IRS Amnesty Covers More than Foreign Accounts: Analyzing the Updated Voluntary Disclosure Practice, New International Tax Withholding Procedure, and Guidelines for Late Returns by Foreign Corporations

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Hale E. Sheppard analyzes a number of disclosure programs in existence today, many of which remain unknown to taxpayers and tax professionals.

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I. Introduction

The global economy is intertwined, individuals and entities are more mobile than ever, and the U.S. international tax and information-reporting duties are becoming increasingly complex each year. One result is a significant amount of non-compliance, some intentional, some not. The Internal Revenue Service ("IRS"), which is tasked with enforcing the complicated rules, realized long ago that it is impossible, with limited time and resources, to catch all, or even most, of the wrongdoers. Therefore, the IRS introduced various disclosure programs in recent years, attempting to entice taxpayers to pro-actively resolve issues in exchange for favorable settlement terms. Since 2003, when the IRS introduced its first "offshore" program triggered by the discovery of numerous

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unreported assets in the Cayman Islands, efforts and attention have largely centered on sensational issues, namely, individuals with hidden accounts in Switzerland, Liechtenstein, Panama, and so on. There are many other types of non-compliance, though, and the IRS is trying different methods to remedy them all. This article analyzes a number of disclosure programs in existence today, many of which remain unknown to taxpayers and tax professionals.

II. Current Disclosure Programs—The Notorious and the Obscure

The IRS has introduced programs, with different characteristics, to address several types of non-compliance, both domestic and international. A comprehensive review of all disclosure programs could fill volumes and, more importantly, put readers to sleep. Accordingly, this article focuses on just four areas: (i) Lingering international programs, after the closure of the Offshore Voluntary Disclosure Program ("OVDP"); (ii) A broad, updated disclosure practice, introduced in November 2018, covering all categories of taxes and taxpayers; (iii) A new centralized filing practice aimed at fixing failures to properly withhold, report, and remit taxes on international payments from U.S. sources; and (iv) Guidelines for foreign corporations to request a waiver to file late Forms 1120-F (*U.S. Income Tax Return of a Foreign Corporation*) and corresponding international information returns.

A. Lingering International or "Offshore" Programs

1. Critical Background Information

In order to appreciate the existing methods by which individual non-compliant taxpayers can pro-actively resolve global issues with the IRS on favorable terms, one must first understand basic international tax and information-reporting duties, as well as the long list of downsides for shirking such duties. These are described below.

a. Tax and Disclosure Duties. U.S. citizens and residents have several obligations when they decide to hold a foreign financial account, including the following:

- They must check the "yes" box on Schedule B (Interest and Ordinary Dividends) to Form 1040 (*U.S. Individual Income Tax Return*) to disclose the existence of the foreign account;
- They must identify the foreign country in which the account is located, also on Schedule B to Form 1040;
- They must declare all income on Form 1040 before depositing it into the foreign account, as well as all passive income later generated by the account, such as interest, dividends, and capital gains;
- They generally must report the account on Form 8938 (*Statement of Specified Foreign Financial Assets*), which is enclosed with Form 1040;
- If the foreign account holds mutual funds, they ordinarily must enclose a Form 8621 (*Information Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund*) with Form 1040;
- In situations where the foreign account is held indirectly by individual taxpayers through a foreign corporation, then they likely need to file Form 5471 (*Information Return of U.S. Persons with Respect to Certain Foreign Corporations*) and Form 926 (*Return by a U.S. Transferor of Property to a Foreign Corporation*);
- In cases where the foreign account is held through a foreign trust instead, taxpayers normally must file Forms 3520 (*Annual Return to Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts*) and/or Forms 3520-A (*Annual Information Return of Foreign Trust with a U.S. Owner*); and
- They must e-file a FinCEN Form 114 (*Report of Foreign Bank and Financial Accounts*) ("FBAR").[1]

b. Multiple Sanctions for Violations. Many articles focus on the severity of penalties for international non-compliance. That level of detail is unnecessary here. Suffice it to summarize below some of the most common economic punishments imposed by the IRS.

First, taxpayers omitting income from foreign activities and assets often face large U.S. tax liabilities, as well as significant penalties related directly to the tax underpayments. Examples include negligence penalties equal to 20 percent of the tax debt to the IRS, penalties rising to 40 percent of the tax debt in situations involving undisclosed foreign financial assets, and penalties reaching 75 percent of the tax debt if the IRS can prove civil fraud.[2] Taxpayers are also stuck with large interest charges, on both the tax liabilities and penalties.[3]

Second, taxpayers are often overwhelmed by large sanctions for unfiled FBARs. Congress was concerned about widespread FBAR non-compliance for many years; therefore, it enacted stringent penalty provisions in 2004 as part of the American Jobs Creation Act ("Jobs Act").[4] Under the law in existence *before* the Jobs Act, the IRS could only assert penalties where it could demonstrate that taxpayers "willfully" violated the FBAR rules.[5] If the IRS managed to satisfy this high standard, it could impose a relatively small penalty, ranging from just $25,000 to $100,000, regardless of the size of the hidden accounts.[6]

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Thanks to the Jobs Act, the IRS may now assert a penalty on any person who fails to file a required FBAR, period.[7] In the case of non-willful violations, the maximum penalty is $10,000.[8] The Jobs Act calls for higher penalties where willfulness exists. Specifically, when a taxpayer willfully fails to file an FBAR, the IRS may assert a penalty equal to $100,000 or 50 percent of the balance in the undisclosed account at the time of the violation, whichever amount is larger.[9] Given the multi-million dollar balances in many unreported accounts, given that the IRS can assert a penalty worth 50 percent of the account for every single year that the violation occurred, and given that the IRS can impose both civil and criminal penalties for the same infraction, FBAR penalties can be enormous.[10]

Third, if a taxpayer fails to file Form 8938 in a timely manner, then the IRS generally will assert a penalty of $10,000 per violation.[11] The penalty increases to a maximum of $50,000 if the taxpayer does not rectify the problem quickly after contact from the IRS.[12]

Fourth, additional penalties apply when foreign trusts are involved. Form 3520 must be filed in various circumstances. For instance, a "responsible party" generally must file a Form 3520 within 90 days of certain "reportable events," such as the creation of a foreign trust by a U.S. person, the transfer of money or other property (directly or indirectly or constructively) to a foreign trust by a U.S. person, and the death of a U.S. person, if the decedent was treated as the "owner" of any portion of the trust under the grantor trust rules, or if any portion was included in the gross estate of the decedent.[13] A U.S. person also must file a Form 3520 if he receives during a year (directly or indirectly or constructively) any distribution from a foreign trust.[14] The penalty for not filing a Form 3520 is $10,000 or 35 percent of the so-called "gross reportable amount," whichever is larger.[15] A Form 3520-A normally must be filed if, at any time during the relevant year, a U.S. person is treated as the "owner" of any portion of the foreign trust under the grantor trust rules.[16] The normal penalty for Form 3520-A violations is the higher of $10,000 or five percent of the "gross reportable amount."[17]

Fifth, holding an interest in a foreign corporation triggers more complications and potential penalties. Four categories of U.S. persons who are officers, directors, and/or shareholders of certain foreign corporations ordinarily must file a Form 5471 with the IRS.[18] If a person neglects to do so, then the IRS may assert a penalty of $10,000 per violation, per year.[19] This standard penalty increases at a rate of $10,000 per month, to a maximum of $50,000, if the problem persists after notification by the IRS.[20]

The penalties described above can be significant, even when considered separately. They can become untenable, though, when the IRS decides to "stack" the penalties, asserting multiple penalties in connection with the same unreported foreign assets or activities. As recently as March 2019, a District Court held the "stacking" of certain penalties by the IRS was prohibited neither by law nor by the constitution.[21]

c. Fighting the U.S. Government on Multiple Fronts. Taxpayers with undeclared foreign accounts, assets, entities and/or income often find themselves engaged in a multi-faceted war against the U.S. government, each of which costs taxpayers a significant amount of time, money, and anguish.

A simple example shows how this works. Assume that Risktaker Rob held foreign accounts during 2017, with an aggregate balance of approximately $2 million, which yielded a total of $100,000 in interest income. Further assume that Risktaker Rob did not report the foreign-source income on his 2017 Form 1040, did not disclose the existence of the foreign accounts by checking the "yes" box on Schedule B to the 2017 Form 1040, did not enclose a Form 8938 with his 2017 Form 1040, and did not electronically file an FBAR.

After conducting an audit, the IRS might issue the following items to Risktaker Rob: (i) a Notice of Deficiency proposing increased taxes on the $100,000 of unreported income, tax-related penalties (such as civil fraud penalties), and interest charges, (ii) an FBAR 30-Day letter (*i.e.*, Letter 3709) asserting a penalty of $1 million, which constitutes the maximum sanction of 50 percent of the highest aggregate balance of the unreported foreign accounts, and (iii) a Notice Letter (*i.e.*, Letter 4618) and/or Form 8278 (*Assessment and Abatement of Miscellaneous Civil Penalties*) asserting a penalty of $10,000 for failure to file Form 8938.[22]

If Risktaker Rob disputes everything, then he will become familiar with at least three different venues. First, Risktaker Rob would file a Petition with the Tax Court to dispute the income taxes and tax-related penalties proposed in the Notice of Deficiency.[23]

Second, because the FBAR penalty derives from Title 31 of the U.S. Code (*i.e.*, Money and Finance) as opposed to Title 26 of the U.S. Code (*i.e.*, Internal Revenue Code), it cannot be challenged in Tax Court.[24] Thus, after Risktaker Rob exhausts his administrative appeal rights with the IRS, the Department of Justice ("DOJ") will bring an action against him in District Court to collect the FBAR penalty.[25]

Third, because penalties for not filing Form 8938 are not related to a tax deficiency, the IRS takes the position that they cannot be challenged in the Tax Court in a

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proceeding triggered by a Notice of Deficiency.[26] Since the Form 8938 sanction is an "assessable" penalty, taxpayers generally find themselves disputing it in one or more of the following manners: (i) Filing a penalty-abatement letter in response to the first bill/notice from the IRS; (ii) Administratively challenging with the Appeals Office any negative decision by the IRS Service Center about the initial penalty-abatement request; (iii) Filing a request for, and participating in, a Collection Due Process ("CDP") hearing with the IRS, after the IRS issues its notice threatening imminent seizure of the taxpayer's property; and (iv) After receiving an unfavorable Notice of Determination from a Settlement Officer in connection with the CDP hearing, seeking review by the Tax Court, or paying the penalty under protest and then initiating a refund action with the IRS, or simply waiting for the DOJ to start a collection suit in District Court.

