One-Size-Fits-Small: A Look at the History of the FBAR Requirement, the Offshore Voluntary Disclosure Programs, and Suggestions for Increased Participation and Future Compliance

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INTRODUCTION

According to the most recent estimate in 2006, the tax gap, defined as "the amount of tax liability faced by taxpayers that is not paid on time,"[1] was $450 billion,[2] with an estimated $100 billion resulting from unreported international income annually.[3] Perhaps not coincidentally, in 2002, the foreign bank account reporting (hereinafter "FBAR") compliance rate was estimated to be potentially less than 20%.[4] In response, the government has drastically increased the penalties for noncompliance,[5] and the Internal Revenue Service (hereinafter "IRS") has introduced a series of pseudo-amnesty programs.[6] The recent Offshore

* JD, 2014, Chapman University Dale E. Fowler School of Law; BS Accounting, 2006, San Diego State University. I wish to express my sincere gratitude to Professor Robert K. Morrow for his time and effort spent in providing invaluable guidance and direction throughout the writing process. I would also like to thank the members of the *Chapman Law Review* for their time and commitment to the editing process. Finally, I would like to thank my wife, Eva Brown, for her continued love and support throughout law school, particularly while working on this paper.

1 Internal Revenue Serv., *The Tax Gap*, IRS.GOV, http://www.irs.gov/uac/The-Tax-Gap (last updated Dec. 3, 2013).

2 *See* Internal Revenue Serv., *Tax Gap "Map"*, IRS.GOV., (Dec. 2011), http://www.irs.gov/pub/newsroom/tax_gap_map_2006.pdf.

3 STAFF OF S. PERMANENT SUBCOMM. ON INVESTIGATIONS, 110TH CONG., REP. ON TAX HAVEN BANKS AND U.S. TAX COMPLIANCE 1 (Comm. Print 2008); *see also* Susan C. Morse, *Tax Compliance and Norm Formation Under High-Penalty Regimes*, 44 CONN. L. REV. 675, 701 n.92 (2012) (providing several estimates ranging from $50 billion to $255 billion annually).

4 *See* SEC'Y 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, at 6 (2002), *available at* http://www.fincen.gov/news_room/rp/files/ReportToCongress361.PDF. A perfectly accurate compliance rate would have been difficult to determine due to the limited amount of available information. However, this approximation is based on the Service's estimate from the limited information it did have. *Id.*

5 31 U.S.C. § 5321(a)(5)(C) (2012).

6 *See* I.R.S. News Release IR-2003-5 (Jan. 14, 2003), *available at* www.irs.gov/pub/irs-news/ir-03-05.pdf (announcing the 2003 Offshore Voluntary Compliance Initiative);

Voluntary Disclosure (hereinafter "OVD") programs have been instrumental in increased compliance for FBAR and reporting of worldwide income.[7] Although the programs have been considered successful,[8] there are still a large number of taxpayers who remain noncompliant with respect to reporting their foreign income and assets.[9]

This Article will offer suggestions to improve the current OVD program which will further the purposes of increased compliance and revenue collection.[10] Part I will provide a history of FBAR, including the events leading to increased penalties for noncompliance and the introduction of the first OVD program in 2003. Part II will establish the reemergence of the pseudo-amnesty OVD programs in 2009 and 2011, as well as the quiet disclosure and opt-out alternatives to voluntary disclosure. Part III will evaluate the meaning of "willfulness" in the context of FBAR penalties by detailing recent developments in case law, and will discuss the resulting uncertainties in the context of the OVD program. Part IV will explore the continuation of the OVD program in its current state, including an analysis of problems with the program.

Internal Revenue Serv., *Statement from IRS Commissioner Doug Shulman on Offshore Income*, IRS.GOV (Mar. 26, 2009), http://www.irs.gov/uac/Statement-from-IRS-Commissioner-Doug-Shulman-on-Offshore-Income (announcing the 2009 Offshore Voluntary Disclosure Initiative); I.R.S. News Release IR-2011-84 (Aug. 8, 2011), *available at* http://www.irs.gov/uac/IRS-Reminds-Taxpayers-that-the-Aug.-31-Deadline-Is-Fast-Approaching-for-the-Second-Special-Voluntary-Disclosure-Initiative-of-Offshore-Accounts (announcing the 2011 Offshore Voluntary Disclosure Program); I.R.S. News Release IR-2012-5 (Jan. 9, 2012), *available at* http://www.irs.gov/uac/IRS-Offshore-Programs-Produce-$4.4-Billion-To-Date-for-Nation's-Taxpayers;-Offshore-Voluntary-Disclosure-Program-Reopens (announcing the 2012 Offshore Voluntary Disclosure Program).

7 *See* Leandra Lederman, *The Use of Voluntary Disclosure Initiatives in the Battle Against Offshore Tax Evasion*, 57 VILL. L. REV. 499, 526 (2012).

8 *See* I.R.S. News Release IR-2012-64 (June 26, 2012), *available at* http://www.irs.gov/uac/IRS-Says-Offshore-Effort-Tops-$5-Billion,-Announces-New-Details-on-the-Voluntary-Disclosure-Program-and-Closing-of-Offshore-Loophole (quoting IRS Commissioner Doug Shulman, who stated that the IRS "'continue[d] to make strong progress in our international compliance efforts that help ensure honest taxpayers are not footing the bill for those hiding assets offshore'").

9 *See* NAT'L TAXPAYER ADVOCATE, 2012 ANNUAL REPORT TO CONGRESS 134 (2012) ("While an estimated five to seven million U.S. citizens reside abroad, and many more U.S. residents have FBAR filing requirements, the IRS received only 741,249 FBAR filings in 2011, and as of September 29, 2012, it had received fewer than 28,000 OVD submissions from FBAR violators. Thus, significant FBAR filing compliance problems likely remain unaddressed.").

10 *See* Internal Revenue Serv., *Offshore Voluntary Disclosure Program Frequently Asked Questions and Answers*, IRS.GOV, http://www.irs.gov/Individuals/International-Taxpayers/Offshore-Voluntary-Disclosure-Program-Frequently-Asked-Questions-and-Answers (last updated Aug. 26, 2013) (stating that the objective of the program is "to bring taxpayers that have used undisclosed foreign accounts and undisclosed foreign entities to avoid or evade tax into compliance with United States tax laws").

This Article will conclude that in order to further increase compliance, the OVD program should eliminate the one-size-fits-all approach by expanding the current penalty structure with the goal of drastically increasing participation. The program should be given an end date, and it should coincide with public prosecutions of the most egregious offenders. Doing so will give taxpayers who have not yet come forward to disclose their foreign accounts a great incentive to do so by reducing the penalty for past actions. The result will be a huge boost to current and future tax revenues. Alternatively, if the program is not expanded, the majority of taxpayers who have not yet come forward will likely continue to hide their assets offshore and the international tax gap will continue to be astoundingly large, putting a strain on compliant taxpayers.

