FEATURED PERSPECTIVES

The 'Willfulness' Element in the IRS's Offshore Voluntary Disclosure Program

by John Anthony Castro

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What constitutes ''willful'' in determining the meaning of the term ''non-willful'' as used by the Internal Revenue Service in the offshore voluntary disclosure program?

The IRS recently published its own definition of non-willful conduct to mean ''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''[1] (emphasis added). This definition is identical to the standard applied under Internal Revenue Code section 7203.

The willfulness element under section 7203 requires proof that the taxpayer voluntarily and intentionally failed to file a return that the taxpayer *knew* he was required to file. This element is typically established by circumstantial evidence that the taxpayer previously filed the particular return; received tax documents or notifications from third parties that should have alerted the taxpayer of the duty to file returns, such as a letter from the IRS,[2] notice from the IRS,[3] or income tax documents;[4] or had an educational, vocational, or professional background that required some knowledge of tax obligations.[5]

The definition and meaning of willfulness are the same in both the civil and criminal context;[6] it is only the evidentiary standard and burden of proof requirements that differ.[7]

Willful Failure

Under section 7203, any person required to file an income tax return who willfully fails to do so is guilty of a misdemeanor.[8] The standard for willfulness is ''a voluntary intentional violation of a known legal

[1] *See* IRS, ''U.S. Taxpayers Residing Outside the United States, Streamlined Foreign Offshore Procedures'' (June 26, 2014), *available at* http://www.irs.gov/Individuals/International-Taxpayers/U-S-Taxpayers-Residing-Outside-the-United-States.

[2] *See U.S. v. Poschwatta*, 829 F.2d 1477 (9th Cir. 1987); *U.S. v. Green*, 757 F.2d 116 (7th Cir. 1985).

[3] *See U.S. v. Sempos*, 772 F.2d 1 (1st Cir. 1985).

[4] *See U.S. v. Bergman*, 813 F.2d 1027 (9th Cir. 1987).

[5] *See U.S. v. MacKenzie*, 777 F.2d 811, 818 (2d Cir. 1985).

[6] *See* CCA 200603026.

[7] *See Bradford v. C.I.R.*, 796 F.2d 303 (9th Cir. 1986); *Stone v. C.I.R.*, 56 T.C. 213 (1971).

[8] *See Spies v. U.S.*, 317 U.S. 492 (1943); *U.S. v. McCabe*, 416 F.2d 957 (7th Cir. 1969); *U.S. v. Bell*, 734 F.2d 1315 (8th Cir. 1984); *Edwards v. U.S.*, 375 F.2d 862 (9th Cir. 1967); *U.S. v. Sullivan*, 369 F. Supp. 568 (D. Mont. 1974).

duty.''[9] The elements of the offense are the failure to file a return[10] and willfulness in doing so.[11] The offense is not committed unless the taxpayer has *actual knowledge* of the existence and the *specific intent* to evade it or *reckless disregard* of the foreseen possible existence of the obligation.[12] Willfulness requires that failure be committed purposefully with awareness of action, not just negligently or inadvertently.[13] It means a voluntary, intentional violation of the known legal duty to file,[14] and the taxpayer's motives in failing to file that return are immaterial and irrelevant.[15]

Note that although the U.S. Supreme Court once stated that ''until Congress speaks otherwise, we . . . shall continue to require, in both tax felonies and tax misdemeanors that must be done 'willfully,' the bad purpose or evil motive described in *Murdock v. U.S.*,''[16] it later quietly reversed that position and held that there is ''no requirement of finding of 'evil motive' beyond a specific intent to violate the law.''[17] Although the government need not show *mens rea* or that the taxpayer had an evil-meaning mind, a finding of willful conduct would necessarily negate any possibility of good faith in failing to file an income tax return.[18] Therefore, whether the taxpayer had a good motive[19] or bad motive is irrelevant; the only question is whether the taxpayer knew of the duty to file and deliberately failed to do so.[20]

Evidentiary Standard

As previously noted, the definition and meaning of willfulness are the same in both the civil and criminal context.[21] However, the burden of proof and evidentiary standards differ. In the civil context, the government must prove willfulness by clear and convincing evidence.[22] In the criminal context, however, the standard is, of course, beyond a reasonable doubt.[23] While a set of facts and circumstantial evidence may not be enough to prove willfulness beyond a reasonable doubt in a criminal case, it may be enough to prove willfulness with clear and convincing evidence in a civil case.