The preceding illustration centers on the fictional character of Risktaker Rob, but this type of multi-venue fighting often occurs in real life. For example, one deceased taxpayer and his beneficiaries, with unreported foreign income, accounts, and trusts, were engaged in disputes with the IRS or DOJ for years, in the Tax Court, two District Courts, and a state Probate Court.[27]

d. Endless Assessment Periods. It is important to note that failure to timely file nearly all international information returns (except the FBAR) not only triggers penalties, but also gives the IRS an unlimited period of time to audit the Form 1040 to which the information returns should have been attached, and then assess additional taxes, penalties, and interest charges. A relatively obscure procedural provision, Code Sec. 6501(c)(8)(A), contains a powerful tool for the IRS. It generally states that, where a taxpayer does not properly file a long list of international information returns, the assessment-period remains open "with respect to any tax return, event, or period" to which the information returns relate, until three years after the taxpayer ultimately files the information returns.[28] Consequently, if a taxpayer never files, say, a Form 8938 to reveal his interest in foreign financial assets, then the assessment-period never begins to run against the IRS. This obligates taxpayers with undisclosed foreign assets to act, because keeping a low profile and allowing the clock to run out is no longer a realistic option.

2. Description of Programs Still Available

Taxpayers, after becoming cognizant of the international duties and consequences described above, often start exploring ways to resolve issues with the IRS on the most painless terms possible. As of the writing of this article, the options consist of participating in the Streamline Foreign Offshore Procedure ("SFOP"), Streamline Domestic Offshore Procedure ("SDOP"), Delinquent International Information Return Submission Procedures ("DIIRSP"), or Delinquent FBAR Submission Procedure ("DFSP"). These four programs, all introduced in 2014, share certain characteristics, but they differ in important ways.[29]

a. SFOP. In order to be eligible for the SFOP, a taxpayer (who is a U.S. citizen or Green Card holder) must meet the following criteria: (i) he was physically outside the United States for at least 330 days in one or more of the past three years; (ii) he did not have an "abode" in the United States during the relevant year; (iii) he either did not file annual Forms 1040 with the IRS or filed annual Forms 1040 that did not properly report all income from everywhere in the world; (iv) he might have also failed to file proper international information returns; (v) the violations were the result of "non-willful" conduct; (vi) neither the IRS nor the DOJ has initiated a civil examination or criminal investigation of the taxpayer or a related party; and (vii) the taxpayer is an individual (or the estate of an individual), because the SFOP is not open to business entities. Under the SFOP, taxpayers are only required to file Forms 1040 or Forms 1040X for the past three years, international information returns for the past three years, and FBARs for the past six years. The taxpayer must pay all tax liabilities and interest charges stemming from the Forms 1040 or Forms 1040X, but the IRS does not impose any penalties whatsoever on taxpayers who successfully resolve matters through the SFOP.

b. SDOP. The SDOP is similar to the SFOP, with three critical distinctions. First, participants in the SDOP do not satisfy the foreign-residency requirement; that is, they spent too much time in the United States. Second, they must have filed timely Forms 1040 with the IRS each year, but neglected to report all worldwide income and/or enclose all required international information returns. Finally, if taxpayers are accepted into the SDOP, the IRS does not waive all penalties, imposing instead a so-called "offshore" penalty equal to five percent of the highest total value of all non-compliant assets during the relevant six-year period.

c. DIIRSP. The DIIRSP provides that taxpayers who/which have not filed one or more international information returns can file them, on a penalty-free basis, if the taxpayers (i) previously filed U.S. tax returns each year, reporting all income, (ii) have "reasonable cause"

for not timely filing the information returns, (iii) are not under a civil examination or a criminal investigation by the IRS or DOJ, and (iv) have not already been contacted by the IRS about the delinquent information returns. The guidance that the IRS later issued about the DIIRSP, in the form of Frequently Asked Questions ("FAQs"), relaxed the eligibility criteria somewhat. FAQ #1 expressly states that the existence of unreported income in earlier years does *not* necessarily exclude a taxpayer from the DIIRSP:

> FAQ #1—QUESTION. Are the Delinquent International Information Return Submission Procedures announced on June 18, 2014 different from the [previous] procedures?
>
> FAQ #1—ANSWER. Yes. The IRS eliminated 2012 OVDP FAQ 18, which gave automatic penalty relief, *but was only available to taxpayers who were fully tax compliant*. The Delinquent International Information Return Submission Procedures clarify how taxpayers may file delinquent international information returns in cases where there was reasonable cause for the delinquency. *Taxpayers who have unreported income or unpaid tax are not precluded from filing delinquent international information returns* … .

d. DFSP. The DFSP is geared toward taxpayers who/which previously filed timely U.S. tax returns each year reporting all worldwide income (including income generated by foreign accounts), yet neglected to file annual FBARs. The DFSP allows such taxpayers to rectify FBAR issues without incurring any penalties. The rationale here is that taxpayers willfully hiding foreign accounts do not report income from such accounts on their annual U.S. tax returns and pay the resulting taxes.

B. Updated Voluntary Disclosure Practice After November 2018

In conjunction with the termination of the OVDP in September 2018, the IRS announced the updated voluntary disclosure practice ("UVDP") in November 2018.[30] The UVDP seemingly applies to all types of taxes, including income, gift, estate, employment, excise, *etc*. It also covers both international and purely domestic matters. According to the IRS, the objective of the UVDP is "to provide taxpayers concerned that their conduct is willful or fraudulent, and that may rise to the level of tax and tax-related criminal acts, with a means to come into compliance with the law and potentially avoid criminal prosecution."[31]

1. Overview of UVDP Procedure

The IRS describes the procedure under the UVDP as follows: (i) Taxpayers first need to send a request for "preclearance" to the Criminal Investigation Division ("CI"), at a designated address or fax number; (ii) CI will review the applications for eligibility; (iii) Once CI grants "preclearance," taxpayers must promptly submit to CI all required documents, using a revised version of Form 14457, which is expected to demand specific and detailed information about the non-compliance, including an explanation of the facts and circumstances, assets, entities, related parties, and/or professional advisors involved; (iv) CI will then issue a "preliminary acceptance" letter to taxpayers and simultaneously forward the materials to the LB&I unit in Austin, Texas, but it will not process tax returns, information returns, or payments; (v) LB&I will handle certain preparatory functions and then route each case to the appropriate office of the Examination Division; and (vi) The Examination Division will follow "standard examination procedures" to determine the appropriate tax liabilities, penalties, and more.[32]

2. Ambiguous Settlement Terms

On what terms will cases be settled under the UVDP? The IRS indicates that it will apply the following "civil resolution framework" to all cases, which has already triggered complaints about "uncertainty" and "significant grey area."[33]

a. Disclosure Period; Relevant Years. In terms of scope, cases generally will cover the most recent six closed tax years. There are several exceptions to this general rule. For instance, if the IRS and taxpayer cannot resolve a case by mutual agreement, then the Revenue Agent "has discretion to expand the scope to include the full duration of the noncompliance and may assert maximum penalties under the law with the approval of management."[34] Moreover, in situations where the non-compliance lasted fewer than six years, the scope can be limited to just those years with issues. Going the other way, with the IRS's consent, taxpayers might be allowed to expand the UVDP disclosure period to more than six years. They might want a longer period in order to correct tax issues with foreign governments that mandate more years, to rectify tax matters occurring before the acquisition or sale of an entity, to disclose taxable and/or reportable gifts in earlier years, *etc*.[35]

b. Civil Fraud Penalty or Penalties. Generally, the IRS will assert a civil fraud penalty, equal to 75 percent of the tax liability, to the one year during the disclosure period with the highest tax liability. For taxpayers filing amend

returns, the fraud penalty will derive from Code Sec. 6663, while for non-filers, it will originate in Code Sec. 6651(f).[36] In "limited circumstances," Revenue Agents may apply the civil fraud penalty to more than one year, up to all six years, "based on the facts and circumstances of the case."[37] The example provided by the IRS is a situation where a taxpayer and Revenue Agent cannot agree on the tax liability as part of the UVDP process. Additionally, Revenue Agents can impose civil fraud penalties "beyond six years" if taxpayers fail to cooperate and resolve the audit by agreement.[38]

c. FBAR Penalties in Cases of Unreported Foreign Accounts. The IRS announced that FBAR penalties, possibly including those for "willful" violations, will be asserted pursuant to the existing penalty guidelines found in Internal Revenue Manual ("IRM") §4.26.16 and §4.26.17.[39] This is one of the biggest areas of concern for taxpayers with international violations, and it is explored further, below.

d. Ability to Request Reduced Penalties. Taxpayers are "not precluded" from (i) seeking an accuracy-related penalty under Code Sec. 6662 in the amount of 20 percent of the tax liability, instead of a civil fraud penalty at 75 percent, or (ii) requesting non-will FBAR penalties, in place of willful ones. However, given the purpose of the UVDP, the acceptance of lesser penalties by the IRS will be "exceptional," and taxpayers must present "convincing evidence" to justify a reduction.[40]

e. Perhaps No Information Return Penalties. Contrary to the harsh stance by the IRS regarding the disclosure period, tax-related penalties (*i.e.*, civil fraud penalties), and FBAR penalties, taxpayers might escape sanctions for unfiled information returns. The IRS will not automatically assess these under the UVDP. Moreover, Revenue Agents are instructed to consider the application of other penalties, such as civil fraud penalties and FBAR penalties, in resolving information return infractions.[41]

f. Applicability to All Types of Taxes. The IRS explained that penalties related to non-income-tax matters (*e.g.*, excise, employment, gift, or estate taxes) will be resolved "based on the facts and circumstances with [Revenue Agents] coordinating with appropriate subject matter experts."[42]

3. Interesting Aspects of the UVDP

The UVDP features many interesting aspects, some of which are expressly addressed, while others suffer from silence. Comments about such features are set forth below.

a. Challenging the IRS Within the UVDP. The IRS stated that taxpayers retain the right to request reconsideration of the issues by the Appeals Office. This is positive news for taxpayers, although difficult to reconcile with the repeated warnings from the IRS that taxpayers could face grave consequences if they fail to "promptly and fully cooperate" in the UVDP process, disagree with the Revenue Agent on the appropriate tax liability, and/or refuse to execute a written agreement with the IRS to conclude matters.[43]

b. "Revoking" Ability to Participate in the UVDP. The IRS indicated that it will develop procedures for Revenue Agents to "revoke" a taxpayer from the UVDP under certain circumstances.[44] A high-ranking IRS official later provided some relief in this regard, explaining at a major tax conference that Revenue Agents will give ample warning of lack of cooperation before taking steps to "revoke" a "preliminary acceptance" letter previously issued to a taxpayer.[45]

c. Payment of Liabilities Resulting from the UVDP. The UVDP procedures also imply that taxpayers can participate, only if they can pay the full freight: "In general, the [IRS] expects that voluntary disclosures will be resolved by agreement with full payment of all taxes, penalties, and interest for the disclosure period."[46] This posture by the IRS under the new UVDP is inconsistent with the historic manner in which the IRS has addressed the payment issue. In particular, under the OVDP, the IRS expressly allowed taxpayers to become fully compliant, notwithstanding the fact that they lacked the financial wherewithal to make the IRS whole:

