MSP #22 OFFSHORE VOLUNTARY DISCLOSURE: The IRS Offshore Voluntary Disclosure Program Disproportionately Burdens Those Who Made Honest Mistakes

RESPONSIBLE OFFICIALS

John Dalrymple, Deputy Commissioner, Services and Enforcement
Heather C. Maloy, Commissioner, Large Business and International Division
Karen Schiller, Commissioner, Small Business/Self-Employed Division
Debra Holland , Commissioner, Wage and Investment Division
William J. Wilkins, Chief Counsel

DEFINITION OF PROBLEM

Since 2009, the IRS has generally required those who failed to report offshore income and file one or more related information returns (*e.g.*, the *Report of Foreign Bank and Financial Accounts* (FBAR)) to enter into successively more punitive offshore voluntary disclosure (OVD) programs.[1] Designed for "bad actors," these programs burdened "benign actors" who inadvertently violated the rules by requiring them to "opt in and opt out" to get a fair result. The programs were punitive, charging average penalties of more than double the unpaid tax and interest associated with the unreported accounts.[2] Because those opting out faced prolonged uncertainty and a risk of even more severe penalties, some agreed to pay more than they should, as described in prior reports.[3]

Unlike those who remain in the programs, those who opt out are audited, which essentially penalizes them for coming forward. On average, the IRS assessed penalties of nearly 70 percent of the unpaid tax and interest in the audits of those who opted out.[4] Thus, while those who opt out generally face smaller penalties than those inside the OVD programs, they still face very significant ones.

For those who remained in the 2009 program, the median offshore penalty applied to those with the smallest accounts (*i.e.*, those in the 10th percentile with accounts of $87,145 or less) was disproportionate — nearly six times the median unpaid tax.[5] Among unrepresented taxpayers with small accounts it

1 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"]. The IRS subsequently established a "streamlined" program for certain nonresidents, as described below.

2 IRS response to TAS information request (Sept. 17, 2013) (indicating $1.46 billion in tax and interest was assessed in connection with the 2009 and 2011 program certifications and amended returns, as compared to $3.95 billion in penalties).

3 *See* National Taxpayer Advocate 2012 Annual Report to Congress 134-153; 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 IRS response to TAS information request (Sept. 17, 2013) (indicating the IRS assessed about $30.38 million in tax and interest and $20.89 million in penalties).

5 Compliance Data Warehouse (CDW) (Sept. 27, 2013) (TAS analysis of closed cases where an offshore penalty was assessed, as reflected on AIMs and ERIS).

The National Taxpayer Advocate has offered many common sense recommendations that would bring taxpayers into compliance and help restore confidence in the IRS, but IRS has not fully adopted them.

was even more disproportionate — nearly eight times the unpaid tax.[6] It was also disproportionately greater than the median penalty paid by those with the largest accounts (*i.e.*, those in the 90th percentile with accounts of more than $4.2 million) who paid about three times the unpaid tax.[7] Given the harsh treatment applied to those with small accounts, some have made "quiet" disclosures by correcting old returns and others have begun to comply prospectively — in each case without subjecting themselves to the lengthy and seemingly-unfair OVD process.

While 7.6 million U.S. citizens reside abroad and many more U.S. residents have FBAR filing requirements,[8] the IRS received only 807,040 FBAR submissions in 2012.[9] Yet the FBAR audit rate is less than one quarter of one percent.[10] Thus, the IRS has likely failed to address significant information reporting noncompliance. The National Taxpayer Advocate has offered many common sense recommendations that would bring taxpayers into compliance and help restore confidence in the IRS, but IRS has not fully adopted them.

ANALYSIS OF PROBLEM

The IRS's OVD settlement programs are a good deal for "bad actors" but not for "benign actors."

The combination of the FBAR statute and the way the IRS administers it creates the potential for such draconian penalties that some taxpayers may agree to pay unwarranted amounts. The 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).[11] 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).[12]

> **Example:** Assume a U.S. resident has a joint account with extended family abroad. The account has had a constant balance of $1 million for at least the past six years. Because this individual violated the reporting requirements by failing to file an FBAR over a six-year period, the penalty could be as high as $3 million — three times the balance! The penalty may be an even greater percentage of the balance if the account value has fallen since the end of the

6 Compliance Data Warehouse (CDW) (Sept. 27, 2013) (TAS analysis of closed cases where an offshore penalty was assessed, as reflected on AIMs and ERIS).

