, 3520 or 5471) potentially numbers in the tens of millions.

Seemingly inexplicably, taxpayers have difficulty accurately answering the simplest question on Form 1040, Schedule B: Do you have a financial interest in or signature authority over a financial account located in a non-U.S. country? No wonder non-U.S. account and asset reporting remains a top IRS priority.

In addition, courts also appear to have little patience for taxpayers answering "no" on Schedule B when "yes" was the correct response, and find those taxpayers willfully failed to accurately report non-U.S. account ownership.

For example and most recently, in *Kimble v. United States*, No. 1:17-cv-00421 (Fed. Cl.) (Dec. 27, 2018), the court granted summary judgment on the issues of willfulness based solely on the fact that Kimble signed a 2007 income tax return without first reading it and the return falsely answered "no" to the question whether she had any foreign bank accounts.

In *United States v. Horowitz*, Case No. PWG-16-1997 (Md., 1/19/19), the court held that the taxpayer's signing a tax return that incorrectly checked the Schedule B non-U.S. account ownership question "no" was sufficient conduct to establish willfulness.

Clearly your return preparation and tax advising clients need your help to ensure compliance and avoid the unnecessary expense associated with incorrect reporting. They also need your knowledgeable, wise guidance to protect their confidential information if you detect potential willful, or criminal, conduct under the law and to respond responsibly to legal questions associated with tax reporting.

Your pre-return preparation fact-finding may uncover non-U.S. account and asset ownership and income—for 2018 and prior years. Your client can be compliant for 2018. As for prior years, what are the options for correcting reporting shortcomings? Is a voluntary disclosure for prior years right for your clients considering what to do?

Last year was a transition year for voluntary disclosure of delinquent non-U.S. accounts and assets. After the dust settled in late November, clients out of compliance for prior years had at least four options. Only your clients can decide the best option for them; however, they need competent guidance to make an informed decision. They turn to you early on the path to that informed decision.

Options include:

1. DO NOTHING

This choice has its own risks, including, at worst, maximum penalties and a possible tax evasion civil inquiry, criminal investigation or criminal tax charge. Taxpayers should consider non-disclosure of delinquent reporting only after being fully informed about all potential benefits, risks and penalties of doing nothing. Your client may be best served by a consultation with a tax attorney with non-U.S. account and asset expertise, within a zone of confidentiality afforded by attorney-client privilege protections. If the taxpayer chooses disclosure, the CPA re-enters to team with the attorney, lending expertise to amended returns, FBARs and other filing requirements. The attorney handles statements and explanations addressing legal issues. A Kovel arrangement between CPA and attorney protects client confidential communications.

2. PURSUE VOLUNTARY DISCLOSURE PROCESS TO AVOID CRIMINAL PROSECUTION

As prescribed by the IRS Criminal Investigation division Nov. 20, 2018, in a memorandum regarding updated voluntary disclosure practices, clients with criminal tax exposure may seek to participate in a voluntary disclosure process that effectively exchanges serious inconvenience and expense associated with amended returns, information reports and forms, filed delinquent FBARs and substantial sums for no felony conviction or plea and priceless freedom (i.e., a closing agreement with assurance of no criminal prosecution for the disclosure period). This process may be invoked to disclose both domestic and non-U.S. tax items.

If you even suspect criminal tax exposure, immediately stop all information exchange with your client. Your client's communications with you will have no confidentiality protections. Advise your client to say no more to anyone. Immediately refer your client to a tax attorney you trust who, if not a criminal tax specialist, will competently recommend proper legal representation. Depending on your involvement in the case, and how quickly you detect criminal indicia, you may be retained as the Kovel CPA to assist with the disclosure.

3. STREAMLINED DISCLOSURE OF NON-U.S. ACCOUNTS AND ASSETS, BECAUSE THE CLIENT'S FAILURE TO DISCLOSE WAS NON-WILLFUL

The IRS continues to offer the streamlined voluntary disclosure process to qualifying taxpayers, requiring limited reporting and FBAR filings. This availability was confirmed in the aforementioned Nov. 20, 2018, memorandum. For taxpayers residing in the U.S., all tax and interest is collected, as well as a 5 percent "miscellaneous" penalty based on the highest year-end balance for the three-year disclosure period. While the streamlined disclosure process does not offer the assurance against examination for the years and items in issue (that is, no closing agreement), the IRS's intention and practice has been to process fulsome streamlined submissions without audit.