I. HISTORY OF FOREIGN BANK ACCOUNT REPORTING AND PENALTIES FOR NONCOMPLIANCE

The FBAR requirement was initially established by the Currency and Foreign Transactions Reporting Act of 1970, commonly referred to as the Bank Secrecy Act, part of which is codified in Title 31 of the United States Code.[11] The purpose of the requirement was to obtain data with "a high degree of usefulness in criminal, tax, or regulatory investigations or proceedings."[12] In 2001, the Patriot Act[13] expanded the purpose to include protecting against international terrorism.[14] The Patriot Act amendment made the reporting requirements of Title 31 more of a priority, with one commentator noting, "Nowadays, once something has been labeled as crucial to the ubiquitous 'war on terror,' there seem to be few (if any) limits on governmental efforts."[15]

Section 5314(a) of the Patriot Act provides that

> the Secretary of the Treasury shall require a resident or citizen of the United States or a person in, and doing business in, the United States, to keep records, file reports, or keep records and file reports, when the resident, citizen, or person makes a transaction or

11 *See* 31 U.S.C. §§ 5311–5314 (2012); *see also* U.S. Dep't of the Treasury, *Bank Secrecy Act*, FINCEN.GOV, http://www.fincen.gov/statutes_regs/bsa/ (last visited Apr. 6, 2014).

12 31 U.S.C. § 5311 (2000) (prior to 2004 amendment).

13 Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism (USA PATRIOT ACT) Act of 2001, Pub. L. No. 107-56, 115 Stat. 272 (codified at 31 U.S.C. § 5314 (2012)).

14 31 U.S.C. § 5311 (2012) (adding "or in the conduct of intelligence or counterintelligence activities, including analysis, to protect against international terrorism").

15 Hale E. Sheppard, *Evolution of the FBAR: Where We Were, Where We Are, and Why It Matters*, 7 HOUS. BUS. & TAX L.J. 1, 3 (2006).

> maintains a relation for any person with a foreign financial agency.[16]

The Code then states that the "records and reports shall contain . . . information in the way and to the extent the Secretary prescribes."[17] Under this authority, the Secretary of the Treasury developed Form TD F 90-22.1 "Report of Foreign Bank and Financial Accounts,"[18] commonly referred to as Foreign Bank Account Reporting, or FBAR, which has recently been replaced by FinCEN Form 114.[19] The Form requires reporting of the maximum value of all foreign accounts exceeding $10,000 at any time during the calendar year.[20]

Prior to 2004, the Secretary of the Treasury could have imposed a civil monetary penalty on any person "willfully violat[ing]" the FBAR requirement.[21] According to the Supreme Court in *Cheek v. United States*, "[w]illfulness . . . require[d] the Government to prove that the law imposed a duty on the defendant, that the defendant knew of this duty, and that he voluntarily and intentionally violated that duty."[22] Furthermore, "carrying this burden require[d] negating a defendant's claim of ignorance of the law or a claim that because of a misunderstanding of the law, he had a good-faith belief that he was not violating any of the provisions of the tax laws."[23] Although willfulness required such a high evidentiary standard, if proven, the Secretary could have imposed monetary civil penalties, ranging from $25,000 up to the balance in the account at the time of the violation, whichever was greater, with a maximum penalty of $100,000 for each violation.[24] In addition to the civil penalty provision, any person found willfully violating

16 31 U.S.C. § 5314(a).

17 *Id.*

18 U.S. DEP'T OF THE TREASURY, FORM TD F 90-22.1, REPORT OF FOREIGN BANK AND FINANCIAL ACCOUNTS (2012) [hereinafter FORM TD F 90-22.1], *available at* www.fincen.gov/forms/files/f9022-1_fbar.pdf.

19 Internal Revenue Serv., *2012 Offshore Voluntary Disclosure Program*, IRS.GOV, http://www.irs.gov/uac/2012-Offshore-Voluntary-Disclosure-Program (last updated Jan. 24, 2014).

20 *See* FORM TD F 90-22.1, *supra* note 18, at 6; *see also* FIN. CRIMES ENFORCEMENT NETWORK, BSA ELECTRONIC FILING REQUIREMENTS FOR REPORT OF FOREIGN BANK AND FINANCIAL ACCOUNTS (FINCEN FORM 114) 4 (2014), *available at* http://www.fincen.gov/forms/files/FBAR%20Line%20Item%20Filing%20Instructions.pdf.

21 31 U.S.C. § 5321(a)(5)(A) (2000) (prior to 2004 amendment).

22 Cheek v. United States, 498 U.S. 192, 201 (1991).

23 *Id.* at 202. Although this case was regarding the FBAR civil penalty under Title 31, the Court opted to use the term "tax laws." Several courts and commentators use terms such as "tax laws" and "taxpayers" when referring to the FBAR penalty. *See, e.g.*, United States v. Williams, 489 F. App'x 655 (4th Cir. 2012); United States v. McBride, 908 F. Supp. 2d 1186 (D. Utah 2012); Internal Revenue Serv., *supra* note 10. Due to the nature of the OVD programs, this Article will do the same.

24 31 U.S.C. § 5321(a)(5)(B)(ii) (2000) (prior to 2004 amendment).

the FBAR requirement could have been subject to a criminal penalty of up to $250,000, or up to five years in prison, or both.[25]

Section 361(b) of the Patriot Act requires annual reports to Congress as follows:

> The Secretary of the Treasury shall study methods for improving compliance with the reporting requirements established in section 5314 of title 31, United States Code, and shall submit a report on such study to the Congress by the end of the 6-month period beginning on the date of enactment of this Act [Oct. 26, 2001] and each 1-year period thereafter. The initial report shall include historical data on compliance with such reporting requirements.[26]

The initial report, given in April 2002,[27] estimated that FBAR compliance was potentially below 20%.[28] The report also indicated that enforcement was virtually nonexistent.[29] Some of the reasons cited for the lack of enforcement included difficulty in obtaining evidence of undisclosed foreign financial accounts,[30] the U.S. Department of Justice's preference to charge taxpayers with other violations (typically illegal conduct such as tax evasion, fraud, or money laundering),[31] and the difficulty prosecutors had in demonstrating willfulness for civil penalties.[32]

The report gave recommendations for improving compliance with FBAR reporting requirements, and provided the IRS and the Financial Crimes Enforcement Network (hereinafter "FinCEN")[33] with five objectives for the following year: update and improve the FBAR form and instructions, review filing and processing procedures, enhance outreach and education to tax practitioners, establish a joint task force on prosecutions and enforcement, and consider delegating penalty authority from FinCEN to the IRS.[34] Additionally, although the report

25 31 U.S.C. § 5322(a) (2012).

26 Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism (USA PATRIOT ACT) Act of 2001, Pub. L. No. 107-56, § 361(b), 115 Stat. 272, 332.

27 SEC'Y OF THE TREASURY, *supra* note 4.

28 *Id.* at 6.

29 *Id.* at 8 ("Between 1996 and 1998, Justice Department statistics reveal that only nine indictments were filed charging 31 U.S.C. 5314; in 1999 and 2000, no one appears to have been charged. The Customs Service reports only three convictions since 1995."); *see also id.* at 9 (reporting only twelve referrals for civil enforcement since 1993, only two of which were assessed monetary penalties).

30 *Id.* at 8.

31 *Id.* at 9.

32 *Id.* at 10.

33 The Financial Crimes Enforcement Network was established in 1990 as a bureau of the Department of the Treasury and was tasked with enforcing the FBAR provisions under Chapter 53 of Title 31, among other things. *See* 31 U.S.C. § 310 (2012).