In the OVDP streamlined context, it is fair to ask whether the Service is requesting certification of non-willfulness beyond a reasonable doubt or to a degree that is clear and convincing. Because the clear and convincing standard is the lower threshold, the focus should be on the civil evidentiary standard. If the government can prove willfulness beyond a reasonable doubt, the evidence would undoubtedly qualify as clear and convincing.

Therefore, because the government can more easily prove willfulness in the civil context, the only way to certify non-willfulness is for the taxpayer to be certain

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[9] *See Ratzlaf v. U.S.*, 510 U.S. 135 (1994). In *Ratzlaf*, the Court determined that the language of section 5324 on its own was not clear as to the requisite level of knowledge required to violate the statute and consulted section 5322(a) for additional guidance. Based on that section, the Court required that the government demonstrate proof of knowledge of illegality before a defendant could be convicted. However, since *Ratzlaf*, Congress amended section 5324 to provide ''its own criminal penalty provision so reliance on [section] 5322 is no longer necessary.'' *See U.S. v. Vazquez*, 53 F.3d 1216, n.2 (11th Cir. 1995). Thus, the only mental state apparently required under the new penalty provision is a purpose to evade the filing requirement.

[10] *See U.S. v. Buckley*, 586 F.2d 498 (5th Cir. 1978); *Poschwatta*, 829 F.2d at 1477; *U.S. v. Crowhurst*, 629 F.2d 1297 (9th Cir. 1980); *U.S. v. Brown*, 600 F.2d 248 (10th Cir. 1979); *U.S. v. Goetz*, 746 F.2d 705 (11th Cir. 1984) (secretary of Treasury's execution of return for taxpayer as provided under statute did not relieve taxpayer of obligation to file return); *U.S. v. Grabinski*, 558 F. Supp. 1324 (D. Minn. 1983), *aff'd*, 727 F.2d 681 (8th Cir. 1984); *U.S. v. Birkenstock*, 823 F.2d 1026 (7th Cir. 1987) (employer's filing of its copy of employee's Form W-2 with government did not serve as substitute for employee's income tax return, for purpose of relieving employee of liability for failure to file income tax return).

[11] *See Sempos*, 772 F.2d at 1; *U.S. v. Verkuilen*, 690 F.2d 648 (7th Cir. 1982); *U.S. v. Moore*, 627 F.2d 830 (7th Cir. 1980); *U.S. v. Farber*, 630 F.2d 569 (8th Cir. 1980); *Poschwatta*, 829 F.2d at 1477; *Grabinski*, 727 F.2d at 681.

[12] *See U.S. v. Vitiello*, 363 F.2d 240 (3d Cir. 1966); *Birkenstock*, 823 F.2d at 1026; *U.S. v. Thompson*, 230 F. Supp. 530 (D. Conn. 1964), *aff'd*, 338 F.2d 997 (2d Cir. 1964); *U.S. v. Klein*, 438 F. Supp. 485 (S.D.N.Y. 1977).

[13] *See U.S. v. Merritt*, 639 F.2d 254 (5th Cir. 1981); *U.S. v. Rosenfield*, 469 F.2d 598 (3d Cir. 1972). The U.S. Court of Appeals for the Ninth Circuit has held that the term ''willfully'' means ''voluntary, or purposeful, deliberate, and intentional as distinguished from accidental, inadvertent, or negligent. Mere negligence, even gross negligence, is not sufficient to constitute willfulness.'' *See U.S. v. Hawk*, 497 F.2d 365 (9th Cir. 1974).

[14] *See Cheek v. U.S.*, 498 U.S. 192 (1991); *Sempos*, 772 F.2d at 1; *U.S. v. Shivers*, 788 F.2d 1046 (5th Cir. 1986); *U.S. v. Burton*, 737 F.2d 439 (5th Cir. 1984); *Birkenstock*, 823 F.2d at 1026; *U.S. v. Callery*, 774 F.2d 1456 (9th Cir. 1985); *U.S. v. Ferguson*, 615 F. Supp. 8 (S.D. Ind. 1985), *aff'd*, 793 F.2d 828 (7th Cir. 1986); *U.S. v. Marks*, 534 F. Supp. 663 (W.D. Mo. 1982); *U.S. v. Powell*, 955 F.2d 1206 (9th Cir. 1991).