7 *Id*.

8 U.S. Department of State, Bureau of Consular Affairs, *Who We Are and What We Do: Consular Affairs by the Numbers* (May 2013), http://travel.state.gov/pdf/ca_fact_sheet.pdf.

9 IRS response to TAS information request (Aug. 12, 2013). As of November 25, 2013, the Treasury Department had processed only 594,061 FBAR filings in 2013, including 556,739 paper filings thru June 27 and E-filings thru September 30. IRS response to TAS information request (Dec. 6, 2013).

10 Even if the universe of potential violations only consisted of the FBARs filed in 2011, the 1,626 civil FBAR examinations closed in 2012 would reflect an audit rate of 0.2 percent (1,626/741,249). 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* (CY 2012) (reporting 741,249 FBAR filings in 2011 and 1,626 civil FBAR examinations closed in 2012).

11 31 U.S.C. § 5321(a)(5)(C). The maximum penalty for nonwillful violations is $10,000, but it is difficult for taxpayers to predict in advance whether the IRS will seek the willful or the nonwillful penalty. *See* 31 U.S.C. § 5321(a)(5)(B).

12 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).

sixth year (or if the account is less than $200,000, as the maximum penalty is never less than $100,000). This would be true even if the taxpayer did not owe any U.S. tax on unreported income from the account, and even if the taxpayer's tax preparer did not inform him or her of the FBAR filing requirement.[13]

Far from allaying taxpayer concerns about the draconian impact of this statute, the IRS OVD programs magnify them. In general, the programs offer to settle potential FBAR and other penalties for failure to file information returns for a fixed amount called the "offshore penalty." The offshore penalty is 27.5 percent (or 20 or 25 percent for the 2009 and 2011 programs, respectively) of the highest account value during an eight-year period.[14] For taxpayers who believe the IRS can prove they willfully violated the disclosure statute and who might otherwise be subject to criminal prosecution, this is probably a good deal.[15] For others, the maximum civil penalty under the statute is $10,000 for each non-willful failure or zero if the reasonable cause exception applies.[16] Thus, the IRS settlement programs were generally not a good deal for those whose failure was not willful.[17]

Unrepresented taxpayers with small accounts paid more than those with representation or large accounts.

Under a "fair" settlement program, one might expect that those with larger undisclosed accounts — that produced greater amounts of unreported income – would be asked to pay a proportionately greater penalty.[18] By this measure, the IRS's 2009 program was unfair. The median offshore penalty under the 2009 OVDP for those with the smallest accounts was nearly six times the median unpaid tax, whereas it was only about three times the unpaid tax for those with the largest accounts, as shown in the following table.

13 However, a penalty may not apply if the taxpayer establishes reasonable cause. *See* 31 U.S.C. § 5321(a)(5)(B).

14 A six-year period (2003-2008) applied to the 2009 program. Our discussion focuses on the FBAR because it is often the largest and most disproportionate penalty involved. In very limited circumstances, some could qualify for an offshore penalty rate of 5 percent or 12.5 percent, applicable to certain dormant or small accounts, respectively. 2011 OVDI FAQ #52 and #53; 2012 OVDP FAQ #52 and #53.

15 Even in criminal cases, however, the government has had difficulty obtaining a penalty of more than 50 percent of the highest account balance, at least where the taxpayer has tried to correct the problem. *See, e.g.*, Jeremiah Coder, *Judge Chastises DOJ for Offshore Account Prosecution, Suggests Pardon*, 2013 TNT 81-3 (Apr. 26, 2013).

