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**THE IRS 2011 OFFSHORE VOLUNTARY DISCLOSURE INITIATIVE: FBAR, FATCA
AND THE FUTURE OF GLOBAL INFORMATION REPORTING**

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The 2011 Annual Income Tax Seminar
The IRS 2011 Offshore Voluntary Disclosure Initiative: FBAR, FATCA and the Future of Global Information Reporting

TABLE OF CONTENTS

	<u>Page</u>
1. FBAR – Rules	4
A. FBAR – In General	4
B. Establishment of the FBAR Filing Requirements	4
C. Who Must File an FBAR?	4
<input type="checkbox"/> “U.S. person”	4
<input type="checkbox"/> “Financial account”	4
<input type="checkbox"/> “Foreign country”	4
<input type="checkbox"/> “Financial interest”	5
(1) Owner of record or holder of legal title	5
(2) Other financial interest	5
(3) Anti-avoidance rule	5
<input type="checkbox"/> Signature or other authority	5
<input type="checkbox"/> Potential FBAR Penalties	5
<input type="checkbox"/> Non-Willful Penalty	5
<input type="checkbox"/> Willful Violation – Civil Penalty	5
<input type="checkbox"/> Willful Violation – Criminal Penalty	6
o “Willfulness” - In General	6
o FBAR – “Willfulness” in Civil Cases	6
o FBAR – “Willfulness” in Criminal Cases	7
2. Potential Tax Penalties	7
A. Potential Civil Tax Penalties	8
<input type="checkbox"/> 20% Accuracy-Related Penalty	8
<input type="checkbox"/> 25% Failure to Pay Tax Penalty	8
<input type="checkbox"/> 75% Civil Fraud Penalty	8
B. Potential Criminal Tax Penalties	9
<input type="checkbox"/> Tax Evasion (IRC Section 7201)	9
<input type="checkbox"/> Filing a False Return (Perjury)(IRC Section 7206(1))	9
3. 2011 Offshore Voluntary Disclosure Initiative (“OVDI”)	11
A. Background	11
B. Eligibility	11
C. Procedural Steps to Participate in 2011 OVDI	11
D. Deadlines	12
E. Opt Out and Removal Procedures	12
F. Questions	12

G. Alternatives to 2011 OVDI.....	12
4. California – FTB Voluntary Compliance Initiative	12
A. In General	12
B. Definitions	12
C. Election to Participate	13
D. Waiver of Penalties	13
5. FATCA - The Most Significant Change in U.S. In-Bound Tax Policy in the Last 50 Years	13
A. What is FATCA and How Does it Work?	13
B. FATCA’s Purpose (Expressly Stated Purposes)	14
C. Definition of FFI.....	14
D. Principal Businesses Affected By FATCA.....	16
E. Who is a US Person.....	17

1. **FBAR – Rules.** The following provides a brief background regarding the FBAR as well as the current filing requirements.

A. **FBAR – In General.** Form TD F 90-22.1, Report of Foreign Bank and Financial Accounts (“FBAR”), must be filed by U.S. persons to disclose a financial interest in, signature authority over, or other authority over, a foreign bank, security or financial account. Extreme civil and criminal penalties can be imposed for a “willful” failure to file the FBAR.

B. **Establishment of the FBAR Filing Requirements.** The FBAR was first established when the Bank Secrecy Act was enacted in 1970.¹ One purpose of the Bank Secrecy Act was to require the filing of certain reports by U.S. persons, including the FBAR, where doing so would be helpful to the U.S. government in carrying out various investigations, including criminal tax and regulatory investigations.

Title 31 (Money and Finance), rather than the Internal Revenue Code (“IRC”) (Title 26), governs the FBAR filing requirements. In April 2003, the Department of Treasury transferred authority to enforce the FBAR provisions from the Financial Crimes Enforcement Network (FinCEN) to the IRS.² Consequently, the IRS is now empowered to investigate potential violations, issue summonses, assess civil tax liabilities, issue administrative rulings, and take any other action reasonably necessary to enforce the FBAR rules.³

The FBAR is an informational return, not a tax return. The FBAR is not filed with a taxpayer’s income tax return. The FBAR must be filed with Treasury by June 30th of the calendar year following the year in which the U.S. person had an interest in, or signature or other authority over, a foreign account.⁴ Thus, you must file an FBAR for the tax year 2010 on or before June 30, 2011. If you dispose of your foreign account during the tax year 2011, you must still file an FBAR for 2011 on or before June 30, 2012.

C. **Who Must File an FBAR?**

The new regulations clarify that FBARs are required when several conditions are satisfied. These are (i) a “U.S. person,” (ii) had a “financial interest” in, or “signature, or other authority” over (iii) one or more bank, securities, or “financial accounts”; (iv) located in a “foreign country”; (v) and the aggregate value of each account(s) exceeded US\$10,000 at any time during the calendar year. Each of the first four elements/definitions is described in more detail below as recently clarified by the February 2011 regulations:⁵

- **“U.S. person”** means: (1) a citizen of the U.S.; (2) a resident of the U.S.; or (3) an entity, including, but not limited to, a corporation, partnership, trust, or limited liability company created, organized, or formed under the laws of the U.S., any State, the District of Columbia, the Territories and Insular Possessions of the U.S., or the Indian Tribes.⁶

- **“Financial account”** is broadly defined and includes mutual funds, savings, demands, checking, deposit or any other account (including debit card and prepaid credit card accounts) maintained with a financial institution or other person engaged in the business of a financial institution. It also includes an account with a person who acts as a broker or dealer for futures or options transactions in any commodity on or subject to the rules of commodity exchange or association.⁷

- **“Foreign country”** means any geographical areas located outside of the U.S.⁸

¹ P.L. 91-508, 10/26/70, Titles I and II.

² 68 Fed Reg. 26489 (5/16/03).

³ 31 C.F.R. Section 103.56(g). Penalty determinations by IRS Examination Division can be protested to the Appeals Division. The Tax Court, however, has no jurisdiction over the FBAR penalties.

⁴ See 31 C.F.R. Sections 103.24 and 103.27.

⁵ This discussion does not include some of the various exceptions. See 31 C.F.R. Section 1010.350(f)(2).

⁶ 31 C.F.R. Section 1010.350(b).

