Modified IRS remediation program: are you wilful?

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In late 2018, the Internal Revenue Service (IRS) closed the Offshore Voluntary Disclosure Program and has since released an updated voluntary disclosure program with significant operational and procedural changes that will impact taxpayers seeking to enter the program. Members of wealthy Australian families who relocate to the US, or members of US-based families moving to Australia, are often doing so without being fully aware of the stringent reporting and filing requirements on foreign assets, financial accounts and asset holdings they will be subject to. This invariably results in taxpayers seeking to enter into remediation programs to limit or mitigate penalty exposure on misreporting and non-compliance with the IRS. Deciding which program is best for a taxpayer is imperative and can now result in further penalty exposure where a lack of analysis of the facts and circumstances surrounding the non-compliance is conducted. The question remains: have you been wilful?

The new wave of information reporting is shaping the way global economies work together to tackle tax avoidance and financial crimes. As a residual effect of this, globally mobile individuals and wealthy family groups with a United States taxpayer presence are increasingly and unwittingly running afoul of information and reporting disclosure requirements with respect to non-US assets and financial accounts.

To address this issue, the Internal Revenue Service (IRS) has released a number of voluntary disclosure programs over the years to allow taxpayers that have failed to file tax returns, misreported global income or have unreported foreign assets to get back into compliance and limit or eliminate associated penalties. A key feature of these programs is that the IRS is able to close the programs at any time, which can leave taxpayers without any opportunity to mitigate penalties for non-compliance.

Members of wealthy Australian families who relocate to the US, or members of US-based families moving to Australia, are often doing so without being fully aware of, or advised about, the stringent reporting and filing requirements on foreign assets, financial accounts and holdings they will be subject to on becoming a US person for tax purposes. This invariably results in the taxpayer seeking to enter into a remediation program to limit or mitigate penalty exposure on misreporting and non-compliance with the IRS.

Deciding which program is best for a taxpayer is imperative and can now result in further penalty exposure where a lack of analysis of the facts and circumstances surrounding the non-compliance is conducted. Prior to entering into a remediation program, a taxpayer should seek a comprehensive analysis of their particular circumstances and an analysis of which program is the most appropriate for them.

In a previous article, "Voluntary disclosure options for US taxpayers with Australian assets",[1] the authors discussed the remediation programs available for US taxpayers with Australian assets and the ability of the IRS to close the Offshore Voluntary Disclosure Program (OVDP) at any time. The OVDP was a voluntary disclosure program for taxpayers that do not meet the "non-wilful" requirement to be eligible for the streamline procedures and allowed taxpayers to come into compliance while avoiding criminal liability and limiting their penalty exposure. This program has since been closed by the IRS.

Since the closure of the OVDP, the IRS has released an updated version of the program with some significant operational and procedural changes that can impact taxpayers both positively and negatively. The key question in determining which remediation process is right for a taxpayer remains: have you been wilful?

Before discussing the new voluntary disclosure program, the authors will address what it means to be "wilful". This determination is essential because a taxpayer will only get one shot at making an application under the remediation processes. If an application is rejected from the streamline procedures and a taxpayer argues that their actions are non-wilful, they close all doors to other remediation programs and face potential civil and criminal penalties. With the rise of information disclosure requirements under the *Foreign Account Tax Compliance Act* (US) (FATCA) and various inter-governmental information reporting agreements, proving ignorance to the law may no longer cut it.

What does it mean to be "wilful"?

Although the statute and regulations under the Internal Revenue Code (Code) do not define the term "wilful", the IRS has defined "wilfulness" under the foreign bank account report (FBAR). The IRS has concluded that the standard for wilfulness is the civil wilfulness standard and that it includes not only knowing violations of the FBAR requirements, but wilful blindness to, as well as reckless violations of, the FBAR requirements.

In making this definition, the IRS noted from case law that the Supreme Court has delineated between the term "wilful" for criminal purposes and the term "wilful" for civil purposes.

In criminal cases, a narrow interpretation of the term "wilful" was taken to limit liability to "knowing violations". The IRS also noted that, where "wilfulness" is a statutory condition of civil liability, the Supreme Court has generally interpreted "wilfulness" as not only including "knowing violations" of a standard but also "reckless violations" of a standard.

Further, case law has considered the wilfulness standard that applies for civil FBAR violations is "wilful blindness" and "recklessness".

The IRS has stated that "wilful blindness is established when an individual takes deliberate actions to avoid confirming a high probability of wrongdoing and when he can almost be said to have actually known the critical facts". The government seeks to show wilful blindness by evidence that the taxpayer made a conscious effort to avoid learning about reporting requirements.

Further, the recklessness standard will be met if the taxpayer clearly ought to have known that there was a grave risk that withholding taxes were not being paid and if they were in a position to find out for certain very easily.

With that in mind, although a taxpayer may believe their actions were not deliberate or deceptive in nature, the IRS may take a different view.