16 1 U.S.C. § 5321(a)(5)(B). *See also* IRM 4.26.16.4.4(2) (July 1, 2008) (reasonable cause); IRM 4.26.16.4.5.3 (July 1, 2008) ("The burden of establishing willfulness is on the Service."); IRM 4.26.16.4.7(3) (July 1, 2008) (warning letter in lieu of penalties); IRM Exhibit 4.26.16-2 (July 1, 2008) (mitigation guidelines); IRM 4.26.16.4.7(4) (July 1, 2008) ("the assertion of multiple [FBAR] penalties … should be considered only in the most egregious cases.").

17 The offshore penalty is even more disproportionate if you consider that taxpayers are required to pay both an offshore penalty and an accuracy related penalty under the OVD programs. *See, e.g.*, 2012 OVDP FAQ 51.1. An accuracy-related penalty does not normally apply when a taxpayer files an amended return to correct an error before the error is detected by the IRS. *See, e.g.*, Treas. Reg. § 1.6664-2 (discussing qualified amended returns).

18 For example, under the IRS's "mitigation guidelines" those with unreported accounts of less than $250,000 are eligible for reduced FBAR penalties in connection with an examination. *See, e.g.*, IRM Exhibit 4.26.16-2 (July 1, 2008).

TABLE 1.22.1, Comparison of median 2009 OVD penalties to median unpaid tax by account size[19]

	Bottom 10 percent	Middle 80 percent	Top 10 percent
Offshore account(s) balance	$44,855	$607,875	$7,259,580
2009 OVDP penalty	$8,540	$117,803	$1,410,517
Additional tax, tax years 2003-2008	$1,472	$30,894	$452,966
Offshore penalty as a percent of tax assessed	580%	381%	311%

Moreover, among those with the smallest accounts (*i.e.*, the bottom 10 percent), those who were unrepresented paid an even greater median 2009 OVD penalty — 794 percent of the additional tax assessment for tax years 2003-2008.[20] By comparison, represented taxpayers in this group paid a median of 514 percent.[21] Perhaps unrepresented taxpayers with small accounts felt more pressure to accept a disproportionate offshore penalty than those who were represented or had larger accounts.

A new "streamlined" program is less burdensome, but is overly narrow and does not provide certainty.

Recognizing the OVD programs were excessively burdensome and unfair to benign actors, in 2012 the IRS created a "streamlined" program that allows some "low risk" nonresidents to avoid the burdensome opt-in-opt-out process.[22] However, the program still requires a voluminous submission (*e.g.*, a questionnaire, three returns, and six FBARs), is closed to U.S. residents, and fails to provide certainty for those deemed "high risk." Worse, the IRS has not clearly explained what will trigger this high risk designation.[23] For example, are you high risk if you owe $25,000 in tax? Applicants deemed high risk may be worse off than those making quiet disclosures or even ignoring the problem. After making a streamlined submission, the applicant may still face the possibility of draconian civil penalties and criminal

19 CDW (Sept. 27, 2013) (TAS analysis of closed cases where an offshore penalty was assessed, as reflected on AIMs and ERIS). All figures are medians rather than the averages because the data contains extreme outliers. These findings are consistent with data published by the Government Accountability Office (GAO), which suggests an even greater disparity between those with large and small accounts. *See* National Taxpayer Advocate 2014 Objectives Report to Congress 37-38 (discussing GAO, GAO-13-318, *IRS Has Collected Billions of Dollars, but may be Missing Continued Evasion* 13 (Mar. 2013) (Table 2)).

20 CDW (Nov. 14, 2013). TAS identified "unrepresented" taxpayers as those with no representative reflected on the Centralized Authorization File (CAF) — a database used to record third-party representation in tax matters — for any of the tax years 2003-2008. Taxpayers with a representative on the CAF at any time for any of those years were counted as "represented," even though they may have been unrepresented in connection with the OVD program. By this measure, 44 percent of those with accounts in the bottom 10 percent were unrepresented, as compared to 22 percent of those with accounts in the middle 80 percent, and 16 percent of those with accounts in the top 10 percent. CDW (Nov. 14, 2013). A third party who is only authorized to address delinquent FBAR issues and not tax issues might not be reflected on the CAF. However, representatives of OVD program participants should be reflected on the CAF because taxpayers who did not have income tax issues should not have applied to the OVD program(s). *See, e.g.*, 2009 OVDP FAQ 9.

