

Wait, I Owe How Much In Penalties?: U.S. International Tax Considerations For Servicemembers with Foreign Bank Accounts & Foreign Securities

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I. Introduction

Foreign bank accounts created by servicemembers stationed outside the continental United States (OCONUS) may prove to be financially convenient while living abroad. Even though there are reasons for OCONUS servicemembers to obtain foreign accounts, the United States imposes a number of burdensome reporting requirements related to these foreign accounts. In addition, these reporting requirements may apply because of a servicemember marrying a foreign spouse or having certain business activities abroad. Failure to report these foreign accounts and assets may result in civil and criminal penalties. Several programs, however, offered by the Internal Revenue Service (IRS) provide a fresh start for individuals with civil penalties and criminal liability. This article reviews the U.S. international tax requirements related to ownership of foreign assets, discusses the strict penalty provisions for failing to meet certain compliance obligations, and provides options that judge advocates should consider when assisting servicemembers with penalty mitigation.

The tax consequences for U.S. citizens holding foreign bank accounts and foreign assets is a growing concern when considering the potential civil monetary fines and criminal penalties that can be imposed under U.S. law. For example, in 2012, Dr. Michael Canale, a former U.S. Army surgeon and Bronze Star recipient, pled guilty to a charge of willfully failing to notify the IRS of his ownership of a foreign bank

account.¹ In 2000 Dr. Canale and his brother inherited the foreign bank account, and then later concealed the ownership from the IRS by linking the foreign account to a sham Lichtenstein foundation.² By 2010 the estimated value of the foreign bank account grew to roughly \$1.4 million.³ After a criminal investigation and indictment by the Department of Justice, Dr. Canale received six months of incarceration in federal prison for his attempt to conceal the foreign bank account.⁴ A civil monetary fine of \$100,000 and back taxes of \$216,407, plus 400 hours of community service, were also imposed on Dr. Canale.⁵

Issues related to owning foreign assets prove to be relevant when considering the number of current and retired U.S. military personnel living abroad. At the end of fiscal year 2016, it is estimated that 201230 servicemembers in all branches of the U.S. military were stationed OCONUS.⁶ When national guard and reservist are added to this amount, OCONUS servicemembers totaled 241,634 during 2016.⁷ In addition, it is believed that 65,628 U.S. civilians were employed abroad by the Department of Defense.⁸ The total U.S. military retiree population living in foreign countries during 2015 is unclear; however, some assessments indicate that as many as 550,000 U.S. military retirees and their families are living abroad.⁹ For those living abroad, special tax requirements may apply for individuals who have a connection to certain foreign accounts and foreign securities maintained abroad.

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¹ See David Voreacos & Patricia Hurtado, *U.S. Tax Cheats Nailed After Swiss Adviser Mails It In*, BLOOMBERG BUSINESS (Mar. 12, 2013), <http://www.bloomberg.com/news/articles/2013-03-12/u-s-tax-cheats-picked-off-after-adviser-mails-it-in> (stating Dr. Canale had a distinguished Army career as a paratrooper and then later worked for the Veteran's Administration until his retirement in 2010).

² Press Release, Department of Justice Office of Public Affairs, Manhattan U.S. Attorney Announces Charges Against Kentucky Resident for Maintaining Secret Swiss Bank Accounts (Nov. 18, 2014), <http://www.justice.gov/opa/pr/manhattan-us-attorney-announces-charges-against-kentucky-resident-maintaining-secret-swiss>.

³ Patricia Hurtado, *Peter Canale Avoids Prison in Swiss Bank Tax Evasion Case*, Daily Tax Rep. (BNA), Dec. 4, 2015, at K-2.

⁴ See David Voreacos, *Beanie Baby Billionaire Sentence Comes Amid Tax Leniency*, BLOOMBERG (Nov. 1, 2013), <http://www.bloomberg.com/news/articles/2013-11-01/beanie-baby-billionaire-sentence-comes-amid-tax-leniency> (stating Dr. Canale was

instructed to use the foreign account to care for his mother, but the matter resulted in Dr. Canale losing his dignity when he "betrayed his core values of duty, honor and country").

⁵ David Voreacos, *Offshore Tax Scorecard: Bankers, Lawyers, Other Advisers See Charges Alongside Clients*, Daily Tax Rep. (BNA), Nov. 5, 2013, at J-3.

⁶ See DEFENSE MANPOWER DATA CENTER, TOTAL MILITARY PERSONNEL AND DEPENDENT END STRENGTH BY SERVICE, REGIONAL AREA, AND COUNTRY (Sept. 30, 2015), https://www.dmdc.osd.mil/appj/dwp/dwp_reports.jsp (providing a numeric breakdown of U.S. military servicemember who are stationed abroad by each individual foreign country compared to U.S. servicemembers who are stationed in the continental United States (CONUS)).

⁷ *Id.*

⁸ *Id.*

⁹ See Liz Davidson, *A Great Retiree Migration Abroad is Not So Far Fetched*, FORBES (Apr. 7, 2011), <http://www.forbes.com/sites/financialfinesse/2011/04/07/a-great-retiree-migration-abroad-is-not-so-far-fetched-2/> (re-stating that the Department of State believes that 6.6 million Americans live abroad, and of that total population, it is estimated that 550,000 are U.S. military retirees and their families).

Congress provides, under the Internal Revenue Code (IRC), that U.S. citizens are required to report all worldwide income to the IRS annually.¹⁰ Various U.S. international reporting requirements related to foreign accounts should be considered for judge advocates who provide tax assistance to servicemembers, civilians, and retirees living abroad. These international reporting requirements may not be relevant for the average servicemember stationed abroad.

Of particular importance are the monetary penalty provisions for failure to meet certain annual reporting requirements imposed by the IRS. Failure to meet these reporting obligations could result in substantial civil penalties enforced by the IRS.¹¹ In recent years, the IRS has increased its enforcement of reporting requirements related to foreign bank accounts and foreign assets.¹² Likewise, the IRS has increased its collection of civil penalties over the past twenty years.¹³ Failure to file certain reports related to foreign bank accounts could result in substantial civil monetary penalties.¹⁴ An additional interest charge may be added to the outstanding penalties related to the failure to file certain IRS reports.¹⁵ Moreover, potential criminal penalties may apply in the case of an individual who willfully fails to file certain required annual reports.¹⁶

The purpose of this article is to guide judge advocates providing tax assistance to servicemembers and retirees living abroad.¹⁷ This article first summarizes the United States reporting rules related to the ownership of foreign bank accounts. Next, this article reviews a number of programs established by the IRS and Department of Justice may assist in mitigating the civil and criminal penalties. The article concludes by noting how a judge advocate may assist to minimize substantial monetary penalties, in addition to limiting potential criminal liability if willful conduct is

discovered. A thorough review of the international tax compliance rules is first discussed below.

II. International Tax Reporting Law

This section reviews international tax reporting rules and regulations imposed by Congress and the Department of Treasury. First, the Foreign Bank and Financial Accounts (FBAR) reporting requirements imposed by the Department of Treasury are reviewed for servicemembers who have a connection to certain foreign financial accounts.¹⁸ Second, if a servicemember has a connection to a foreign financial account that is in excess of a specific monetary value, additional reporting requirements are imposed under the IRC. Third, other reporting rules are considered for special situations that may apply to OCONUS servicemembers who hold certain foreign security interests. A review of the FBAR rules in Part II.A. is first addressed.

