Is My Case Criminal? Civil Fraud vs. Tax Evasion

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In this article, Walker examines the concept of willfulness in the context of international tax enforcement, focusing on the factors that can transform a civil tax case into a criminal tax matter.

A. Introduction

When does a taxpayer's negligence, inadvertence, mistake, or good-faith misunderstanding of the law rise to the level of a civil fraud penalty or criminal offense, such as tax evasion? Stated differently, when does the government view failing to report income, claiming false deductions, or filing an incorrect tax return trigger a criminal investigation and possibly a referral to the Department of Justice for prosecution?

There is sometimes a fine line between a civil and criminal tax case. Although the government must establish that the taxpayer's conduct was willful in either case, it is not always easy to predict whether the IRS will refer a case for criminal prosecution. There are, however, some telltale signs to look out for and important strategic moves a taxpayer can take to steer clear from a problem with the government.

This article draws from the following example: Max, a U.S. citizen, works for a small technology company in San Francisco. Originally from Hong Kong, he frequently travels overseas to China, Hong Kong, and Taiwan for work. Through family connections in Asia, Max purchased an apartment in Hong Kong as an investment property with the proceeds from exercising his stock options. He rents the unit to a business acquaintance who works full time in Hong Kong. Max deposits the rental income in a Hong Kong bank account, which he opened using his U.S. passport. Max also invested in a small start-up company in Shanghai with some of his tech friends. From that overseas venture Max receives a salary and yearly bonus, which he has been depositing directly into an account in Shanghai. The account is held in the name of a foreign trust, for which Max designated his children as beneficiaries. On a recent flight home, Max read an article discussing the Foreign Account Tax Compliance Act, a relatively new law that requires a foreign financial institution to report to the IRS information about financial accounts held by U.S. taxpayers. Max also learned that U.S. citizens and even lawful permanent residents (green card holders) are required to report their foreign financial accounts to Treasury's Financial Crimes Enforcement Network and the IRS. This led Max to question whether he should report the existence of his foreign accounts. He wonders how the IRS would view his case, whether he is at risk for detection if the bank reports his accounts, and how the case could be improved.

The IRS has broad authority to impose a wide range of civil penalties and even recommend criminal prosecution to the Justice Department Tax Division to enforce the tax code. The IRS can impose a civil accuracy-related penalty for negligence when a taxpayer has failed "to make a reasonable attempt to comply with the provisions of the internal revenue laws or to exercise ordinary and reasonable care in the preparation of a tax return."[1] Negligence also includes "any failure by the taxpayer to keep adequate books and records or to substantiate items properly."[2] The regulations state that negligence is "strongly indicated" when:

- a taxpayer fails to include on an income tax return an amount of income shown on an information return; or
- a taxpayer fails to make a reasonable attempt to determine the correctness of a claimed deduction, credit, or exclusion that would seem too good to be true to a reasonable and prudent person under the circumstances.[3]

Resolving a case with only a negligence penalty can be a good result for many taxpayers who, like Max, have exposure and risk. The penalty is 20 percent of the portion of the tax underpayment attributable to negligence.[4]

However, if large amounts of unreported income, multiple years of adjustments, false statements to an IRS agent, concealment of assets, or inadequate

[1]Reg. section 1.6662-3(b)(1).
[2]*Id.*
[3]Reg. section 1.6662-3(b)(1)(i) and (ii).
[4]Section 6662(a).

records are involved, a negligence case can morph into something far more serious, such as a fraud case. Fraud is defined as the ''intentional wrongdoing on the part of the taxpayer with the specific intent to avoid a tax known to be owing.''[5] If the IRS has clear and convincing evidence to establish that any underpayment of tax is attributable to fraud, it can seek to impose the civil fraud penalty, which is 75 percent of the portion of the underpayment attributable to fraud.[6] For example, if Max owes additional tax of $100,000 for one year, the civil fraud penalty would be $75,000.