> If I don't have the ability to full pay, can I still participate in this program?
>
> Yes. The terms of this program require the taxpayer to pay with his submission the tax, interest, offshore penalty, and accuracy-related penalty, and, if applicable, the failure-to-file and failure-to-pay penalties. However, it is possible for a taxpayer who is unable to make full payment of these amounts to request the IRS to consider other payment arrangements. If you cannot pay the total amount of tax, interest, offshore penalty, and other penalties required, submit your proposed payment arrangement and [complete financial data]. The burden will be on the taxpayer to establish inability to pay, to the satisfaction of the IRS, based on full disclosure of all assets and income sources, domestic and foreign, under the taxpayer's control. Assuming that the IRS determines that the

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inability to fully pay is genuine, the taxpayer must work out other financial arrangements, acceptable to the IRS, to resolve all outstanding liabilities to be entitled to the penalty structure of this program.[47]

d. IRS Changes Stance on "Quiet Disclosures". The IRS has warned taxpayers since it began introducing its recent wave of voluntary disclosure programs back in 2009 *not* to make to circumvent such programs by making a so-called "quiet disclosure." This essentially means taxpayers proactively resolving issues with the IRS by filing amended tax returns and/or information returns, without officially participating in a recognized disclosure program, with hopes that the IRS will process the returns in the regular course, not start an audit, and not impose penalties. The IRS repeatedly announced that it planned to identify and harshly sanction attempted "quiet disclosures."[48] With the recent introduction of the UVDP, though, the IRS has completely changed course, telling taxpayers that it is acceptable to make a "quiet disclosure," provided that there is no risk of criminality.[49] The IRS stated the following in this regard:

> Voluntary disclosure is a long-standing practice of the IRS to provide taxpayers with criminal exposure a means to come into compliance with the law and potentially avoid criminal prosecution … This memorandum [announcing the UVDP] updates that voluntary disclosure practice. *Taxpayers who did not commit any tax or tax related crimes and do not need the voluntary disclosure practice to seek protection from potential criminal prosecution can continue to correct past mistakes using the procedures mentioned above or by filing an amended or past due tax return*. When these returns are examined, examiners will follow existing law and guidance governing audits of the issues.[50]

Tax professionals were suspicious about this drastic reversal of position by the IRS, so they asked pointed questions of a high-ranking IRS official during a recent tax conference. Such official confirmed that the IRS changed its earlier position and indicated that the normal look-back period for "quiet disclosures" will be six years, just like submissions under the UVDP.[51]

e. Analyzing What Type of FBAR Penalty Applies. As explained above, in cases resolved through the UVDP involving unreported foreign accounts, the IRS intends to assert FBAR penalties. The only question is their size, which depends on the standards applied by the IRS. The IRS referenced the IRM in announcing the UVDP, the relevant portions of which are summarized below.

i. Indicia of Willfulness. The IRM provides the following guidance to IRS personnel regarding the concept of "willfulness" in the FBAR arena:

- "The test for willfulness is whether there was a voluntary, intentional violation of a known legal duty."[52]
- "Willfulness is shown by the person's knowledge of the reporting requirements and the person's conscious choice not to comply with the requirements. In the FBAR situation, the person only need to know that a reporting requirement exists. If a person has that knowledge, the only intent needed to constitute a willful violation of the requirement is a conscious choice not to file the FBAR."[53]
- "Under the concept of 'willful blindness,' willfulness is attributed to a person who made a conscious effort to avoid learning about the FBAR reporting and recordkeeping requirements. Example: Willful blindness may be present when a person admits knowledge of, and fails to answer questions concerning, his interest in or signature or other authority over financial accounts at foreign banks on Schedule B of his Federal income tax return. This section of the income tax return refers taxpayers to the instructions for Schedule B, which provides guidance on their responsibilities for reporting foreign bank accounts and discusses the duty to file the FBAR. These resources indicate that the person could have learned of the filing and recordkeeping requirements quite easily. It is reasonable to assume that a person who has foreign bank accounts should read the information specified by the government in tax forms. The failure to act on this information and learn of the further reporting requirement, as suggested on Schedule B, may provide evidence of willful blindness on the part of the person."[54]
- "Willfulness can rarely be proven by direct evidence, since it is a state of mind. It is usually established by drawing a reasonable inference from the available facts. The government may base a determination of willfulness on inference from conduct meant to conceal sources of income or other financial information. For FBAR purposes, this could include concealing signature authority, interests in various transactions, and interests in entities transferring cash to foreign banks."[55]

If the IRS determines that an FBAR violation was "willful," it must then decide what penalty amount is appropriate under the circumstances. The IRM contains the following tips on this topic:

- "For violations occurring after October 22, 2004, a penalty for a willful FBAR violation may be imposed up to the greater of $100,000 or 50% of the amount in the account at the time of the violation … For cases involving willful violations over multiple years, examiners may recommend a penalty for each year for which the FBAR violation was willful."[56]
- "After May 12, 2015, in most cases, the total penalty amount for all years under examination will be limited to 50 percent of the highest aggregate balance of all unreported foreign financial accounts during the years under examination. In such cases, the penalty for each year will be determined by allocating the total penalty amount to all years for which the FBAR violations were willful based upon the ratio of the highest aggregate balance for each year to the total of the highest aggregate balances for all years combined, subject to the maximum penalty limitation in 31 USC 5321(a)(5)(C) for each year. Note: Examiners should still use the mitigation guidelines and their discretion in each case to determine whether a lesser penalty amount is appropriate."[57]
- "Examiners may recommend a penalty that is higher or lower than 50 percent of the highest aggregate account balance of all unreported foreign financial accounts based on the facts and circumstances. In no event will the total penalty amount exceed 100 percent of the highest aggregate balance of all unreported foreign financial accounts during the years under examination. The examiner's workpapers must support all willful penalty determinations and document the group manager's approval."[58]

ii. Non-Willfulness, Penalty Mitigation, and IRS Discretion. Some good news exists. Provided that an FBAR violation does not rise to the level of willfulness, Revenue Agents are allowed to apply lower penalties, if the following four "mitigation threshold conditions" are met: (i) The taxpayer has no history of criminal tax or Bank Secrecy Act convictions for the preceding 10 years and no history of FBAR penalty assessments; (ii) No money passing through any of the foreign accounts associated with the taxpayer was from an illegal source or used to further a criminal purpose; (iii) The taxpayer cooperated during the examination, which means that the IRS was not obligated to issue a Summons, the taxpayer responded to reasonable requests for documents, meetings, and interviews, and the taxpayer filed all necessary returns and FBARs; and (iv) The IRS did not determine a civil fraud penalty against the taxpayer for an income tax underpayment for the year in question due to the failure to report income related to any amount in a foreign account.[59]

The IRM also indicates that Revenue Agents have significant latitude in determining which FBAR penalty, if any, should be applied in a particular case. The portions of the IRM favorable to taxpayers on this issue include the following:

- "The examiner may determine that the facts and circumstances of a particular case do not justify asserting a penalty."[60]
- "Factors to consider when applying examiner discretion may include, but are not limited to, the following: Whether compliance objectives would be achieved by issuance of a warning letter; Whether the person who committed the violation had been previously issued a warning letter or assessed an FBAR penalty; The nature of the violation and the amounts involved; and The cooperation of the taxpayer during the examination."[61]
- "Given the magnitude of the maximum penalties permitted for each violation, the assertion of multiple penalties and the assertion of separate penalties for multiple violations with respect to a single FBAR, should be carefully considered and calculated to ensure the amount of the penalty is commensurate to the harm caused by the FBAR violation."[62]
- "There is a penalty ceiling but no minimum amount. This discretion has been delegated to the FBAR examiner. The examiner may determine that the facts and circumstances of a particular case do not justify a penalty. If there was an FBAR violation but no penalty is appropriate, the examiner must issue the FBAR warning letter, Letter 3800."[63]
- "When a penalty is appropriate, IRS established penalty mitigation guidelines to ensure the penalties determined by the examiner's discretion are uniform. The examiner may determine that: A penalty under these guidelines is not appropriate, or A lesser amount than the guidelines otherwise provide is appropriate."[64]

iii. Positions Taken by U.S. Government in FBAR Litigation. The fact that Revenue Agents tasked with resolving cases filed under the UVDP are instructed to follow the guidance in the IRM engenders optimism, at least in theory. However, taxpayers and tax professionals remain concerned that the IRS and DOJ will simply continue to advance the same positions that they are now taking in recent FBAR litigation. A growing number of courts have examined the issue of what constitutes "willfulness" in the context of civil FBAR penalties.[65] Notable decisions include *Williams* in 2012,[66] *McBride* in 2012,[67] *Bussell* in 2015,[68] *Bohanec* in 2016,[69] *Bedrosian* in 2017,[70]

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Kelley-Hunter in 2017,[71] *Toth* in 2018,[72] *Colliot* in 2018,[73] *Wadhan* in 2018,[74] *Garrity* in 2018,[75] *Markus* in 2018,[76] *Norman* in 2018,[77] *Flume* in 2018,[78] *Kimble* in 2018,[79] and *Horowitz* in 2019.[80]

Trying to digest all the data about willfulness in the FBAR context is incredibly challenging. The rules are complex, the court decisions are dense and inconsistent, and the IRS and the DOJ sometimes take conflicting positions on the same issue in different cases. Below is a consolidation of some of the critical issues learned from prior FBAR cases:

- The Tax Court lacks jurisdiction over FBAR penalty matters, in both pre-assessment and post-assessment (*i.e.*, collection) cases, so FBAR litigation takes place in District Court or the Court of Federal Claims.
- The standard for asserting maximum FBAR penalties is "willfulness."
- The government is only required to prove willfulness by a preponderance of the evidence, not by clear and convincing evidence.
- If the taxpayer makes a damaging admission during a criminal trial, the government will use such statement against him in a later civil FBAR penalty action.
- The taxpayer's motives for not filing an FBAR are irrelevant, because nefarious, specific intent is not necessary to trigger willfulness.
- The government can prove willfulness through circumstantial evidence and inference, including actions by the taxpayer to conceal sources of income or other financial data.
- In determining whether an FBAR violation was willful, courts might consider after-the-fact unprivileged communications between a taxpayer and his advisors, as well as unprotected communications with foreign banks and other third-parties.
- The courts review the question of willfulness on a *de novo* basis, meaning that taxpayers generally cannot offer evidence at trial related to the IRS's administrative process in conducting the audit, initially determining whether willfulness existed, *etc*.
- Courts might reject as irrelevant, in an evidentiary sense, reports and testimony from experts who attempt to make a link between general ignorance of FBAR duties by the public and the particular ignorance of such duties by the taxpayer under attack.
- The government can establish willfulness by showing that a taxpayer either knowingly or recklessly violated FBAR duties.
- Recklessness might exist where a taxpayer fails to inform his accountant about foreign accounts.
- Recklessness might also exist where a taxpayer is "willfully blind" or has "constructive knowledge" of his FBAR duties, which can occur when he executes but does not read and understand every aspect of a Form 1040, including all Schedules attached to the Form 1040 (like Schedule B containing the foreign-account question) and any separate forms referenced in the Schedules (like the FBAR).