A. FBAR Reporting Requirements

Congress enacted the Bank Secrecy Act of 1970 in order to collect certain information related to criminal activity with ties to international terrorism.¹⁹ Congress delegated to the Department of Treasury the ability to adopt regulations requiring U.S. citizens to file certain reports for transactions occurring with a foreign financial agency.²⁰ The FBAR regulations, if applicable, impose serious civil and monetary penalties for those who fail to meet the annual reporting requirements.²¹ Currently, FBAR noncompliance is a significant issue, which should result in increased enforcement by the IRS in future years.²²

¹⁰ See 3 BORIS I. BITTKER & LAWRENCE LOKKEN, FEDERAL TAXATION OF INCOME, ESTATES AND GIFTS ¶ 65.1.2 (rev. 3d. ed. 2005 & 2016 Cum. Supp. No. 2) (summarizing the U.S. tax rules applied to U.S. citizens who earn both foreign and domestic sourced income).

¹¹ See 31 U.S.C. § 5321 (2012) (outlining civil monetary penalties for failure to file certain reports related to foreign transactions).

¹² See Internal Revenue Service, *Voluntary Disclosure: Questions and Answers* (Sept. 21, 2009), <https://www.irs.gov/uac/Voluntary-Disclosure:-Questions-and-Answers> (stating, "[r]ecent IRS enforcement efforts in the offshore area have led to an increased number of voluntary disclosures").

¹³ Compare INTERNAL REVENUE SERVICE, 2014 DATA BOOK 41 (March 2015), <https://www.irs.gov/pub/irs-soi/14databk.pdf> (stating the IRS assessed almost \$25.6 billion in civil penalties during fiscal year 2014), with INTERNAL REVENUE SERVICE, 1993–1994 DATA BOOK 100 (1993–1994) (stating the IRS assessed \$13.1 billion in civil penalties during fiscal year 1994).

¹⁴ For example, if a U.S. servicemember fails to file Form 8938, discussed *infra* at Part I.A, a civil monetary penalty of \$10,000 is due for *each* year that a failure to file occurs.

¹⁵ See I.R.C. § 6601(a) (2012) (requiring an interest charge of the federal short-term rate plus 3 percentage points, as stated in I.R.C. § 6621, is due on any non-payments or underpayments).

¹⁶ See 31 U.S.C. § 5322 (2012) (outlining criminal penalties for willful violations of failure to file required foreign transaction reports).

¹⁷ Note that this discussion of international compliance law related to foreign accounts may also apply to dual citizen servicemembers who maintain foreign accounts in their native country. Judge advocates serving CONUS should also consider any compliance obligations related to these dual citizen servicemembers who maintain a foreign bank account in their native country.

¹⁸ See *infra* pp. 4-7.

¹⁹ 31 U.S.C. § 5311 (2012).

²⁰ 31 U.S.C. § 5314 (2012).

²¹ See 3 BORIS I. BITTKER & LAWRENCE LOKKEN, FEDERAL TAXATION OF INCOME, ESTATES AND GIFTS ¶ 65.6.4 (rev. 3d. ed. 2005 & 2016 Cum. Supp. No. 2) (summarizing the FBAR rules, filing requirements, and discussing the civil and criminal penalties).

²² For example, in 2012 the IRS only received 807,040 FBAR submissions even though an estimated 7.6 million U.S. citizens lived abroad. See *Offshore Tax Evasion: The Effort to Collect Unpaid Taxes on Billions in Hidden Offshore Accounts Before the Permanent Subcommittee on Investigations of the S. Comm on Homeland Security and Government Affairs*, 113th Cong. 22 (2014) (citing the Taxpayer Advocate as stating "[w]hile 7.6 million U.S. citizens reside abroad and many more U.S.

1. FBAR Rules

The Department of Treasury requires an FBAR report for any U.S. person who has a financial interest or signature authority over any foreign financial account and the aggregate maximum value of the account exceeds \$10,000 at any time during a calendar year.²³ First, the reporting requirement is imposed on all U.S. persons, which includes U.S. citizens, U.S. residents, and any entity formed in the United States.²⁴ Second, the reporting requirements apply for any foreign financial account.²⁵ Third, the U.S. person must have a financial interest over the foreign financial account, which occurs if a U.S. person is the owner of record, holder of legal title, agent, nominee, or attorney of the foreign financial account.²⁶ If a U.S. citizen does not have a financial interest in a foreign account, a reporting requirement may still apply if that citizen has signature authority over the foreign account.²⁷ Fourth, the aggregate value of the foreign accounts must exceed \$10,000 per calendar year.²⁸

2. Filing Requirements

For U.S. persons who are subject to the FBAR rules, a taxpayer must report this information on his or her annual

residents have FBAR filing requirements, the IRS received only 807,040 FBAR submissions in 2012”).

²³ 31 C.F.R. 1010.350(a) (2015).

²⁴ 31 C.F.R. 1010.350(b) (2015).

²⁵ See 31 C.F.R. 1010.350(c) (2015) (noting that foreign financial accounts include foreign bank accounts, foreign brokerage accounts, foreign life insurance and annuity accounts, and many other accounts held by a foreign entity).

²⁶ 31 C.F.R. 1010.350(e)(1)–(2)(i) (2015). A financial interest is broadly defined to include any U.S. person who owns a greater than 50 percent, direct or indirect, interest in a U.S. entity or a partnership. 31 C.F.R. 1010.350(e)(2)(ii) (2015). In addition, a financial interest may also occur for any U.S. person who holds an interest in a grantor trust or a greater than 50 percent beneficial interest in assets held in trust. 31 CFR 1010.350(e)(2)(iii)–(iv) (2015).

²⁷ Signature authority includes any individual who has the authority to control the disposition of assets held by the foreign financial account, but does not include an officer or employee of a foreign financial institution related to the foreign financial account. 31 C.F.R. 1010.350(f) (2015); see also Internal Revenue Service, *IRS FBAR Reference Guide 5* (2016), <https://www.irs.gov/pub/irs-utl/irsfbarreferenceguide.pdf> [hereinafter *IRS FBAR Reference Guide*] (noting that a U.S. person who has a power of attorney over a foreign financial account is required to meet the annual FBAR filing obligations).

²⁸ The aggregate maximum value applies to all foreign financial accounts held by a U.S. person during the calendar year. See, e.g., *IRS FBAR Reference Guide*, *supra* note 27, at 3 (providing an example: “Kristin, a United States person, owns foreign financial accounts A, B and C with account balances of \$3,000, \$1,000 and \$8,000, respectively. Kristin is required to report accounts A, B and C because the aggregate value of the accounts is over \$10,000. It does not matter that no single account exceeded \$10,000”).