21 *Id*.

22 GAO, GAO-13-318, *IRS Has Collected Billions of Dollars, but May be Missing Continued Evasion* 20 (Mar. 2013) (discussing the reasons for the streamlined program).

23 In 2012, the IRS began allowing certain "low risk," nonresident nonfilers — those with simple returns and owing less than $1,500 in tax — to file the returns without triggering penalties. See 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. In early 2013, following publication of the National Taxpayer Advocate's recommendation to expand the streamlined program to both U.S. residents and those owing more than $1,500, the IRS eliminated the $1,500 threshold. *See* National Taxpayer Advocate 2014 Objectives Report to Congress 37-38.

prosecution. As of September 2013, 2,990 taxpayers had submitted returns under the streamlined program, reporting an additional $3.8 million in taxes, and 57 were identified as high risk.[24]

The IRS expects other benign actors to opt in and then opt out of an OVD program, subjecting themselves to more burden and risk than bad actors.

The only option for benign actors who feel the offshore penalty is "too severe given the facts of the case" is to opt out and be audited.[25] This is unappealing for many. Because IRS settlement programs are a good deal for bad actors concerned about criminal prosecution, bad actors do not need to opt out or risk draconian penalties. Moreover, the IRS initially processed applications from benign actors who are expected to opt out much more slowly than others, though it has recently begun to process them more quickly, as shown by the following table.

TABLE 1.22.2, OVD Program Applications, Dispositions, and Processing Times as of September 30, 2013[26]

	2009 OVDP		2011 OVDI		2012 OVDP	
	Number	Average Processing Days	Number	Average Processing Days	Number	Average Processing Days
Total cases	**11,217**	**N/A**	**13,160**	**N/A**	**4,046**	**N/A**
Total closed cases	**11,132**	**319.6**	**7,391**	**194.6**	**216**	**115.9**
Closed certifications	10,760	310.4	6,578	203.2	216	115.9
Closed opt-outs	277	590.6	813	128.6	0	N/A
Closed removals	95	651.8	0	N/A	0	N/A
Total open cases	**85**	**896.4**	**5,769**	**248.9**	**3,830**	**75.9**
Open certifications	32	970.5	5,482	245.0	3,821	75.9
Open opt-outs	33	780.5	249	302.4	2	125.3
Open removals	14	989.9	15	272.6	0	N/A
Open suspense	6	997.0	23	212.8	7	59.0

24 IRS response to TAS information request (Sept. 17, 2013). This figure does not include taxpayers who opted out of the 2011 OVD program into the streamlined program. For example, it does not include 339 of the 475 Canadians who opted out of the 2011 OVD program and who were placed into the streamlined program. *Id*. We understand this is an estimate, as a system error prevented accurate reporting on these cases before September 2013. The IRS was unable to provide data regarding the resources it used or the time it took to process streamlined submissions. *Id*.

25 2011 OVDI FAQ 51; 2012 OVDP FAQ 49 and 51.

26 IRS response to TAS information request (Oct. 29, 2013). These figures do not include the time that taxpayers waited for the IRS's Criminal Investigation Division to clear them to participate or for the IRS to load their cases onto its tracking system.

TAS has recently assisted benign actors who waited for extended periods, as illustrated in the example below. Thus, the IRS's inflexible opt-in-opt-out approach offered bad actors a relatively better deal and also provided them with better customer service than benign actors.[27]

> **Example**: A U.S. citizen residing in Sweden had a life savings of less than $1 million in various foreign accounts and funds. In 2010, he applied to the IRS's 2009 OVD program. Only after TAS issued a Taxpayer Assistance Order in 2012 did the IRS assign a revenue agent to review the submission. In February 2013, the taxpayer opted out. In May 2013 — more than two years after receiving the application — the IRS issued a warning letter. Although unrepresented during most of the process, the taxpayer still spent over $50,000 in fees and mailing costs, and countless hours typing emails to the IRS (that the IRS could not return) or on the phone during business hours in the U.S. — often at night in Sweden.[28]

The IRS's one-size-fits-all approach disproportionately penalizes those who apply.

