Practitioners Responsibilities in Offshore Reporting (FBAR) Cases

As the legal services provider for the CPAmerica organization of accounting firms, we get lots of questions from the CPA community. One of the hot topics this year is foreign reporting. With so many criminal prosecutions for unreported offshore accounts, tax lawyers and CPAs are taking notice. While taxpayers wonder about their responsibilities and obligations, practitioners have similar questions. Recently we were asked, however, by a practitioner as to how to handle a client who was suspected to be *withholding information* about an unreported foreign account.

The answer is in Circular 230. Unfortunately, Circular 230 has been with us for so long that most of us have not read its provisions in quite some time. For some busy practitioners, Circular 230 has become nothing more than a footer in tiny number 8 font at that bottom of emails…"Circular 230 Disclosure: Pursuant to U.S. Treasury Department Regulations, we are now required to…"

Clients aren't happy when they receive a notice from the IRS imposing penalties. This is especially true if the penalties are related to unfiled FBARs. It seems the IRS takes the default position that a client's failure to file FBARs and report a foreign account was "willful". As most tax lawyers reading this post already know, penalties for willful failure to file an FBAR are huge; up to the greater of $100,000 or 50% of the historic high balance of the account.

Luckily for taxpayers, the IRS says that some folks may claim a "reasonable cause" defense against these onerous penalties by blaming the preparer! Great for the taxpayer but not so good for the preparer who now has an unhappy clients and may have to fight preparer penalties as well.

The reasonable reliance claims fall into two camps. "My lawyer / accountant never properly explained my foreign reporting obligations" and / or "she never even asked me if I had foreign accounts." Both are

closely related.

To qualify for a penalty relief, the taxpayer must demonstrate that he or she reasonably relied on the accountant's advice. There is a difference, then, for clients who received bad advice versus no advice at all.

So what are our obligations as tax attorneys, CPAs and preparers? Look no further than Circular 230 for the answer.

According to the IRS, "Practitioners who prepare income tax returns have a duty under Circular 230 to inquire of their clients with sufficient detail to prepare correct responses to the foreign bank and financial account questions. The required level of due diligence required is addressed in Circular 230."

What does Circular 230 say? We will start with section 10.22.

§10.22 **Diligence as to accuracy**.

(a) A practitioner must exercise due diligence –

1. In preparing or assisting in the preparation of, approving, and filing tax returns, documents, affidavits, and other papers relating to Internal Revenue Service matters;

2. In determining the correctness of oral or written representations made by the practitioner to the Department of the Treasury; and

3. In determining the correctness of oral or written representations made by the practitioner to clients with reference to any matter administered by the Internal Revenue Service."

Later, section 10.34(d) says that a practitioner "generally may rely, in good faith and without verification, on information furnished by a client." There is a requirement to make "reasonable inquiries" if the information provided by the taxpayer appears questionable or incomplete.

There is a dearth of case law, however, interpreting these provisions. That leaves us with general IRS guidance, best practices and common sense. These all dictate that practitioners should make inquiries if there is reason to believe there are offshore transactions, income or accounts. As a general rule, we recommend asking everyone these questions and not simply relying on boilerplate disclosures in an engagement letter or a general question placed in an organizer or tax planning worksheet. This is especially true if you know the client is a dual national, green card holder, recent immigrant, has family in another country or foreign business interests.

We also recommend speaking in terms of accounts or transactions located “outside the United States.” Using the term “foreign account”, for example, to someone who is a green card holder is an invitation to confusion. To those folks, their “foreign” account may be the one in the United States!

Section 10.34(c) requires practitioners to warn clients of potential penalties that may apply including penalties that can be avoided by disclosure. With a current amnesty program, nonresident “amnesty” and other disclosure options, make sure you let clients know their options.

If the client has complex offshore reporting issues are you required to do the work? Not necessarily. If you don’t feel competent or it is beyond the services you typically provide, make sure you are clear in what services you are performing and that they understand their options. Simply preparing a 1040 or 1120 return without discussing FBARs is not an option.

Practitioners who make too many mistakes could also find themselves facing an IRS Director of Practice action. Although rare, these could effectively shut down a tax lawyer or accountant.

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Of course, this post is “in accordance with Circular 230 disclosures.”