Form 1040 tax return.²⁹ In addition, Report 114a of the U.S. Treasury Department’s Financial Crimes Enforcement Network (FinCEN) is annually required by the deadline prescribed by the Department.³⁰ FinCEN Report 114a must be electronically filed by June 30, 2016, with no extensions for a taxpayer who is subject to the FBAR rules during calendar year 2015.³¹ For tax year 2016, the deadline is moved to April 15, 2017, and includes a six-month extension.³² If a servicemember fails to timely file FinCEN Form 114a, civil penalties may apply.³³

3. Civil and Criminal Penalties

Civil penalties for failure to file FinCEN Form 114a range depending on the nature of the violation.³⁴ The amount of civil monetary penalty depends on whether the taxpayer’s conduct was the result of either non-willful or willful conduct.³⁵ For non-willful conduct, a civil monetary penalty will range between \$500 for a negligent violation up to \$10,000 for violations that were not due to reasonable cause.³⁶ For any willful conduct related to the deficient FBAR filing, the civil monetary penalty is increased to the greater of \$100,000 or 50 percent of the total balance of the foreign financial account.³⁷ Interest will apply to an outstanding

²⁹ See Form 1040, Sch. B, Part III, Line 7a, Internal Revenue Service (2015) (reminding the taxpayer that FinCEN Form 114 is required to be filed if the taxpayer answered “Yes” to line 7a.).

³⁰ Note that the Department of the Treasury initially required Form TD F 90-22.1 to be timely submitted to it through the mail. Today, FinCEN Report 114a must be electronically filed on the Bank Secrecy Act’s e-Filing website at <http://bsaeifiling.fincen.treas.gov/main.html>.

³¹ See Financial Crimes Enforcement Network, BSA Electronic Filing Requirements For Report of Foreign Bank and Financial Accounts (FinCEN Form 114) 47 (Mar. 2015), <http://bsaeifiling.fincen.treas.gov/docs/FinCENFBARElectronicFilingRequirements.pdf> (“The FBAR must be received by the Department of the Treasury on or before June 30th of the year immediately following the calendar year being reported. The June 30 filing date may not be extended.”).

³² See Surface Transportation and Veterans Health Care Choice Improvement Act of 2015, Pub. L. No. 114-41, § 2006, 129 Stat. 443, 458–59 (2015) (“The due date of FinCEN Report 114 . . . shall be April 15 with a maximum extension for a 6-month period ending on October 15 . . .”).

³³ See 31 U.S.C. § 5321(a)(5) (2012) (outlining the civil penalties imposed by the Department of Treasury for failure to annually file certain reports related to foreign financial agency transactions).

³⁴ *Id.*

³⁵ See *infra* p. 13.

³⁶ Compare 31 U.S.C. § 5321(a)(6)(A) (2012) (noting a \$500 civil penalty for any negligent failure to file any foreign financial agency transaction), with 31 U.S.C. § 5321(a)(5)(B) (stating the civil penalty imposed shall not exceed \$10,000 for violations there were not the result of reasonable cause).

³⁷ See 31 U.S.C. § 5321(a)(5)(C) (2012) (declaring any willful violations for failure to file FinCEN Form 114a will result in a civil penalty of the greater of either (i) \$100,000, or (ii) 50 percent of the value of the foreign financial account).

FBAR penalty at a rate of 6 percent if a taxpayer does not pay the FBAR penalty within ninety days of assessment.³⁸ Criminal penalties may apply in certain circumstances.³⁹

4. FBAR Military Exception

One important exception to the FBAR filing requirement in regard to OCONUS servicemembers relates to foreign accounts maintained at a U.S. military finance facility.⁴⁰ Specifically, any account that is operated by a U.S. military banking facility designated by the U.S. government to serve at U.S. military installations abroad does not meet the definition of a foreign financial account and therefore is not required to be reported to the on FinCEN Report 114a.⁴¹ Any account, however, that is not maintained by a U.S. military banking facility and does not serve U.S. military installations abroad would not meet the exception provided in the FBAR regulations, which should require an annual FBAR filing requirement.⁴²

B. Specified Foreign Financial Assets & Form 8938

In addition to the FBAR filing requirements, OCONUS servicemembers should also be aware of the annual reporting requirements related to Form 8938.⁴³ As of 2011, Form 8938 is required for specified individuals⁴⁴ who own a specified foreign financial asset and the total value of that asset meets certain reporting thresholds.⁴⁵ The reporting threshold varies depending on the servicemember's residence in or outside the United States, marital status, and individual tax return filing status.⁴⁶ The difference between the FBAR reporting requirements and Form 8938 depends on the value of the

foreign financial asset. It is important to note that filing Form 8938 does not relieve a servicemember of their FBAR filing requirement.⁴⁷

1. Rules for Form 8938

Similar to the FBAR rules, Form 8938 requires an annual filing requirement for any specified foreign financial assets.⁴⁸ A specified foreign financial asset is broadly defined to include any financial account that is maintained by a foreign financial institution.⁴⁹ This definition includes any foreign financial asset that is held for investment that is either stock, security, any interest in a foreign entity, financial instrument, or contract with a counterparty who is not a U.S. person.⁵⁰ In addition, a specified foreign financial asset includes a foreign partnership interest, foreign mutual funds, foreign issued life insurance policies and annuities, and interests held in foreign hedge funds and private equity funds.⁵¹

The total value requirement of a specified foreign financial asset depends on the individual circumstances of each taxpayer. Generally, the valuation requirement is met if the aggregate value of all the foreign financial assets exceeds either \$50,000 on the last day of the taxable year or \$75,000 at any time during the taxable year.⁵² If the taxpayer is married filing jointly, the valuation amounts of the foreign financial asset is increased to include \$100,000 on the last day of the taxable year or \$150,000 at any time during the taxable year.⁵³ The valuation amounts of foreign financial assets are increased to \$200,000 on the last day of the taxable year or \$300,000 at any time during the taxable year if a specified individual qualifies under I.R.C. § 911(d)(1).⁵⁴ In addition, the valuation rules of a foreign financial asset are increased to

³⁸ 31 U.S.C. § 3717(b) (2012).

³⁹ See 31 U.S.C. § 5321(d) (2012) (stating a "civil money penalty may be imposed . . . with respect to any violation of this subchapter notwithstanding the fact that a criminal penalty is imposed with respect to the same violation").

⁴⁰ 31 C.F.R. 1010.350(c)(4)(iii) (2015).

⁴¹ *Id.*

⁴² For example, any foreign bank account opened by a servicemember at a foreign branch that is off-post would not meet the FBAR military exception. Therefore, a judge advocate needs to determine whether the foreign account is managed by a bank with a branch either on or off a military installation.

⁴³ See generally I.R.S. Notice 2011-55, 2011-29 I.R.B. 53 (discussing guidance for enacting I.R.C. § 6038D and the corresponding reporting requirements for filing Form 8938).

⁴⁴ See Treas. Reg. § 1.6038D-1(a)(2) (as amended in 2016) (defining broadly who qualifies as a "specified individual" for purposes of IRC § 6038D); see also Internal Revenue Service, Instructions for Form 8938 at 1 (Oct. 22, 2015) (stating a specified individual is broadly defined to include U.S. citizens, resident aliens, and certain non-resident aliens).

⁴⁵ See I.R.C. § 6038D(a) (2012) (noting the general rule for those who are required to meet certain information reporting requirements related to foreign financial assets).

⁴⁶ See Internal Revenue Service, Instructions for Form 8938 at 2 (Oct. 22, 2015) (noting the reporting thresholds for each individual's tax status).