As of September, 2013, nearly ten IRS examiners (9.5 FTEs) had examined 2,828 returns as a result of opt-out and removal cases, and assessed penalties equivalent to nearly 70 percent (on average) of the tax and interest due.[29] While these results are not as draconian as many fear, the IRS is still assessing substantial penalties against taxpayers who have voluntarily come forward to correct a mistake. By contrast, those who make quiet disclosures or ignore the problem are unlikely to be detected or penalized.[30] As the IRS closed only 1,626 civil FBAR examinations in 2012, its FBAR audit rate is less than one quarter of one percent.[31] Moreover, many of these examinations involved taxpayers who opted in and out of an OVD program in an effort to correct a mistake, rather than more egregious cases that the IRS could identify on its own.[32] Although it may try to do more in this area, the IRS is unlikely to have the resources to do significantly more. Its resources are tied up auditing (or certifying) those who came forward voluntarily. Thus, the IRS's programs effectively penalize taxpayers for coming forward even if they opt out. The National Taxpayer Advocate has recommended the IRS substitute a more nuanced three-category approach for its one-size-fits-all programs, as follows:[33]

27 This process made it difficult for benign actors to compute and pay the correct amount, while delaying their right to appeal and to be heard, each of which are fundamental taxpayer rights. For proposals to clarify these rights and others, see National Taxpayer Advocate 2011 Annual Report to Congress 493-518 (Legislative Recommendation: *Enact the Recommendations of the National Taxpayer Advocate to Protect Taxpayer Rights) and The IRS Should Adopt a Taxpayer Bill of Rights as a Framework for Effective Tax Administration, supra*.

28 TAS has permission from the taxpayer to discuss these facts. For similar examples, see, *e.g.*, Marie Sapirie, *The Personal Impact of Offshore Enforcement*, 2013 TNT 136-1 (July 16, 2013).

29 IRS response to TAS information request (Sept. 17, 2013) (reporting the IRS examined 2,828 returns associated with opt outs or removals, spent 7 hours per return, assessed $24,373,726 in income tax, $6,005,301 in interest, $16,819,876 in tax-related penalties, and $4,069,795 in FBAR penalties). These examiners are very productive because those entering the program have already provided nearly everything they need to close the case — and have agreed to most, if not all, of the assessment for tax, interest, and tax-related penalties.

30 *See generally*, GAO, GAO-13-318, *IRS Has Collected Billions of Dollars, but May be Missing Continued Evasion* (Mar. 2013) (GAO recommended and the IRS agreed to do more to detect quiet disclosures).

31 IRS response to TAS information request (Sept. 23, 2013) (reporting 1,626 FBAR examination closures for 2012, about 15 percent (or 239) of which resulted in warning letters). Although the number of people who should be filing an FBAR is unknown, even if it consists solely of those who actually filed one in 2012, the audit rate would be 0.2 percent (1,626 / 807,040). Thus, the IRS is using the relatively empty threat of criminal prosecution to drive people — including benign actors — into its programs. We say "relatively empty" because the IRS initiated only 30 criminal investigations of FBAR violations in 2012. *Id.*

32 As noted on the table above, the IRS has closed 277 opt outs from the 2009 program and 813 from the 2011 program. As all taxpayers who opt out are subject to an exam, IRS-reported examination closures likely included many who opted out.

33 *See, e.g.*, National Taxpayer Advocate 2012 Annual Report to Congress 134-153.