⁷ 31 C.F.R. Section 1010.350(c); see also FBAR instructions.

⁸ 31 C.F.R. Section 1010.350(d).

• **“Financial interest”** in a bank, securities or other financial account in a foreign country means any of the following:⁹

(1) **Owner of record or holder of legal title.** A U.S. person has a financial interest in each bank, securities or other financial account in a foreign country for which he is the owner of record or has legal title whether the account is maintained for his own benefit or for the benefit of others. If an account is maintained in the name of more than one person, each U.S. person in whose name the account is maintained has a financial interest in that account.

(2) **Other financial interest.** A U.S. person has a financial interest in each bank, securities or other financial account in a foreign country for which the owner of record or holder of legal title is –

(i) A person acting as an agent, nominee, attorney or in some other capacity on behalf of the U.S. person with respect to the account;

(ii) A corporation in which the U.S. person owns directly or indirectly more than 50 percent of the voting power or the total value of the shares, a partnership in which the U.S. person owns directly or indirectly more than 50 percent of the interest in profits or capital, or any other entity (other than an entity in paragraphs (iii) and (iv) directly below) in which the U.S. person owns directly or indirectly more than 50 percent of the voting power, total value of the equity interest or assets, or interest in profits;

(iii) A trust, if the U.S. person is the trust grantor and has an ownership interest in the trust for U.S. Federal tax purposes. *See* 26 U.S.C. 671-679 and the regulations thereunder to determine if a grantor has an ownership interest in the trust for the year; or

(iv) A trust in which the U.S. person either has a present beneficial interest in more than 50 percent of the assets or from which such person receives more than 50 percent of the current income.

(3) **Anti-avoidance rule.** A U.S. person that causes an entity, including but not limited to a corporation, partnership, or trust, to be created for a purpose of evading this section shall have a financial interest in any bank, securities, or other financial account in a foreign country for which the entity is the owner of record or holder of legal title.

• **Signature or other authority** – Signature or other authority means the authority of an individual (alone or in conjunction with another) to control the disposition of money, funds or other assets held in a financial account by direct communication (whether in writing or otherwise) to the person with whom the financial account is maintained.¹⁰

• **Potential FBAR Penalties.** The FBAR penalties were revised in October 2004 as part of the American Jobs Creation Act (AJCA). For FBAR violations, the government must assess the penalty within six years of the violation.¹¹ The potential FBAR penalties which can be assessed against a U.S. person are as follows:

• **Non-Willful Penalty.** For a non-willful violation, the penalty shall not exceed \$10,000 per violation.¹² In the case of a non-willful violation, no penalty should be imposed if the failure is due to reasonable cause and the account was properly reported.¹³

• **Willful Violation – Civil Penalty.** For each willful violation (as discussed below under “Definition of ‘Willful’ – FBAR”), the maximum penalty that may be imposed is the greater of \$100,000 or 50% of

⁹ 31 C.F.R. Section 1010.350(e).

¹⁰ 31 C.F.R. Section 1010.350(f).

¹¹ 31 U.S.C. Section 5321(b)(1).

¹² 31 U.S.C. Section 5321(a)(5)(B). This penalty applies only to violations occurring after 10/22/04 (i.e., FBARs due on or after 6/30/05).

¹³ 31 U.S.C. Section 5321(a)(5)(B)(ii). The second condition has been interpreted to mean that the taxpayer agrees to file delinquent FBARs with the Revenue Agent as part of the audit. I.R.M. 4.26.16.4.4 (7/1/08).

the value of the account at the time of the violation.¹⁴ The violation is deemed to occur on the due date for filing the FBAR.¹⁵ Thus, for example, the maximum penalty for failing to file a 2010 FBAR would be determined by reference to the value of the foreign financial account on June 30, 2011.¹⁶ You could not be subject to this penalty for your accounts in 2010, provided you get your FBAR timely filed in 2011.

- **Willful Violation – Criminal Penalty.** A person who willfully fails to file an FBAR (as discussed below under “Definition of ‘Willful’ – FBAR”) is also subject to up to five years in prison and/or maximum fine of \$250,000.¹⁷ If a willful failure is part of a pattern of illegal activity involving more than \$100,000 over a 12-month period, or is committed while violating another law of the U.S., the failure may subject the taxpayer to a fine of not more than \$500,000 and/or imprisonment for not more than ten years.¹⁸

- **“Willfulness” - In General.** There is very little guidance on how the term or phrase “willfulness” is established in the context of an FBAR violation, both civil and criminal.¹⁹ Nevertheless, the government has stated on at least one occasion that it will apply the willfulness standard used when determining whether there has been a violation of the tax laws.²⁰ It appears to be the current IRS view that in order for there to be a voluntary intentional violation of a known legal duty, the U.S. person would just have to have knowledge that he or she had a duty to file an FBAR, because knowledge of the duty to file an FBAR would entail knowledge that it is illegal not to file the FBAR. A corollary of the principle is that there is no willfulness if the U.S. person has no knowledge of the duty to file an FBAR.²¹

It is well established that “willfulness” can be established by circumstantial evidence. This is because it is inherently difficult in proving, or disproving, a state of mind (willfulness) at the time of the violation. In civil cases, the government is required to establish willfulness by “clear and convincing evidence.” With respect to criminal cases, the government must establish willfulness “beyond a reasonable doubt.”²²

- **FBAR – “Willfulness” in Civil Cases.** In the context of civil cases, and as noted above, the government can prove willfulness if they can demonstrate that the U.S. person had knowledge of the FBAR reporting requirement. It is the IRS’s position that the term “willfulness” can be established by a showing of willful blindness (or intentional ignorance). For example, willfulness may be attributed to a person who has made a conscious effort to avoid learning about the FBAR reporting and recordkeeping requirements.²³ “It is reasonable to assume that a person who has foreign bank accounts should read the information specified by the government in tax forms. The failure to follow-up on this knowledge and learn of the further reporting requirement as suggested on Schedule B may provide some evidence of “willful blindness” on the part of the person.”²⁴

In *U.S. v. Williams*, 106 AFTR.2d 2010-6150 (E.D. Va. 2010)(September 1, 2010), the District Court had to decide whether Mr. Williams, who had admitted he evaded income tax for failing to report income earned from a Swiss account, had willfully failed to file an FBAR with respect to his Swiss accounts for purposes of the FBAR civil penalty (31 U.S.C. Section 5321(a)(5)(C)). In order to prove willfulness, the government pointed toward Mr. Williams’ overall course of conduct, focusing on this guilty plea to tax evasion and conspiracy to defraud, his actions to conceal the unreported income, and his willful ignorance (i.e., his conscious effort to avoid learning about the FBAR reporting requirements).