The IRS and DOJ now regularly raise multiple theories for FBAR liability, employing the throw-everything-at-the-wall-and-see-what-sticks technique. This often includes allegations that the taxpayer knew about the FBAR duty, which is "actual knowledge," or, alternatively, that he should have known about the FBAR duty, which is "constructive knowledge." The second argument presented by the IRS and DOJ can be summarized as follows: (i) The taxpayer signed his Form 1040 under penalties of perjury, thereby representing that he reviewed the entire Form 1040, including Schedule B; (ii) Schedule B put the taxpayer on notice of his potential FBAR duty; (iii) To the extent that the taxpayer had questions about the FBAR, Schedule B expressly directed the taxpayer to the Instructions to Form 1040, the FBAR itself, and the Instructions to the FBAR; (iv) If the taxpayer checked the "no" box in response to the foreign-account question on Schedule B, then he filed a false Form 1040, he was aware of the FBAR duty, and his FBAR violation was willful; and (v) If the taxpayer instead left the box blank, answering neither "yes" nor "no" about foreign accounts, and if the taxpayer professes not to have reviewed Form 1040 or Schedule B, then his FBAR violation was willful because he had constructive knowledge of the FBAR duty, he was on inquiry notice, he was "willfully blind," he showed "reckless disregard" for the rules, or some combination thereof. To make matters worse for taxpayers, several courts have accepted this argument in recent years. The most explicit case on this issue is *McBride*.

In addressing the FBAR issue, the District Court in *McBride* pointed out that "knowledge of what instructions are contained within the form is directly inferable from the contents of the form itself, even if it were blank."[81] Fortifying its position, the District Court cited and quoted various criminal cases, including a criminal FBAR case, where the courts attributed to the taxpayer knowledge of the contents of a return based solely on the taxpayer's signature on the tax return.[82] The District Court, eliminating any ambiguity about its stance on the theory of constructive knowledge, rendered the following holding:

> Knowledge of the law, including knowledge of the FBAR requirements, is imputed to McBride. The knowledge of the law regarding the requirement to

file an FBAR is sufficient to inform McBride that he had a duty to file [an FBAR] for any foreign account in which he had a financial interest. McBride signed his federal income tax returns for both the tax year 2000 and 2001. Accordingly, McBride is charged with having reviewed his tax return and having understood that the federal income tax return asked if at any time during the tax year he held any financial interest in a foreign bank or financial account. The federal income tax return contained a plain instruction informing individuals that they have the duty to report their interest in any foreign financial or bank accounts held during the taxable year. McBride is therefore charged with having had knowledge of the FBAR requirement to disclose his interest in any foreign financial or bank accounts, as evidenced by his statement at the time he signed the returns, under penalty of perjury, that he read, reviewed, and signed his own federal income tax returns for the tax years 2000 and 2001, as indicated by his signature on the federal income tax returns for both 2000 and 2001. As a result, McBride's willfulness is supported by evidence of his false statements on his tax returns for both the 2000 and the 2001 tax years, and his signature, under penalty of perjury, that those statements were complete and accurate.[83]

C. International Tax Withholding Non-Compliance Program

Complying with the U.S. international tax withholding rules involves reviewing ultra-dense and evolving regulations promulgated under different parts of the Internal Revenue Code, foreign entity classification, obtaining and verifying forms from payees regarding their status, identifying the ultimate beneficiary, preparing and filing multiple returns and statements, analyzing the potential effect of relevant treaties, and more. Therefore, it comes as no surprise that non-compliance in this area is commonplace. The IRS recognizes this and has recently taken steps to help taxpayers help themselves.

1. Synopsis of International Tax Withholding

Generally, if a foreign person derives investment-type income from sources within the United States, then the *gross amount* of such income is taxed at a flat rate of 30 percent.[84] The burden of collecting such tax and then remitting it to the IRS is placed on the person controlling the payment, commonly known as a U.S. withholding agent ("USWA").[85] These USWAs have an incentive to get the withholding done correctly, because they are personally liable for the taxes, penalties, and interest, if they fail to meet their duties.[86]

There are exceptions to the general rules, of course. For instance, many of the bilateral income tax treaties to which the United States is a party reduce the withholding rate on certain categories of passive income from 30 percent, to lower amounts, and even to zero.[87] Moreover, capital gains often escape U.S. taxes, provided that they do not relate to sales of U.S. real property interests.[88]

There are two main U.S. tax withholding tax regimes affecting investment-type income. The first is the Foreign Account Tax Compliance Act ("FATCA"), which imposes withholding in situations where foreign payees fail to provide information about U.S. recipients of payments.[89] The second is the longstanding withholding regime related to payments to foreign persons of fixed, determinable, annual, or periodic ("FDAP") income from U.S. sources.[90]

There is a different set of withholding rules applicable to foreign persons selling U.S. real property. These were promulgated pursuant to the Foreign Investment in Real Property Tax Act ("FIRPTA"), which generally dictates that gains or losses realized by foreign persons from the sale, exchange, or other disposition of a "U.S. real property interest" are taxed in the same manner as income that is effectively connected to a trade or business in the United States.[91] To ensure collection of FIRPTA tax from foreign persons, any transferee (*i.e.*, any person who/that acquires a U.S. real property interest by purchase, exchange, gift, or any other type of transfer) must deduct, withhold, and remit to the IRS 15 percent of the total amount realized on the disposition.[92] Similar to the rules applicable to USWAs, a transferee who/that fails to meet all duties is personally liable for the uncollected taxes, plus various penalties.[93]

Complying with the information-reporting and tax-withholding duties is complicated. Depending on the circumstances, this might involve preparing and filing Form 1042 (*Annual Withholding Tax Return for U.S. Source Income for Foreign Persons*), Form 1042-S (*Foreign Person's U.S. Source Income Subject to Withholding*), Form 1042-T (*Annual Summary and Transmittal of Forms 1042-S*), Form 8804 (*Annual Return for Partnership Withholding Tax*), Form 8805 (*Foreign Partner's Information Statement of Section 1446 Withholding Tax*), Form 8813 (*Partnership Withholding Tax Payment Voucher—Section 1446*), Form 8828 (*U.S. Withholding Tax Return for Dispositions by Foreign Persons of U.S. Real Property Interests*), and more.

As one would expect, the IRS has the ability to encourage compliance with all these obligations through sanctions. The IRS can assert penalties when a taxpayer files a late, incomplete, or incorrect "information return" or "payee statement."[94] For these purposes, Forms 1042 and

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Forms 8804 are considered "information returns," while Forms 1042-S and Forms 8805 are considered "payee statements."[95] Ordinarily, any person who violates the filing requirements must pay a penalty of $250 for each violation, with a maximum of $3 million per year.[96] This penalty increases to $500 per violation, with no cap, when violations are attributable to "intentional disregard" by the taxpayer.[97] Notably, the IRS may *not* assert penalties where (i) the violation is due to reasonable cause, and (ii) the taxpayer acted in a responsible manner before and after the violation.[98] The rules regarding reduction or waiver of penalties for "information returns" and "payee statements" are unique to these violations.[99]

2. New Mechanism to Rectify Foreign Payment Problems

The IRS recognizes that significant non-compliance exists, many of the problems are caused by ignorance of or confusion about complicated rules and returns, taxpayers are reluctant to voluntarily remedy matters if doing so will trigger unreasonable penalties, and getting as many taxpayers as possible back in the system is fundamental. Therefore, the IRS issued a memorandum in February 2019 describing a new mechanism for resolving past international tax withholding issues ("Foreign Payment Program").[100] In an effort to provide "consistent treatment" to all taxpayers, the IRS created a "central point of contact" where USWAs can file late returns and pay the corresponding liabilities.[101]

a. Eligibility Criteria. To participate in the Foreign Payment Program, the USWA must (i) file all outstanding withholding tax returns, including related information returns, (ii) make "full payment" of the taxes due, and (iii) provide a statement containing an explanation of the areas or lines of business for which there was non-compliance, a clarification of how the non-compliance was discovered, a description of the corrective procedures implemented to ensure compliance in future years, and a copy of the communications by the USWA to employees or other relevant parties about the corrective procedures.[102]

Moreover, only USWAs, as defined in Reg. §1.1441-7(a)(1), that are not "qualified intermediaries," "withholding foreign partnerships," or "withholding foreign trusts" are eligible for the Foreign Payment Program.[103]

A USWA is not eligible for the Foreign Payment Program if he/it is already under examination with respect to withholding tax filings. For these purposes, an examination begins on the date that the USWA receives notice "of an impending examination or of an impending referral for examination." In addition, a USWA is ineligible if he/it has the same issues currently before the Appeals Office or in litigation.[104]

b. Paying the Piper. In terms of making financial amends, the IRS indicates that the USWA must pay *all* taxes and interest, as well as all penalties that the IRS does not abate under the Foreign Payment Program. However, in cases involving "large" underpayments, whatever that means, the IRS will consider payment over time *via* an Installment Agreement.[105]

c. Verification of Corrective Procedures and Payments. The IRS reserves the right to verify that the USWA has instituted appropriate corrective measures; such verification does not constitute an "examination."[106] As part of the Foreign Payment Program, the IRS will issue an "acknowledgment letter" at the end of the verification, provided that the IRS is satisfied that the systems triggering the non-compliance in the first place have been corrected and the USWA has fully paid, or made satisfactory arrangements with the IRS to pay, all outstanding liabilities.[107]

d. Disclosure Period; Relevant Years. On a positive note, USWAs are required to file late returns for only the past six years. Extending beyond this six-year period requires managerial approval within the IRS.[108]

e. Lack of Closure. The IRS is clear in that USWAs resolving matters through the Foreign Payment Program will *not* get a Closing Agreement with the IRS, which would definitively conclude matters pursuant to Code Sec. 7121, provided that there was no fraud, material misrepresentation, *etc.*, occurred.[109] The IRS warns that any submission under the Foreign Payment Program can get examined, as opposed to simply being subjected to a more superficial "verification" process.[110] The IRS also stated, augmenting the level of uncertainty for participants, that the Foreign Payment Program procedures do not entail determinations by the IRS about whether a payment was subject to withholding, which requires an analysis of the amount, timing, character, and/or source of such payment.[111]

f. Seeking Penalty Relief Based on "Reasonable Cause". When returns are filed under the Foreign Payment Program, Revenue Agents will review them and consider any acceptable penalty-abatement request. To reach acceptability in this context, the request must contain the following: (i) a description of the current procedures that the USWA uses to determine tax, withholding, and reporting obligations with respect to payments to foreign persons, (ii) an explanation of the prior shortfalls