Depending on the facts and circumstances, the IRS can refer a case to the Tax Division to prosecute a tax offense such as tax evasion under section 7201, which is a felony. This is a harder case for the government to prove because willfulness must be shown. Nevertheless, the IRS has a criminal law enforcement arm, the Criminal Investigation division, whose mission is to investigate potential criminal violations of the tax code to foster confidence in the tax system and compliance with the law.[7]

Many taxpayers understandably want to know whether their cases will be investigated by CI. The answer is never clear cut. However, the Internal Revenue Manual provides some insight into the selection process, stating that the following should be considered in determining whether an investigation meets the definition of CI's mission:

- high profile;
- egregious allegations;
- deterrent effect; and
- conformity with CI's annual business plan.[8]

The IRM makes a point of distinguishing tax avoidance from tax evasion, noting that the distinction is ''fine, yet definite'':

> Avoidance of taxes is not a criminal offense. Any attempt to reduce, avoid, minimize, or alleviate taxes by legitimate means is permissible. The distinction between avoidance and evasion is fine, yet definite. One who avoids tax does not conceal or misrepresent. He/she shapes events to reduce or eliminate tax liability and, upon the happening of the events, makes a complete disclosure. Evasion, on the other hand, involves deceit, subterfuge, camouflage, concealment, some attempt to color or obscure events or to make things seem other than they are. For example, the creation of a bona fide partnership to reduce the tax liability of a business by dividing the income among several individual partners is tax avoidance. However, the facts of a particular investigation may show that an alleged partnership was not, in fact, established and that one or more of the alleged partners secretly returned his/her share of the profits to the real owner of the business, who, in turn, did not report this income. This would be an instance of attempted evasion.[9]

In short, there is a difference between evasion and legitimate tax planning to avoid taxes. Max's case might reach the level of tax evasion if he kept a double set of books for unreported offshore income in Asia, if he concealed assets in Hong Kong, if he used a foreign trust to hide his foreign sources of income, or if he engaged in some other affirmative conduct to conceal his tax liability. In those instances, Max might be considered to have willfully attempted to evade or defeat the assessment of a tax under section 7201.[10]

Another key distinction between civil and criminal tax fraud is the burden of proof.[11] In a criminal case, the government must present sufficient evidence to prove guilt beyond a reasonable doubt. In a civil fraud case, by contrast, the government must prove fraud by clear and convincing evidence.[12] Consequently, the state of the evidence (for example, how well the IRS agent has put the case together) has a profound influence on whether the government pursues a taxpayer civilly or criminally. Knowing what evidence the government has (and does not have), as well as understanding the significance of the evidence and how the government views it, can provide insight into which path the IRS may choose for a case.

B. Development of a Civil Fraud Case

Often a case will start out as a civil examination in which an IRS revenue agent is assigned to examine a particular tax year. An IRS agent may send Max a letter stating that his tax return has been selected for examination. Throughout the course of the audit, an IRS revenue agent will issue information document requests. The agent is trained to look out for indicators of fraud and has the authority to develop a civil fraud case when appropriate. The

[5]*Akland v. Commissioner*, 767 F.2d 618, 621 (9th Cir. 1985).
[6]Section 6663(a).
[7]IRM section 9.1.1.2.
[8]IRM section 9.1.1.4.
[9]IRM section 9.1.3.3.2.1.
[10]*See Spies v. United States*, 317 U.S. 492, 499 (1943) (providing illustrations of ''a willful attempt to defeat and evade'' a tax).
[11]IRM section 25.1.1.2.2.
[12]Section 7454(a); *Stone v. Commissioner*, 56 T.C. 213, 220 (1971) (''The respondent has the burden of proving, by clear and convincing evidence, that some part of the understatement of income in each year for which a deficiency has been determined was due to fraud.'').

agent will often ask seemingly harmless questions at the outset of the audit and take detailed notes about, for example, the whereabouts of a taxpayer's bank accounts, whether there are related entities such as corporations or partnerships, and the taxpayer's banking practices. False answers are documented. Some telltale signs of fraud may be undisclosed bank accounts and large amounts of unreported income that the agent later discovers (and that the taxpayer did not reveal) during a detailed bank deposit analysis.

If the revenue agent recognizes indictors of fraud, he will discuss the case with his manager. And if the manager concurs, an IRS fraud technical adviser will be assigned to the case and provide guidance to the agent on how to factually develop it.[13] The IRS's Fraud Handbook instructs revenue agents in handling a civil fraud case:

> Civil fraud penalties will be asserted when there is clear and convincing evidence to prove that some part of the underpayment of tax was due to fraud. Such evidence must show the taxpayer's intent to evade the assessment of tax, which the taxpayer believed to be owing.[14]

The IRM explains that fraudulent intent "is distinguished from inadvertence, reliance on incorrect technical advice, sincerely-held difference of opinion, negligence, or carelessness."[15] Consequently, a defense based on negligence or carelessness should be developed during an audit to rebut a proposed determination of civil fraud.