⁴⁷ See Internal Revenue Service, *Comparison of Form 8938 and FBAR Requirements* (last updated May 4, 2016), <https://www.irs.gov/Businesses/Comparison-of-Form-8938-and-FBAR-Requirements> [hereinafter Form 8938/FBAR Comparison] (comparing Form 8938 with certain FBAR filing requirements and noting that Form 8938 does not relieve any reporting obligations related to FinCEN Form 114).

⁴⁸ See I.R.C. § 6038D(b) (2012) (defining broadly that a "specified foreign financial account" is any financial instrument, stock or security interest issued by a foreign person, any financial instrument or contract issued by a foreign person, and any interest in a foreign entity).

⁴⁹ I.R.C. § 6038D(b)(1) (2012). See also I.R.C. § 1471(d)(2), (4) (2012) (defining what qualifies as a financial account and a foreign financial institution).

⁵⁰ I.R.C. § 6038D(b)(2) (2012).

⁵¹ See Form 8938/FBAR Comparison, *supra* note 47.

⁵² Treas. Reg. § 1.6038D-2(a)(1) (as amended in 2016).

⁵³ Treas. Reg. § 1.6038-2(a)(2) (as amended in 2013).

⁵⁴ Treas. Reg. § 1.6038-2(a)(3) (as amended in 2013).

\$400,000 on the last day of the taxable year or \$600,000 at any time during the taxable year if the individual meets the requirements under I.R.C. § 911(d)(1) and files a joint return with his or her spouse.⁵⁵

For purposes of determining whether a servicemember is treated as living within the United States or abroad, one must analyze whether the servicemember is a qualified individual under I.R.C. § 911(d)(1). To qualify under I.R.C. § 911(d)(1), an individual must have a “tax home” in a foreign country, and be either a *bona fide* resident of a foreign country for an uninterrupted entire taxable year or the individual must be present in a foreign country for 330 days of the taxable year.⁵⁶ The term “tax home” includes an individual’s place of business or, if the individual has no place of business, then at his or her regular place of abode.⁵⁷ An individual’s “tax home,” however, does not include a foreign country if the individual has an abode within the United States.⁵⁸ For purposes of applying the correct valuation amount of a foreign financial asset, careful analysis should include determining whether a servicemember is treated as living in the United States or living abroad.

2. Reporting Requirements and Penalties

Various monetary penalties may apply if the event the annual compliance obligations are not met. Form 8938 is due on the date when an individual’s annual Form 1040 is due, which includes extensions in the event an individual timely files Form 4868. If a servicemember fails to timely file Form 8938 with his or her annual Form 1040, then civil penalties may apply.⁵⁹ Specifically, a \$10,000 penalty applies for failure to file Form 8938, in addition to another \$10,000 penalty for each 30-day period after the IRS sends notice to the servicemember about the failure to file.⁶⁰ No penalties, however, will apply if the servicemember has reasonable cause for failure to timely file Form 8938.⁶¹ Accuracy-related

penalties and criminal penalties may also apply in certain circumstances.⁶²

C. Other Miscellaneous Considerations for OCONUS Servicemembers

Some circumstances may impose other international tax reporting requirements for certain foreign security interests owned by a servicemember. In addition to the FBAR and Form 8938 rules, other annual reporting requirements may apply to servicemembers who have an interest in either foreign corporations or foreign partnerships. In this case, if certain reporting requirements are not met, civil penalties will apply in addition to penalties already imposed by any FBAR or Form 8938 violations. Judge advocates should be familiar with these unique tax reporting requirements in the event the rules apply to a servicemember.

1. Interests in Foreign Corporations

Reporting requirements will apply to any servicemember who holds a stock interest in a foreign corporation. Specifically, Form 5471 is required for any U.S. person who holds a ten percent or greater interest in any foreign corporation.⁶³ Any servicemember who meets these requirements should file Form 5471 in order avoid any civil penalties. Specifically, a \$10,000 penalty is imposed for failure to timely file Form 5471, in addition to a \$10,000 penalty for each 30-day period after the IRS sends notice to the servicemember about the failure to file.⁶⁴

2. Interests in Foreign Trusts

U.S. servicemembers who own an interest in a foreign trust will have additional annual reporting requirements.⁶⁵ While not common, this reporting obligation may occur if a

⁵⁵ Treas. Reg. § 1.6038-2(a)(4) (as amended in 2013).

⁵⁶ I.R.C. § 911(d)(1)(A)–(B) (2012).

⁵⁷ Treas. Reg. § 1.911-2(b) (1985).

⁵⁸ I.R.C. § 911(d)(3) (2012).

⁵⁹ See I.R.C. § 6038D(d) (2012) (noting the civil penalty for failure to timely disclose Form 8938).

⁶⁰ The maximum additional penalty for continuing to fail to file Form 8938 is \$50,000. See Internal Revenue Service, Instructions for Form 8938 at 7 (Oct. 22, 2015) (listing the penalty provisions for failure to timely file Form 8938).

⁶¹ I.R.C. § 6038D(g) (2012).

⁶² Treas. Reg. § 1.6038D-8(f) (2014).

⁶³ See, e.g., Treas. Reg. § 1.6046-1(a)(2) (as amended in 2014) (noting a filing requirement for any U.S. citizen or resident who is an officer or director of a foreign corporation if a U.S. person either acquires 10 percent or more of the total voting power of all classes of the foreign corporation or acquires an additional 10 percent or more voting interest in the foreign corporation); Treas. Reg. § 1.6046-1(c)(1) (noting a Form 5471 filing

requirement for U.S. citizens who acquire 10 percent or more voting power of a foreign corporation, U.S. citizens who acquire an additional 10 percent or more voting interest in certain foreign corporations, and certain U.S. citizens who dispose of stock of a foreign corporation that results in owning less than 10 percent voting interest in the foreign corporation); Treas. Reg. § 1.6038-2(a) (as amended in 2013) (noting a Form 5471 filing requirement for U.S. citizens who control, as defined by holding a more than 50 percent vote or value, a foreign corporation for an uninterrupted period of at least 30 days). See also Internal Revenue Service, Instructions for Form 5471 at 2 (Jan. 13, 2015) (requiring Form 5471 to be filed by any U.S. citizens who are U.S. shareholders of a foreign corporation that is treated as a controlled foreign corporation for an uninterrupted period of 30 days or more).

⁶⁴ The maximum additional penalty for continuing to fail to file Form 5471 is \$50,000. See Internal Revenue Service, Instructions for Form 5471 at 4 (Jan. 13, 2015) (listing the penalty provisions for failure to timely file Form 5471).

⁶⁵ See I.R.C. § 6048(a) (2012) (requiring notification to the IRS if either (i) a U.S. person creates a foreign trust, (ii) a U.S. person transfers property to a foreign trust, or (iii) a U.S. beneficiary receives a distribution from a foreign trust).