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of the procedures, why they occurred, and the number of years affected, (iii) a calculation of the number of foreign persons impacted, (iv) a determination of the total amount of taxes that were not properly withheld, excluding penalties and interest, for all open tax periods, (v) a list of materials being filed with the IRS as part of the Foreign Payment Program, and (vi) the signature of the USWA, not his/its representative, confirming the following: "Under penalties of perjury, I declare that I have examined this submission, including the accompanying documents listed below, and to the best of my knowledge and belief the facts presented in support of this request are true, correct, and complete."[112]

g. Additional Materials Required. In addition to the items mentioned above, filings under the Foreign Payment Program must include (i) the relevant information returns, or a schedule of them, if they are filed electronically, (ii) if there are more than 25 information returns, then the USWA must enclose a spreadsheet tying the information returns to the primary return, and (iii) a completed Form 2848 (*Tax Power of Attorney*), if a tax representative is involved.[113]

h. Relevant IRS Office. The IRS instructs USWAs to send the materials to the following address: Internal Revenue Service, Attn: WIIC, W&C Team 1743, 5100 River Road, Mail Stop 603, Schiller Park, IL 60176-1076.[114]

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D. Filing Late Forms 1120-F by Foreign Corporations

Foreign corporations with limited activities in the United States, especially those with minimal international business experience, sometimes are unaware of their duty to file annual Forms 1120-F. In addition to normal penalties for late filing, late payment, and failure to enclose required information returns, foreign corporations running afoul of their Form 1120-F duties face a formidable stick: The IRS disallows business-related deductions and credits to which the foreign corporations normally would have been entitled, such that they are essentially taxed on gross income, instead of net.

Cognizant of the harshness of the deduction-and-credit disallowance rule, the IRS created an exception. The IRS will ignore tardiness in situations where a foreign corporation can demonstrate that, based on the facts and circumstances, it acted reasonably and in good faith ("Late-Filing Waiver").[115] Inconsistencies have arisen over the years concerning where foreign corporations should submit requests for Late-Filing Waivers, the degree of scrutiny to be applied by the IRS, the number of years that must be addressed, *etc*. The IRS, in an effort to centralize and standardize the process, issued in February 2018 instructions for handling late Forms 1120-F and requests for Late-Filing Waivers ("Guidelines").[116] This represents another voluntary disclosure program, limited in scope.

1. Description of Applicable Law—Code Sec. 882

a. Broad General Filing Duty. A foreign corporation generally must file a Form 1120-F if it (i) was engaged in a U.S. trade or business, regardless of whether it derived any income that was effectively connected with such trade or business ("ECI"), (ii) has income, gains, or losses that are treated as if they were ECI, (iii) was not engaged in a U.S. trade or business, but had other U.S.-source income that was not fully paid through tax withholding, (iv) is making a claim for refund, (v) is claiming the benefit of any deductions or credits, or (vi) needs to file a Form 8833 (*Treaty-Based Return Position*) to disclose to the IRS that it is taking the position that a tax treaty overrules or modifies the normal rules found in the Internal Revenue Code.[117]

b. Disallowance of Deductions and Credits for Tardiness. Code Sec. 882 generally allows foreign corporations that derive ECI to be taxed at the rates applicable to domestic corporations on "taxable income."[118] In determining "taxable income," foreign corporations (i) include only the amount of gross income that is ECI, and (ii) then reduce such amount by claiming all allowable deductions and credits.[119] Code Sec. 882(c) and the corresponding regulations allow foreign corporations to claim such tax benefits *only if* they file proper, timely Forms 1120-F with the IRS.[120]

c. Ability to File "Protective" Forms 1120-F. Because of the severe consequences for not filing timely Forms 1120-F, and because of the complexities of U.S. international tax law, the regulations expressly allow foreign corporations to file "protective" Forms 1120-F, and many take advantage of this offer.[121]

If a foreign corporation conducts "limited activities" in the United States which it believes do not generate ECI, or if the foreign corporation initially determines that it has no U.S. tax liability under an income tax treaty, then it can file a "protective" Form 1120-F by the normal deadline.[122] This filing serves to preserve the right to claim deductions and credits related to gross income later, if the IRS audits and determines that ECI exists and the foreign corporation's original tax position was incorrect.[123] The foreign corporation is not required to report income, deductions, and credits on a "protective" Form

1120-F; rather, it attaches a statement indicating to the IRS that it is filing on a "protective" basis only pursuant to the regulations.[124]

The IRS itself urges taxpayers to file in cases of uncertainty. For instance, the Instructions to Form 1120-F provide the following recommendations to foreign corporations:

> If a foreign corporation conducts limited activities in a tax year that [it] determines does not give rise to [ECI], the foreign corporation *should* follow the instructions for filing a protective return to safeguard its right to receive the benefit of the deductions and credits attributable to that gross income [and] a foreign corporation *should* also file a protective return if it determines initially that it has no U.S. tax liability under the provisions of any applicable income tax treaty (for example, because its income is not attributable to a permanent establishment in the United States).[125]

2. Late-Filing Waiver

The IRS can grant a Late-Filing Waiver, thereby allowing a delinquent foreign corporation to still claim deductions and credits, under certain circumstances. Currently, the IRS can grant a Late-Filing Waiver if a foreign corporation establishes that, based on the facts and circumstances, it acted reasonably and in good faith in not filing a timely Form 1120-F.[126] The regulations begin by explaining that the IRS will not grant a Late-Filing Waiver if the foreign corporation "knew" it had a duty to file Form 1120-F but "chose not to do so."[127] Moreover, the regulations clarify that one condition to getting a Late-Filing Waiver is cooperation with the IRS in determining the income tax liability for the relevant years.[128] Finally, a foreign corporation is ineligible for a Late-Filing Waiver if it has a "permanent establishment" in the United States, as this term is used in treaties.[129]

With those preliminaries out of the way, the regulations provide that the IRS will permit a Late-Filing Waiver if the foreign corporation can demonstrate that, in light of the relevant facts and circumstances, it acted "reasonably and in good faith" in failing to file a timely Form 1120-F or "protective" Form 1120-F.[130] This IRS must consider the following list of factors in deciding whether a foreign corporation meets the current standard for relief:

- Whether the foreign corporation voluntarily identifies itself to the IRS as having failed to file a Form 1120-F before the IRS discovers the issue;
- Whether the foreign corporation did not become aware of its ability to file a "protective" Form 1120-F by the normal deadline;
- Whether the foreign corporation has previously filed a Form 1120-F;
- Whether the foreign corporation failed to file a Form 1120-F because, after exercising reasonable diligence (taking into account its relevant experience and level of sophistication), the foreign corporation was unaware of the necessity;
- Whether the foreign corporation failed to file a Form 1120-F because of intervening events beyond its control; and
- Whether other mitigating or exacerbating factors exist.[131]

The regulations contain several examples regarding the Late-Filing Waiver. They have been slightly altered to enhance readability.[132]

a. Foreign Corporation Voluntarily Discloses

> **Facts:** In Year 1, foreign corporation ("FC") became a limited partner with a passive investment in a U.S. limited partnership that was engaged in a U.S. trade or business. During Year 1 through Year 4, FC incurred losses with respect to its U.S. partnership interest. FC's foreign tax director incorrectly concluded that because it was a limited partner and had only losses from its partnership interest, FC was not required to file a Form 1120-F. FC's management was aware neither of FC's obligation to file a Form 1120-F for those years, nor of its ability to file a "protective" Form 1120-F for those years. FC had never filed a Form 1120-F before. In Year 5, FC began realizing a profit rather than a loss with respect to its partnership interest and, for this reason, engaged a U.S. tax advisor to handle its responsibility to file U.S. returns. In preparing FC's Form 1120-F for Year 5, FC's U.S. tax advisor discovered that Forms 1120-F were not filed for Year 1 through Year 4. Therefore, with respect to those years for which applicable filing deadlines were not met, FC would be barred from claiming any deductions that otherwise would have given rise to net operating losses on returns for those years, and that would have been available as loss carryforwards in subsequent years. At FC's direction, its U.S. tax advisor promptly contacted the appropriate examining personnel and cooperated with the IRS in determining FC's income tax liability, for example, by preparing and filing the appropriate Forms 1120-F for Year 1 through Year 4 and by making FC's books and records available to an IRS examiner.
>
> **Conclusion:** FC has *met* the standard for a Late-Filing Waiver.

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b. Foreign Corporation Does Not File a "Protective" Return

Facts: Same facts as in Example 1, except that in Year 1 through Year 4, FC's foreign tax director also consulted a U.S. tax advisor, who advised FC's foreign tax director that it was uncertain whether Forms 1120-F were necessary for those years and that FC could protect its right subsequently to claim the loss carryforwards by filing "protective" Forms 1120-F. FC did not file Forms 1120-F or "protective" Forms 1120-F for those years. FC did not present evidence that intervening events beyond FC's control prevented it from filing Forms 1120-F, and there were no other mitigating factors.

Conclusion: FC has *not met* the standard for a Late-Filing Waiver.

The IRS has introduced programs, with different characteristics, to address several types of non-compliance, both domestic and international.

c. Foreign Corporation with ECI

Facts: In Year 1, FC, a technology company, opened an office in the United States to market and sell a software program that FC had developed outside the United States. FC had minimal business or tax experience internationally, and no such experience in the United States. Through FC's direct efforts, U.S. sales of the software produced income effectively connected with a U.S. trade or business. FC, however, did not file Forms 1120-F for Year 1 or Year 2. FC's management was aware neither of FC's obligation to file Forms 1120-F for those years, nor of its ability to file a "protective" Form 1120-F for those years. FC had never filed a Form 1120-F before. In January of Year 4, FC engaged U.S. counsel in connection with licensing software to an unrelated U.S. company. U.S. counsel reviewed FC's U.S. activities and advised FC that it should have filed Forms 1120-F for Year 1 and Year 2. FC immediately engaged a U.S. tax advisor who, at FC's direction, promptly contacted the appropriate examining personnel and cooperated with the IRS in determining FC's income tax liability, for example, by preparing and filing the appropriate Forms 1120-F for Year 1 and Year 2 and by making FC's books and records available to an IRS examiner.

Conclusion: FC has *met* the standard for a Late-Filing Waiver.

d. IRS Discovers the Non-Compliance

Facts: In Year 1, FC, a technology company, opened an office in the United States to market and sell a software program that FC had developed outside the United States. Through FC's direct efforts, U.S. sales of the software produced income effectively connected with a U.S. trade or business. FC had extensive experience conducting similar business activities in other countries, including making the appropriate tax filings. However, FC's management was aware neither of FC's obligation to file a Form 1120-F for those years, nor of its ability to file a "protective" Form 1120-F for those years. FC had never filed a Form 1120-F before. Despite FC's extensive experience conducting similar business activities in other countries, it made no effort to seek advice in connection with its U.S. tax obligations. FC failed to file either Forms 1120-F or "protective" Forms 1120-F for Year 1 and Year 2. In January of Year 4, an IRS examiner asked FC for an explanation of FC's failure to file Forms 1120-F. FC immediately engaged a U.S. tax advisor, and cooperated with the IRS in determining FC's income tax liability, for example, by preparing and filing Forms 1120-F for Year 1 and Year 2 and by making FC's books and records available to the examiner. FC did not present evidence that intervening events beyond its control prevented it from filing a Form 1120-F, and there were no other mitigating factors.