34 SEC'Y OF THE TREASURY, *supra* note 4, at 12–13.

recognized that uninformed taxpayers[35] would benefit from education and outreach,[36] it found that this would not increase compliance for "taxpayers who fail to file because they are concealing income or are engaged in some kind of criminal activity."[37] For this group, the report suggested deterrence through "a series of highly publicized criminal actions against intentional violators in order to raise the cost of being an FBAR scofflaw."[38]

In April 2003, the second report was presented, the bulk of which detailed the progress made on the objectives from the initial report.[39] In an agreement reached weeks before the second report was issued, FinCEN delegated its authority to enforce FBAR provisions to the IRS.[40] The IRS also took over the responsibility of updating and improving the FBAR form and instructions; however, no such updates or improvements were made and no new target date was given for this goal.[41] The IRS also assumed the responsibility of reviewing filing and processing procedures of the FBAR forms,[42] and began taking steps to improve outreach and education such as utilizing media outlets and working with tax practitioner organizations.[43] Lastly, a joint task force was formed between the IRS, FinCEN, and the Department of Justice to enhance prosecutions and enforcement, which included the IRS's 2003 Offshore Voluntary Compliance Initiative (hereinafter "OVCI").[44] The second report concluded with goals for the following year: emphasize examination of offshore activities, identify potential non-filers, continue outreach and education, and use input from filers to improve the FBAR form.[45]

The 2003 OVCI was the first program administered by the IRS designed to allow taxpayers with "offshore financial arrangements" to voluntarily come forward and "clear up their

35 Common scenarios in which taxpayers may be unwittingly subject to the FBAR rules include students studying abroad, taxpayers with temporary offshore work assignments, individuals with inherited foreign accounts, and immigrants. *See* Sheppard, *supra* note 15, at 26–27.

36 SEC'Y OF THE TREASURY, *supra* note 4, at 10–11.

37 *Id.* at 11.

38 *Id.*

39 *See* SEC'Y 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, at 3 (2003), *available at* http://www.fincen.gov/news_room/rp/files/fbar3613.pdf.

40 *Id.* at 4–5.

41 *Id.* at 5.

42 *Id.*

43 *Id.* at 5–6.

44 *Id.* at 6–7.

45 *Id.* at 7–8.

tax liabilities."[46] The program came on the heels of an Offshore Credit Card Program that included credit card summonses in 2000 and 2002 meant to find offshore tax evaders.[47] The purpose was to quickly bring taxpayers back into compliance and to simultaneously gather information about promoters of offshore schemes.[48] Essentially, the initiative was a pseudo-amnesty program allowing taxpayers to voluntarily amend their tax returns to include offshore income in exchange for a waiver of certain penalties and a guarantee of no criminal prosecution.[49] According to a July 2003 IRS News Release, the program brought in $75 million in taxes, at a cost of approximately $2 million.[50] These results were not without controversy however, with one report suggesting that only $3.3 million had been assessed at a cost of an estimated $56 million.[51] Although the success may have been limited, the IRS did identify over 400 offshore promoters, about half of which were previously unknown to the IRS.[52]

In April 2005, a third report was presented,[53] ingeniously referred to as the third annual report.[54] This report detailed the progress made on the objectives from the prior two periods, including reiterating and at times expanding on the second report.[55] One noteworthy point included in the third annual report was a list of several problems identified with the current FBAR form, leading to the uninspired conclusion that the IRS would concentrate on the instructions, "leaving material revision of the form itself to another day."[56] Also of note, the report

46 *See* I.R.S. News Release IR-2003-5, *supra* note 6, at 1.

47 *Id.* at 2.

48 *Id.* at 1.

49 *Id.*; *see also* Rev. Proc. 2003-11, 2003-4 I.R.B. 311.

50 I.R.S. News Release IR-2003-95 (July 30, 2003), *available at* http://www.irs.gov/pub/irs-news/ir-03-95.pdf.

51 *See* Lederman, *supra* note 7, at 507. Such results lead one to question government accounting methods. If a taxpayer's calculations resulted in such a discrepancy, it would be deemed fraudulent.

52 *See* I.R.S. News Release IR-2003-95, *supra* note 50.

53 SEC'Y 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 (USA PATRIOT ACT) (2005) (listing the year 2004 in the web address even though the report was presented in 2005). One point of interest is the date is that not included on the cover page as in the prior two reports, perhaps because the report came a year later than that mandated by law under the Patriot Act. Furthermore, this is the last report to Congress despite the continuing requirement for annual reports.

54 *Id.* at 3.

55 *Id.* at 5–11.

56 *Id.* at 6–8. The Form and Instructions were eventually updated in 2008. *See* Philip T. Pasmanik & Neil A. J. Sullivan, *Report of Foreign Bank and Financial Accounts: Significant Revisions and Severe Penalties*, J. ACCT. (July 2009), http://www.journalofaccountancy.com/Web/TTAFBARReport.htm.

showed a 17% increase in FBAR filings from 2000 to 2003, believed to be in significant part from the 2003 OVCI.[57]

Overall, these reports convinced Congress that FBAR compliance was unsatisfactory, and several bills were introduced to address the problem.[58] Eventually, on October 22, 2004, the American Jobs Creation Act of 2004[59] was passed, part of which gave section 5321 a major overhaul.

Following this overhaul, a revised section 5321(a)(5)(C) increased the penalty for a person who willfully violates the FBAR requirement to the greater of $100,000 or 50% of the account balance, with no ceiling.[60] As one commentator noted, "Given the astronomical balance in some unreported accounts, and the fact that the IRS often applies the penalty on a per-account-per-year basis, the penalties can be enormous."[61] Under section 5321(a)(5)(A), the Secretary of the Treasury was given discretion to impose a penalty of up to $10,000 for non-willful violations,[62] though an exception for "reasonable cause" is provided if "the amount of the transaction or the balance in the account at the time of the transaction was properly reported."[63] The criminal penalties remain unchanged following this overhaul.[64]

II. 2009 AND 2011 OVD PROGRAMS AND ALTERNATIVES

Six years passed before the successor to OVCI, the 2009 Offshore Voluntary Disclosure Program (hereinafter "OVDP"), was put in place.[65] This program ran in conjunction with a

57 *See* SEC'Y OF THE TREASURY, *supra* note 53, at 11.

58 *See* Sheppard, *supra* note 15, at 17 n.101.

59 American Jobs Creation Act of 2004, Pub. L. No. 108-357, 118 Stat. 1418.

60 31 U.S.C. § 5321(a)(5)(C) (2012).

61 *See* Hale E. Sheppard, *Third Time's the Charm: Government Finally Collects 'Willful' FBAR Penalty in* Williams, 117 J. TAX'N 319, 320 (2012); *see also* NAT'L TAXPAYER ADVOCATE, *supra* note 9, at 147 ("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).").

62 31 U.S.C. § 5321(a)(5)(A)–(B)(i). The IRS has taken the aggressive position that the non-willful penalty can be applied on a per-account, per-year basis; however, this issue has not yet been litigated. Internal Revenue Serv., *Internal Revenue Manual 4.26.16.4, Report of Foreign Bank and Financial Accounts*, IRS.GOV (July 1, 2008), http://www.irs.gov/irm/part4/irm_04-026-016.html.

63 31 U.S.C. § 5321(a)(5)(B)(ii)(II).

64 31 U.S.C. § 5322(a).

