

What is Willfulness?

The Streamlined Disclosure Program and What We Know

U.S. taxpayers with unreported foreign accounts or assets are in an increasingly precarious position. The IRS has [repeatedly announced](#) that it is devoting resources to finding and penalizing taxpayers who do not disclose such offshore accounts and assets. In addition, many U.S. taxpayers, both domestic and international, are facing intense pressure from foreign banks to disclose their U.S. taxpayer status or close their accounts.

IRS Disclosure Programs

Most taxpayers and their representatives now are aware of the various programs allowing taxpayers to correct foreign reporting delinquencies. Starting in 2009, the IRS offered the [Offshore Voluntary Disclosure Program](#) ("OVDP") as a means for taxpayers to avoid criminal penalties and secure fixed terms when resolving civil liabilities. Under the OVDP, taxpayers are subject to a 27.5% penalty on the highest aggregate balance of their undisclosed accounts and must pay taxes on undisclosed income for the previous eight years with interest. On July 1, 2014, the IRS created the [Streamlined Disclosure Programs](#) for taxpayers with non-willful failures to report foreign assets and accounts. Under these programs, taxpayers are only required to file three years of amended tax returns and six years of [Report of Foreign Bank and Financial Accounts](#) ("FBARs"). In addition, domestic taxpayers are subjected to a reduced penalty of 5% of the highest aggregate balance of their undisclosed accounts, while U.S. taxpayers living abroad are not subject to any penalties.

The Importance of Willfulness

Because of their lower penalties and simplified reporting requirements, taxpayers often prefer to participate in Streamlined Disclosure Programs as opposed to the OVDP. The programs, however, come at a price: under penalties of perjury, taxpayers must certify that their conduct in failing to disclose their accounts or assets was non-willful. [The IRS advises](#) that "Non-willful conduct is conduct that is due to negligence, inadvertence, or mistake or conduct that is the result of a good faith misunderstanding of the requirements of the law." However, this definition does not address what willfulness is, it only uses vague terms to describe what it is not. The line between non-willfulness



by Christopher A. Karachale

and willfulness remains unclear.

Over the last few months, informal remarks of an IRS representative and a recent federal court case have provided additional guidance on the meaning of "willfulness" for the streamlined programs. On October 21, 2016, John McDougal, a special trial attorney and division counsel for the IRS Small Business/Self-Employed Division, stated: "Anything that doesn't rise to the level of tax fraud or the willfulness standard for [FBARs] is fair game for streamlining...As long as you weren't fraudulent or willful in the FBAR sense...even gross negligence is an appropriate basis for filing streamlined."

In addition, a recent case, [*United States v. Bohanec*](#), No. 2:15-cv-4347 (C.D. Cal. Dec. 8, 2016), concludes that a "reckless disregard of a statutory duty" constitutes willfulness in the FBAR filing context. The taxpayers in *Bohanec* were naturalized citizens who operated a camera store in Pasadena, California. They deposited the store's international sales commissions into a Swiss bank account, but failed to file tax returns or FBARs between 1998 and 2011. In 2010, they applied to participate in the OVDP disclosing the Swiss account, but even then failed to report additional foreign bank accounts in Mexico and Austria. Eventually they were rejected from the OVDP. The federal court held that these taxpayers were reasonably sophisticated business people who had recklessly disregarded a statutory duty regarding their reporting obligations for their foreign bank accounts. Therefore, they had "willfully" failed to file required FBARs and could be subject to increased penalties.

Putting the Willful Puzzle Together

While *Bohanec* is not a Streamlined Disclosure Program case, it may help taxpayers who are unsure whether they qualify for these program. *Bohanec* says that a "reckless disregard of a statutory duty" is enough to be willful. So what, exactly, constitutes "reckless disregard of a statutory duty"? In *Bohanec*, the following facts showed the taxpayers were "at least recklessly indifferent to a statutory" duty: (1) the taxpayers were specifically asked about foreign bank accounts on tax returns but did not report them, (2) the taxpayers never provided their Swiss bank with their home address and never told anyone but their children about the account's existence, (3) they failed to engage professional accounting help once they opened their Swiss bank account, (4) they operated a professional business (and were thus "reasonably sophisticated business people" who were aware of the duty to file and pay taxes), and (5) they were rejected from the OVDP for failure to disclose all foreign bank accounts.

Conclusion

The takeaway from recent IRS statements, as well as the *Bohanec* case appears to be the following: willfulness for the Streamlined Disclosure Programs falls somewhere between gross negligence and recklessness. Informal IRS guidance tells us that a willful failure to file FBARs requires *more* than gross negligence. Gross negligence is generally understood to refer to consciously and voluntarily not using reasonable care. But *Bohanec* may mean that reckless indifference to filing an FBAR is enough to be "willful" in the Streamlined Disclosure Program context.

Under *Bohanec*, a finding that the taxpayer is reasonably sophisticated could tip the balance to show "reckless disregard" of the obligation to file FBARs. Arguably, this could mean that such taxpayers do not qualify for the streamlined program. But consider a reasonably sophisticated taxpayer who simply failed to use reasonable care in filing FBARs; such a taxpayer may be only grossly negligent with respect to his FBAR reporting obligations, which would mean that he qualifies for the streamlined programs.

In short, the recent guidance on willfulness in the FBAR context may create as many questions as it

answers for taxpayers hoping to meet the "non-willfulness" requirement of the Streamlined Disclosure Programs.

Tax attorneys at Hanson Bridgett regularly provide guidance to taxpayers and their CPAs regarding the various options available to address foreign account and asset reporting delinquencies. Taxpayers or their representatives with questions about the IRS' voluntary disclosure programs should contact Christopher Karachale at ckarachale@hansonbridgett.com or Katie Gardner at kgardner@hansonbridgett.com.

For more information, please contact:

Christopher A. Karachale, Partner
415-995-5863
ckarachale@hansonbridgett.com