U.S. servicemember has an interest in a foreign trust and the servicemember is included as a beneficiary of that foreign trust. In that case, Form 3520 is required to be filed with the taxpayer's annual tax return in the year that the notification requirement under IRC § 6048 occurs.⁶⁶ Further, the foreign trust with a U.S. citizen beneficiary must file Form 3520-A as part of the notification event that corresponds with Form 3520.⁶⁷ Failure to file Form 3520 and the corresponding Form 3520-A will result in a civil monetary penalty the greater of either (i) \$10,000, or (ii) 35 percent of the gross value of any property transferred or distributions received by the foreign trust.⁶⁸

3. Interests in Foreign Partnerships

Other reporting requirements will apply to any servicemember who holds an interest in a foreign partnership. Any U.S. citizen who holds certain interests in foreign partnerships must timely file Form 8865.⁶⁹ Similar to the rules for Form 5471, there are four categories that may require U.S. citizens to file Form 8865.⁷⁰ While not discussed in depth for purposes of this overview, judge advocates should be aware of this filing requirement in the event a servicemember happens to hold an interest in a foreign partnership.

III. Options For Mitigating Compliance Deficiencies

This section outlines options for mitigating civil and criminal penalties for servicemembers whose tax reporting deficiencies are the result of owning a foreign financial asset, while distinguishing options between willful and non-willful conduct by a taxpayer servicemember. First, if a taxpayer's activity results in willful conduct, judge advocates should carefully consider the Offshore Voluntary Disclosure

Program ("OVDP") after analyzing potential civil and criminal penalties imposed by this program.⁷¹ Second, if a servicemember's delinquent international tax return filing is the product of non-willful conduct, judge advocates should consider five different programs offered by the IRS that may either eliminate or mitigate outstanding civil monetary penalties.⁷² Each option offered by the IRS provides for different eligibility rules and penalty abatement features, so judge advocates should research the benefits of each based on their clients' facts and concerns.

A. Options for Willful Conduct

Civil and criminal liability may attach if it is determined that the tax compliance deficiency was the result of willful conduct.⁷³ In that case, taxpayers should be concerned about both increased civil penalties and criminal liability that will attach if the deficiency is not corrected.⁷⁴ Regarding deficient international tax compliance, a taxpayer only needs to know that the reporting requirement exists in order for the conduct to become willful.⁷⁵ In certain situations, willful conduct may be present if there is a reckless disregard of a statutory duty.⁷⁶ This section outlines the options that judge advocates should consider if a servicemember's international tax compliance deficiency is the result of willful conduct.

1. Do Nothing and Pray

The first option is to simply do nothing and hope that the IRS never discovers the deficient filing requirement.⁷⁷ The option to do nothing may lead to many sleepless nights for the taxpayer and is ill-advised given the recent increased international tax compliance enforcement by the IRS and the Department of Justice.⁷⁸ Taxpayers need to weigh the benefits, if any, of this option—the taxpayer hopes the IRS

⁶⁶ See Internal Revenue Service, Instructions for Form 3520, at 1 (Nov. 25, 2014) (listing the various requirements for a U.S. person to file Form 3520).

⁶⁷ See Internal Revenue Service, Instructions for Form 3520-A, at 1 (Dec. 2, 2014) (requiring a foreign trust with a U.S. owner to first file Form 3520-A in order to allow the U.S. owner to file Form 3520).

⁶⁸ I.R.C. § 6677.

⁶⁹ See Internal Revenue Service, Instructions for Form 8865, at 2 (Sept. 30, 2014) (describing the four different categories of filers that will require Form 8865 to be filed by a U.S. person).

⁷⁰ *Id.*

⁷¹ See discussion *infra* Part III.A.3.

⁷² See discussion *infra* Part III.B.

⁷³ See, e.g., *Cheek v. United States*, 498 U.S. 192, 201 (1991) (noting willfulness occurs if there is an intentional violation of a known legal duty); see also INTERNAL REVENUE SERVICE, INTERNAL REVENUE MANUAL § 4.26.16.6.5.1(4) (last visited Oct. 12, 2016), <https://www.irs.gov/irm/> [hereinafter IRM] ("Willfulness is shown by the person's knowledge of the reporting requirements and the person's conscious choice not to comply with the requirements.").

⁷⁴ See, e.g., 31 U.S.C. § 5321(a)(5) (2012) (noting the civil penalty for willfully failing to file the annual FBAR is increased to the greater of either \$100,000 or 50 percent of the total balance of the foreign financial account).

⁷⁵ See, e.g., IRM, *supra* note 73 at § 4.26.16.6.5.1(4) ("Willfulness is shown by the person's knowledge of the reporting requirements and the person's conscious choice not to comply with the requirements.").

⁷⁶ See, e.g., *United States v. Williams*, 489 F. App'x 655, 660 (4th Cir. 2012) (finding that the taxpayer's reckless conduct of refusing to learn about FBAR filing requirements was enough to demonstrate willful conduct; the taxpayer's signature on his annual tax returns was enough to demonstrate that he knew of a duty to file returns related to his financial interest in two Swiss bank accounts).

⁷⁷ See JOINT COMMITTEE ON TAXATION, 109TH CONG., GENERAL EXPLANATION OF TAX LEGISLATION ENACTED IN THE 108TH CONGRESS, JCS-5-05, at 377-78 (Comm. Print 2005) (discussing the reason for enacted legislation related to civil penalties and enforcement to combat abusive tax schemes).

⁷⁸ See JOINT COMMITTEE ON TAXATION, GENERAL EXPLANATION OF TAX LEGISLATION ENACTED IN THE 108TH CONGRESS, JCS-5-05, at 377-78 (2005) (discussing the reason for enacted legislation related to civil penalties and enforcement in order to combat abusive tax schemes).

never notices the compliance deficiency and, therefore, none of the civil penalties will apply. The risk, however, is that the deficiency will eventually be caught by the IRS. Therefore, this option is not advised for a taxpayer with deficient international compliance issues.

2. Quiet Disclosure

The second option includes a taxpayer making his or her tax disclosure in the current tax year for all delinquent international filings during the statute of limitations period.⁷⁹ This option is known as a “quiet disclosure” because the taxpayer files all the deficient tax returns without alerting the IRS for applying the applicable penalties—the taxpayer hopes that the quiet filing is not noticed by the IRS so that the civil penalty provisions are never applied to the taxpayer.⁸⁰ In addition, a quiet disclosure would include a taxpayer filing amended Form 1040s for as many years as applicable under the tax return statute of limitations.⁸¹

Here, the advantage of the quiet disclosure occurs only if the IRS never notices the amended filing and, thus, full civil penalties for the late filings would not apply once the statute of limitations period expires.⁸² The risk, however, is that late filing will trigger an indication of a deficient taxpayer filing,

which may result in willful conduct by the taxpayer and the application of full penalties imposed by the IRS.⁸³ At a minimum, the quiet disclosure option brings the taxpayer back into good standing for meeting his or her annual compliance obligation; however, this option would not cut off potential criminal liability related to willful conduct for the deficient filing requirements.⁸⁴ Therefore, judge advocates should carefully review the third and final option before recommending a quiet disclosure.