Conclusion: FC has *not met* the standard for a Late-Filing Waiver.

e. Foreign Corporation with Prior Filing History

Facts: FC began a U.S. trade or business in Year 1. FC's tax advisor filed the Forms 1120-F for Year 1 through Year 6, reporting income effectively connected with FC's U.S. trade or business. In Year 7, FC replaced its tax advisor with a tax advisor unfamiliar with U.S. tax law. FC did not file a Form 1120-F for any year from Year 7 through Year 10, although

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it had effectively connected income for those years. FC's management was aware of FC's ability to file a "protective" Form 1120-F for those years. In Year 11, an IRS examiner contacted FC and asked its chief financial officer for an explanation of FC's failure to file Forms 1120-F after Year 6. FC immediately engaged a U.S. tax advisor and cooperated with the IRS in determining FC's income tax liability, for example, by preparing and filing Forms 1120-F for Year 7 through Year 10 and by making FC's books and records available to the examiner. FC did not present evidence that intervening events beyond its control prevented it from filing Forms 1120-F, and there were no other mitigating factors.

Conclusion: FC has *not met* the standard for a Late-Filing Waiver.

3. New Guidelines About Late-Filing Waiver

The IRS released the Guidelines for handling late Forms 1120-F and requests for Late-Filing Waivers in February 2018.[133] Their official purpose was "to ensure that examiners are analyzing [Late-Filing Waiver] requests in a fair, consistent, and *timely manner under the* regulations."

a. Centralized Filing and Processing. Perhaps the most significant revelations by the Guidelines are that (i) Revenue Agents and others working on the compliance side of the IRS generally will not entertain late Forms 1120-F filed directly with them, and (ii) late Forms 1120-F will effectively be subjected to some form of an audit. The Guidelines provide the following mandate on this topic:

> No one involved in a compliance function should accept as filed a delinquent Form 1120-F from a taxpayer, or discuss in advance of filing a return whether a [Late-Filing Waiver] will be granted. Once a return is filed, and LB&I has selected the return for examination, these Guidelines for handling [Late-Filing Waivers] will apply.[134]

The Guidelines indicate that a request for a Late-Filing Waiver will be handled in the following manner. An Exam Team will review and analyze the request and make an initial recommendation on whether to grant or deny it. Then, the Exam Team will prepare a "Waiver Request Package" and send it to the appropriate Territory Manager. The "Waiver Request Package" will contain, to the extent applicable, (i) the Late-Filing Waiver application, including exhibits, (ii) a completed "Waiver Summary Analysis," which is a two-page document created by the IRS to facilitate the inputting of information by the Exam Team about each of the six relevant factors that the IRS must consider pursuant to Reg. §1.882-4(a)(3), (iii) copies of any Information Document Requests ("IDRs") issued to the foreign corporation and its responses, (iv) Form 886-A (*Explanation of Items*), (v) Protest Letter filed by the foreign corporation, (vi) any Rebuttal by the IRS to the Protest Letter, and (vii) recommendation by the Exam Team about acceptance or denial of the request for a Late-Filing Waiver.

> *Trying to digest all the data about willfulness in the FBAR context is incredibly challenging. The rules are complex, the court decisions are dense and inconsistent, and the IRS and the DOJ sometimes take conflicting positions on the same issue in different cases.*

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Next, the Territory Manager and Exam Team will have a call to review the "Waiver Request Package" and discuss the recommendation. This might result in the Exam Team needing to obtain additional data from the foreign corporation. This data-gathering and dialogue continue until the Exam Team and the Territory Manager come to a recommendation and send it to the Director of Field Operations ("DFO") for Cross Border Activities ("CBA").

There are some variations depending on whether the Territory Manager and Exam team suggest granting or denying the Late-Filing Waiver, but the ultimate review and decision-making authority resides with a specialized "Waiver Committee" and the DFO for CBA. The Exam Team is responsible for delivering the news to the foreign corporation about the Late-Filing Waiver, good or bad.

b. Interesting Issues. The Guidelines are interesting for a number of reasons, some obvious, some not. Below is a discussion of various noteworthy issues.

i. No Substantive Changes. The Guidelines establish a new internal IRS procedure for processing, examining, and analyzing late Forms 1120-F and requests for Late-Filing Waivers, but they do not change the standards by which

the IRS arrives at its conclusions. The IRS will continue to consider the same six criteria found in the regulations. This is apparent from the fact the Guidelines contemplate the Exam Team providing a "Waiver Request Package" to the Territory Manager, which will contain, among other things, a completed "Waiver Summary Analysis." This, as explained above, consists of a two-page document created by the IRS to allow the Exam Team to insert into boxes information about each of the six criteria for ease of review.

ii. No Offer of Amnesty. The Guidelines do not constitute tax "amnesty." Indeed, they do not offer any guarantee that a foreign corporation will be granted a Late-Filing Waiver, latitude on the applicable standard, limitation on the number of past years for which Forms 1120-F must be filed, *etc*. The Guidelines solely provide a set of rules for foreign corporations and IRS personnel to follow in the case of Form 1120-F violations. Consequently, to the extent that the IRS denies a request for a Late-Filing Waiver and thus proposes a large U.S. tax liability (which is logical given that the IRS would be taxing *gross* income that is effectively connected with a U.S. trade or business, plus penalties and interest), one would expect to see tax litigation initiated by foreign corporations. They would be alleging that they meet the standard for receiving a Late-Filing Waiver because there was "reasonable cause" and they acted in "good faith" (based on the six criteria found in the regulations), that the IRS abused its administrative discretion in denying the Late-Filing Waiver, and more.

iii. Uncertainty About Penalties. The Late-Filing Waiver allows a foreign corporation to escape the harsh treatment contemplated by Code Sec. 882(c)(2); that is, paying U.S. taxes on gross income effectively connected with a U.S. trade or business, without the benefit of many deductions and credits. This is beneficial to a foreign corporation, no doubt, but it is far from *carte blanche*. Foreign corporations that file late Forms 1120-F often are subject to other penalties. For example, under Code Sec. 6651(a), the IRS generally may assert so-called delinquency penalties if a taxpayer fails to file certain returns and/or fails to pay certain taxes by the deadline (including extensions).[135] In addition, certain U.S. persons generally are required to file a Form 8833 to notify the IRS that they are taking a position that a provision in a treaty to which the United States is a party overrules or modifies a provision of the Internal Revenue Code during the relevant year ("Treaty-Based Return Position").[136] If a U.S. person is required to file a Form 8833 and fails to do so, then the IRS generally may assert a penalty of $1,000 for each failure to disclose a Treaty-Based Return Position. This sanction increases to $10,000 per violation in the case of a C corporation.[137] Finally, Form 5472 (*Information Return of a 25% Foreign-Owned U.S. Corporation or a Foreign Corporation Engaged in a U.S. Trade or Business*) generally must be filed to disclose certain "reportable transactions" between a "reporting corporation" and "related parties." There are two main categories of "reporting corporations," one of which is a foreign corporation that operates a U.S. trade or business at any time during the year at issue.[138] A reporting corporation normally must file a separate annual Form 5472 with respect to each related party with which it had any reportable transaction during the taxable year, and the Form 5472 must be filed even though it may not affect the amount of U.S. tax due.[139] The reporting corporation must file Form 5472 with its annual income tax return by the due date of that return.[140] A reporting corporation that fails to file a timely and substantially complete Form 5472 is subject to a penalty of $10,000.[141]

The standard for achieving a Late-Filing Waiver is "reasonable cause" and "good faith." This is identical or very similar to the thresholds for obtaining abatement of delinquency penalties, Form 8833 penalties, and Form 5472 penalties. Therefore, logic dictates that, if the IRS were to grant a Late-Filing Waiver after reviewing the six criteria set forth in the regulations (*i.e.*, Reg. §1.882-4(a)(3)(ii)), then the IRS should also eliminate the potential penalties on the following grounds. First, thanks to the Late-Filing Waiver, the Form 1120-F is not considered delinquent, such that any tax payments triggered by the Form 1120-F and any international information returns enclosed with Form 1120-F should not be deemed late either. Second, if the IRS has concluded that a foreign corporation has acted reasonably and in good faith with respect to Form 1120-F, then it should reach the same conclusion with respect to all related payment and filing issues.

The preceding paragraph has some appeal, but it has problems, too. These include the fact that the Guidelines do not mention, cross-reference, or evoke penalties; there is ominous silence on this critical issue. Moreover, history shows that, just because the IRS will allow Late-Filing Waivers in certain circumstances, this does not mean that it intends to let taxpayers off the hook entirely. Case in point, when the IRS introduced the "compliance initiative" many years ago in Notice 2003-38, it specifically stated that it would still charge participating taxpayers back taxes, delinquency penalties under Code Sec. 6651, and "other applicable penalties, as appropriate." One might guess that penalties for missing Forms 5472 and/or Forms 8833 might be "appropriate" from the IRS's perspective.

III. Conclusion

Because the U.S. tax system is rooted in affirmative reporting by taxpayers, because the rules are terribly complicated and getting more so every day, because retaining qualified tax professionals can be expensive, and because many taxpayers take aggressive positions to minimize their tax burdens, non-compliance will always abound. Logically, then, the IRS will continue offering methods to address the issues. At this point, taxpayers and their advisors should be aware of lingering offshore programs (*i.e.*, SFOP, SDOP, DIIRSP, and DFSP), the UVDP, the Foreign Payment Program, and the Guidelines for Late-Filing Waivers. They should also understand that these opportunities and others are fleeting; the voluntary disclosure landscape is fluid, with programs changing constantly, as circumstances demand.

