Monday, May 20, 2013

THE DAILY RECORD

WESTERN NEW YORK'S SOURCE FOR LAW, REAL ESTATE, FINANCE AND GENERAL INTELLIGENCE SINCE 1908

Civil LITIGATION

Substantial sanctions can be imposed on unwitting holders

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Historically, assets could be hidden in offshore bank accounts without significant risk of exposure. Due to the efforts of the federal government over the past decade, Swiss bank accounts no longer provide a safe haven for hiding assets from the Internal Revenue Service.

The Bank Secrecy Act of 1970 requires individuals to report their foreign bank account and changes to this Act over the past decade have given teeth to enforcement. Anyone having a balance in excess of $10,000 in foreign accounts at any time during the taxable year must report this account on Treasury Form TD F 90-22.1 (FBAR). Failure to file the FBAR can lead to criminal and civil penalties. Criminal charges are usually reserved for the more egregious tax-evaders, however steep civil penalties can hit upstanding citizens with no fraudulent intent.

FBARs are required not only for accounts in well-known bank havens like Switzerland or the Cayman Islands, but an account in any foreign country. For example, accounts in Canada, the Dominican Republic or Ukraine must be reported. Furthermore, even if a person is not the account holder, he or she has an obligation to report the account when merely signatory authority is held.

There are plenty of examples of taxpayers being subjected to civil penalties for accounts held for legitimate business purposes, by immigrants maintaining accounts in their homeland, and by heirs inheriting foreign accounts from relatives. Many lawyers and accountants have clients in similar situations; clients they would never expect to hold a foreign bank account that has not been reported.

FBARs must include: 1) the identity and address of participants; 2) the legal capacity in which a participant is acting; 3) the identity of real parties in interest; and 4) a description of the transaction. A failure to report the foreign bank account, which is not a willful failure, subjects the non-filer to a penalty of up to $10,000. However, a willful failure to report subjects the non-filer to a maximum penalty of the greater of $100,000 and 50 percent of the value of the account. 31 U.S.C. § 5321. Therefore, defining willfulness is critical to analyzing risk and representing a client with an unreported foreign bank account.

Not much guidance has been available in defining willfulness. In a 2006 Chief Counsel Advice Memorandum, the IRS took the position that willfulness was the same in both the civil and criminal contexts, CCA 200603026; see also Internal Revenue Manual 4.26.16.4.5.3. This standard requires "a voluntary intentional violation of a known legal duty."

In other words, the government must prove that the account holder had acted with knowledge that an FBAR must be filed. Knowledge of the illegality of failing to file the FBAR is not required to meet the willfulness element. The chief counsel advised that the standard of proof is "clear and convincing" evidence.

To date, courts have offered very limited guidance on defining a willfulness standard and applying a burden of proof standard. In a 2010 District Court case, the IRS argued that one entry on the taxpayer's 1040 created prima facie evidence of willfulness, *United States v. Williams*, 106 A.F.T.R.2d 2010-6150 (E.D. Va. 2010). Line 7a of Form 1040 asks whether the taxpayer has a foreign account. By checking "No," the IRS argued that the taxpayer willfully failed to comply with the FBAR requirement.

The court stated the standard of willfulness is knowingly or recklessly failing to comply. Also, the court stated that only repeated failures of a known regulation raise negligent failures to reckless, and, thus, willful, failures. Additionally, the District Court applied only the "preponderance of the evidence" burden. Given the facts of the taxpayer's belief that the government was aware of the account, the District Court found that the government failed to show willful failure by a preponderance of the evidence. The IRS appealed and found a more favorable Fourth Circuit.

The Court of Appeals reasoned that the District Court's standard was clearly erroneous and that recklessness by the taxpayer

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was sufficient for a finding of willfulness, *U.S. v. Williams*, 489 Fed.Appx. 655 (4th Cir. 2012). The Circuit Court held that signing a return is prima facie evidence of the contents of the return.

Because the return inquires about whether a taxpayer has a foreign account, the court held that Williams recklessly disregarded the regulations requiring disclosure. Therefore, the court held that Williams willfully failed to disclose his foreign accounts and was subject to the penalty. The Court of Appeals did not address the government's standard of proof in its decision.

One other district has addressed this question of willfulness. In *United States v. McBride*, the District Court held that recklessness amounts to willfulness. 110 A.F.T.R.2d 2012-6600 (D. Utah 2012). Like in *Williams*, the court imputed knowledge of the reporting requirement to the taxpayer. Because the taxpayer had knowledge of the requirement and failed to report, he recklessly disregarded his obligation. The court found that this reckless disregard was a willful failure to comply. The court also found that the government merely had a burden of proving willfulness by a preponderance of the evidence.

Although limited, the existing guidance has established a definition of "willful" that includes merely reckless. Also, this willfulness need only be proven by a preponderance of the evidence. It is worth noting that, in both *Williams* and *McBride*, the taxpayers acted in an egregious manner and likely would have been found to be willfully failing to comply even without being found reckless.

These facts arguably make the recklessness reasoning dicta. These cases also demonstrate the government's tried and true method of establishing bad law on good facts. If the imputed knowledge leading to recklessness argument becomes established precedent, it is certain that many more unwitting taxpayers will be unknowingly trapped in this web and subjected to penalties likely not intended by Congress in passing the Bank Secrecy Act.

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