3. Offshore Voluntary Disclosure Program

The third option allows taxpayers to confess their violations before the IRS in order to bring the taxpayer back into full compliance. Under the current version of the Offshore Voluntary Disclosure Program (OVDP),⁸⁵ a taxpayer agrees to come into full compliance with the U.S. tax rules by filing for up to eight years of non-compliant tax returns.⁸⁶ If any tax deficiencies apply to any of the previous non-compliant eight years, the taxpayer is obligated to pay any outstanding tax liability in addition to a 20 percent accuracy-related penalty, a failure-to-file penalty, and interest.⁸⁷

⁷⁹ See 31 U.S.C. § 5321(b)(1) (2012) (noting the six-year statute of limitations period of assessing civil penalties for FBAR filings). In the FBAR context, a six-year statute of limitations period applies from the date of the transaction for assessing the civil penalty for FBAR violations. 31 U.S.C. 5321(b)(1) (2012). According to the IRS, the date of the transaction starts the six-year statute of limitations period on the due date for when FinCEN Report 114a should be reported. For example, a taxpayer’s FBAR that applies to calendar year 2015 would be due on June 30, 2016, and therefore the statute of limitations for assessing civil penalties would expire on June 30, 2021. See IRM, *supra* note 73, § 4.26.17.5.5.1(2) (“The date of the transaction for report filing violations is June 30th of the year following the calendar year for which the foreign financial account should be reported.”). The liability could turn into a willful violation of failure to file FinCEN Report 114a if the taxpayer becomes aware of his or her FBAR filing requirement and then does nothing to correct this deficiency. See IRM, *supra* note 73 at § 4.26.16.6.5.1(4) (“Willfulness is shown by the person’s knowledge of the reporting requirements and the person’s conscious choice not to comply with the requirements.”).

⁸⁰ See Michael S. Kirsch, *Revisiting the Tax Treatment of Citizens Abroad: Reconciling Principle and Practice*, 16 FLA. TAX REV. 117, 156 (2014) (discussing the motivations for a taxpayer to file a quiet disclosure in order to avoid the FBAR civil penalty).

⁸¹ A three-year statute of limitations generally begins to run after a taxpayer has filed his or her tax return with the IRS. I.R.C. § 6501(a) (2012). A six-year statute of limitations, however, would apply if the taxpayer omits 25 percent or more of gross income on his or her tax return. I.R.C. § 6501(e)(1) (West Supp. 2016). In either case, taxpayers who make a quiet disclosure must amend Form 1040 to correctly reflect their ownership of a foreign account on Line 7a on Schedule B, Part III.

⁸² Note that the benefit of avoiding the FBAR civil penalty is only achieved once the two separate statute of limitations periods for the FBAR and tax return filings have expired. Similar to the first option, this may lead to many sleepless nights for the taxpayer and, therefore, should be carefully considered when weighing the benefits of this option.

⁸³ Again, the civil penalties for non-willful conduct will range between a minimum of \$500 for a negligent violation and up to \$10,000 for each FBAR violation that is not the result of reasonable cause. 31 U.S.C. §

5321(a)(5)(B)(i) (2012). The willful civil penalty is as high as the greater of either \$100,000 or 50 percent of the total balance of the foreign financial account per violation. 31 U.S.C. § 5321(a)(5)(C) (2012).

⁸⁴ If the IRS discovers any willful conduct by the taxpayer in a quiet disclosure scenario, criminal prosecution may be recommended to the Department of Justice. See Internal Revenue Service, *Offshore Voluntary Disclosure Program Frequently Asked Questions and Answers 2014* (last updated Sept. 20, 2016), <https://www.irs.gov/Individuals/International-Taxpayers/Offshore-Voluntary-Disclosure-Program-Frequently-Asked-Questions-and-Answers-2012-Revised> (stating “quiet disclosures provide no protection from criminal prosecution and may lead to civil examination and the imposition of all applicable penalties”); see also IRM, *supra* note 73, § 9.5.11.9(1) (“It is currently the practice of the IRS that a voluntary disclosure will be considered along with all other factors in the investigation in determining whether criminal prosecution will be recommended.”).

⁸⁵ The IRS implemented the first OVDP in 2009 to encourage taxpayers with FBAR deficiencies to come forward and pay a reduced FBAR civil penalty. After the expiration of the 2009 OVDP, the IRS extended the program again in 2011 and 2012 after taxpayers and tax practitioners showed strong interest in clearing up compliance issues related to foreign accounts. Currently the OVDP is extended for an indefinite period of time. See Internal Revenue Service, *Hiding Money or Income Offshore Among the “Dirty Dozen” List of Tax Scams for the 2015 Filing Season* (Jan. 28, 2015), <https://www.irs.gov/uac/Newsroom/Hiding-Money-or-Income-Offshore-Among-the-Dirty-Dozen-List-of-Tax-Scams-for-the-2015-Filing-Season> (noting the OVDP is extended for an indefinite period until otherwise announced).

⁸⁶ See Internal Revenue Service, *Offshore Voluntary Disclosure Program Frequently Asked Questions and Answers 2014*, FAQ 9 (last updated Sept. 20, 2016) [hereinafter OVDP FAQ], <https://www.irs.gov/Individuals/International-Taxpayers/Offshore-Voluntary-Disclosure-Program-Frequently-Asked-Questions-and-Answers-2012-Revised> (requiring a taxpayer to voluntarily disclose the eight most recent non-compliant tax returns).

⁸⁷ *Id.* at FAQ 7.

The OVDP provides the option of a reduced civil penalty regime. For taxpayers eligible for the OVDP, the penalty is limited to only 27.5 percent of the highest balance of the foreign account over the period of time covering the deficient filing period.⁸⁸ Here, the benefit to the taxpayer is that the IRS is limited to the 27.5 percent penalty over a period of eight years compared to the increased willful conduct civil penalty.⁸⁹

Perhaps one of the strongest reasons for taxpayers to enter into the OVDP is the ability to cut off potential criminal liability. If a taxpayer's deficient filing is the result of willful conduct, the potential for criminal prosecution may end when the taxpayer enters into the OVDP.⁹⁰ This policy, however, does not apply to taxpayers with certain illegal source income.⁹¹ Nevertheless, in most cases for taxpayers with willful conduct, the OVDP offers the best chance to start fresh from any criminal liability.

The IRS imposes strict procedural requirements when applying to enter the OVDP. First, a taxpayer must meet the preclearance process.⁹² Second, if the taxpayer is precleared to enter the OVDP, then he or she will need to amend and submit all the non-compliant tax returns during the eight-year lookback period, in addition to a voluntary disclosure letter to the IRS filed within 45 days.⁹³ Third, if the taxpayer is preliminarily accepted into the OVDP, the taxpayer will then need to submit all voluntarily disclosure documents to the IRS within 90 days.⁹⁴ It is important to note that the OVDP is unavailable to a taxpayer when the IRS previously started either a civil or criminal investigation related to the deficient taxpayer filing.⁹⁵

When weighing the benefits of entering the OVDP, taxpayers should note that the penalty imposed while in the

OVDP is 27.5 percent compared to the increased penalty regime for taxpayers outside the OVDP.⁹⁶ In addition, taxpayers are able to eliminate the chance of criminal prosecution if any willful conduct occurred from the deficient filings. The downside, however, is that the taxpayer agrees to pay any tax liability, penalties and interest for a period of up to eight years of non-compliant tax returns. Judge advocates assisting taxpayers entering into the OVDP would need to conduct a complete calculation as to the total payment owed to the IRS under both the OVDP and non-OVDP options.⁹⁷

B. Options for Non-Willful Conduct

Civil liability may attach if it is determined that the tax compliance deficiency was the result of only non-willful conduct. Taxpayer negligence resulting in the reporting deficiency is generally the type of conduct that is considered non-willful.⁹⁸ This section outlines the options that judge advocates should consider if a servicemember's international tax compliance deficiency is the result of non-willful conduct.