ENDNOTES

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1 For a detailed analysis of common filing requirements, including Form 8938, *see* the following articles by the same author: Hale E. Sheppard, *The New Duty to Report Foreign Financial Assets on Form 8938: Demystifying the Complex Rules and Severe Consequences of Noncompliance*, Int'l Tax J., 2012, at 11; Hale E. Sheppard, *Form 8938 and Foreign Financial Assets: A Comprehensive Analysis of the Reporting Rules after IRS Issues Final Regulations*, Int'l Tax J., 2015, at 25; Hale E. Sheppard, *Specified Domestic Entities Must Now File Form 8938: Section 6038D, New Regulations in 2016, and Expanded Foreign Financial Asset Reporting*, Int'l Tax J., 2016, at 5; Hale E. Sheppard, *Canadian Retirement Plans: What Does Revenue Procedure 2014-55 Mean for U.S. Tax Deferral, Form 8891, Form 8938, and the FBAR?* Int'l Tax J., 2016, at 25; and Hale E. Sheppard, *Unlimited Assessment-Period for Form 8938 Violations: Ruling Shows IRS's Intent to Attack Multiple Tax Returns*, Taxes, May 2017, at 31; Hale E. Sheppard, *Extended Assessment Periods and International Tax Enforcement: Rafizadeh v. Commissioner, Unreported Foreign Assets, and Use of FATCA Weapons*, Taxes, June 2018, at 35 and 44 J. Int'l Taxation 25 (2018).

2 Code Sec. 6662; Code Sec. 6663.

3 Code Sec. 6621.

4 The American Jobs Creation Act, P.L. 108-357 (Oct. 22, 2004).

5 31 USC §5321(a)(5)(A) (as in effect before Oct. 22, 2004).

6 31 USC §5321(a)(5)(B)(ii) (as in effect before Oct. 22, 2004).

7 31 USC §5321(a)(5)(A).

8 31 USC §5321(a)(5)(B)(i). This penalty cannot be asserted if the taxpayer was "non-willful" and there was "reasonable cause" for the violation. *See* 31 USC §5321(a)(5)(B)(ii).

9 31 USC §5321(a)(5)(C)(i).

10 31 USC §5321(d) ("A civil penalty may be imposed under [31 U.S.C. § 5321(a)] with respect to any violation of this subchapter notwithstanding the fact that a criminal penalty is imposed with respect to the same violation.")

11 Code Sec. 6038D(d)(1); Reg. §1.6038D-8(a).

12 Code Sec. 6038D(d)(2); Reg. §1.6038D-8(c).

13 Code Sec. 6048(a)(1); Code Sec. 6048(a)(4).

14 Code Sec. 6048(c)(1).

15 Code Sec. 6677(a).

16 Code Sec. 6048(b)(1). The grantor trust rules are located in Code Secs. 671 to 679.

17 Code Sec. 6677(b).

18 Code Sec. 6038; Reg. §1.6038-2; Code Sec. 6046; Reg. §1.6046-1; Code Sec. 6679; Reg. §301.6679-1; Instructions to Form 5471.

19 Code Sec. 6038(b)(1); Reg. §1.6038-2(k)(1)(i); Code Sec. 6046(f); Reg. §1.6046-1(k).

20 Code Sec. 6038(b)(2); Reg. §1.6038-2(k)(1)(ii); Code Sec. 6046(f); Reg. §1.6046-1(k).

21 Hale E. Sheppard. *What Garrity Teaches About FBARs, Foreign Trusts, "Stacking" of International Penalties, and Simultaneously Fighting the U.S. Government on Multiple Fronts*, J. Tax Practice & Procedure, 2019, at 27.

22 IRM §4.26.17.3 (Jan. 1, 2007); IRM §20.1.9.2 (Apr. 22, 2011); IRM §20.1.9.2.1 (Apr. 22, 2011); IRM §20.1.9. 22 (Apr. 22, 2011).

23 Code Sec. 6213(a).

24 Hale E. Sheppard, *Two More Blows to Foreign Account Holders: Tax Court Lacks FBAR Jurisdiction and Bankruptcy Offers No Relief from FBAR Penalties*, J. Tax Practice & Procedure, 2009, at 27.

25 31 USC §5321(b)(2).

26 IRM §20.1.9.2 (Apr. 22, 2011) (emphasis added); IRM Exhibit 20.1.9-4; *see also* CCA 201226028.

27 Hale E. Sheppard, *What Garrity Teaches About FBARs, Foreign Trusts, "Stacking" of International Penalties, and Simultaneously Fighting the U.S. Government on Multiple Fronts*, J. Tax Practice & Procedure, 2019, at 27.

28 Code Sec. 6501(c)(8)(B) contains a limitation, stating that the assessment period will remain open only with respect to "the item or items" related to the late Form 8938 if the taxpayer can demonstrate that the violation was due to reasonable cause and not due to willful neglect.

29 Hale E. Sheppard, *Alarming U.S. Tax Rules and Information-Reporting Duties for Foreign Retirement Plans and Accounts: Analyzing Problems and Solutions*, 129 J. Taxation 14 (2018) (explaining the four remaining international disclosure programs, as well as the now defunct OVDP).

30 IRS Memorandum LB&I-09-1118-014 (Nov. 20, 2018).

31 IRS Memorandum LB&I-09-1118-014 (Nov. 20, 2018).

32 IRS Memorandum LB&I-09-1118-014 (Nov. 20, 2018).

33 Nathan J. Richman and Andrew Velarde, *Uncertainty May Weigh Down New Voluntary Disclosure Regime*, Tax Analysts Doc. 2019-4599 (Feb. 8, 2019).

34 IRS Memorandum LB&I-09-1118-014 (Nov. 20, 2018).

35 IRS Memorandum LB&I-09-1118-014 (Nov. 20, 2018).

36 IRS Memorandum LB&I-09-1118-014 (Nov. 20, 2018).

37 IRS Memorandum LB&I-09-1118-014 (Nov. 20, 2018).

38 IRS Memorandum LB&I-09-1118-014 (Nov. 20, 2018).

39 IRS Memorandum LB&I-09-1118-014 (Nov. 20, 2018).

40 IRS Memorandum LB&I-09-1118-014 (Nov. 20, 2018).

41 IRS Memorandum LB&I-09-1118-014 (Nov. 20, 2018).

42 IRS Memorandum LB&I-09-1118-014 (Nov. 20, 2018).

43 IRS Memorandum LB&I-09-1118-014 (Nov. 20, 2018).

44 IRS Memorandum LB&I-09-1118-014 (Nov. 20, 2018).

45 Andrew Velarde, *Noncooperation in Voluntary Disclosure Won't Blindside Taxpayer*, Tax Analysts Document 2019-9094 (Mar. 12, 2019) (comments by John Cardone, Director of Withholding and International Individual Compliance, LB&I Division).

46 IRS Memorandum LB&I-09-1118-014 (Nov. 20, 2018).

47 OVDP, Frequently Asked Question #20; *see also* Internal Revenue Service, *Offshore Voluntary Disclosure Initiative Collection Procedure*, Tax Analyst Doc. 2015-22100.

48 *See, e.g.*, Robert B. Stack and Douglas M. Andres, *Expedited Opt-Out Needed for OVDI Participants Who Owe No Tax*, 2012 Tax Notes Today 21-12 (Jan. 30, 2012) (stating that the taxpayer "is worried that requesting retroactive treaty relief through the letter ruling process could be deemed a quiet

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filing, [the taxpayer] decides to enter the OVDI"); Robert Goulder, *Quiet Disclosures Get No Love from IRS*, 2010 TAX NOTES TODAY 90-1 (May 11, 2010); Marie Sapirie, *Charges Against HSBC Bank Bermuda Client Raise Quiet Disclosure Questions*, 2011 TAX NOTES TODAY 98-1 (May 20, 2011); U.S. Government Accountability Office, *IRS Has Collected Billions of Dollars, but May Be Missing Continued Evasion*, GAO-13-318 (2013) (explaining that IRS intends to increase efforts to identify "quiet disclosures" by analyzing taxpayers who have for the first time filed an FBAR, checked "yes" to the foreign-account question on Schedule B to Form 1040, or filed a Form 8938, that the IRS will cross-reference data received from financial institutions received through FATCA, and that the IRS plans to penalize taxpayers attempting to achieve compliance without participating in one of the many voluntary disclosure programs established by the IRS).

[49] IRS Memorandum LB&I-09-1118-014 (Nov. 20, 2018).

[50] IRS Memorandum LB&I-09-1118-014 (Nov. 20, 2018).

[51] Andrew Velarde, *Noncooperation in Voluntary Disclosure Won't Blindside Taxpayer*, Tax Analysts Document 2019-9094 (Mar. 12, 2019) (comments by John Cardone, Director of Withholding and International Individual Compliance, LB&I Division).

[52] IRM §4.26.16.6.5.1 (Nov. 6, 2015).

[53] IRM §4.26.16.6.5.1 (Nov. 6, 2015).

[54] IRM §4.26.16.6.5.1 (Nov. 6, 2015).

[55] IRM §4.26.16.6.5.2 (Nov. 6, 2015).

[56] IRM §4.26.16.6.5.3 (Nov. 6, 2015).

[57] IRM §4.26.16.6.5.3 (Nov. 6, 2015).

[58] IRM §4.26.16.6.5.3 (Nov. 6, 2015).

[59] IRM §4.26.16.6.6.1 (Nov. 6, 2015).

[60] IRM §4.26.16.6.7 (Nov. 6, 2015).

[61] IRM §4.26.16.6.7 (Nov. 6, 2015).

[62] IRM §4.26.16.6.7 (Nov. 6, 2015).

[63] IRM Exhibit 4.26.16-1 (Nov. 6, 2015).

[64] IRM Exhibit 4.26.16-1 (Nov. 6, 2015).

[65] For more detailed information about recent court battles regarding "willful" FBAR penalties, *see* the following articles by the same author: Hale E. Sheppard, *United States v. Horowitz: Sixth Case Analyzing Constructive Knowledge as Determinant of FBAR Penalties*, INT'L TAX J., March-April 2019; Hale E. Sheppard, *Constructive Knowledge and FBAR Penalties: Does Merely Filing a Form 1040 Suffice to Establish Willfulness?* INT'L TAX J., January-February 2019, at 35 and TAXES, May 2019; Hale E. Sheppard, *Appellate Court Jeopardizes First Holding of Non-Willfulness in FBAR Penalty Case: Round Three of the Bedrosian Battle*, __ J. INT'L TAXATION ___ (2019) and 130 J. TAXATION ___ (2019); Hale E. Sheppard, *Courts Hold that U.S. Government Can Pursue Executors, Representatives, Fiduciaries, Beneficiaries, Distributees, and Others for FBAR Penalties Assessed Against Deceased Taxpayers*, 30 J. INT'L TAXATION ___ (2019) and 130 J. TAXATION 16 (2019); Hale E. Sheppard, *What Constitutes a "Willful" FBAR Violation? Comprehensive Guidance Based on Eight Important Cases*, 129 J. TAXATION 24 (2018); Hale E. Sheppard, *Delays by IRS in Processing International Voluntary Disclosure Cases: Expatriations Thwarted, Estate Taxes Imposed, and Solutions Explored*, INT'L TAX J., November-December 2018, at 19; Hale E. Sheppard, *Court Holds that Pervasive Ignorance Is No Defense to Willful FBAR Penalties: This and Other Lessons from United States v. Garrity*, INT'L TAX J., July-August 2018, at 51; Hale E. Sheppard, *Willful FBAR Penalty Case Shows Importance of Protecting Privileged Communications: What Kelley-Hunter Adds to the Foreign Account Defense Discussion*, INT'L TAX J., *January-February 2018, at 15; Hale E. Sheppard, Analysis of the Reasonable Cause Defense in Non-Willful FBAR Penalty Case: Teachings from Jarnagin*, 128 *J. Taxation* 6 (2018); Hale E. Sheppard, *First Taxpayer Victory in a Willful FBAR Penalty Case: Analyzing the Significance of Bedrosian for Future Foreign Account Disputes (Part 1)*, 128 *J. Taxation* 12 (2018); Hale E. Sheppard, *First Taxpayer Victory in a Willful FBAR Penalty Case: Analyzing the Significance of Bedrosian for Future Foreign Account Disputes (Part 2)*, 128 *J. Taxation* 14 (2018); Hale E. Sheppard, *Can Recent "Willful" FBAR Penalty Cases Against Taxpayers Help Tax Firms Fend Off Malpractice Actions?* INT'L TAX J., July-August 2017, at 33; Hale E. Sheppard, *Government Wins Fourth Straight FBAR Penalty Case: Analyzing Bohanec and the Evolution of "Willfulness,"* 126 *J. Taxation* 110 (2017); Hale E. Sheppard, *Government Wins Second Willful FBAR Penalty Case: Analyzing What McBride Really Means to Taxpayers*, 118 *J. Taxation* 187 (2013); Hale E. Sheppard, *Third Time's the Charm: Government Finally Collects "Willful" FBAR Penalty in Williams Case*, 117 *J. Taxation* 319 (2012); Hale E. Sheppard, *District Court Rules That Where There's (No) Will, There's a Way to Avoid FBAR Penalties*, 113 *J. Taxation* 293 (2010).