[15] *See U.S. v. Edelson*, 604 F.2d 232 (3d Cir. 1979). Good motive is irrelevant if taxpayer knows of duty to file income tax returns and deliberately fails to file. *U.S. v. Quimby*, 636 F.2d 86 (5th Cir. 1981); *U.S. v. Weninger*, 624 F.2d 163 (10th Cir. 1980). Offenses of a willful failure to file income tax returns occurred when the taxpayer willfully failed to pay taxes at time or times required by

(Footnote continued in next column.)

law, despite the taxpayer's contention that offenses did not occur until his commodity futures trading company was closed because he expected, up until that time, to pay back his investors and did not consider any investor funds to be taxable income. *See U.S. v. Morrison*, 938 F.2d 168 (10th Cir. 1991).

[16] *See U.S. v. Bishop*, 412 U.S. 346 (1973) (citing *U.S. v. Murdock*, 290 U.S. 389 (1933)).

[17] *See U.S. v. Pomponio*, 429 U.S. 10 (1976).

[18] *See U.S. v. Sato*, 814 F.2d 449 (7th Cir. 1987).

[19] *See Quimby*, 636 F.2d at 86.

[20] *See Weninger*, 624 F.2d at 163.

[21] *See* CCA 200603026 (Jan. 20, 2006).

[22] *See Bradford*, 796 F.2d at 303; *see also* CCA 200603026.

[23] *See Stone*, 56 T.C. at 213.

that the facts do not support a finding of willfulness by clear and convincing evidence. Generally, because IRS forms 14653 and 14654 require the taxpayer, individually, to certify non-willfulness for purposes of the streamlined filing compliance procedures, practitioners will have limited liability exposure.

Specific Intent Required

Because willful failure to file is a specific intent crime, it absolutely requires proof of the intentional violation of a known legal duty.[24] A subjective, rather than objective, standard is to be applied in evaluating a good-faith defense to a charge of willfully failing to file tax returns.[25] In other words, in determining whether the failure to file income taxes is willful, it is one's subjective state of mind that must be judged.[26] For example, if a taxpayer genuinely believes that the law does not require him to file an income tax return because wages are not legally considered income, it is a defense to the finding of willfulness.[27]

There must be a deliberate intent to disobey the filing requirement.[28] This may *possibly* be inferred by supporting circumstantial evidence as discussed below.

Circumstantial Evidence

Although courts will take into account both direct and circumstantial evidence,[29] the IRS has acknowledged that ''cases involving willful FBAR violations will generally have to rely on circumstantial evidence.''[30] Circumstantial evidence of willfulness, standing alone, is sufficient to prove willfulness.[31] Circumstantial evidence includes ''any conduct, the likely effect of which would be to mislead or to conceal.''[32] This could include the use of aliases and nominee entities,[33] concealing assets through the use of nominee trusts,[34] utilizing untraceable forms of payments like cash or money orders,[35] numbered accounts at foreign banks,[36] working with a foreign financial institution or adviser under U.S. indictment, or earning substantial income on reportable accounts but not reporting that income on one's federal income tax return.[37]

The element of ''willfulness'' as used in this section requires a finding of a specific wrongful intent.[38] Nevertheless, if one intentionally disregards apprising himself of the law, that deliberate ignorance may constitute willful blindness.[39]

As noted above, there are two ways for the government to establish willfulness. First, the government can prove *actual knowledge* of the existence and the *specific intent* to evade it. Second, the government can prove *reckless disregard* of the foreseen possible existence of the filing obligation.[40]

Under the first method, although the government can prove actual knowledge by simply showing that the taxpayer signed his income tax return, the government must still provide specific intent to disregard the filing obligation.[41] Nevertheless, when the government can establish specific intent by direct or circumstantial evidence, knowledge is implied. In other words, specific intent infers knowledge, which together establishes willfulness, but knowledge alone does not establish specific intent. Therefore, ''knowledge'' is a superfluous element; specific intent is the only true element of willfulness.

Under the second method, the government must establish enough circumstantial evidence to either infer specific intent or establish reckless disregard of the reasonably foreseeable likelihood of the filing obligation.[42]

Willful Blindness

In *Cheek v. U.S.*,[43] the U.S. Supreme Court held that the taxpayer's belief about what the law requires, regardless of how unreasonable it appears to be, is a question of fact for the jury.[44] In that case, the defendant, John L. Cheek, claimed that based on his reading of the law, it was his understanding that he was not a ''person'' required to file a return because wages were not ''income.'' The district court refused to instruct the jury on this defense. The U.S. Supreme Court held that

[24] *See Birkenstock*, 823 F.2d at 1026.

[25] *See U.S. v. Jerde*, 841 F.2d 818 (8th Cir. 1988).