Category 1. Full relief from FBAR and information reporting penalties. Taxpayers who underreported offshore income by less than a reasonable threshold amount — at least as high as the IRC § 6662(d) threshold (*i.e.*, the greater of $5,000 or 10 percent of the tax required to be shown) — should be permitted to file delinquent returns without penalty, regardless of whether they are residents.[34] 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 program.[35]

Category 2. Taxpayers who have reasonable cause or who acted non-willfully. Taxpayers who underreported more than the threshold but who believe they have reasonable cause or who acted non-willfully should explain their circumstances, file delinquent returns, pay any applicable tax, interest, and penalties under Title 26 (unless asserting reasonable cause). Depending on the circumstances and explanation, these taxpayers should be required to pay either the non-willful FBAR penalty or no penalty under the reasonable cause exception.[36] Because they are required to cooperate, the IRS should have little difficulty evaluating their circumstances without requiring them to opt in and then opt out. Rather than examining each of these returns in full, the IRS should examine a small percentage of them using its normal audit selection techniques, thereby improving its ability to identify noncompliance and encouraging voluntary compliance without unnecessarily burdening taxpayers.

The combination of the FBAR statute and the way the IRS administers it creates the potential for such draconian penalties that some taxpayers may agree to pay unwarranted amounts.

Category 3. Taxpayers not included in Category 1 or 2. Taxpayers who do not fall into categories one or two, but voluntarily come forward to correct their violations should be required to file delinquent or amended returns and pay tax, interest, delinquency and accuracy-related penalties, and the offshore penalty, as currently required under the 2012 OVDP.

For those in Category Two, the IRS could provide more comprehensive guidance and examples to help taxpayers, practitioners, and IRS employees determine whether reasonable cause applies, potentially reducing anxiety, uncertainty, and controversy in this area. Anti-abuse rules could discourage Category Three taxpayers from self-selecting into Category Two. This three-category approach could prevent the IRS from being viewed as extorting or bullying unjustified penalties from taxpayers — particularly unrepresented taxpayers with small accounts — and ultimately improve voluntary compliance.

34 Persons who failed to file an FBAR and did not report all of their income are currently required to pay the offshore penalty, even if they do not have a tax deficiency (*e.g.*, due to an offsetting foreign tax credit). *See, e.g.*, 2011 OVDI FAQ 17; 2012 OVDP FAQ 17; and 2012 OVDP FAQ 33.

35 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.

36 Although IRS Fact Sheet 2011-13 provides some guidance, the IRS should more expressly define what constitutes "reasonable cause" for purposes of FBAR and provide examples about the difference between willful and non-willful violations based on the taxpayer's background, education level, cultural concerns, etc. The IRS should also clarify that it will not seek a penalty for a willful violation unless it can show "a voluntary intentional violation of a known legal duty." *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 government has imposed new and duplicative information reporting requirements, and made filing an FBAR more difficult.

Beginning in tax year 2011, the IRS has required some taxpayers to file duplicative information about foreign accounts on the FBAR and Form 8938, *Statement of Foreign Financial Assets*.[37] Thus far, the IRS has not adopted the National Taxpayer Advocate's recommendation (or a similar recommendation by the GAO) to reduce this duplicative reporting.[38]

Moreover, after June 30, 2013, the Financial Crimes Enforcement Network (FinCEN) requires the FBAR to be filed electronically on a new system that does not accept attachments (such as explanations for late filings), making compliance more difficult for some.[39] While the FinCEN BSA E-File system still does not accept attachments, as of October 1, 2013, it was updated to allow late FBAR filers to provide a 750 character explanation.[40] However, the system's inability to accept attachments could potentially generate unnecessary inquiries or audits.

Education, burden reduction, and improved guidance could bring millions of benign actors into compliance, while preserving respect for the IRS.

While 7.6 million U.S. citizens reside abroad and many more U.S. residents have FBAR filing requirements,[41] the Treasury Department processed only 807,040 FBAR filings in 2012.[42] Further, GAO has reported significant confusion about the reporting requirements, identified a significant number of participants in the IRS's programs who were unaware of the FBAR filing requirements, observed the IRS has failed to educate recent immigrants and that it has not formally evaluated any of its outreach efforts.[43] Thus, a more effective initiative — one combined with burden reduction and education — could prompt significantly more taxpayers to come into compliance.