[66] *J.B. Williams III*, 131 TC 54, Dec. 57,547 (2008); *Williams*, No. 1:09-cv-437, 2010 WL 347221 (E.D. Va. 2010); *Williams*, CA-4, 489 FedAppx 655 (2012).

[67] *J. McBride*, DC-UT, 2012-2 USTC ¶50,666, 908 FSupp2d 1186.

[68] *Bussell*, 117 AFTR 2d 2016-439 (D.C. C.D. Cal. 2015).

[69] *Bohanec*, 118 AFTR 2d 2016-5537 (D.C. C.D. Cal. 2016).

[70] *Bedrosian*, 120 AFTR 2d 2017-5671 (D.C. Pa. 2017).

[71] *Kelley-Hunter*, 120 AFTR 2d 2017-5566 (D.C. Dist. Col. 2017).

[72] *Toth*, 122 AFTR 2d 2018-6280 (D.C. Mass. 2018).

[73] *Colliot*, 121 AFTR 2d 2018-1834 (D.C. Tx. 2018).

[74] *Wadhan*, 122 AFTR 2d 2018-5208 (D.C. Co. 2018).

[75] *Garrity*, Case No. 3:15-cv-243 (D.C. Conn. 2018).

[76] *Markus*, 122 AFTR 2d 2018-5166 (D.C. N.J. 2018).

[77] *Norman*, FedCl, 138 FedCl 189 (2018), 122 AFTR 2d 2018-5334.

[78] *Flume*, 122 AFTR 2d 2018-5641 (D.C. S.D. Tex. 2018).

[79] *Kimble*, Case No. 17421, 122 AFTR 2d 2018-XXXX (Ct. Fed. Cl. Dec. 27, 2018).

[80] *Horowitz*, 123 AFTR 2d 2019-XXXX (D.C. MD Jan. 18, 2019).

[81] *McBride* Slip Opinion, at 36–37.

[82] *McBride* Slip Opinion, at 37–38.

[83] *McBride* Slip Opinion, at 38–39 (internal citations omitted).

[84] Code Sec. 871(a) and Code Sec. 881(a).

[85] Code Sec. 1441(a) and Code Sec. 1442(a).

[86] Code Sec. 1461.

[87] *See, e.g.*, U.S. Model Income Tax Convention of November 15, 2006, Article 10(2)(b) (Dividends) and Article 11(2)(b) (Interest).

[88] Reg. §1.1441-2(b)(2).

[89] Code Secs. 1471 through 1474.

[90] Reg. §1.1442-1 (explicitly states that Reg. §1.1441-2 applies to withholding for foreign corporations under Code Sec. 1442), Reg. §1.1442-2, and Reg. §1.1442-3.

[91] Code Sec. 897(a)(1).

[92] Reg. §1.1445-1(g)(4). For these purposes, the "amount realized" is the sum of the cash paid, the market value of other property transferred, and the amount of liabilities assumed by the transferee. *See* Reg. §1.1445-1(g)(5).

[93] Code Sec. 1461; Code Sec. 1445(c)(1)(A).

[94] Code Sec. 6721(a); Reg. §301.6721-1(a)(1); Code Sec. 6722(a); Reg. §301.6722-1(a).

[95] Reg. §301.6721-1(g)(4); Reg. §1.1461-1(c)(4)(i); Code Sec. 6724(d); Reg. §301.6722-1(d)(3).

[96] Code Sec. 6721(a)(1); Code Sec. 6722(a)(1). For a Form 8805 required to be filed after December 31, 2015, the penalty is $260 per Form 8805, with a maximum penalty of $3,178,500 per year.

[97] Code Sec. 6721(e); Code Sec. 6722(e).

[98] Code Sec. 6724(a); Reg. §301.6724-1(a)(1) and (2).

[99] The special rules in Code Sec. 6724 and the corresponding regulations are applicable to the information-reporting duties found in Code Sec. 6721 (covering certain "statements," "returns," and "other items"), Code Sec. 6722 (covering "payee statements"), and Code Sec. 6723 (covering other "specified information reporting requirements"). *See also* Code Sec. 6724(a); Reg. §301.6724-1(a)(1), (a)(2).

[100] IRS Memorandum LB&I-04-0219-002 (Feb. 27, 2019); Tax Analysts Document 2019-8432.

[101] IRS Memorandum LB&I-04-0219-002 (Feb. 27, 2019); Tax Analysts Document 2019-8432.

[102] IRS Memorandum LB&I-04-0219-002 (Feb. 27, 2019); Tax Analysts Document 2019-8432.

[103] IRS Memorandum LB&I-04-0219-002 (Feb. 27, 2019); Tax Analysts Document 2019-8432.

[104] IRS Memorandum LB&I-04-0219-002 (Feb. 27, 2019); Tax Analysts Document 2019-8432.

[105] IRS Memorandum LB&I-04-0219-002 (Feb. 27, 2019); Tax Analysts Document 2019-8432.

[106] IRS Memorandum LB&I-04-0219-002 (Feb. 27, 2019); Tax Analysts Document 2019-8432.

[107] IRS Memorandum LB&I-04-0219-002 (Feb. 27, 2019); Tax Analysts Document 2019-8432.

[108] IRS Memorandum LB&I-04-0219-002 (Feb. 27, 2019); Tax Analysts Document 2019-8432.

[109] IRS Memorandum LB&I-04-0219-002 (Feb. 27, 2019); Tax Analysts Document 2019-8432.

[110] IRS Memorandum LB&I-04-0219-002 (Feb. 27, 2019); Tax Analysts Document 2019-8432.

[111] IRS Memorandum LB&I-04-0219-002 (Feb. 27, 2019); Tax Analysts Document 2019-8432.

[112] IRS Memorandum LB&I-04-0219-002 (Feb. 27, 2019); Tax Analysts Document 2019-8432.

[113] IRS Memorandum LB&I-04-0219-002 (Feb. 27, 2019); Tax Analysts Document 2019-8432.

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[114] IRS Memorandum LB&I-04-0219-002 (Feb. 27, 2019); Tax Analysts Document 2019-8432.

[115] Reg. §1.882-4(a)(3)(ii).

[116] Internal Revenue Service, *LB&I Guidelines for Handling Delinquent Forms 1120-F and Requests for Waiver Pursuant to Treas. Reg. § 1.882-4(a)(3)(ii)*, February 1, 2018.

[117] 2016 Instructions for Form 1120-F (*U.S. Income Tax Return of a Foreign Corporation*), at 2.

[118] Code Sec. 882(a).

[119] Code Sec. 882(b); Code Sec. 882(c)(1)(A).

[120] Code Sec. 882(c)(2); Reg. §1.882-4(a)(2).

[121] Reg. §1.882-4(a)(3)(vi).

[122] Reg. §1.882-4(a)(3)(vi).

[123] Reg. §1.882-4(a)(3)(vi).

[124] Reg. §1.882-4(a)(3)(vi).

[125] 2016 Instructions for Form 1120-F (*U.S. Income Tax Return of a Foreign Corporation*), at 2.

[126] Reg. §1.882-4(a)(3)(ii).

[127] Reg. §1.882-4(a)(3)(ii).

[128] Reg. §1.882-4(a)(3)(ii).

[129] Reg. §1.882-4(a)(3)(v).

[130] Reg. §1.882-4(a)(3)(ii).

[131] Reg. §1.882-4(a)(3)(ii)(A) through (F).

[132] Reg. §1.882-4(a)(3)(iii).

[133] Internal Revenue Service, *LB&I Guidelines for Handling Delinquent Forms 1120-F and Requests for Waiver Pursuant to Treas. Reg. § 1.882-4(a)(3)(ii)*, February 1, 2018.

[134] Internal Revenue Service, *LB&I Guidelines for Handling Delinquent Forms 1120-F and Requests for Waiver Pursuant to Treas. Reg. § 1.882-4(a)(3)(ii)*, February 1, 2018. The Guidelines indicate that exceptions to this rigid rule might be appropriate where (i) a related-party is currently under audit, (ii) the IRS is auditing a year other than the one for which a late Form 1120-F was filed, or (iii) the IRS is auditing something other than the late Form 1120-F. *See* footnote 3.

[135] Code Sec. 6651(a); Reg. §301.6651-1(a)(1); 2016 Instructions for Form 1120-F (*U.S. Income Tax Return of a Foreign Corporation*), at 9.

[136] Code Sec. 6114; Reg. §301.6601-1(a).

[137] Code Sec. 6712(a); Reg. §301.6712-1(a).

[138] Code Sec. 6038C(a); Reg. §1.6038A-1(c)(1). If a foreign corporation is a resident of a foreign country that has a tax treaty with the United States, then it will not be considered a "reporting corporation," unless it has a "permanent establishment" in the United States. *See* Reg. §1.6038A-1(c)(5)(i).

[139] Reg. §1.6038A-2(a)(1).

[140] Reg. §1.6038A-2(d).

[141] Code Sec. 6038A(d)(1); Reg. §1.6038A-4.

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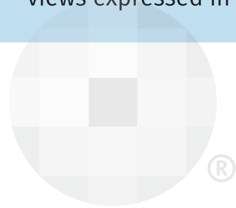
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