65 *See* Memorandum from Linda E. Stiff, Deputy IRS Comm'r for Servs. and Enforcement, to Comm'r, Large and Mid-Size Bus. Div. and Comm'r, Small Bus./Self-Employed Div. (Mar. 23, 2009) [hereinafter Memorandum from Linda E. Stiff], *available at* http://hodgen.com/irs-amnesty-offshore-account/; *see also* Internal Revenue Serv., *supra* note 6.

crackdown on offshore tax evasion[66]—which focused on the international banking giant UBS—that began when a disgruntled employee revealed that "he was part of a UBS team that made frequent trips across the Atlantic to aggressively market investment strategies to rich Americans to elude the scrutiny of the Internal Revenue Service."[67] In the summer of 2008, the U.S. Department of Justice issued a John Doe Summons asking UBS to disclose the names of all of its U.S. clients, representing "the first time that the United States ha[d] attempted to pierce Swiss bank secrecy by compelling a Swiss bank to name its U.S. clients."[68] This led to an agreement by UBS to pay a $780 million penalty and release the names of 250 Americans.[69]

The Department of Justice was not satisfied, however, and in February 2009 "filed another civil lawsuit against UBS seeking the identities of 52,000 more Americans suspected of stashing a total of $15 billion at the bank."[70] Following an agreement between the United States and Swiss governments, a settlement was reached in the case, with UBS agreeing to supply the names of close to 4450 American account holders the IRS suspected of evading taxes.[71] Specific details of the agreement were not released until after the completion of the 2009 OVDP, which brought in more than 15,000 taxpayers, many more than the 1000 taxpayers the IRS expected would participate.[72]

The 2009 OVDP required taxpayers to amend or file six years of tax returns and FBARs, and pay any resulting increase in tax with interest.[73] Taxpayers were assessed either an accuracy or delinquency penalty for all six years, with no possibility for a reasonable cause exception.[74] Additionally, in lieu of all other penalties, including the statutory FBAR

66 The timing of the 2009 program was intended to capitalize on the publicity of the scandal. *See* Lederman, *supra* note 7, at 510 ("The 2009 initiative was timed to profit from the publicity about Birkenfield and UBS . . . .").

67 Graham Bowley, *A Privileged World Begins to Give Up Its Secrets*, N.Y. TIMES, Aug. 23, 2009, at WK3.

68 Jared Seff, *Cracking Down on Tax Evaders—Swiss Banking: Secrets, Lies, and Deception*, 38 S.U. L. REV. 159, 162 (2010).

69 *Id.* at 162–63.

70 *Id.* at 164.

71 *Id.* At 164–65. Although the results of the agreement have led to increased disclosure by many Americans, some members of Congress were not appeased. As Michigan Senator Carl Levin stated, "[T]he tortured wording and the many limitations in this Annex shows the Swiss Government trying to preserve as much bank secrecy as it can for the future, while pushing to conceal the names of tens of thousands of suspected U.S. tax cheats. It is disappointing that the U.S. government went along." *Id.* at 172.

72 *See* Lederman, *supra* note 7, at 510.

73 *See* Internal Revenue Serv., *supra* note 6.

74 *See* Memorandum from Linda E. Stiff, *supra* note 65, at 2.

penalties, participants in the program had to pay a penalty equal to 20% of the amount in foreign accounts in the year with the highest aggregate balance during the six-year period.[75] The IRS warned that taxpayers who do not come forward through the program could be subject to additional penalties, with agents instructed to pursue "both civil and criminal avenues, and consider all available penalties including the maximum penalty for the willful failure to file the FBAR report and the fraud penalty."[76] The IRS considered the program a resounding success, boasting an estimated $3.4 billion of tax revenue.[77]

Although the IRS considered the 2009 OVDP as highly effective, some taxpayers chose to go outside of the program and make a "quiet disclosure"[78] by simply amending their returns to include any foreign income and paying the resulting tax. A quiet disclosure was seen by taxpayers as a safe substitute to get around the severe penalties imposed through the OVDP.[79] The IRS, on the other hand, saw it as undermining the credibility of a program that was otherwise proving a success.[80] The government discouraged the practice, therefore, by reminding those opting to make a quiet disclosure that they were risking criminal prosecution, relief from which was only possible by open participation in the program.[81] Despite this, there has not been a widely publicized case of significant penalties being assessed after a quiet disclosure. Therefore, the public's perception may be that circumventing the program to avoid penalties is a viable option.[82]

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75 *Id.* There was a narrow exception to reduce the penalty to 5% if the taxpayer did not open the foreign accounts, there was no activity in the accounts, and all U.S. taxes had been paid on the funds in the accounts, with only account earnings escaping taxation. *Id.*

76 *See* Internal Revenue Serv., *supra* note 6.

77 *See* I.R.S. News Release IR-2012-5, *supra* note 6. Following the program, the IRS combed through the data received and continued to prosecute UBS clients. *See* Lederman, *supra* note 7, at 511. As another strategy to curb offshore tax evasion, in 2010 Congress enacted the Foreign Account Tax Compliance Act (FATCA) as part of the Hiring Incentives to Restore Employment (HIRE) Act, requiring additional foreign asset reporting on U.S. tax returns while creating some overlap with existing FBAR requirements. *Id*. at 512. FATCA also imposes information-sharing obligations on foreign banks, incentivized by a 30% withholding on United States-sourced payments against institutions that do not comply. *Id.*

78 *See* Internal Revenue Serv., *Voluntary Disclosure: Questions and Answers*, IRS.GOV, Q&A 10 (May 6, 2009), http://www.irs.gov/uac/Voluntary-Disclosure:-Questions-and-Answers.

79 *See* Morse, *supra* note 3, at 720–21.

80 *Id.* at 721.

81 *Id.* at 722.

82 *Id.* The closest the government has come to such a prosecution occurred in August of 2011, after a taxpayer made a quiet disclosure by amending his returns and submitting FBARs. Although he was in compliance in those regards, he left off significant income from a partnership on both the original returns and the amended ones. *See* Jeremy

Following the success of the 2009 OVDP, on February 8, 2011, the 2011 Offshore Voluntary Disclosure Initiative (2011 OVDI) was introduced.[83] The program was similar to the 2009 OVDP, with three key differences: the look-back period was extended to eight years,[84] the penalty imposed on the highest aggregate offshore account balances was increased from 20% to 25%—although some taxpayers may qualify for a reduced penalty of 5% or 12.5% in certain narrow circumstances[85]—and, to help combat quiet disclosures, the program provided participants with an option to opt out of the penalty.[86]

Opting out of the civil settlement structure alternative allows taxpayers who do not agree with the flat penalty under the program to opt out of the penalty.[87] However, taxpayers choosing to opt out are subjected to a complete examination.[88] The examiner will determine whether willfulness exists, and no penalty will be assessed if the IRS deems that the failure to file was due to reasonable cause.[89] While participation in the program comes with a recommendation not to prosecute for violations up to the date of the disclosure,[90] participants who opt out "could be referred to Criminal Investigation for investigation and possible prosecution and assertion of the civil fraud penalty."[91] Without any type of assurances, it is not a surprise

Pelofsky, *Bank Executive to Plead Guilty to Hiding Account*, REUTERS, May 19, 2011, *available at* https://1.next.westlaw.com/Document/I2ed6a540956511e19fefb85885c303b5/View/FullText.html. The question remains whether the government will prosecute a taxpayer making a quiet disclosure that is complete and accurate. *See* Remy Farag, *HSBC Client Prosecuted After Quiet Disclosure*, J. INT'L TAX'N, Aug. 2011, at 8, 9. The IRS says they will be on the lookout for taxpayers making quiet disclosures and look to penalize and perhaps prosecute. *See* Internal Revenue Serv., *supra* note 10, at FAQ 15–16. The reality of that threat remains questionable. *See* Randall P. Andreozzi & Arlene M. Hibschweiler, *FBAR: Handle With Care*, 43 TAX ADVISER 330, 335 (2012) ("Since *Schiavo* involves an *incomplete* quiet disclosure, whether the IRS will treat *complete and accurate* quiet disclosures similarly remains unclear.").

83 *See* I.R.S. News Release IR-2011-84, *supra* note 6.