[26] *See U.S. v. Aitken*, 755 F.2d 188 (1st Cir. 1985).

[27] *See U.S. v. Phillips*, 775 F.2d 262 (10th Cir. 1985).

[28] *See U.S. v. Lachmann*, 469 F.2d 1043 (1st Cir. 1972).

[29] *See U.S. v. Santiago*, 83 F.3d 20, 23 (1st Cir. 1996).

[30] CCA 200603026.

[31] *See U.S. v. Boulerice*, 325 F.3d 75, 80 (1st Cir. 2003).

[32] *See Spies*, 317 U.S. at 492.

[33] *See U.S. v. Stierhoff*, 549 F.3d 19, 26 (1st Cir. 2008) (citing *U.S. v. Daniel*, 956 F.2d 540, 543 (6th Cir. 1992)).

[34] *See U.S. v. Threadgill*, 3:11-CR-86 (E.D. Tenn. Apr. 29, 2013), *aff'd*, 13-5897 (6th Cir. July 11, 2014).

[35] *See U.S. v. Conley*, 826 F.2d 551, 557 (7th Cir. 1987); *U.S. v. Tipton*, 56 F.3d 1009, 1013-1014 (9th Cir. 1995).

[36] *See* Treas. reg. section 301.7609-2(b)(3).

[37] *See U.S. v. Bohrer*, 807 F.2d 159, 162 (10th Cir. 1986).

[38] *See Thompson*, 338 F.2d at 997.

[39] *See Cheek*, 498 U.S. at 192.

[40] *See Vitiello*, 363 F.2d at 240; *Birkenstock*, 823 F.2d at 1026; *Thompson*, 338 F.2d at 997; *Klein*, 438 F. Supp. at 485.

[41] *See U.S. v. Mohney*, 949 F.2d 1397, 1407 (6th Cir. 1991) (''A taxpayer's signature on a return . . . is *prima facie* evidence that the signer knows the contents of the return.''); *U.S. v. Harper*, 458 F.2d 891, 894 (7th Cir. 1971); *U.S. v. Drape*, 668 F.2d 22, 26 (1st Cir. 1982) (holding that a defendant's signature is sufficient to establish knowledge).

[42] CCA 200603026.

[43] *See Cheek*, 498 U.S. at 192.

[44] *See Cheek*, 498 U.S. at 203.

it was an error to not instruct the jury on Cheek's defense of a good-faith misunderstanding of the law. Evidence that the taxpayer researched the question, attended seminars, consulted experts, inquired of the IRS, or even talked with neighbors is helpful in establishing not only that he believed it but that his belief was not a recent, convenient invention.

Essentially then, the Court in *Cheek* stated that the requirement of willfulness is an exception to the general rule that ignorance is not an exception to criminal liability, and distinguished between two types of persons: one who, in good faith, is ignorant of a duty or misunderstands it, and one who recklessly avoided knowledge of a legal duty. Although the court held that willfulness cannot attach to the former type of person, it can attach to the latter. The term ''reckless'' is a highly technical legal term and should not be confused with the ordinary meaning of the term. *Black's Law Dictionary* defines recklessness as ''[c]onduct whereby the actor does not desire [an unlawful outcome] but nonetheless foresees the possibility and consciously takes the risk.'' Therefore, reckless disregard of the possibility of a filing obligation despite circumstances that would have apprised an ordinary, prudent person is sufficient to establish deliberate ignorance to evidence willfulness, which is not prohibited by the decision in *Cheek*.[45] In essence, this case created what is now known as the doctrine of willful blindness.

Therefore, willfulness can ''be inferred from a conscious effort to avoid learning about reporting requirements'' or when ''a defendant was subjectively aware of a high probability of the existence of a tax liability, and purposefully avoided learning the facts point to such liability.''[46] Nevertheless, the government must still prove that at some point, the taxpayer was made aware of the possibility of compliance issues.

Note that the Eighth Circuit Court of Appeals[47] has held that willfulness ''cannot fairly be equated with carelessness or recklessness.''[48] This is not, however, the general rule; it only represents a possible exception for taxpayers in that circuit.

Good-Faith Misunderstanding of Law

A taxpayer is not excused from the offense of willfully failing to file a return because he had not previously been prompted or notified of his duty to file a return,[49] because he *disagreed* with the law,[50] or because he held the legal *opinion* that the statute[51] or Federal Reserve System[52] was unconstitutional. However, a taxpayer's good-faith belief that he need not file his tax return,[53] no matter how unreasonable the belief,[54] or a good-faith misunderstanding or an inadvertence on his part,[55] constitutes justification for failure to file a return.