¹⁴ 31 U.S.C. Section 5321(a)(5)(C). Prior to 10/24/04, the maximum civil penalty for willful violations was the greater of \$25,000 or the balance in the account at the time of violation, up to a maximum of \$100,000.

¹⁵ IRM 4.26.16.4.5.5.

¹⁶ Any person required to file the FBAR must also keep certain records of account for five years. 31 C.F.R. Section 103.32.

¹⁷ 31 U.S.C. Section 5322(a).

¹⁸ 31 U.S.C. Section 5322(b).

¹⁹ See Sardar, Michael, “What Constitutes ‘Willfulness’ for Purposes of the FBAR Failure-to-File Penalty?,” *Journal of Taxation* (September 2010).

²⁰ CCA 200603026.

²¹ CCA 200603026; citing *Ratzlaf v. U.S.*, 510 U.S. 135, FN #5 (1994).

²² *Id.*

²³ IRM 4.26.16.4.5.3(6).

²⁴ *Id.*

In *Williams*, the court noted that it is well established that “[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.” *citing Safeco Ins. Co. of Am. v. Burr*, 551 U.S. 47 (2007)(emphasis added). The court further stated that “a single, or even a few, inadvertent errors would not amount to a ‘willful’ violation. At some point, however, a repeated failure to comply with known regulations can move a [defendant’s] conduct from inadvertent neglect into reckless or deliberate disregard (and thus willfulness). . . .” *citing Am. Arms Int’l v. Herbert*, 563 F.3d 78 (4th Cir. 2009).

Mr. Williams lived in the U.S. and had intentionally not reported the income he earned from it; hence the criminal guilty plea to tax evasion.

Nevertheless, the district court ultimately ruled that Mr. Williams did not act willfully as it relates to the FBAR willfulness penalty. In rendering its decision, the court noted that the case was one of first impression regarding the proper legal standard to be applied in reviewing FBAR penalty issues. The court noted that the government failed to adequately differentiate between “simply failing” and “willfully failing” to disclose an interest in foreign accounts. Ultimately, the court held that there was not enough evidence that Mr. Williams was lying about his ignorance of the law (i.e., that an FBAR filing requirement existed). The court acknowledged that the box on Schedule B of the taxpayer’s Form 1040 was marked “no” in response to the foreign account question. The court underscored, however, this action or inaction occurred after Mr. Williams learned that the U.S. authorities knew about his foreign financial accounts (and thus lacked any motivation to willfully conceal the accounts from the authorities after that point).

Based on the foregoing, it appears that at least in one FBAR civil penalty case, the court held that ignorance of the law relating to the FBAR filing requirement is a valid defense. Nevertheless, the passage of time, combined with the government’s publicizing of its efforts to eliminate noncompliance with reporting of offshore accounts, may make such an argument ineffective in the future in that the government may be able to prove that such U.S. person was actually not ignorant of the law.²⁵

○ **FBAR – “Willfulness” in Criminal Cases.** The IRS has noted its position that the phrase “willful violation” has the same definition and interpretation under 31 U.S.C. Section 5321 (the FBAR civil penalty) and 31 U.S.C. Section 5322 (the FBAR criminal penalty).²⁶

In *Cheek v. U.S.*, 498 U.S. 192 (1991), the Supreme Court held that a good faith misunderstanding of the law or good faith belief that one is not violating the law negates the willfulness element of a tax evasion charge, regardless of whether the claimed misunderstanding or belief is objectively reasonable. Thus, if a taxpayer truly believes that a law does not apply to him, his violation of that law cannot be willful because the element of knowledge, which is required to prove willfulness, is absent. Furthermore, a showing that the defendant acted with careless disregard (i.e., reckless) is not adequate in establishing “willfulness” for a criminal penalty.²⁷ (See the additional discussion of “willfulness” in the context of criminal matters below under “Potential Criminal Tax Penalties.”)

In summary, in the context of a criminal prosecution, the jury must find based on the evidence, direct or indirect, that the defendant was aware (had knowledge) of the FBAR reporting obligations. In accordance with *Cheek*, it appears that an honest and good faith mistake regarding the FBAR laws, no matter how unreasonable, is a defense for failing to file the FBAR.

2. **Potential Tax Penalties.**

The vast majority of tax assessments against taxpayers are civil tax assessments. These civil tax assessments generally impose the burden of proof on the taxpayer. They commonly relate to items of income (commonly increased by the government) or items of expenses or deductions (commonly decreased by the government). They can be (i) very technical in nature, i.e., regarding the correct application of complex tax law, or (ii) very basic and routine (e.g., regarding the correct number of personal exemptions or itemized deduction

²⁵ See Sheppard, Hale F., “District Court Rules That Where There’s No Will, There’s A Way to Avoid FBAR Penalties,” *Journal of Taxation* (November 2010).

²⁶ CCA 200603026.

²⁷ *United States v. Griffin*, 524 F.3d 71 (1st Cir. 2008).

expenses allowable). The civil tax world is where tax assessments are most commonly asserted by the government against taxpayers for deficiencies in taxes owed. The petitions filed in U.S. Tax Court by taxpayers contesting these assessments are necessarily civil tax matters by definition. On the other hand, criminal tax matters (the few criminal indictments that are filed annually) are brought by the U.S. Justice Department against taxpayers and are relatively quite rare.

A. Potential Civil Tax Penalties.

- **20% Accuracy-Related Penalty.** If any portion of an underpayment of tax is attributable to negligence or disregard of rules or regulations, then there can be added to the tax an amount equal to 20 percent of the amount of the underpayment which is so attributable.²⁸ The term “negligence” includes any failure to make a reasonable attempt to comply with the statute, and the term “disregard” includes any careless, reckless, or intentional disregard.²⁹

The accuracy-related penalty does not apply to any part of the underpayment for which there was reasonable cause with respect to which the taxpayer acted in good faith.³⁰ The determination of whether a taxpayer acted with reasonable cause and in good faith is made on a case-by-case basis, taking into account all pertinent facts and circumstances.³¹ The most important factor, however, is the extent of the taxpayer’s efforts to assess the proper tax liability. An honest misunderstanding of fact or law that is reasonable in light of the experience, knowledge, and education of the taxpayer could indicate reasonable cause and good faith.