84 *See* Lederman, *supra* note 7, at 515. The look-back period was extended so OVD participants "did not get a 'pass' with respect to the 2003 and 2004 tax years." *Id.*

85 *Id.* at 516. The circumstances necessary for the 5% penalty were similar to the requirements under the 2009 OVDP, *see supra* note 75, except that instead of no account activity being allowed, there must have been less than $1000 withdrawn per year. *See* Internal Revenue Serv., *2011 Offshore Voluntary Disclosure Program Frequently Asked Questions*, IRS.GOV, FAQ 52, http://www.irs.gov/Businesses/International-Businesses/2011-Offshore-Voluntary-Disclosure-Initiative-Frequently-Asked-Questions-and-Answers (last updated Jan. 24, 2014). In order to qualify for the 12.5% penalty, the highest aggregate balance during the look-back period must have been less than $75,000. *Id.* at FAQ 53.

86 *See* Lederman, *supra* note 7, at 516.

87 *See* Internal Revenue Serv., *supra* note 85, at FAQ 51.

88 *Id.*

89 *Id.* at FAQ 51.1.

90 *Id.* at FAQ 51.3.

91 *Id.*

that less than 1% of program participants have opted out since it has become an option.[92] As a recent report by the National Taxpayer Advocate noted,

> even where taxpayers feel strongly that their FBAR noncompliance was due to reasonable cause or was not willful, faced with the choice of accepting the IRS's proposed penalty . . . or opting for a full examination — with the hope of avoiding the penalty . . . of far more than their net worth . . . — many will not want to risk opting out.[93]

The IRS reported that it had received a total of 33,000 voluntary disclosures under the 2009 and 2011 programs combined, and collected $4.4 billion.[94] However, at the time of these two OVD programs, taxpayers and tax practitioners alike were just becoming aware of the FBAR requirements, so many of the OVD participants would not have been subject to the civil penalty for willfulness for the tax years at issue.[95] Even so, the IRS opted to impose a penalty that is an excellent deal for willful violators, but a terrible option for non-willful violators.[96] Unfortunately, many taxpayers entering the program succumbed to the fear tactics of the IRS and agreed to pay a penalty through the OVD program that is greater than the penalty that would have otherwise been assessed, if any.[97]

III. WILLFULNESS: THE *WILLIAMS* TRILOGY AND THE CURRENT STATE OF UNCERTAINTY

As discussed in Part II above, under the old law, imposing the FBAR penalty required a high evidentiary standard due to the willfulness requirement.[98] This resulted in a serious lack of prosecutions under the old regime.[99] More recently, however, a trilogy of cases culminating in the Fourth Circuit as *United States v. Williams*[100] has left tax practitioners with considerable

92 *See* NAT'L TAXPAYER ADVOCATE, *supra* note 9, at 138 (depicting 30 out of 11,941 participants electing to opt out of the 2011 program, with only 8 of those cases closed as of September 29, 2012, one year after the close of the 2011 program).

93 *Id.* at 149.

94 *See* I.R.S. News Release IR-2012-5, *supra* note 6.

95 *See* Morse, *supra* note 3, at 715 ("It is conceivable, given the historic lack of publicity about, and enforcement of, the FBAR filing requirements, that a defendant might be able to show a lack of willfulness.").

96 *See id.* at 714 ("[The government] used twenty percent . . . and twenty-five percent . . . as the price for entering the voluntary disclosure program. This represents a discount from the statutory civil willfulness penalty of fifty percent of the account balance for each annual failure to file.").

97 *See id.* at 715–16.

98 *See* Cheek v. United States, 498 U.S. 192, 201 (1991).

99 *See* SEC'Y OF THE TREASURY, *supra* note 4.

100 *See* Sheppard, *supra* note 61, at 319 ("The *Williams* trilogy has been a long road, with stops in the U.S. Tax Court (131 TC 54 (2008); '*Williams I*'), the U.S. district court

uncertainty as to what is required to establish willfulness with respect to FBAR violations.[101] In these cases, the taxpayer was an attorney who, after graduating from NYU, worked in the corporate finance department of a major international law firm.[102] He then obtained employment at Mobil Oil Corporation, where he worked in various legal and business positions, including, in 1991, exploring business opportunities for Mobil in the newly opened Russian markets.[103] Two years later, he created a British Virgin Islands corporation, ALQI Holdings, Ltd., and opened up two bank accounts in the corporation's name for holding the funds he received from foreign sources.[104] From 1993 to 2000, Williams deposited more than $7 million into these accounts, which generated more than $800,000 of interest and investment income.[105] With respect to these foreign accounts, Williams had three duties: report the foreign income on his tax returns, check "yes" on Schedule B of his tax return to indicate that he has one or more foreign accounts,[106] and file an FBAR.[107] He violated all three of these duties.[108]

Beginning in 2000, Williams came under scrutiny by the IRS, which eventually led to guilty pleas in 2003 on one count of criminal tax evasion and one count of criminal conspiracy to defraud the government.[109] At his sentencing in September 2003, the court imposed a punishment of forty-six months in jail, a $25,000 fine, restitution of over $3.5 million, and three years of supervised release.[110]

Williams's troubles were not over yet, as the IRS initiated a civil examination of his finances following the criminal

(106 AFTR2d 2010-6150 (2010); '*Williams II*'), and, most recently, the Fourth Circuit in *Williams III*.").

101 *See id.* ("[*Williams III*], already the subject of much criticism by the tax community, raises more questions than answers.").

102 *See id.* at 320.

103 *Id.*

104 *Id.*

105 *Id.*

106 U.S. DEP'T OF THE TREASURY, FORM 1040, SCHEDULE B—INTEREST AND ORDINARY DIVIDENDS (2000), *available at* http://www.irs. gov/pub/irs-prior/f1040sab--2000.pdf. Line 7a asks: "At any time during 2000, did you have an interest in or a signature or other authority over a financial account in a foreign country, such as a bank account, securities account, or other financial account?" *Id.* It then instructs the taxpayer to "[s]ee page B-2 for exceptions and filing requirements for Form TD F 90-22.1." *Id*. The government argues that this instruction is enough to establish knowledge of the FBAR requirement. *See* United States v. Williams, No. 1:09-cv-437, 2010 WL 3473311, at *4 (E.D. Va. Sept. 1, 2010).

107 *See* Sheppard, *supra* note 61, at 320.

108 *Id.*

109 *Id.* at 321.

110 *Id.* at 322.

sentencing.[111] In January 2007, the revenue agent asked him to file an FBAR for 2000, which Williams later claimed was the first time he had heard of the requirement.[112] Thereafter, the IRS issued a notice of deficiency, assessing significant increases to Williams's income tax liabilities for the tax years 1993 through 2000, as well as penalties for negligence and civil fraud.[113] Additionally, the revenue agent assessed a civil FBAR penalty for 2000,[114] charging Williams the then-maximum penalty of $100,000 for each account.[115]

Following these assessments, Williams petitioned the Tax Court, contesting all of the proposed deficiencies as well as the FBAR penalties.[116] The Tax Court determined that it only has authority to review determinations of taxes imposed by Title 26, concluding that "the [FBAR] penalty . . . falls outside our jurisdiction to review deficiency determinations."[117]

Williams never paid the FBAR penalty, so in April 2009 the government filed a complaint in district court in order to collect.[118] Due to Williams's checking "No" on Schedule B in response to having any foreign bank accounts, the government argued that his "signature on his Form 1040 is *prima facie*

111 *Id.*

112 *Id.*

113 *Id.* Generally, the statute of limitations for income tax and related penalties is three years from the later of the date of filing or the due date of the return. I.R.C. § 6501(a) (2012). However, there is no statute of limitations for fraudulent or unfiled returns. I.R.C. § 6501(c)(1)–(3).