1. Streamlined Foreign Offshore Procedures

For individuals whose non-willful conduct resulted in the deficient international tax filing, the Streamlined Foreign Offshore Procedures (SFOP) program provides certain penalty relief to taxpayers who failed to report certain foreign accounts. Specifically, eligible taxpayers who meet the non-residency requirement, who are not under examination, and who certify that their tax return deficiency was the product of non-willful conduct are eligible for certain penalty relief.⁹⁹

⁸⁸ *Id.*

⁸⁹ An analysis is needed in order to determine whether the penalties imposed outside of the OVDP over a period of three to six years would be less than the penalties imposed under the OVDP over a period of eight years. Under the OVDP, the penalty should be less compared to taxpayers who are subject to penalties outside the OVDP. The calculation under both scenarios is needed to accurately weigh all the benefits of OVDP.

⁹⁰ IRM, *supra* note 73 at § 9.5.11.9(2) ("A voluntary disclosure will not automatically guarantee immunity from prosecution; however, a voluntary disclosure may result in prosecution not being recommended.")

⁹¹ *Id.*

⁹² The preclearance process requires that the IRS's Criminal Investigation Lead Development Center confirm that the taxpayer is eligible to enter into the OVDP. If, for example, the taxpayer is already under investigation for failure to meet certain filing requirements related to their foreign accounts, then the taxpayer would be ineligible to enter into the OVDP. See OVDP FAQ, *supra* note 86, at FAQ 23 (noting the disclosure requirements for entering the preclearance process).

⁹³ *Id.* at FAQ 24.

⁹⁴ Required documents include, but are not limited to, copies of original and amended tax returns during the eight-year period, a signed voluntary disclosure letter, a completed foreign account asset statement, a completed penalty computation worksheet, completed FBARS (if applicable), signed

extension of time to assess tax, and payment by the taxpayer for the outstanding tax, penalties, and interest. *Id.* at FAQ 25.

⁹⁵ *Id.* at FAQ 14.

⁹⁶ Again, penalties imposed by the IRS for taxpayers with willful conduct could be the greater of either \$100,000 or 50 percent of the highest value of the foreign account. 31 U.S.C. § 5321(a)(6)(A) (2012).

⁹⁷ The IRS offers special taxpayer assistance related to FBAR filings and penalty calculations. Judge advocates should consider these resources when trying to calculate taxpayer penalties for entering into the OVDP. The IRS office dedicated to the OVDP may be contacted toll free at 1-866-270-0733 or toll charge at 1-313-234-6146.

⁹⁸ For example, in the FBAR context, non-willful conduct occurs if the taxpayer's intent does not meet the definition of willful. In that case, non-willful conduct may be present if the taxpayer had no knowledge of any FBAR reporting requirement. See, e.g., IRM, *supra* note 73, § 4.26.16.6.5.1 ("Willfulness is shown by the person's knowledge of the reporting requirements and the person's conscious choice not to comply with the requirements.")

⁹⁹ See Internal Revenue Service, *U.S. Taxpayers Residing Outside the United States* (last updated Aug. 5, 2016) [hereinafter *Taxpayers Residing Outside the U.S.*], <https://www.irs.gov/Individuals/International-Taxpayers/U-S-Taxpayers-Residing-Outside-the-United-States> (noting eligibility for a taxpayer entering into the SFOP option).

For U.S. citizen servicemembers, the SFOP only applies to those who meet the non-residency test. This test analyzes whether a U.S. citizen, if in at least one of the most recent three tax years, did not maintain a U.S. abode and whether the U.S. citizen was outside the United States for at least 330 days of a tax year.¹⁰⁰ First, the U.S. citizen must not have an abode in the United States during one of the previous three tax years.¹⁰¹ An abode is broadly defined by the IRS to include a home, habitation, residence, domicile or place of dwelling.¹⁰² Second, the U.S. citizen must have resided outside the United States for at least 330 days during a tax year.¹⁰³

For taxpayers who meet the eligibility requirements for the SFOP, they must take the following steps to qualify. First, the taxpayer must file all delinquent tax returns up to the most recent three years with the statement at the top of the first page “Streamlined Foreign Offshore” in red text.¹⁰⁴ Second, the taxpayer must submit Form 14653 certifying that the deficient filing was the result of non-willful conduct.¹⁰⁵ Third, the taxpayer must pay all tax and interest due, if any, that relates to the deficient filing.¹⁰⁶ Fourth, if the deficient return relates to an FBAR filing, then the taxpayer must electronically file no more than six years of FBARs.¹⁰⁷

Eligible taxpayers who enter the SFOP are able to eliminate most penalties related to the tax deficiency. Specifically, taxpayers entering the SFOP are not subject to the following penalties: (i) failure-to-file and failure-to-pay penalties, (ii) accuracy-related penalties, (iii) information return penalties, or (iv) the FBAR penalty.¹⁰⁸ It is important to note that a taxpayer who submits an application to enter the SFOP is no longer eligible to enter the OVDP, so careful analysis must be made before submitting an application to this program.¹⁰⁹

2. Streamlined Domestic Offshore Procedures

¹⁰⁰ *Id.*

¹⁰¹ *Id.*

¹⁰² Internal Revenue Service, Publication 54, *Tax Guide for U.S. Citizens and Resident Aliens Abroad*, 12 (Dec. 14, 2015).

¹⁰³ *Taxpayers Residing Outside the U.S.*, *supra* note 99.

¹⁰⁴ *Id.*

¹⁰⁵ *Id.*

¹⁰⁶ *Id.*

¹⁰⁷ *Id.*

¹⁰⁸ *Id.*

¹⁰⁹ See Internal Revenue Service, *Streamlined Filing Compliance Procedures*, (last updated July 18, 2016), <https://www.irs.gov/Individuals/International-Taxpayers/Streamlined-Filing-Compliance-Procedures> (noting the limitations when entering into the Streamlined Compliance Procedures compared to the OVDP).

¹¹⁰ *Taxpayers Residing in the United States*, *supra* note 99.

For servicemembers who are ineligible for the SFOP, penalty relief may still occur through the Streamlined Domestic Offshore Procedures (SDOP) program offered by the IRS. For servicemembers who fail to meet the non-residency requirements under the SFOP, the SDOP applies to U.S. citizens who previously filed tax returns for the past three years, who failed to report a foreign financial asset, and whose tax return deficiency results in non-willful conduct.¹¹⁰ If eligible, the SDOP offers a taxpayer the ability to limit his or her imposed penalties to only 5 percent of the highest aggregate value of the foreign financial asset during the years of the covered tax return period.¹¹¹ The SDOP offers similar procedural requirements for taxpayers who are eligible for this option, in addition to submitting payment for the 5 percent penalty.¹¹² While not as favorable as the SFOP, the SDOP provides for penalty mitigation and thus should be considered as a potential option for taxpayers who face considerable penalties related to deficient tax returns.

