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Fax No. 202-622-5756

The Honorable Douglas H. Shulman
Commissioner of Internal Revenue
1111 Constitution Ave., NW, 3000 IR
Washington, DC 20224

Re: Use of Offshore Bank Accounts to Evade Tax

Honorable Sir:

This letter addresses an aspect of the referenced subject that has not received as much attention from the Service as has the welcome pursuit of wealthy individuals who go offshore to avoid paying taxes. The prosecution of Steven Michael Rubinstein for deliberate tax evasion, which was reported in last Friday's and yesterday's editions of *Tax Notes Today*, and others like him is long overdue and strongly to be encouraged. In fact, it is hard to argue with anything you said in your testimony at the March 31st, 2009 hearing before the House Ways and Means Subcommittee on Select Revenue Measures.

The point of this letter is to introduce a note of caution regarding the universe of non-compliant FBAR filers, to offer suggestions for refining the FBAR reporting regime, and to enhance FBAR compliance. Before doing so, let me provide a brief introduction to our firm.

Flott & Co. PC specializes in the US taxation of international transportation income. Since 1989 I have traveled extensively to countries in Europe, Asia and the Middle East, primarily advising companies engaged in international transportation on US tax law and assisting them with their US tax compliance obligations.

During my travels I have met a number of US citizens who have resided outside the United States for many years and are surprised to learn that they are subject to US taxation and required to file US tax returns. This is especially true for dual nationals who reside in the country of their other citizenship. Many proudly obtained US citizenship and carry a US passport genuinely unaware that the United States taxes on the basis of citizenship, in addition to residence.

Let me describe one of these US citizens whom I will call John – not his real name. John's father was employed by a major hotel chain. He and his wife moved as his employment required. John was born in San Francisco when his father was stationed there. When John was three years old, the family moved to Canada, where his younger brother was born. The family then moved to Europe, living in several countries. After attending school in Europe, John began his own career in the hotel business in Europe, eventually becoming an executive at a major hotel in Greece. His younger

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brother was working for a shipping company in London where I met him. A colleague of John's brother was an American who had married a non-US national and resided in London. As it happened, this person had a US tax issue and asked me for assistance. During a casual conversation at the office one day, John's brother was surprised to learn that his colleague had to file US tax returns despite the fact that he had been a long time resident of London and did not have any US source income. I explained that US taxation extends to the worldwide income of citizens regardless of where they reside and for how long, and to non-citizens, who are residents (or deemed residents) of the US. Whereupon he said he was sure his brother John was unaware of this. As it turned out, he was right. John, who had not returned to the US even for a day since leaving when he was three, had obtained US citizenship and proudly had a US passport in addition to his Greek one.

John got himself "right" with the US government. Based on inquiries to various areas of the Service, we determined how many back years would bring his filings up-to-date. He remained compliant with his US tax filing obligation (and paid US taxes) until he died in 2007. I admired John for his determination to do the right thing as required by US law even though he had never lived in the United States and, other than as a tourist, did not plan to return to the US.

John was not FBAR compliant though. Clearly, we have to accept responsibility for this failure as we did not fully appreciate the details of the FBAR filing requirements. While it is certainly hard to overlook the reference in Part III of Schedule B to the Form 1040 to Form TD F 90-22.1, John was never required to file that schedule because he did not receive more than \$1,500 in interest or dividend income in any one year.

There is no reference in the general 1040 instructions to advise those not required to file Schedule B that they must file an FBAR. There is no reference to the FBAR form even in the current edition of Publication 54, *Tax Guide for U.S. Citizens and Resident Aliens Abroad*, which was posted to the www.irs.gov website almost two months after the revised FBAR form was. The instructions for Form 2555, Foreign Earned Income, do not refer to the form either. These are logical places for one to look for information on FBAR requirements. The absence of such references is not offered to excuse our failure to know the FBAR requirements. However, it does suggest that there are many "innocent" FBAR non-filers who need to be separated from the deliberate non-filers.

Another example of FBAR non-compliance involves someone I will call Sarah, again not her real name. Sarah is a US citizen. A long time resident of Europe, she is a financial executive with a private holding company. She has signing authority over several business accounts, all of which fall within the FBAR filing requirements even though she has no personal interest in any of them. After reading press reports about the UBS investigation and learning about the FBAR filing requirement, she became concerned that her failure to file an FBAR might adversely affect her employer. As a practical matter, since the funds in the accounts in question belong to her employer, not to her, I advised her that the consequences of her failure to file an FBAR on her employer are zero as the Service cannot collect a penalty on funds that do not belong to her.

John's and Sarah's are cautionary tales as the Service tackles the legitimate goal of reducing deliberate tax cheating, often aided and abetted by willful non-filing of the FBAR and other such reporting forms. The John's and Sarah's are likely to be alarmed by the statements in the "Getting Right with the Government" section of your testimony. We appreciate that you were not offering



comprehensive guidance on how the IRS will proceed in all delinquent FBAR filing cases, but the tone is worrying to these kinds of individuals who are contemplating compliance.