Because the revenue agent cannot get into the taxpayer's head to determine whether there was fraudulent intent, he will look at tangible things or circumstantial evidence.[16] The IRM states that "courts focus on key badges of fraud in determining whether there was an 'intent to evade tax'" and that "a determination of fraud is based upon the taxpayer's entire course of conduct."[17] According to the IRS, the common badges of fraud include:

- understatement of income (such as omissions of specific items or entire sources of income, or failure to report substantial amounts of income received);
- fictitious or improper deductions (such as an overstatement of deductions, or the deduction of personal items as business expenses);
- accounting irregularities (such as two sets of books and false entries on documents);
- obstructive actions by the taxpayer (such as false statements, destruction of records, transfer of assets, failure to cooperate with the examiner, and concealment of assets);
- a consistent pattern over several years of underreporting taxable income;
- implausible or inconsistent explanations of behavior;
- engaging in illegal activities (such as drug dealing) or attempting to conceal illegal activities;
- inadequate records;
- dealing in cash;
- failure to file returns; and
- "education and experience."[18]

If Max was unlucky enough to be contacted by the IRS for a routine audit, one of the first questions the agent might ask Max is whether he has any foreign accounts. A false answer is never a good idea, and a truthful answer can cause additional problems. Either way, Max does not win. The big picture is that it is difficult for the government to prove a fraud case. If Max's options are to fabricate a story or not talk, his better option may be silence or to invoke the Fifth Amendment privilege against self-incrimination. Otherwise, Max might make it easy for the government to prove its case through his own false statements. A takeaway is that it is far better for Max to be proactive and handle his foreign account issues than face the uncertainty of an audit and have his ticket punched.

C. Criminal Charges — Tax Evasion

If the revenue agent establishes what the IRM refers to as "affirmative acts (firm indications) of fraud/willfulness," the agent is to suspend the audit and immediately notify his manager and the fraud technical adviser. The case will be referred to CI if specific criminal criteria are met.[19] At that point, the agent will suspend the audit without disclosing the reason for the suspension.[20] CI will evaluate the referral, and decide whether to accept or decline it.[21] Although the IRM lacks details about the criminal criteria CI looks for in deciding whether to accept a referral, it indicates that the factors CI considers include "the additional tax due to fraud, flagrancy, significance, public interest, and the deterrent effect."[22] Often what can make or break a case from going criminal is whether the amount of the tax loss is sufficient to meet the

[13]IRM section 25.1.1.1.
[14]IRM section 25.1.6.1.
[15]*Id.*
[16]IRM section 25.1.6.3.
[17]*Id.*
[18]*Id.*; *Bradford v. Commissioner*, 796 F.2d 303, 307 (9th Cir. 1986) (listing six badges of fraud).
[19]IRM sections 25.1.2.2 and 25.1.3.1.
[20]IRM section 25.1.3.2.
[21]IRM section 25.1.3.3.
[22]*Id.*

Justice Department's guidelines — information that is not publicly available. Other key factors are whether the case involves a pattern of unreported income (multiple years of non-compliance) and who is the taxpayer (age, health, level of sophistication, and education).

If the case is accepted by CI, an IRS special agent takes over. She will examine records and interview witnesses through the use of summonses, and at the end of her investigation, she may refer the case to the Justice Department with a recommendation to institute a criminal prosecution.[23] A criminal investigation is a slow-moving process, and a typical administrative investigation can last 18-23 months.

There are a variety of criminal tax offenses, but one of the most commonly charged is tax evasion.[24] (This was the crime with which Al Capone was charged in the 1930s.) Having a basic understanding of this offense and the elements that the government must prove in a tax evasion prosecution can help distinguish a civil fraud penalty case from a criminal case. For a defendant to be found guilty, the government must establish each of the following elements beyond a reasonable doubt:

- that the defendant owed more federal income tax for the calendar year than was declared due on his income tax return for that year;
- that the defendant knew that more federal income tax was owed than was declared due on his income tax return;
- that the defendant made an affirmative attempt to evade or defeat that additional tax; and
- that in attempting to evade or defeat the additional tax, the defendant acted willfully.[25]