What is the new voluntary disclosure program?

The IRS released a memorandum containing procedures for the Updated Voluntary Disclosure Practice (UVDP) on 29 November 2018. Similar to the OVDP, the UVDP provides taxpayers who are concerned that their conduct is wilful with a program to make voluntary disclosures and avoid criminal prosecution. The UVDP allows the voluntary disclosures for both domestic and offshore disclosures, whereas the OVDP provided for offshore disclosures only.

There are some significant differences between the UVDP and the OVDP. Importantly, the memorandum procedures allow for significant discretion to the IRS case agent with respect to penalties, so those with significant penalty exposure should consider a timely voluntary disclosure to mitigate potential penalties. The memorandum specifically states:

> "Proper penalty consideration is important in these cases. A timely voluntary disclosure may mitigate exposure to civil penalties. Civil penalty mitigation occurs by focusing on a specific disclosure period and the application of examiner discretion based on all relevant facts and circumstances including prompt and full cooperation during the civil examination of a voluntary disclosure."

The memorandum steps out the procedural framework of the program, summarised as follows:

1. all taxpayers seeking to enter the program must first seek pre-clearance from IRS criminal investigations (CI). A pre-clearance request is made using IRS Form 14457, which will serve as the basis for determining eligibility;
2. once pre-clearance has been granted, the taxpayer must submit and disclose all required information to CI relating to non-compliance. The information must be accompanied by a comprehensive narrative of the facts and circumstances, assets, entities, related parties and also professional advisers involved;
3. preliminary acceptance is then provided by CI and CI will forward all information to the IRS's Large Business and International Division (LB&I) for preparation;
4. LB&I will route the case for assignment and examination;
5. the relevant IRS business operating division will take the assignment and will follow standard examination procedures. On the assumption the taxpayer fully cooperates, the voluntary disclosure will be resolved by agreement and payment of full taxes, interest and penalties associated with the disclosure period; and
6. taxpayers that disagree with the assessment of the examination retain the right to go to appeal.

What is the disclosure period under the new program?

As previously mentioned, the UVDP provides more flexibility to the IRS agent than in the OVDP. In general, the disclosure period includes six years. This is a reduction of the disclosure period under the OVDP which required eight years of tax returns. For all years, the taxpayer must file amended tax returns, pay all taxes due including interest and penalties to be determined by the examiner (discussed below).

The procedures also detail that where disclosures are not resolved by agreement, the examiner has the discretion to expand the scope of the disclosure period to all years of non-compliance and to assess the maximum penalties to the taxpayer.

Under certain circumstances, cooperative taxpayers may be allowed to expand the disclosure period to include additional tax years. This may be requested where a taxpayer is looking to correct tax issues with other governments looking at additional tax years, correcting tax issues in anticipation of a mergers and acquisitions transaction or general correction of misreporting.

> *"... the procedures allow for significant discretion to the IRS case agent with respect to penalties ..."*

How are penalties assessed under the UVDP?

The procedures state that the examiners will determine applicable taxes, interest and penalties under each of the existing laws and procedures. These are summarised as the following:

- **s 6663 of the Code (civil fraud penalty) or s 6651 of the Code (civil fraudulent failure to file penalty):** the fraudulent failure to file income tax returns penalty applies for a single tax year with the highest tax liability in the disclosure period. This will result in an increase in penalty from the OVDP period which provided limits to penalty. In certain circumstances, the examiner has the discretion to apply this penalty to all six years;
- **wilful FBAR penalty:** wilful FBAR penalties will be asserted in accordance with existing IRS penalty

guidelines. In general, the total penalty amount in the disclosure period is limited to 50% of the highest aggregate balance of unreported foreign financial accounts. However, for wilful FBAR penalties, the examiner has the discretion to recommend a greater penalty, however, the penalty cannot exceed 100%;

- **failure to file information returns:** failure to file information returns will not be automatically applied. The examiner has discretion to take into account the application of the other penalties and resolve by agreement; and
- **penalties relating to excise taxes, employment taxes, estate and gift tax:** these penalties are to be determined based on the facts and circumstances.

What next?

The introduction of the UVDP provides a welcome avenue for compliance in circumstances where the facts and circumstances of a particular taxpayer may be complex and determining wilfulness is not straightforward.

Determination as to whether a taxpayer should file under the streamline procedures or the UVDP is an extremely important assessment and should be undertaken by an experienced international tax attorney. The professional fees, penalties and exposure to the potential criminal liability of getting the application wrong far outweigh the costs of an initial assessment by an experienced adviser. An initial assessment should be undertaken to take a deep dive into a taxpayer's particular fact pattern and circumstances to determine their eligibility for the various programs which can assist with the compliance.

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Reference

1 (2017) 20(3) *The Tax Specialist* 114.

1 column
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Destelle Taylor