3. Delinquent FBAR Submission Procedure

The third option, while applying only to delinquent FBAR returns, offers favorable penalty relief for taxpayers with deficient FBAR filings. Specifically, a taxpayer who only failed to file an annual FBAR but correctly filed all tax returns reporting all foreign income in a given taxable year is eligible for the Delinquent FBAR Submission Procedure.¹¹³ This option allows a taxpayer simply to file delinquent FBARs during the six-year statute of limitations period without paying any penalties imposed by the IRS.¹¹⁴ Eligible taxpayers include only those who (i) correctly filed all tax returns, (ii) do not owe any additional tax liability, (iii) are not currently under civil or criminal investigation by the IRS, and (iv) were not already notified by the IRS about the delinquent FBAR.¹¹⁵ The important reason to consider the Delinquent FBAR Procedure option is that the IRS will not impose any penalties for filing delinquent FBARs.¹¹⁶ Based on the

¹¹¹ *Id.*

¹¹² See *id.* (requiring the following procedural steps to be made: (i) submit delinquent tax returns for the most recent three years including the statement “Streamlined Domestic Offshore” written in red text at the top of the first page of the return, (ii) complete and sign Form 14653 certifying that the delinquent return was the product of non-willful conduct by the taxpayer, (iii) submit and pay all tax and interest, if any, due on the delinquent tax returns, (iv) submit payment related to the 5% penalty, and (v) if the deficient return relates to a FBAR filing, then the taxpayer must electronically file no more than six years of FBAR filings).

¹¹³ See Internal Revenue Service, *Delinquent FBAR Submission Procedures* (last updated Apr. 8, 2016), <https://www.irs.gov/Individuals/International-Taxpayers/Delinquent-FBAR-Submission-Procedures> (outlining the requirements for eligible taxpayers meeting the Delinquent FBAR Submission Procedure option).

¹¹⁴ *Id.*

¹¹⁵ *Id.*

¹¹⁶ *Id.*

eligibility requirements, however, this option likely applies to a very limited group of taxpayers, so judge advocates must confirm that a taxpayer qualifies before recommending this option.¹¹⁷

4. *Delinquent International Information Return Submission*

The fourth option applies to taxpayers who have reasonable cause for failing to file a non-FBAR international return.¹¹⁸ The Delinquent International Information Return Submission option applies only to a taxpayer who (i) has not filed one or more required international information returns, (ii) has reasonable cause for his or her failure to timely file the international information returns, (iii) is not under a civil or criminal examination by the IRS, and (iv) has not already been contacted by the IRS about the delinquent informational return.¹¹⁹ The taxpayer must include a statement establishing that he or she has reasonable cause for failure to timely file the international informational return.¹²⁰ If the IRS disagrees that the taxpayer has reasonable cause for failing to file the international information return, then penalties for the late filing would apply.¹²¹ Therefore, the decision to submit late returns under the Delinquent International Information Return Submission option is somewhat of a gamble in the event the IRS disagrees with whether the taxpayer has reasonable cause.

5. *Offshore Voluntary Disclosure Program*

The fifth and final option discussed for non-willful conduct resulting in international tax compliance deficiencies is the OVPD. While the rules of this program were already discussed for purposes of willful conduct, taxpayers may still apply for the OVPD even though their conduct resulted in non-willful conduct.¹²² All of the same eligibility rules

previously outlined will apply in the event a taxpayer considers this option.¹²³ The important feature about considering the OVPD is that any potential criminal liability is extinguished in the event a judge advocate is unsure whether the taxpayer's conduct is the result of willful or non-willful conduct. The civil penalties, however, are not completely eliminated, but are mitigated, if the taxpayer considers entering the OVPD.¹²⁴ Therefore, judge advocates should confirm with a strong level of certainty that a servicemember has no criminal liability before considering the OVPD as a potential option.

IV. Conclusion

A number of international reporting rules may apply to OCONUS servicemembers with a financial interest in certain foreign accounts. The Dr. Canale example shows what could go wrong if the U.S. international tax rules are ignored and later discovered by the IRS. In order to avoid such draconian penalties, judge advocates should first inquire as to whether any of the reporting rules apply to a servicemember. If it is determined that the reporting rules apply, a judge advocate should analyze the outstanding civil and criminal liability. A judge advocate should then review all of the programs offered by the IRS in order to assist with penalty mitigation or elimination. Legal assistance related to international tax compliance issues may save a servicemember from significant monetary penalties, in addition to possible criminal liability.

¹¹⁷ Note that the taxpayer must have properly reported all the income from any foreign financial account on Form 1040. If the taxpayer failed to report the foreign financial account on Form 1040, Sch. B, Part III, Line 7a, then the taxpayer may not be eligible for the Delinquent FBAR Submission Option. Judge advocates should confirm that the taxpayer correctly reported all the income from any foreign accounts before recommending the Delinquent FBAR Submission Option.

¹¹⁸ International informational returns include, but are not limited to, Forms 8938, 8621, 5471, 5472, 3520, 3520-A, 926, 8858, and 8865.

¹¹⁹ See Internal Revenue Service, *Delinquent International Information Return Submission Procedures* (last updated Aug. 23, 2016), <https://www.irs.gov/Individuals/International-Taxpayers/Delinquent-International-Information-Return-Submission-Procedures> (noting the requirements for entering into the Delinquent International Information Return Submission Procedure).

¹²⁰ Reasonable cause is present if the IRS determines that the taxpayer exercised ordinary care and prudence in determining his or her tax obligations but was nevertheless unable to timely file the international informational return. See, e.g., Treas. Reg. § 1.6038-2(k)(3)(ii) (as amended in 2013) (noting the reporting requirements for making an affirmative showing that reasonable cause existed); Treas. Reg. § 1.6038-3(k)(4) (as amended in 2003) (discussing reasonable cause limitations for taxpayer who fail to file Form 8865); Treas. Reg. § 1.6038A-4(b) (as

amended in 2014) (stating “[i]f an affirmative showing is made that the taxpayer acted in good faith and there is reasonable cause for a failure that results in the assessment of the monetary penalty, the period during which reasonable cause exists shall be treated as beginning on the day reasonable cause is established and ending not earlier than the last day on which reasonable cause existed for any such failure”); Treas. Reg. § 301.6679-1(a)(3) (as amended in 1985) (noting the reasonable cause requirement when taxpayer fail to file certain returns related to foreign corporations or foreign partnerships).

¹²¹ In this event, all the penalties under IRC §§ 6038 and 6038A would apply if the taxpayer is ineligible for the Delinquent International Information Return Submission option.

¹²² See OVDP FAQ, *supra* note 86 at FAQ 4 (stating the reasons to consider the OVDP compared to the either the SFOP or SDOP).

¹²³ See *supra* text accompanying notes 80–92.

¹²⁴ Compared to the SFOP or Delinquent International Information Return Submission program, which provides for the waiver of *all* civil penalties, the OVDP only mitigates civil penalties that are applied against the taxpayer. Therefore, judge advocates should weight the potential criminal liability, if any, against possible civil penalties imposed on the servicemember.