The IRS has discontinued an FBAR Compliance Initiative Project to educate those with foreign bank accounts who are most likely to have FBAR violations (*e.g.*, immigrants to the U.S. and U.S. citizens

37 Sections 511 and 521 of the Hiring Incentives to Restore Employment Act (the HIRE Act), Pub. L. No. 111-147, 124 Stat. 71 (2010) (codified at IRC §§ 6038D and 1298(f)) enacted these new reporting requirements. It applied to taxable years beginning after March 18, 2010, but implementation was delayed. See Notice 2011-55, 2011-29 I.R.B. 53 (July 18, 2011). For further discussion of FATCA, see Most Serious Problem: *The Foreign Account Tax Compliance Act Has the Potential to Be Burdensome, Overly Broad, and Detrimental to Taxpayer Rights, infra*.

38 *See, e.g.*, FinCEN, *Final Reminder for Electronic Filing Requirement* (June 29, 2012), http://www.fincen.gov/news_room/nr/html/20120629.html. For GAO's recommendation, see GAO, GAO-12-403, *Reporting Foreign Accounts to the IRS, Extent of Duplication Not Currently Known, but Requirements Can Be Clarified* 26 (Feb. 2012) (recommending "[A]s data becomes available, determine whether the benefits of implementing a less duplicative reporting process exceed the costs and if so, implement that process.").

39 *See, e.g.*, FinCEN, *Final Reminder for Electronic Filing Requirement* (June 29, 2012), http://www.fincen.gov/news_room/nr/html/20120629.html. Paper IRS FBAR Form TD F 90–22.1 was replaced by FinCEN FBAR Report 114, which must be filed electronically. Although international taxpayers report having access the internet from home more often than domestic taxpayers (85 percent vs. 77 percent for domestic), a smaller percentage actually e-file (27 percent vs. 72 percent overall in 2011). *See* Wage and Investment, Research and Analysis, *Understanding the International Taxpayer Market* 7, 13 (June 2011), www.irs.gov/pub/irs-utl/5_david_cico.pdf. It is unclear whether the FBAR e-filing requirement has reduced compliance. As of November 25, 2013, the Treasury Department had processed 594,061 FBAR filings in 2013, including 556,739 paper filings thru June 27 and 37,322 E-filings thru September 30. IRS response to TAS information request (Dec. 6, 2013). By comparison, there were 798,993 paper filings and 8,047 electronic filings, for a total of 807,040 FBAR filings in 2012. IRS response to TAS information request (Sept. 23, 2013).

40 IRS response to TAS information request (Dec. 6, 2013) (citing FinCEN Notice, *Important Notice to BSA E-Filers: Updated Report of Foreign Bank and Financial Accounts (FBAR), FBAR Batch Capability, and Web Site Updates* (Sept. 30, 2013), http://www.fincen.gov/whatsnew/html/20130930.html).

41 U.S. Department of State, Bureau of Consular Affairs, *Who We Are and What We Do: Consular Affairs by the Numbers* (Jan. 2013), http://travel.state.gov/pdf/ca_fact_sheet.pdf.

42 IRS response to TAS information request (Aug. 12, 20013).

43 GAO, GAO-13-318, *IRS Has Collected Billions of Dollars, but May be Missing Continued Evasion* 21-22 (Mar. 2013).

abroad).[44] The National Taxpayer Advocate previously recommended the IRS reinstate this program.[45] The IRS could also reach out to those who immigrate to the U.S. when they apply for an ITIN, visa, or residency status. It could work with other agencies such as the State Department and the Department of Homeland Security.[46]

The National Taxpayer Advocate has also recommended the IRS use its normal guidance-making process to redesign its settlement programs, after taking stakeholder concerns into account, and publish the resulting guidance in the Internal Revenue Bulletin to avoid any confusion about what the rules are or whether the IRS will change them — by changing an FAQ posted to a website — without consulting with stakeholders. These steps would go a long way toward improving the fairness of the tax system, restoring respect for the IRS, and improving voluntary compliance.[47]

Moreover, the IRS should provide guidance about the information reporting required with respect to common situations.[48] For example, most people who have worked in Mexico have a government-mandated retirement account (called an AFORES).[49] In at least one case, an IRS Technical Advisor concluded a taxpayer should report them on Form 3520, *Annual Return To Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts*, and Form 3520-A, *Annual Information Return of Foreign Trust With a U.S. Owner*, before the IRS could process the taxpayer's decision to opt out of the OVD program. Imposing new requirements at the end of the process without having clear public guidance on the subject delayed the process and frustrated the taxpayer.[50] Moreover, by some accounts, more than one million U.S. citizens reside in Mexico and many Mexican citizens reside in the U.S., and a large percentage of each group could be subject to information reporting on AFORES.[51] Thus, the IRS should issue clear guidance about what accounts are reportable (and on what form(s)) before it requires taxpayers to report them.