- **25% Failure to Pay Tax Penalty.** A penalty of ½% per month (.005) up to an aggregate of 25% of the amount of the underpayment of tax is imposed unless the failure to pay tax was due to reasonable cause and not willful neglect.³²

- **75% Civil Fraud Penalty.** The tax law provides that: “[i]f any part of any underpayment of tax required to be shown on a return is due to fraud, there shall be added to the tax an amount equal to 75 percent of the portion of the underpayment which is attributable to fraud.”³³ Generally, the definitions of fraud contained in criminal tax evasion cases also have application to civil fraud cases, but the burden of proof is higher in criminal cases.³⁴

Civil fraud is not defined in either the statute or the regulations. Courts have defined fraud as the intentional wrongdoing on the part of the taxpayer with the specific purpose of evading a tax believed to be owing.³⁵ As noted above under the FBAR penalty discussion, the mere negligence or ignorance of the law does not generally constitute fraud.³⁶ The IRS has the burden to establish, by clear and convincing evidence, that the following elements of fraud are met:

- 1) a knowing falsehood by the taxpayer (scienter);
- 2) an intent to evade tax; and
- 3) an underpayment of tax (i.e., a tax deficiency).³⁷

Because of the “scienter” requirement, fraud requires intentional conduct that misleads or conceals undertaken for the purpose of evading tax (that actually remains underpaid). The U.S. Supreme Court has identified the following activities (or badges of fraud or circumstantial evidence) as indicating underpayment and intent, thus evidencing fraud: (1) continuous substantial understatement of income; (2) concealing assets or

²⁸ IRC Section 6662(a).

²⁹ IRC Section 6662(c).

³⁰ IRC Section 6664(c)(1); Treas. Reg. Section 1.6664-4(b)(1).

³¹ Treas. Reg. Section 1.6664-4(b)(1).

³² IRC Section 6651(a)(2).

³³ IRC Section 6663(a); *Loeb v. Commissioner*, T.C. Memo. 2009-6.

³⁴ *Raney v. Commissioner*, T.C. Memo. 2000-277.

³⁵ See *Wilkinson v. Commissioner*, T.C. Memo. 1997-40.

³⁶ See *Barnard v. Commissioner*, T.C. Memo. 2001-242.

³⁷ *Considine v. U.S.*, 683 F.2d 1285 (9th Cir. 1982).

income; (3) maintaining false or altered records, invoices, and documents; (4) destroying books or records; (5) keeping two sets of books; and (6) conducting the taxpayer's affairs so as to avoid making records or otherwise conceal or deceive.³⁸

The civil fraud penalty can be avoided by showing reasonable reliance. For example, the intention to defraud is not found where a taxpayer reasonably relies on an advisor's erroneous advice as to the proper treatment of certain items (and assuming all relevant facts were provided to the advisor).³⁹

B. Potential Criminal Tax Penalties. The following are the potential criminal penalties that can apply for failing to timely and properly report income.⁴⁰

- **Tax Evasion (IRC Section 7201).** IRC Section 7201 (also referred to as "tax fraud") provides that "[a]ny person who willfully attempts in any manner to evade or defeat any tax imposed by this title or the payment thereof shall, in addition to other penalties provided by law, be guilty of a felony and, upon conviction thereof, shall be fined not more than \$100,000 (\$500,000 in the case of a corporation), or imprisoned not more than 5 years, or both, together with the costs of prosecution."

As noted above, establishing criminal tax evasion involves similar elements as the civil fraud penalty. Tax evasion is the most serious of all tax crimes and carries the most severe punishment. The burden is on the government to establish the following elements beyond a reasonable doubt:

- 1) the existence of a tax deficiency;
- 2) a willful attempt on the part of the defendant to evade taxes or the payment of any tax; and
- 3) an affirmative act constituting an evasion or attempted evasion of the tax.⁴¹

Willfulness is the voluntary intentional violation of a known legal duty.⁴² A showing of "evil motive, bad purpose, or corrupt design" is not required for a conviction of a tax crime.⁴³ A good faith misunderstanding of the law, even if objectively unreasonable, is a defense to a tax crime.⁴⁴ Negligence, even gross negligence, is insufficient to establish willfulness.⁴⁵ Nevertheless, tax evasion may be found where there has been a "deliberate ignorance" meaning that the defendant purposely contrived to avoid learning all of the facts.⁴⁶

Good faith reliance on the advice of a tax advisor, after complete disclosure of all relevant facts to the advisor, is a defense to tax evasion.⁴⁷

Tax evasion must be prosecuted generally within six years of the time the tax return is filed.⁴⁸ A taxpayer has a right to a jury trial in any such criminal indictment.

- **Filing a False Return (Perjury)(IRC Section 7206(1)).** IRC Section 7206(1) (a lesser included offense of IRC Section 7201) provides in part that a taxpayer who "[w]illfully makes and subscribes [signs] any return, statement, or other document, which contains or is verified by a written declaration that it is made under the penalties of perjury, and which he does not believe to be true and correct as to every material matter . . .

³⁸ *Meier v. Commissioner*, 91 T.C. 273 (1988) (civil case); *Spies v. U.S.*, 317 U.S. 492 (1943) (criminal case).

³⁹ IRC Section 6664(a), (c); see also *Palmer v. Commissioner*, T.C. Memo. 1987-204.

⁴⁰ Again, this discussion assumes that a U.S. income tax return was timely filed.

⁴¹ *Sansone v. United States*, 380 U.S. 343 (1965); *United States v. Mounkes*, 204 F.3d 1024 (10th Cir. 2000).

⁴² *United States v. Pomponio*, 429 U.S. 10 (1976). See also *Ratzlaf v. U.S.*, 510 U.S. 135 (1994) (for statute requiring that it be willfully violated, government must prove that the accused possessed knowledge that the conduct was unlawful).