A common method used to evade or defeat the assessment of tax is the filing of a false tax return that omits income or claims false deductions.[26] In Max's case, the government could assert that his returns are false depending on the extent to which he filed returns and omitted his foreign-source income (rental income from the apartment in Hong Kong or his salary from the business venture in Shanghai). Another problem could arise if, to offset his income and claim a refund, Max took false travel deductions for his work overseas. An IRS special agent may interview Max, and if Max represents that he did not receive any income from accounts in Hong Kong (a false statement), the government could use that evidence to support a finding of willful evasion.[27] Further supporting the government's case, the special agent could testify at trial that Max filed false tax returns.[28]

D. The Concept of Willfulness

Critical to the government's case in both a charge of tax evasion under section 7201 and a civil fraud penalty under section 6663 is the ability to show that the taxpayer's conduct was willful. This is in sharp contrast to conduct attributable to negligence, inadvertence, mistake, or conduct that results from a good-faith misunderstanding of the requirements of the law. Specific intent to violate the law is an element of some federal criminal tax offenses such as tax evasion.

The Supreme Court has defined willfulness as a "voluntary, intentional violation of a known legal duty."[29] This means the government must establish that a taxpayer was aware of his obligations under the tax laws. Stated differently, there must be proof that the taxpayer knew he was violating a "known legal duty." Hence, knowledge (that is, what an individual knew and when) and intent play a central role in determining whether he acted willfully.[30]

On the flip side, it is helpful to know what constitutes non-willful conduct. In the published information explaining eligibility for the IRS streamlined domestic offshore procedures — a program offered by the IRS for handling undisclosed foreign accounts and assets — the IRS has provided an informative definition of what constitutes non-willful conduct:

> 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.[31]

A common misconception about willfulness (and a myth worth debunking) is that the government does not need to show that a taxpayer had an evil motive or a bad intent to violate the law. In other words, it is not a defense to willfulness to argue that Max did not act willfully because he did not have a

[23]Department of Justice, Criminal Tax Manual, section 1.03[1].

[24]Section 7201.

[25]Ninth Circuit, *Manual of Model Jury Instructions*, section 9.37 (1985/1986 ed.).

[26]DOJ, *supra* note 23, at section 8.03.

[27]*See, e.g.*, *United States v. Frederickson*, 846 F.2d 517, 520-521 (8th Cir. 1988) (false statements during IRS investigation were actions sufficient to support the jury's finding of willful evasion).

[28]*United States v. Defoor*, No. 14-10479 (9th Cir. 2015) (district court did not commit plain error by allowing IRS agents to testify that the defendant filed "false" tax returns).

[29]*Cheek v. United States*, 498 U.S. 192 (1991); *United States v. Pomponio*, 429 U.S. 10, 12 (1976); and *United States v. Bishop*, 412 U.S. 346, 360 (1973).

[30]Department of Justice, *supra* note 23, at section 8.08[1].

[31]Form 14654, "Certification by U.S. Person Residing in the United States for Streamlined Domestic Offshore Procedures."

bad purpose to either disobey or disregard the law. Good motive alone is never a defense.[32]

The Justice Department's Criminal Tax Manual lists several factors that the government considers when determining whether a taxpayer's actions are willful:

- evidence of a consistent pattern of underreporting large amounts of income;
- providing the accountant or return preparer inaccurate and incomplete information;
- making false statements to agents — false exculpatory statements, whether made by a defendant or instigated by him;
- keeping a double set of books;
- hiding, destroying, throwing away, or "losing" books and records;
- making or using false documents, false entries in books and records, false invoices, and the like;
- use of nominees;
- use of bank accounts held under fictitious names; and
- how the defendant's general educational background and experience bear on his ability to form willful intent.[33]

The presence or absence of these factors can help gauge the extent to which the government can successfully prove willfulness and build a criminal case for tax evasion.

E. Blind Willfulness

Another way the government can establish willfulness is through the concepts of conscious avoidance or blind willfulness. In the relatively recent civil cases of *McBride*[34] and *Williams*,[35] for example, the government proved willful failure to file foreign bank account reports by showing that the defendants' conduct was reckless and that they acted with blind willfulness. A few general observations can be made from *McBride* and *Williams*:

- the government can establish that an individual was willful in failing to comply with the FBAR requirements by showing reckless conduct or blind willfulness;
- a responsible person is reckless if he knew or should have known of a risk that the taxes were not being paid, had a reasonable opportunity to discover and remedy the problem, yet failed to undertake reasonable efforts to ensure payment; and
- willful blindness may be inferred when an individual was subjectively aware of a high probability of the existence of a tax liability and purposefully avoided learning the facts that point to that liability.