The Service intends to increase compliance with the FBAR filing requirement. However, that worthy objective needs to take into account the John's and Sarah's, not just the Rubinstein's. It also needs to reflect the reality that there are many US citizens with dual citizenship who have lived and worked outside the US for most, if not all, of their lives. An increasingly global economy with highly educated Americans moving around the world is going to result in even more dual national households, many of which may well be tied primarily to the countries where they are also citizens and where they live and work. Yet, many of these same people want to obtain and retain their US citizenship. The FBAR rules need to take these situations into account.

Along these same lines, the most recent FBAR guidance sweeps up many financial accounts that are wholly irrelevant to the objectives of FBAR filing. Sarah's situation is an excellent case in point. The accounts over which she has signature authority belong to companies that are not subject to US tax. How can her FBAR reporting be of any practical assistance to the objectives for which FBAR filings were originally created?

The revised FBAR guidance was not circulated to the practitioner community for comment before the updated FBAR form was posted to www.irs.gov on September 30, 2008. If it had been, we would have suggested for discussion a subdivision of "US persons" along the following lines to distinguish among categories of US citizens and the relevance and scope of their FBAR reporting obligations:

1. US citizens and permanent residents, including those who are deemed to be resident here, who live in the United States;
2. US citizens and permanent residents who are on temporary work assignments outside the United States;
3. US citizens who resided outside the United States continuously for more than ten years prior to 2006 and continue to reside outside the United States;
4. US citizens who were born in the United States, but moved outside the United States prior to their 18th birthday and have resided continuously outside the United States since that time;
5. US citizens who were born outside the United States and have never resided in the United States; and
6. US citizens who hold dual nationality and have resided in the country of their other citizenship continuously since prior to their 18th birthday.

Clearly, there is a strong difference in the purpose of the FBAR filing for those in Categories 1 & 2 compared to those in Categories 4 through 6. We understand the difficulty created by Category 3 in light of Section 877 of the Code regarding expatriation to avoid tax. The date selected in Category 3 coincides with enactment of changes to the section by the Health Insurance Portability and



Accountability Act of 1996. We believe the requirement to file an FBAR for accounts over which the person has signature authority but in which he or she has no financial interest should be dropped for all persons who fall within categories 3 through 6. It is unclear why persons in categories 4 through 6 should be required to file an FBAR at all as long as they reside outside the US.

These issues are not likely to be resolved between now and June 30, 2009 when the 2008 FBAR filings must be completed. However, the Service should review its FBAR program in light of the rapidly globalizing economy, the mobility and movement overseas of Americans, the growth of dual national families, and the desire of most US citizens to pass on their citizenship to their children regardless of where they may live.

A corollary issue that should be addressed as soon as possible is remedial compliance by persons, like John and Sarah, who want to bring themselves into compliance with the FBAR filing requirement (with a caveat about including bank and financial accounts in which they have no personal financial interest). Based on what has been and is being said publicly, they face the prospect of penalties for non-willful violations (per the American Jobs Creation Act of 2004) and the practical challenges of filing for “open” years if they do choose to come forward voluntarily.

FBAR's not filed for 2002, which should have been filed on or before June 30, 2003, become statute barred this year. Thus, someone filing an FBAR for the first time for 2008 should strictly speaking file an FBAR for each year from 2003 to 2008. Based on conversations with the Detroit Computing Center, these FBAR's should include accounts that were open in each “open” year even if they are now closed. Furthermore, we were advised that a separate statement of “reasonable cause” must be attached to each FBAR. To be frank, this “by the rule book” approach is more likely to discourage compliance than it is to enhance it, certainly among people in categories 4 through 6 above.

People in the first two categories should be pursued vigorously. If they live and work in the United States and have acted knowingly to hide assets from the government, they should be held to account. The guidelines set out in your testimony on March 31st, 2009 are reasonable.

However, the Service needs to address the people in Categories 3 through 6 differently both in terms of the scope of the FBAR filing and the method of bringing themselves current within a revised scope of FBAR filing.

One simple expedient would be to allow people in Categories 3 through 6 to catch up on all open years with one filing for 2008, reporting their personal accounts and all accounts in which they have a personal financial interest which were opened anytime after 2003 and were open during 2008. They would file one “reasonable cause” statement with the 2008 FBAR, identifying into which category they fall together with some evidence to substantiate that position.

We understand that the “facts and circumstances” of each case will affect how the Service reacts to the delinquent filings. However, little of what we have read of what has emanated from the Service during the past week has talked about a “safe harbor” for those who wish to voluntarily disclose.¹

¹Barry Shott used the term “safe harbor” in response to comments from a couple of practitioners, including me, in reaction to his statements about heightened FBAR filing enforcement and penalties during the “Ask the IRS” session at last December’s GWU-IRS Institute. He seemed to understand the concerns raised, but I have yet to see any concrete guidance or commentary from the Service in this regard.



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Page 5

Those US citizens who fall into Categories 1 & 2, who have numbered bank accounts at UBS and have failed to report them or pay tax on the income in the accounts, have clear guidance on what will happen if they come forward voluntarily or fail to do so. Those in the other categories have no such guidance but have to fear that a similar approach may be taken with them. The Service should give them some assurance that there is a "safe harbor" for them, too, when they come forward voluntarily.

Thank you for your consideration. If you have any questions, please contact me at your convenience.

Yours truly,

A handwritten signature in black ink, appearing to read "Stephen Flott".

Stephen Flott