114 Sheppard, *supra* note 61, at 322. The FBAR penalties have a six-year statute of limitations. 31 U.S.C. § 5321(b)(1) (2012). Therefore, the only year subject to this penalty was 2000. Sheppard, *supra* note 61, at 322.

115 *See* Sheppard, *supra* note 61, at 322.

116 *Id.*

117 Williams v. Comm'r, 131 T.C. 54, 58 (2008). The Tax Court also concluded that it lacks jurisdiction to address any FBAR penalty collection issue. *Id.* at 59. The Bankruptcy Court also lacks jurisdiction over FBAR penalty assessments. United States v. Simonelli, 614 F. Supp. 2d 241, 246–47 (D. Conn. 2008) (finding that the FBAR penalty is not a tax penalty and is consequently barred from discharge). 28 U.S.C. § 1346(a)(1) (2012) provides an avenue in district court for

> [a]ny civil action against the United States for the recovery of any internal-revenue tax alleged to have been erroneously or illegally assessed or collected, or any penalty claimed to have been collected without authority or any sum alleged to have been excessive or in any manner wrongfully collected under the internal-revenue laws.

Based on this statute, if the penalty is assessed, it cannot be litigated unless it is paid. Thus, it appears that no avenue exists to litigate assessment of a civil FBAR penalty without paying it, except to wait for the government to bring a collection suit as in *Williams II*.

118 United States v. Williams, No. 1:09-cv-437, 2010 WL 3473311, at *1–2 (E.D. Va. Sept. 1, 2010). The suit was brought pursuant to 31 U.S.C. § 5321(b)(2), allowing the government to commence a civil action to recover an FBAR penalty within two years of assessment. *Id.* at *1.

evidence that Williams knew the contents of his tax return."[119] The court was not persuaded, emphasizing that "these actions occurred after Williams found out that the U.S. and Swiss authorities knew about the ALQI accounts."[120] Considering these facts, the Court determined that "it clearly follows logically that Williams was aware that the authorities knew about the ALQI accounts by the fall of 2000, significantly before June 30, 2001 . . . . [This] strongly indicate[s] . . . that Williams lacked any motivation to willfully conceal the accounts from authorities after that point."[121] The court concluded that "Williams' failure to disclose already-frozen assets in a foreign account was not an act undertaken intentionally or in deliberate disregard for the law, but instead constituted an understandable omission given the context in which it occurred."[122] The holding strongly suggested that "the IRS would have a hard time proving willfulness when a taxpayer didn't know about FBARs. [It also] may have caused some with foreign accounts not to step forward."[123]

Unsurprisingly, the government was dissatisfied with this holding, and filed an appeal in November 2010.[124] Beginning with precedent in criminal matters before transitioning to a broader definition for civil violations, the court in *Williams III* gave the following overview in an attempt to define willfulness in the FBAR context:

> "Willfulness may be proven through inference from conduct meant to conceal or mislead sources of income or other financial information," and it "can be inferred from a conscious effort to avoid learning about reporting requirements." *United States v. Sturman*, 951 F.2d 1466, 1476 (6th Cir.1991) (internal citations omitted) (noting willfulness standard in criminal conviction for failure to file an FBAR). Similarly, "willful blindness" may be inferred where "a defendant was subjectively aware of a high probability of the existence of a tax liability, and purposefully avoided learning the facts point to such liability." *United States v. Poole*, 640 F.3d 114, 122 (4th Cir.2011) (affirming criminal conviction for willful tax fraud where tax preparer 'closed his eyes to' large accounting discrepancies). Importantly, in cases "where willfulness is a statutory condition of civil liability, [courts] have generally taken it to cover not only knowing violations of a standard, but *reckless* ones as well." *Safeco Ins. Co. of America v. Burr*, 551 U.S. 47, 57, 127 S.Ct. 2201, 167 L.Ed.2d 1045 (2007)

119 *Id.* at *4.

120 *Id.*

121 *Id.*

122 *Id.* at *5.

123 Robert W. Wood, *FBAR Penalties Just Got Even Worse*, FORBES (July 22, 2012, 11:49 PM), http://www.forbes.com/sites/robertwood/2012/07/22/fbar-penalties-just-got-even-worse/.

124 United States v. Williams, 489 F. App'x 655 (4th Cir. 2012).

> (emphasis added). Whether a person has willfully failed to comply with a tax reporting requirement is a question of fact. *Rykoff v. United States*, 40 F.3d 305, 307 (9th Cir.1994) . . . .[125]

Shortly thereafter, the court stated that "the evidence as a whole leaves us with a definite and firm conviction that the district court clearly erred in finding that Williams did not willfully violate § 5314."[126] The court found that Williams's signature is *prima facie* evidence that he knew what he was signing, and "at a minimum line 7a's directions to '[s]ee instructions for exceptions and filing requirements for Form TD F 90-22.1' put Williams on inquiry notice of the FBAR requirement."[127] The court determined that Williams's lack of attention to the contents of his tax return "constitute[d] willful blindness to the FBAR requirement."[128] The court was further convinced that Williams's acknowledgement "that he willfully failed to report the existence of the ALQI accounts to the IRS or Department of the Treasury as part of his larger scheme of tax evasion. [This] . . . [wa]s an admission of violating § 5314 . . . ."[129] The court concluded that "at a minimum, Williams's undisputed actions establish reckless conduct, which satisfies the proof requirement under § 5314 . . . [and] that the district court clearly erred in finding that willfulness had not been established."[130]

The dissent argued that "a reasonable factfinder [may] conclude that the violation was willful, as the majority believes. But there is also evidence supporting the opposite view."[131]

In December 2012, a Utah district court affirmed the precedent set in *Williams III*, finding that "[f]or an individual to act 'willfully,' an individual need not have been subjectively aware of the FBAR reporting requirement or else an individual would be able to defeat liability by deliberately avoiding learning of his or her legal duties."[132]

Interestingly, the Court in *Williams III* applied a significantly lower legal standard than the IRS published in its

125 *Id.* at 658.
126 *Id.* at 659.
127 *Id.*
128 *Id.*
129 *Id.* at 660.
130 *Id.*
131 *Id.* at 661 (Agee, J., dissenting).
132 United States v. McBride, 908 F. Supp. 2d 1186, 1210 (D. Utah 2012). Additionally, the District Court cited the overturned decision from *Williams II* (noting that the decision was overturned on other grounds), stating that "in a civil FBAR penalty case, . . . the United States' burden of proof was 'the preponderance of the evidence' on all questions before the court, including the question of whether the taxpayer's failure to report in that case was 'willful.'" *Id.* at 1201.

Internal Revenue Manual (hereinafter "IRM"), which requires "the person's knowledge of the [FBAR] reporting requirements and the person's conscious choice not to comply."[133] Although the IRM suggests that willful blindness might rise to the level of willfulness, the IRS states that "[t]he mere fact that a person checked the wrong box, or no box, on a Schedule B is not sufficient, by itself, to establish that the FBAR violation was attributable to willful blindness."[134]

In addition to this conflicting standard, it has been noted that "[g]auging the impact of *Williams III* on opt out decisions will be interesting, yet difficult to quantify . . . . The taxpayer's success in *Williams II*, followed by the taxpayer's defeat in *Williams III*, will trigger additional uncertainty for taxpayers . . . ."[135] Logic dictates that the same uncertainty will apply in the context of quiet disclosures.