The Justice Department's Criminal Tax Manual states:

> Most courts have ruled that if there is evidence that the defendant deliberately avoided acquiring knowledge of a fact or the law, the jury may infer that the defendant actually knew of the fact or the law and was merely trying to avoid giving the appearance (and incurring the consequences) of knowledge.[36]

The IRM's explanation of blind willfulness in the context of the FBAR willfulness penalty is helpful in understanding the concept:

> Under the concept of "willful blindness," willfulness may be attributed to a person who has made a conscious effort to avoid learning about the FBAR reporting and recordkeeping requirements. An example that might involve willful blindness would be a person who admits knowledge of and fails to answer a question concerning signature authority at foreign banks on Schedule B of his income tax return. . . . 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 follow-up on this knowledge and learn of the further reporting requirement as suggested on Schedule B may provide some evidence of willful blindness on the part of the person.[37]

Notably, the IRM states that the mere fact that a person checked the wrong box, or no box, on Schedule B is alone insufficient to establish that the FBAR violation was attributable to willful blindness.[38]

In short, an individual such as Max should not simply take the position, "I did not know," or take the ostrich-with-its-head-in-the-sand approach when answering why he failed to report and pay tax on his foreign-source income or why he failed to report foreign accounts or assets. What is needed is a thoughtful analysis and approach that considers and anticipates an allegation of intentional ignorance. This is particularly true if the government

[32]*Pomponio*, 429 U.S. at 12 ("willfulness in this context simply means a voluntary, intentional violation of a known legal duty"); DOJ, *supra* note 23, at section 8.08[1].
[33]DOJ, *supra* note 23, at section 8.08[3].
[34]*United States v. McBride*, 908 F. Supp.2d 1186 (D. Utah 2012).
[35]*United States v. Williams*, No. 10-2230 (4th Cir. 2012).
[36]DOJ, *supra* note 23, at section 8.08[4].
[37]IRM section 4.26.16.4.5.3.
[38]*Id.*

maintains that the taxpayer, like Max, is well-educated and sophisticated and took otherwise legal actions (such as setting up a foreign trust and naming his children as beneficiaries) as a means to evade the payment of his own taxes.

F. Good-Faith Can Negate Willfulness

The traditional rule is that ignorance of the law is no excuse, but this is not necessarily true for criminal tax offenses, given the complexity of the tax laws.[39] Ignorance and misunderstanding of the law is a valid defense to willfulness and should be considered, when appropriate, when defending taxpayers with unreported income or unfiled returns. A good-faith belief can negate the government's evidence purporting to show a taxpayer's awareness of the legal duty at issue and consequently willfulness. As explained by the Eighth Circuit in *Grunewald*:

> A defendant may claim as a defense that, because of a misunderstanding of the law, he had a good faith belief that he was not violating any of the provisions of the tax laws. The government cannot prove that a defendant was aware of the legal duty at issue if the jury credits the defendant's claimed good faith misunderstanding and belief, whether or not the belief is objectively reasonable.[40]

Thus, ignorance of the law can provide a defense to a federal tax offense.[41]

Suppose that Max had only recently immigrated to the United States from Asia to work at a technology company in San Francisco, and he truly was unaware of his legal duty to report and pay tax on his foreign-source income. His good-faith belief that he was not violating the law could support a finding of non-willfulness and avoid the imposition of more serious penalties.

Further, whether a taxpayer has a good-faith misunderstanding and belief of the law is based on the taxpayer's knowledge and not that of a reasonable person. It is a subjective test. The Justice Department's Criminal Tax Manual states:

> When determining whether a defendant has acted willfully, the jury must apply a subjective standard; thus a defendant asserting a good faith defense is not required to have been objectively reasonable in his misunderstanding of his legal duties or belief that he was in compliance with the law.[42]

Therefore, with Max, it may be important to point out the subjective nature of the willfulness test if the IRS alleges that he knew about his legal duties under the laws. The test is: What did Max know?