What do we mean by "fulsome?" Streamlined-eligible individual taxpayers must certify under penalties of perjury that their failure to report all income, pay all tax and file all required information returns was non-willful. Whether your client's conduct was willful or non-willful is a legal question, generally best determined by a tax attorney during discussions sheltered by the attorney-client privilege. If you attempt to address the legal questions, you may find yourself the star witness in the IRS prosecution of your client, or in your client's litigation against you for practicing law without a license or in defending the malpractice claim asserting you provided services outside the scope of your professional license to the client's detriment.

The most effective and efficient streamlined disclosure submission typically is a partnership between the tax attorney and the CPA, with the balance of the work favoring the expertise of the return preparer. The tax attorney assists the taxpayer with the statement certifying non-willful conduct. The CPA prepares amended tax returns (three years) and delinquent FBARs (six years) among other client-specific filing requirements.

4. THE MIDDLE GROUND: FILE AMENDED TAX RETURNS AND DELINQUENT FBARS—A 'QUIET' DISCLOSURE

Relatively few taxpayers have criminal exposure with respect to unreported non-U.S. accounts and assets. And not every other taxpayer with unreported non-U.S. income, accounts and assets can comfortably certify non-willful conduct, particularly while the courts still are distinguishing the contours of willful conduct compared to non-willful conduct. What voluntary disclosure practice is open to the taxpayer with past mistakes who inhabits the middle ground?

The IRS's November 2018 guidance provides a whisper of appropriate steps: File amended or past due tax returns. When the returns are examined, the "examiners will follow existing law and guidance governing audits of the issues." What might that be?

The existing guidance informing voluntarily filing delinquent or amended tax returns [IRM 1.2.14.1.18, Policy Statement 5-133 (number 5)] advises taxpayers to file returns for the six previous years (as appropriate for the taxpayer's facts and circumstances). For delinquent or amended FBARs, the general rule is to file reports for the prior six years (also as appropriate to the taxpayer).

Prior to November 2018, such a "middle-ground" voluntary disclosure—outside an established, prescribed IRS program such as the Offshore Voluntary Disclosure Program or the streamlined program—was considered a "quiet" disclosure by the IRS and highly disfavored. No more. The "quiet" disclosure currently is the IRS-recommended voluntary disclosure for taxpayers who did not commit any tax or tax-related crimes and do not need the voluntary disclosure practice to seek protection from potential criminal protection.

Advantages of making a "middle ground" voluntary disclosure include potential relief from negligence related penalties associated with the filed returns, which may be qualified amended returns. In addition, the voluntarily amended returns show good faith and cooperation, which may accrue to avoid other potential penalties; for example, penalties for failure to file the forms 8938, 3520 or 5471.

A key reason to hesitate before making a voluntary disclosure to correct past mistakes is the potential, substantial penalties associated with unfiled forms 8938, 3520 or 5471. These penalties are $10,000 or more. Anecdotal evidence indicates penalty enforcement has been random and not always to the full extent permitted by law. A taxpayer considering a middle ground voluntary disclosure needs and deserves a full review of all potential penalties, in addition to a frank discussion of other enforcement risks based on the taxpayer's particular facts and circumstances. Here, too, your greatest service to your client may be to suggest they confer confidentially with a tax attorney to make an informed decision with respect to a voluntary disclosure. After the decision is made, you may re-enter the case to apply your expertise and experience in ways that safely and effectively deliver value to your client.

Whichever path your clients choose to address prior to non-U.S. account and asset reporting, you will play a prominent role in guiding them toward an informed decision. For this—and for 2018 fully compliant reporting—your clients not only will thank you, they will refer you to others. This scenario is a win-win for everyone. CPA

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