The initial success in *Williams II* was a victory for taxpayers, likely encouraging many to avoid the high penalties in the OVD programs altogether, and instead take their chances with an opt-out or a quiet disclosure. Even though the decision was overturned in *Williams III*, the taxpayer clearly intended to hide his assets offshore, and many taxpayers realize that they are unlikely to face an FBAR penalty of any kind if their failure to report is less egregious. Unsurprisingly, the vast majority of taxpayers with foreign accounts still have not come forward through the OVD programs.[136]

IV. 2012 OVDP LEAVES ROOM FOR IMPROVEMENT

Due to the success of the prior programs, the IRS announced the 2012 Offshore Voluntary Disclosure Program (hereinafter "2012 OVDP").[137] Like the 2011 OVDI, the look-back period is eight years, however the penalty on the maximum aggregate of foreign account balances has been increased to 27.5%, and the program is indefinite.[138] The IRS makes clear that the program is

133 Internal Revenue Serv., *supra* note 62.

134 *Id.*

135 *See* Sheppard, *supra* note 61, at 332.

136 *See* NAT'L TAXPAYER ADVOCATE, *supra* note 9, at 142 (suggesting less than 1% have entered the OVD programs).

137 *See* I.R.S. News Release IR-2012-5, *supra* note 6.

138 *See* I.R.S. News Release IR-2012-64, *supra* note 8; Lederman, *supra* note 7, at 517 (suggesting a risky proposition that the open-ended nature of the 2012 OVDP allows taxpayers to strategize with regard to the timing of the voluntary disclosure if the earliest year in the look-back period would create a larger amount of tax and penalty than the current year).

subject to change at any time, including a potential increase in penalties or an end to the program altogether.[139]

Although the OVD Programs have been widely regarded as effective, there is a perception of unfairness as a result of the severe across-the-board penalty for failing to report foreign bank accounts, regardless of the circumstances.[140] Alternatives such as opting out or making a quiet disclosure may be the best choice for some taxpayers, but the uncertainty surrounding both options, in addition to threats imposed by the IRS for utilizing these alternatives,[141] has forced many to accept the draconian penalties imposed by the OVD programs.[142]

Although "[t]axpayers may normally correct their own inadvertent violations without significant penalties or burdens," the IRS's threats against quiet disclosures and the opt-out alternatives discourage self-correction.[143] Rather than face the extreme penalties offered through the program, or risk being caught making a quiet disclosure, "some taxpayers are likely to ignore their problems until the IRS offers them a reasonable way to correct inadvertent errors."[144] Collectively, these problems have contributed to many taxpayers paying too much under the

139 *See* Internal Revenue Serv., *supra* note 82, at FAQ 1.

140 *See* Kevin E. Packman, *Noncompliance After the IRS Offshore Income Reporting Iniative—What Options Remain?*, 111 J. TAX'N 281, 283 (2009) ("The Initiative effectively eliminated the reasonable cause exception for failure to file the FBAR and assumed that all such failures were attributable to the taxpayer's willfulness.").

141 *See* NAT'L TAXPAYER ADVOCATE, *supra* note 9, at 137 ("Because of these threats, many taxpayers were concerned that the IRS would always seek the maximum FBAR penalties, regardless of the situation."); *see also* Gregory J. Bertsch & Benjamin C. Hughes, *Final FBAR Regulations: Navigating the Complex Requirements of Reporting Foreign Bank Accounts*, 25 J. TAX'N & REG. FIN. INSTITUTIONS 23, 31 (2011) ("IRS examiners are given discretion to mitigate penalties and assess less than the maximum amount; however, the recent trend has been for the IRS to pursue willful penalties and assess the maximum amount permitted.").

142 *See* NAT'L TAXPAYER ADVOCATE, *supra* note 9, at 137 (finding "some benign actors were so fearful . . . that they accepted the IRS settlement and paid more than they owed").

143 *Id.* at 135–36 ("[T]hose who failed to report income could normally avoid accuracy-related penalties by filing 'qualified amended returns' before being contacted by the IRS. Thus, in the absence of any special IRS program, a taxpayer could correct a failure to report a foreign account and income from the account while avoiding most penalties by simply filing three (or six) years worth of returns (or amended returns) and FBARs. This approach encourages voluntary compliance and self-correction, which is the IRS's stated goal.").

144 *Id.* at 137. An important aspect in assessing the FBAR penalty outside of the OVD programs is the fact that taxpayers and practitioners alike were unaware of the reporting requirements. However, due to the recent crackdown, the resulting increased awareness will raise the likelihood of the existence of willfulness. *See* Michael Sardar, *What Constitutes 'Willfulness' for Purposes of the FBAR Failure-to-File Penalty?*, 113 J. TAX'N 183, 187 (2010).

current one-size-fits-all structure, and the majority of taxpayers choosing to remain noncompliant.[145]

V. SUGGESTIONS FOR INCREASED OVD PARTICIPATION AND FUTURE COMPLIANCE

Overall, the recent OVD programs have been effective, but there is a lot of room for improvement, as most taxpayers remain non-compliant.[146] The purpose of any amnesty program should be to increase compliance over the long term.[147] The few billions that have been collected is paltry compared to the purported $100 billion annual tax gap resulting from offshore income.[148] Rather than leaving taxpayers with a choice between paying too much or remaining noncompliant, the OVD program should be greatly expanded to make participation an easy decision, which will substantially increase voluntary compliance in the future, thereby reducing the annual tax gap significantly.[149]

The OVD program should utilize a tiered-penalty structure based on the amount of tax owed and the existence of mitigating factors, instead of the one-size-fits-all approach currently being used.[150] Currently, the 2012 OVDP offers options for reduced penalties of 5% and 12.5%.[151] In addition to an opt-out option,[152] however, the reduced penalties are too narrow for most taxpayers entering the program to utilize, and opting out is generally an unappealing option as previously discussed in Part II above.[153]

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145 *See* NAT'L TAXPAYER ADVOCATE, *supra* note 9, at 147 n.61 ("[T]he IRS's current approach may be more likely to reduce voluntary compliance and increase tax evasion.").

146 *See id.* at 142 ("While the OVD programs attracted over 27,000 applications (perhaps less than one percent of those who did not file FBARs) and collected almost $5.5 billion, a more effective initiative could prompt significantly more taxpayers to come into compliance voluntarily.").

147 *See* Lederman, *supra* note 7, at 520 ("[R]evenue-raising should not be the primary purpose of an amnesty . . . . Instead, bringing taxpayers into compliance should be.").

148 *See* STAFF OF S. PERMANENT SUBCOMM. ON INVESTIGATIONS, 110TH CONG., REP. ON TAX HAVEN BANKS AND U.S. TAX COMPLIANCE 1 (Comm. Print 2008). Based on the 2006 estimate, the international tax gap since 2003 is approximately $1 trillion.

149 *See* NAT'L TAXPAYER ADVOCATE, *supra* note 9, at 153. The program should be timed so that simultaneously, the forced compliance elements of FATCA will begin, increasing the incentive for taxpayers to comply while it is still voluntary, and reducing the risk of wasting IRS resources.

150 The National Taxpayer Advocate has suggested a similar approach with three tiers. The first tier would provide an avenue to avoid all penalties, including civil penalties on the additional income, if the amount due on the amended returns is less than the greater of $5000 or 10% of the total tax. The second tier would eliminate the penalty on the highest account balance for taxpayers who can show reasonable cause or who acted non-willfully. The third tier would allow for anyone else who voluntarily comes forward to participate in the program under the current penalty structure. *See id.* at 150–51.