G. Reliance on Professional Adviser Defense

Another defense to willfulness is taxpayer reliance on a professional adviser, such as a return preparer or accountant. The following are the essential elements of the reliance defense:

- full disclosure of all pertinent facts; and
- good-faith reliance on the professional's advice.[43]

As explained by the Seventh Circuit in *Whyte*:

> It is a valid defense to a charge of filing a false return if a defendant provides full information regarding his taxable income and expenses to an accountant qualified to prepare federal tax returns, and that the defendant adopts and files the return as prepared without having reason to believe that it is incorrect.[44]

This defense can be problematic because often, taxpayers with tax compliance issues have failed to disclose the existence of the foreign assets to the accountant (or prepared their own tax returns using a program such as TurboTax).[45] Practically speaking, a tax professional may be reluctant to fall on her sword. Nevertheless, a taxpayer may have a valid reliance defense if he disclosed the existence of the foreign assets to the return preparer and the preparer told him not to worry about it. The IRS, however, may respond in the following ways:

- interview the return preparer to determine what, if anything, the taxpayer told the preparer about the unreported income; or
- ask for a copy of any tax organizer to see whether the taxpayer disclosed the foreign accounts or assets to the return preparer.

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[39]*Cheek*, 498 U.S. at 200 (Congress has accordingly softened the impact of the common law presumption by making specific intent to violate the law an element of some federal criminal tax offenses).

[40]*United States v. Grunewald*, 987 F.2d 531, 535-536 (8th Cir. 1993).

[41]*Cheek*, 498 U.S. at 199-200 ("due to the complexity of the tax laws," certain federal criminal tax offenses require, as an element of the offense, the establishment of a defendant's willfulness).

[42]DOJ, *supra* note 23, at section 8.08[1]; *Grunewald*, 987 F.2d at 535-536 ("The government cannot prove that a defendant was aware of the legal duty at issue if the jury credits the defendant's claimed good faith misunderstanding and belief, whether or not the belief is objectively reasonable.").

[43]*United States v. Whyte*, 699 F.2d 375, 379, 380 (7th Cir. 1983).

[44]*Id.* at 379.

[45]If Max used TurboTax to prepare his own tax returns, the software program may have prompted him with questions regarding whether he had foreign accounts or offshore entities. Max should anticipate this argument by the government and be ready with a well-thought-out response.

If the taxpayer contends that he relied on a professional adviser, the taxpayer should expect the government to contact that adviser to substantiate a reliance defense. Often, one of the first persons an IRS special agent interviews is the return preparer, and the agent will try to lock down his statement. Indeed, in the IRS streamlined filing compliance procedures, the IRS requires disclosure of the accountant's contact information and a summary of the advice.[46]

Strategically, the taxpayer should not raise the reliance defense unless he can document it, preferably with a signed declaration under penalty of perjury, because the accountant can turn and become a government witness. Consider interviewing the accountant early in the case and prior to IRS contact. Try to obtain a few good statements that can help the case. A reliance defense can be strengthened where the accountant admits that the case is complicated and the taxpayer can establish that he lacks any real expertise in tax law, accounting, or business management. In *McBride*, for example, the government relied on an accountant's testimony to support a civil willful FBAR penalty. It obtained a declaration from the taxpayer's accountant, signed under penalty of perjury, detailing what information the accountant used to prepare the defendant's federal income tax return. The declaration stated that the defendant never informed the accountant that he had any foreign bank accounts. The court relied in part on the declaration in holding the defendant liable for a $100,000 civil penalty assessment ($25,000 per account) for willful failure to report interest in the foreign accounts as required by 31 U.S.C. section 5314.[47]

H. Voluntary Disclosure

One of the best ways a taxpayer can handle foreign asset issues is by making a voluntary disclosure. Because taxpayers' non-U.S. investments vary widely, the IRS offers the following options for addressing previous failures to comply with U.S. tax and information return obligations:

1. the offshore voluntary disclosure program;
2. streamlined filing compliance procedures; and
3. delinquent FBAR and international information return submission procedures.[48]

If a U.S. resident's failure to report foreign financial assets and to pay all tax due on those assets was not the result of willful conduct, that taxpayer is subject to only a 5 percent miscellaneous offshore penalty. At the other end of the spectrum, taxpayers whose conduct was willful are directed to the OVDP, under which they pay a much higher (27.5 percent) miscellaneous offshore penalty. Although these programs can be expensive, the alternative of potential criminal investigation is something to avoid.

I. Conclusion

There is often a fine line between a civil fraud penalty case and a criminal tax case, and it sometimes difficult to gauge which path a case will take. Understanding a few key concepts, such as the definition of willfulness and the factors the government considers in establishing willfulness, can provide critical insight into how the government will handle a case and what lies ahead for the taxpayer.

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[46]Form 14654.

[47]*McBride*, 908 F. Supp.2d 1186.

[48]Information about these programs can be found on the IRS website.