⁴³ *United States v. Kelly*, 539 F.2d 1199 (9th Cir. 1976).

⁴⁴ *Cheek v. United States*, 498 U.S. 192 (1991).

⁴⁵ *United States v. Goichman*, 547 F.2d 778 (3rd Cir. 1976).

⁴⁶ *United States v. Mapelli*, 971 F.2d 284 (9th Cir. 1992).

⁴⁷ *U.S. v. Kelly*, 864 F.2d 569 (7th Cir. 1989).

⁴⁸ IRC Section 6531.

shall be guilty of a felony and, upon conviction thereof, shall be fined not more than \$100,000 or imprisoned not more than 3 years, or both, together with costs of prosecution.”

The burden is on the government to establish the following elements beyond a reasonable doubt:

- 1) that the defendant made or caused to be made, a federal income tax return which he verified to be true;
- 2) that the tax return was false as to a material matter;
- 3) the defendant signed the tax return willfully and knowing it was false; and
- 4) that the tax return contained a written declaration that it was made under the penalty of perjury.⁴⁹

The government can prosecute an IRC Section 7206(1) violation whenever the above elements are satisfied, regardless of whether a taxpayer intended to evade or defeat the payment of tax.⁵⁰

The element of willfulness has the same meaning as willfulness under IRC Section 7201, discussed above.⁵¹ IRC Section 7206(1) focuses on the willful act of falsifying a document signed under penalties of perjury, regardless of the tax consequences of the falsehood.⁵² Thus, there must exist sufficient proof that the taxpayer did not believe that the statements contained in his or her tax return were true and the untrue statements were made willfully.

For the purpose of Section 7206(1), “materiality” is defined as all information necessary for the IRS to determine the accuracy of the tax return in question and “is likely to affect the calculation of tax due and payable.”⁵³ Although the government has to prove the materiality of a defendant’s false statements, the government does not have to prove the defendant’s knowledge of the materiality.⁵⁴ A finding of materiality is not dependent upon whether the false statement results in a tax deficiency as a tax deficiency is not an element of this crime.⁵⁵ Omitting income from a tax return, even if there was no net profit, has been held to be material.⁵⁶ Thus, a violation of Section 7206(1) is generally pursued by the government where the elements for tax evasion (Section 7201) cannot be proven.

The same defenses for tax evasion (IRC Section 7201) apply to Section 7206(1). Accordingly, reliance on a tax advisor may serve as a defense if the defendant provided full information to the preparer and then filed the return without having reason to believe it was incorrect.⁵⁷

Answering “no” to the question on Schedule B of whether a taxpayer has a foreign account can be a violation of IRC Section 7206(1).⁵⁸ In *United States v. Williams*, 106 AFTR.2d 2010-6150 (E.D. Va. 2010), discussed above, the court noted that in the context of the FBAR civil penalty, “a taxpayer’s signature on a return does not in itself prove the taxpayer’s knowledge of the contents, but [of course] knowledge can be inferred from the signature along with the surrounding facts and circumstances.”⁵⁹

⁴⁹ *United States v. Marabellas*, 724 F.2d 1374 (9th Cir. 1984).

⁵⁰ I.R.M. Section 9.1.3.3.7.1(3); see also Wiggins, William P., “Think Before You Sign: Implications of Code Secs. 7206(1) and 7207,” *Journal of Tax Practice and Procedure* (Oct-Nov. 2010).

⁵¹ *United States v. Bishop*, 412 U.S. 346 (1973).

⁵² *Gaunt v. United States*, 184 F.2d 284 (1st Cir. 1950).

⁵³ *United States v. Scarberry*, 208 F.3d 228 (10th Cir. 2000); *United States v. Griffin*, 524 F.3d 71 (1st Cir. 2008); Gibbons, Jennifer, “Proof of Tax Deficiency – The Silent Element in False Statements Charges?,” *Arizona Law Review* (Spring 2008).

⁵⁴ *United States v. Boulterice*, 325 F.3d 75 (1st Cir. 2003).

⁵⁵ *United States v. Marashi*, 913 F.2d 724 (9th Cir. 1990).

⁵⁶ *United States v. Taylor*, 574 F.2d 232 (5th Cir. 1978).

⁵⁷ *United States v. Wilson*, 887 F.2d 69 (5th Cir. 1989).

⁵⁸ *United States v. Frank*, 723 F.2d 1482 (10th Cir. 1983).

⁵⁹ citing *United States v. Mohny*, 949 F.2d 1397 (6th Cir. 1991).

An IRC Section 7206(l) violation must be prosecuted generally within six years of the time the tax return is filed.⁶⁰

3. **2011 Offshore Voluntary Disclosure Initiative (“OVDI”)**

A. Background. On February 8, 2011, the IRS announced a special voluntary disclosure initiative designed to both bring offshore money back into the U.S. tax system and help people with undisclosed income from foreign accounts become current with their tax obligations. The deadline for the 2011 OVDI, is August 31, 2011.⁶¹ A great source of guidance relating to the 2011 OVDI can be found on the IRS Website under “2011 Offshore Voluntary Disclosure Initiative Frequently Asked Questions and Answers” (“FAQ”).⁶²

Under the 2011 OVDI, participants with undisclosed foreign accounts and unreported foreign income may be able to avoid significant civil penalties and criminal prosecution by making a voluntary disclosure. The following are the general requirements for participation in the 2011 OVDI:

- 1) The filing of delinquent foreign bank account reports (FBARs) and amended income tax returns for the last eight (8) years (i.e., 2003 through 2010, inclusive);
- 2) Payment of the U.S. income tax owing plus, the 20% accuracy – related penalty, and interest for the eight (8) years of returns; and
- 3) Payment of an amount equal to 25% of the highest aggregate balance in the undeclared foreign accounts during the tax years 2003 through 2010.⁶³

Although the 2011 OVDI’s 25 % payment penalty may appear a bit extreme, the IRS has noted that such total penalties under the 2011 OVDI may be very favorable compared to the total civil penalties (and possible criminal exposure) which could be asserted by the IRS in many cases. The IRS has also stated on its website at FAQ No. 15 that “[t]hose taxpayers making “quiet” disclosures [filing FBARs and past due or amended tax returns] should be aware of the risk of being examined and potentially criminally prosecuted for all applicable years.”