151 *See* Internal Revenue Serv., *supra* note 10, at FAQ 52–53.

152 *Id.* at FAQ 51.

153 *See* NAT'L TAXPAYER ADVOCATE, 2013 ANNUAL REPORT TO CONGRESS 232 (2013). The opt-out option is unappealing for many due to the risks associated with an audit as

Historically speaking, only a small percentage of taxpayers who failed to report offshore accounts will ever be assessed with the willful penalty, which is generally the only penalty that is higher than the penalty assessed through the program. Therefore, the IRS should expand all three of these already existing options to fit the circumstances of the majority of program participants.[154]

The IRS may be experimenting with the idea of providing avenues for a reduced penalty with the addition of the Streamlined Compliance Program, which occurs outside of the OVD program, providing penalty relief for taxpayers who were residing outside of the United States, did not file a tax return, and had a tax liability below $1500 per year.[155] This is an excellent approach by the IRS as it signifies their realization that one size does not fit all; however, much like the other alternatives available, it is far too narrow.[156] The alternative penalty structures should be capable of being utilized just as much as, if not more than, the highest penalty applicable under the OVD program.

In the spirit of fairness, taxpayers who have previously participated in an OVD program should be given an opportunity to establish cause for a lower penalty based on the new parameters and obtain any resulting refund without the possibility of higher penalties being imposed.[157] In order to maximize credibility and increase awareness, the program should be given an end date,[158] and the IRS should carry out on

well as significantly slower processing times. *Id.* Unfortunately, to date, the "inflexible opt-in-opt-out approach offered bad actors a relatively better deal and also provided them with better customer service than benign actors." *Id.* at 233.

154 *See* NAT'L TAXPAYER ADVOCATE, *supra* note 9, at 153. When compared to the penalty assessed under the program, "[t]he existing FBAR statute offers . . . taxpayers a better deal, capping the maximum penalty at $10,000 per violation if the IRS cannot prove the violation was willful and eliminating the penalty altogether if the taxpayer can show 'reasonable cause' for his or her failure to report the account(s)." *Id.* at 148.

155 *See* Internal Revenue Serv., *Frequently Asked Questions Regarding the Streamlined Filing Compliance Procedures for Non-Resident, Non-Filer Taxpayers*, IRS.GOV, http://www.irs.gov/Individuals/International-Taxpayers/FAQReStreamlinedFilingComplianceProceduresNRNFTPs (last updated Dec. 10, 2013). The $1500 threshold is not a requirement, but rather a guideline, as the IRS generally will not consider taxpayers with tax below this amount a risk factor. *Id.*

156 *See* NAT'L TAXPAYER ADVOCATE, *supra* note 153, at 231 ("A new 'streamlined' program is less burdensome, but is overly narrow and does not provide certainty.").

157 The IRS may balk at returning money it previously received under the OVD penalty structure; however, if the tiered approach is successful at increasing future compliance, any refunds given will be insignificant in relation to the reduction in the annual tax gap.

158 *See* Lederman, *supra* note 7, at 518, 524 (suggesting that the ongoing nature of the 2012 OVDP undermines its credibility and effectiveness).

their threats against quiet disclosures[159] and publicly prosecute the most egregious examples of willful behavior.

Currently, IRS resources are tied up processing voluntary disclosures of taxpayers who willingly came forward, leaving few resources to pursue willful evaders.[160] Expanding the program as suggested will significantly increase voluntary compliance and will free up valuable IRS resources to pursue taxpayers who are purposefully evading taxes through the use of offshore accounts.[161] This group of tax evaders makes up a significantly large portion of lost revenues annually, and should be the intended target of IRS enforcement.[162]

159 *See* Morse, *supra* note 3, at 721 (determining that the lack of public prosecutions of serious tax offenders who have made quiet disclosures undermines the IRS's warnings against them). It is clear when comparing the 2003 OVCI to the 2009 OVDP, that the concurrent highly-publicized UBS scandal was extremely effective in increased participation in the program. However, it appears unlikely that the IRS has the resources to carry out their threat. *See* NAT'L TAXPAYER ADVOCATE, *supra* note 9, at 135 (noting concern that the IRS has "[i]ncreased the cost and burden of correcting past violations, as well as the IRS resources required to process these corrections . . . .").

160 *See* NAT'L TAXPAYER ADVOCATE, *supra* note 153, at 233.

161 *See* Gerard Ryle et al., *Secret Files Expose Offshore's Global Impact*, *in* SECRECY FOR SALE: INSIDE THE GLOBAL OFFSHORE MONEY MAZE 4, 5 (2013), *available at* http://cloudfront-files-1.publicintegrity.org/documents/pdfs/ICIJ%20Secrecy%20for%20Sale.pdf ("[O]ffshore financial secrecy has spread aggressively around the globe, allowing the wealthy and the well-connected to dodge taxes . . . .").

162 *See* Lederman, *supra* note 7, at 527 (citing Marie Sapirie, *New Offshore Voluntary Disclosure Initiative Features 25 Percent Penalty, Greater Clarity*, TAX NOTES TODAY, Feb. 9, 2011, at 27-1) (quoting Gregory S. Lynam: "'While it is great that the IRS is stepping up use of all of its enforcement tools, there is a danger that the IRS may focus on the little fish that voluntarily swim into the net.'").

Addendum

September 10, 2014

On June 18, 2014, the IRS announced a modification of terms to the 2012 Offshore Voluntary Disclosure Program.[163] The modification includes an expansion to the Streamlined Compliance Program to include taxpayers living in the United States, taking effect July 1, 2014. Under this modification, taxpayers that did not act willfully may qualify for a reduced OVD penalty of 5%, and only have to amend three years of tax returns.[164] In order to qualify, the taxpayer must certify that the failure to report all income, pay all tax, and/or submit all required information returns, including FBARs, was not willful.[165]

This is a significant change to the government's previous hardline approach, and it is completely in line with the suggestions proposed in this Article. It appears that this new and improved approach may be around for quite some time, which is apparently necessary as compliance slowly begins to improve.

One major flaw with this new approach is the unwillingness of the government to allow taxpayers who previously entered the program to seek reimbursement under the new parameters.[166] Although the government has an efficiency interest in abstaining from reviewing previously resolved cases, this will likely result in an understandable perception of unfairness towards those who came forward immediately to be compliant. This is an unfortunate result, as the taxpayers who previously entered the OVD programs were the first to come forward, and were the most anxious to be in full compliance with the government. Arguably, a majority of this group is most deserving of paying smaller penalties.

In spite of this unfortunate flaw, this new modification is an excellent approach to tackling the problems addressed in this

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[163] *See* Internal Revenue Serv., *2012 Offshore Voluntary Disclosure Program*, IRS.GOV, http://www.irs.gov/uac/2012-Offshore-Voluntary-Disclosure-Program (last updated June 18, 2014).

[164] *See* Internal Revenue Serv., *Streamlined Filing Compliance Procedures*, IRS.GOV, http://www.irs.gov/Individuals/International-Taxpayers/Streamlined-Filing-Compliance-Procedures (last updated Aug. 19, 2014).

[165] *Id.*

[166] *See* Internal Revenue Serv., *Transition Rules: Frequently Asked Questions (FAQs)*, IRS.GOV, FAQ 2, http://www.irs.gov/Individuals/International-Taxpayers/Transition-Rules-Frequently-Asked-Questions-FAQs (last updated June 18, 2014) (stating that a taxpayer who has already completed an OVD program "will not be eligible").

Article, and should go a long way towards closing the significant tax gap resulting from noncompliance in this area.