44 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 [IRS] project remains viable … [but] is currently closed."). Many foreign accounts are reflected in the Web-CBRS database. *Id*. at 5.

45 National Taxpayer Advocate 2012 Annual Report to Congress 134-153.

46 The IRS has shared FBAR information and filing reminders with the Department of State. IRS response to TAS information request (Sept. 23, 2013).

47 Research suggests that seemingly unfair procedures may increase tax evasion by Schedule C filers. *See e.g.*, National Taxpayer Advocate 2012 Annual Report to Congress vol. 2, 1-70 (*Factors Influencing Voluntary Compliance by Small Businesses: Preliminary Survey Results*).

48 Taxpayer are confused about what foreign account information should be reported and how. *See, e.g.*, GAO, *IRS Has Collected Billions of Dollars, but May be Missing Continued Evasion*, GAO-13-318, 21 (Mar. 2013); 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).

49 *See, e.g.*, State Bar of California, Taxation Section, *Proposed Guidance: Why Mexican Retirement Funds Should not be Subject to the New Reporting Requirements Under IRC Section 1298(f)*, 2012 TNT 166-60 (Aug. 27, 2012).

50 TAS has permission from the taxpayer to discuss these facts.

51 *See id*. For further analysis, see, *e.g.*, State Bar of California, Taxation Section, *Proposed Guidance: Why Mexican Retirement Funds Should not be Subject to the New Reporting Requirements Under IRC Section 1298(f)*, 2012 TNT 166-60 (Aug. 27, 2012) (suggesting these holdings are reportable as PFICs on Form 8621, but urging an exception); Mexican Banking Association and Mexican Securities Industry Association, *Comments on the Foreign Account Tax Compliance Act, regulations to be issued thereunder, and Notice 2010-60* (Apr. 1, 2011), http://www.bsmlegal.com/PDFs/FATCA_MexicanComments.pdf (urging the IRS to exempt AFOREs from information reporting under FATCA).

RECOMMENDATIONS

The National Taxpayer Advocate recommends the IRS:

1. Expand and clarify the streamlined program to encourage all benign actors (including U.S. residents) to correct past noncompliance using less burdensome and punitive procedures (*e.g.*, expand and clarify who qualifies). Alternatively, adopt the three-category approach (described above), which does not require benign actors to opt out of the OVD program(s). As with other changes to OVD programs, the IRS should allow those who previously applied (even if they have signed closing agreements) to take advantage of the new approach.
2. Educate persons likely to have foreign accounts (*e.g.*, recent immigrants and U.S. citizens residing overseas) about the information reporting requirements. For example, consider working with other agencies such as the U.S. State Department and the Department of Homeland Security to provide information about the requirements to those who apply for an ITIN, visa, or residency status.
3. Issue guidance about what, if any, information reporting applies to AFOREs (*i.e.*, privatized social security accounts held by those who have worked in Mexico).
4. Incorporate all OVD FAQs and the streamlined program into a Revenue Procedure (or similar guidance published in the Internal Revenue Bulletin) that incorporates comments from internal and external stakeholders.
5. Reduce the duplicative reporting required on both Form 8938, *Statement of Foreign Financial Assets* and the FBAR.[52]

52 The IRS could 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. TAS understands the IRS has access to the FinCEN Query System, which allows IRS employees direct electronic access to the FinCEN database. Using this system, the IRS could download FBAR data for analysis. Therefore, it is unclear why the IRS would need taxpayers to report the same information on a Form 8938. However, the IRS continues to weigh the costs and benefits of this recommendation. IRS response to TAS information request (Dec. 6, 2013).