Voluntary disclosure requests will initially be reviewed by Criminal Investigation (“CI”) of the IRS. CI will take into account timely, accurate and complete voluntary disclosures to determine whether to recommend to the Justice Department that a taxpayer should be criminally prosecuted. This practice by CI could enable non-compliant taxpayers to comply with their tax liability and reduce their chances of criminal prosecution – the IRS comments on its frequently asked questions that when a taxpayer “truthfully, timely and completely” satisfies all the requirements of the voluntary disclosure, the IRS will not recommend criminal prosecution to the Justice Department.⁶⁴ The Tax Division of the Justice Department could open a separate investigation on a criminal tax evasion case, or if non-tax criminal violations exist, another division of the Justice Department could begin a criminal investigation; however, an accepted voluntary disclosure should result in a recommendation by CI to not prosecute the taxpayer.

B. Eligibility. Taxpayers currently under examination (civil or criminal) by the IRS are not eligible to participate. See FAQ No. 14. Taxpayers who have reported and paid tax on all their taxable income in prior years are not eligible for the 2011 OVDI. See FAQ No. 17. In such cases, delinquent FBARs are due by August 31, 2011 with no penalty in such cases. *Id*

C. Procedural Steps to Participate in 2011 OVDI. Obtain pre-clearance screening by faxing a power of attorney and identifying information of taxpayer to CID. See FAQ No. 23. If pre-clearance is accepted, an

⁶⁰ IRC Section 6531.

⁶¹ On October 15, 2009, the first voluntary disclosure program closed with 15,000 voluntary disclosures.

⁶² <http://www.irs.gov/businesses/international/article/0,,id=235699,00.html>

⁶³ See FAQs No. 7, 52, and 53 for a detail of the penalties, including reduced penalties in certain circumstances, including (i) a 12.5% penalty if less than \$75k in account during disclosure period; and (ii) 5% where foreign resident was unaware they were a U.S. citizen. On June 2, 2011, the IRS added to FAQ No. 52 a 5% penalty for nonresidents who were in compliance with the tax laws of their resident country and had \$10K or less of U.S. source income each year.

⁶⁴ See response to Frequently Asked Questions published by the IRS on its website for this statement.

official 2011 OVDI letter is submitted to the Offshore Voluntary Disclosure Coordinator requesting participation in the 2011 OVDI. See FAQ No. 24. If accepted into the program, the taxpayer will be instructed to submit the full voluntary disclosure package. See FAQ No. 25.

D. Deadlines. All required information is due to the IRS no later than August 31, 2011. FAQ No. 1. A 90-day deadline to complete an OVDI submission can be requested if the taxpayer can demonstrate a good faith attempt to comply, including what steps the taxpayer is taking to secure the missing information. See FAQ No. 25.1 (added on June 2, 2011).

E. Opt Out and Removal Procedures. On June 2, 2011, the IRS added opt out procedures to FAQ No.'s 51.1, 51.2, and 51.3, including an Opt Out and Removal Guide (the "**Guide**"). See FAQ No. 51. The Guide provides the steps that should be taken before and after opting out or being removed, sample letters, a rundown of penalties that may apply to a taxpayer, and a list of possible exceptions to the three-year statute of limitations for individuals who have opted out or been removed. Under the procedures outlined in the Guide, a centralized review committee will make a determination as to whether the case merits a normal examination, should be reassigned to a Special Enforcement Program agent, or should receive some other treatment. "The committee will decide the appropriate level of examination, keeping in mind that the taxpayer is not to be punished (or rewarded) for opting out."

F. Questions. Contact OVDI Hotline at 267-941-0020. FAQ No. 22.

G. Alternatives to 2011 OVDI. Many taxpayers who believe they can prove their actions (or lack of action) were not "willful," are making "quiet disclosures" by filing past due or amended income tax returns and delinquent FBARS. See FAQ #15 where the IRS warns taxpayers of the risk of this approach. In a recent matter, Michael Schiavo was criminally charged with failing to file FBARS when shortly before the end of the 2009 OVDI, Schiavo filed amended tax returns which omitted taxable income.

In short, each case must be carefully analyzed to determine the correct approach.

4. California – FTB Voluntary Compliance Initiative.

A. In General.

Legislation was recently passed directing the FTB to establish a voluntary compliance initiative ("**VCI**") to operate between August 1, 2011 through October 31, 2011.⁶⁵ In 2004, California offered a similar VCI that applied to tax liabilities attributable to the use of abusive tax avoidance transactions for taxable years beginning before January 1, 2003 and was conducted from January 1, 2004 through April 15, 2004.⁶⁶ The new VCI applies to tax liabilities attributable to the use of abusive tax avoidance transactions and to unreported income from the use of offshore financial arrangements for taxable years beginning before January 1, 2011.

B. Definitions.

1. Abusive Tax Avoidance Transaction. An "abusive tax avoidance transaction" means any of the following:

- A tax shelter as defined in Internal Revenue Code (IRC) Section 6662(d)(2)(C);
- A reportable transaction as defined in IRC Section 6707A(c)(1) when certain requirements have not been met;
- A listed transaction as defined in IRC Section 6707A(c)(2);
- A gross misstatement within the meaning of IRC Section 6404(g)(2)(D); or

⁶⁵ See S.B. 86.

⁶⁶ See former Rev. & Tax Code Section 19751-19755.

- A transaction subject to a penalty for a noneconomic substance transaction understatement.⁶⁷

2. **Offshore Financial Arrangement.** An “offshore financial arrangement” means any transaction involving financial arrangements that in any manner rely on the use of offshore payment cards, including credit, debit or charge cards, issued by banks in foreign jurisdictions or offshore financial arrangements, including arrangements with foreign banks, financial institutions, corporations, partnerships, trusts or other entities to avoid or evade income or franchise tax.⁶⁸

C. **Election to Participate.** VCI applies to taxpayers that elect to participate in the program.⁶⁹ Taxpayers must file an amended tax return for each taxable year for which the taxpayer has previously filed a tax return using an abusive tax avoidance transaction or an offshore financial arrangement to underreport tax liability or failed to include income from the offshore financial arrangement.⁷⁰ Each amended tax return must report all income from all sources, without regard to the abusive tax avoidance transaction, including all income from offshore financial arrangements. Taxpayers generally must pay all taxes and interest due in full, but the FTB may enter into an installment payment agreement with a taxpayer.⁷¹

D. **Waiver of Penalties.** For all taxable years where the taxpayer elects to participate in the VCI, the FTB generally will waive or abate the penalties incurred as a result of the unreported tax liabilities attributable to the use of abusive tax avoidance transactions and to unreported income from the use of offshore financial arrangements.⁷² However, the FTB may not waive the large corporate underpayment penalty⁷³ or the tax amnesty penalty.⁷⁴ Also, no penalty assessed after July 31, 2011 may be waived or abated if the penalty is attributable to an assessment of taxes that become final prior to this date. No refund or credit will be allowed for amounts paid in connection with abusive tax avoidance transactions or unreported income from the use of offshore financial arrangements. Finally, no criminal action may be brought against the taxpayer for the taxable years with respect to issues for which the taxpayer participated in the VCI.⁷⁵

5. **FATCA - The Most Significant Change in U.S. In-Bound Tax Policy in the Last 50 Years.**

The Foreign Account Tax Compliance Act (“**FATCA**”) is designed to identify U.S. taxpayers with assets and income from non-U.S. financial institutions (i.e., foreign financial institutions- “**FFIs**” and foreign non-financial entities – “**FNFEs**”).

Dual citizens who are also U.S. citizens by birth (e.g., born in the U.S. to a non-U.S. family) who has otherwise never lived in the U.S. will be affected. Lawful permanent residents residing outside the U.S. will also be affected.

The key provisions regarding FFIs and FNFEs become effective January 1, 2013.

A. **What is FATCA and How Does it Work?**

- On March 18, 2010, President Obama signed into law the Hiring Incentives to Restore Employment Act (HIRE Act);

⁶⁷ Rev. & Tax. Code Section 19763(c), 19777.

⁶⁸ Rev. & Tax. Code Section 19764(a)(1)(B).

⁶⁹ Rev. & Tax. Code Section 19762.

⁷⁰ Rev. & Tax. Code Section 19764.

⁷¹ *Id.* An installment payment agreement only is allowed if final payment is due and paid by June 15, 2012. Also, the agreement must include interest on the unpaid amount.

⁷² Rev. & Tax. Code Section 19762.

⁷³ Rev. & Tax. Code Section 19138. This penalty applies to taxpayers with an understatement of tax that exceeds the greater of the following: (1) \$1 million or (2) 20 percent of the tax shown on an original or amended return filed on or before the original or extended due date if the return for the taxable year. The penalty equals 20 percent of the understatement of tax.

⁷⁴ Rev. & Tax. Code Section 19777.5.

⁷⁵ Rev. & Tax. Code Section 19762.

- As part of the measures taken to offset the cost of this law, a series of new rules and audit measures were put in place.
- A Chapter 4 was added to Subtitle A of the Internal Revenue Code named *Foreign Account Tax Compliance Act* (FATCA).
- New IRC Sections 1471 through 1474 and 6038D were added.
- IRS will need to issue significant regulatory guidance for the implementation of FATCA and to date has only issued IRS notices 2011-34 and 2010-60.
- These new FATCA provisions represent the most significant change in U.S. international inbound tax policy in the last 50 years (from the authors/presenters perspective).
- As noted above, the new rules will become effective on January 1, 2013.
- Certain informational reporting requirements became applicable on March 2012.
- FATCA is estimated to generate approximately US\$8.7 billion in new tax revenues.
- The Treasury Department, through FATCA, is establishing a completely new system of reporting and withholding obligations applicable to Foreign Financial Institutions (FFI).
- These reporting obligations are ostensibly designed to identify U.S. owners of various financial accounts of FFIs (by identifying ALL account holders, including non-U.S. owners).
- The withholding obligations under FATCA impose a 30% withholding tax on U.S. sources of income as defined by the law, if the FFI does not voluntarily comply with the new FATCA law.

B. FATCA's Purpose (Expressly Stated Purposes)

- either
- a) To enforce the payment of U.S. taxes by U.S. persons holding overseas accounts and assets
 - directly, or
 - indirectly through entities or other legal instruments; and
 - b) obtain information regarding income and assets of US persons who have assets held in foreign financial institutions.

In essence, FATCA “invites” FFIs and certain FNFES to enter into an agreement (“**FATCA Agreement**”) with the IRS under which detailed information about their U.S. account holders and members would be disclosed to the IRS on an annual basis through extensive information reporting.

This law is “voluntary” for the FFIs and FNFES who are not required to comply with U.S. law, but failure to participate in the FATCA program and enter into FATCA Agreement will have significant economic consequences to the FFIs and their customers and affiliates.

If a FATCA Agreement is not entered into by the FFI, FATCA imposes a 30% withholding tax on payments to the FFI on (i) U.S.-source passive income (*e.g.*, interest and dividends); and (ii) the gross proceeds from the sale of U.S. stocks and securities.

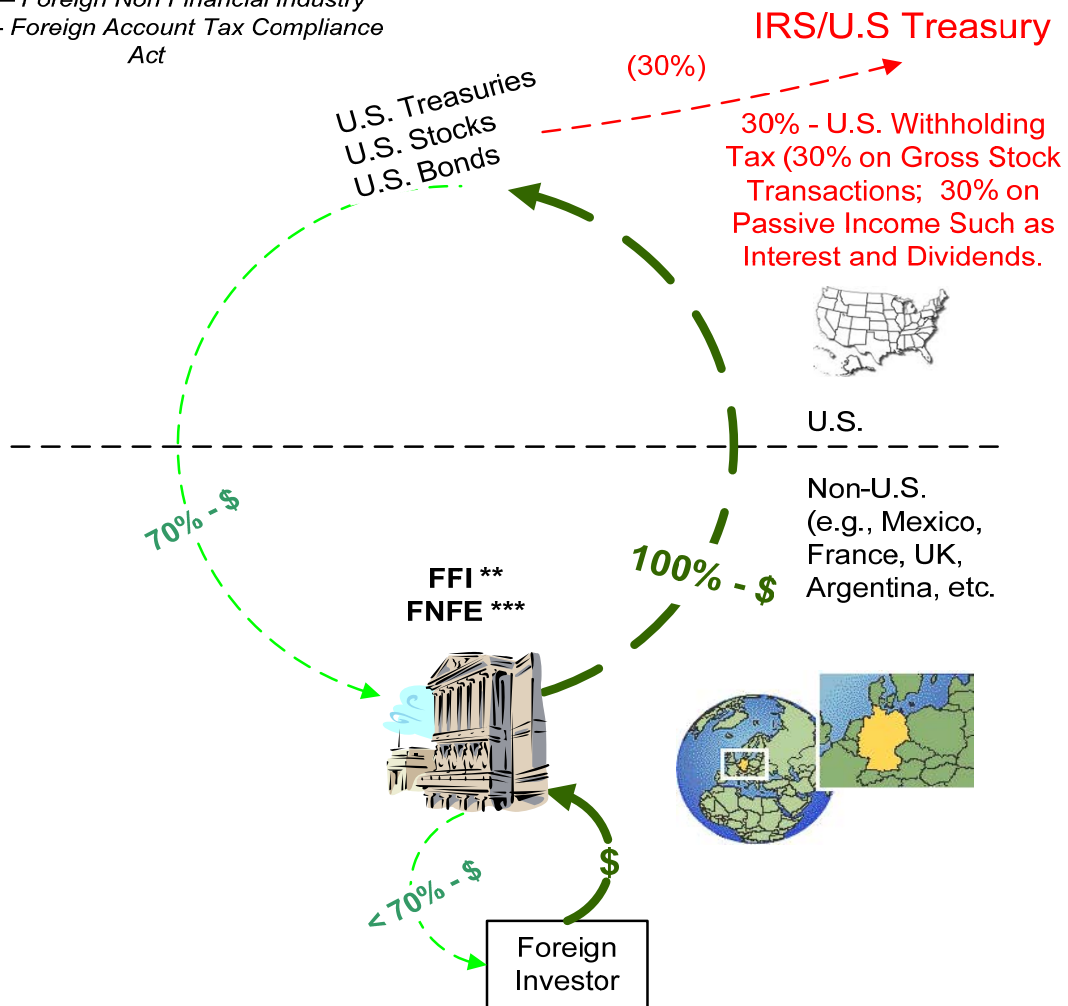
C. Definition of FFI. The definition of a FFI is very broad. New IRC Section 1471(d)(5) defines it as any entity that either:

- a) accepts deposits in the ordinary course of a banking or similar business.
 - e.g., saving banks, commercial banks, credit and savings associations, credit unions and any other banking institutions;
- b) as a substantial portion of its business, holds financial assets for the accounts of others; or
 - e.g., financial Intermediaries, compensation chambers, trusts, custody banks.
- c) is engaged primarily in the business of investing, reinvesting, or trading in securities, partnership interests, or commodities, or any interest (including a futures or forward contract or option) in such securities, partnership interests, or commodities.
 - e.g., investment companies, and certain fund investments structures

The definition of FFI excludes:

- U.S. financial institutions and their branches (e.g., Wells Fargo, Bank of America, etc.).
- Financial Institutions established in American territories (e.g., Puerto Rico).

FFI – Foreign Financial Industry
FNFE – Foreign Non Financial Industry
FATCA – Foreign Account Tax Compliance Act



D. Principal businesses affected by FATCA

- Wealth Management
 - Private Banking
 - Custody of Investment Assets
 - Cash Management
 - Investment and Corporate Banking
 - Insurance
 - Trusts (Trustees and Corporate Trust Services)
 - Business and Commercial Banking
 - Capital Reserves for Foreign Banks
- Even though under FATCA the persons subject to the tax are the final beneficiaries of the payment, the withholding obligation applies to whom makes the payment (American entity), as well as to the FFI that acts as an agent or intermediary of the final beneficiary.
 - The withholding agent is jointly and severally liable for the amount to be withheld.
 - Even though the tax treaties to avoid double taxation will remain in effect, the benefits will now be obtained by filing tax returns directly to the US government.
 - The withholding tax will not be applied to the payments by FFI's that enter into a FATCA Agreement with the IRS nor to the NFFE that provide the information of their beneficial owners
 - By means of the FATCA Agreement between the FFI and IRS, the intermediary agrees to :
 - Obtain information regarding each holder of each account maintained by the institution as is necessary to determine which accounts are "U.S. accounts."
 - The reporting obligation will not apply when:
 - The owners of the accounts are natural persons, and
 - The account balance per institution per year is never higher than US\$50,000 dollars.
 - The annual reporting of information required by FATCA with respect to any U.S. account maintained by the institution is as follows:
 - Comply with verification and due diligence procedures as the IRS may require with respect to the identification of U.S. accounts;
 - Comply with requests by the IRS for additional information with respect to any U.S. account maintained by the institution;

- Attempt to obtain a valid and effective waiver from the customer in any case in which any foreign law would prevent the reporting of the information required by FATCA, and if a waiver is not obtained from each account holder within a reasonable period of time, to close the account; and

- Deduct and withhold 30% from any “pass-through payment” made to a (i) “recalcitrant account holder” (an account holder who refuses to provide information); (ii) foreign financial institution that does not itself enter into a FATCA information reporting FATCA Agreement with the IRS; and (iii) FFI that has elected to be withheld upon, rather than to withhold with respect to the portion of the payment that is allocable to a recalcitrant account holder or nonparticipating foreign entity.

- The following information must be reported regarding US person accounts:

- Name, address, tax identification number (TIN) of the *US Person* or in case of a juridical person considered to be control by an US person, the TIN of each of its owners.

- Account number.

- The account balance or value.

- Net income and possibly the withdraws and payments made through the account.

E. Who is a US Persons

- The term “*US Person*” includes:

- US citizens even those residing abroad.

- Legal permanent residents of the US (green card holders).

- People that comply with the “substantial presence test” – generally, non US citizens present in the U.S for at least 183 days.

- People that present certain traits of American status.

- **Traits of American status...**

- The indication that the account holder is a citizen or resident of the United States.

- The place of birth is the United States.

- Permanent physical or mail address in the United States.

- An account whose only address is a US P.O. Box.

- A power of attorney or signature authority granted to a person with an address in the United States.

- Instructions to send payments to an account in the United States or any other instruction received from the United States.