A failure to file income tax returns while holding the legal *opinion* that the law that includes wages is unconstitutional would be willful since it is based on an unsupported legal opinion, but the failure to file while believing in good faith that wages are not ''income'' as defined under the Internal Revenue Code would not be willful since it would be based on one's understanding of the law.[56] However, a *disagreement* with the Internal Revenue Code's definition of ''gross income'' would not entitle the taxpayer to violate the law by failing to file a proper return.[57] Nevertheless, the courts have labeled constitutional challenges as being per se frivolous opinions that do not prevent the finding of willfulness.[58]

There is a difference between a good-faith disagreement with the law based on an opinion and a good-faith misunderstanding of the law[59] based on one's reasonable efforts to understand it.[60] If, for example, a taxpayer genuinely holds religious beliefs concerning the invalidity of income tax laws or any other good-faith disagreement with the law,[61] it does not prevent the finding of willfulness for the failure to file income

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[45] *See U.S. v. Stadtmauer*, No. 09-1575 (3d Cir. 2010); *U.S. v. Anthony*, 545 F.3d 60 (1st Cir. 2008); *U.S. v. Dean*, 487 F.3d 840 (11th Cir. 2007); *U.S. v. Bussey*, 942 F.2d 1241 (8th Cir. 1991).

[46] *See U.S. v. Williams*, 489 F. App'x 655, 658 (4th Cir. 2012).

[47] The Eighth Circuit covers the states of Arkansas, Iowa, Minnesota, Missouri, North Dakota, Nebraska, and South Dakota.

[48] *See U.S. v. Bengimina*, 499 F.2d 117 (8th Cir. 1974).

[49] *See U.S. v. Commerford*, 64 F.2d 28 (2d Cir. 1933); *U.S. v. Bressler*, 772 F.2d 287 (7th Cir. 1985).

[50] *See U.S. v. McMullen*, 755 F.2d 65 (6th Cir. 1984); *Moore*, 627 F.2d at 830; *U.S. v. Gleason*, 726 F.2d 385 (8th Cir. 1984); *U.S. v. Romero*, 640 F.2d 1014 (9th Cir. 1981); *U.S. v. House*, 617 F. Supp. 232 (W.D. Mich. 1985), *aff'd*, 787 F.2d 593 (6th Cir. 1986).

[51] *See U.S. v. Kraeger*, 711 F.2d 6 (2d Cir. 1983); *Bressler*, 772 F.2d at 287; *Moore*, 627 F.2d at 830; *U.S. v. Hairston*, 819 F.2d 971 (10th Cir. 1987); *U.S. v. Erickson*, 676 F.2d 408 (10th Cir. 1982); *House*, 787 F.2d at 593.

[52] *See U.S. v. Jones*, 628 F.2d 402 (5th Cir. 1980).

[53] *See U.S. v. Pry*, 625 F.2d 689 (5th Cir. 1980); *U.S. v. Pinner*, 561 F.2d 1203 (5th Cir. 1977); *U.S. v. Mann*, 884 F.2d 532 (10th Cir. 1989).

[54] *See Powell*, 955 F.2d at 1206.

[55] *See Burton*, 737 F.2d at 439; *U.S. v. Wilson*, 550 F.2d 259 (5th Cir. 1977); *Green*, 757 F.2d at 116; *Callery*, 774 F.2d at 1456; *U.S. v. Buras*, 633 F.2d 1356 (9th Cir. 1980); *Hairston*, 819 F.2d at 971.

[56] *See Cheek*, 498 U.S. at 192; *U.S. v. Mueller*, 778 F.2d 539 (9th Cir. 1985).

[57] *See Crowhurst*, 629 F.2d at 1297.

[58] *See Hairston*, 819 F.2d at 971.

[59] *See Buras*, 633 F.2d at 1356.

[60] *See Kraeger*, 711 F.2d at 6; *Romero*, 640 F.2d at 1014; *Moore*, 627 F.2d at 830.

[61] *See Gleason*, 726 F.2d at 385.

tax returns.[62] If a taxpayer, however, holds the unsupported legal opinion that the Internal Revenue Code is unconstitutional, that opinion disagreeing with established case law and opinions issued by the Supreme Court would not negate the element of willfulness.[63]

The misunderstanding need not be objectively reasonable to be a defense to the finding of willfulness; a jury need only conclude that the taxpayer honestly misunderstood the law.[64] Therefore, if a taxpayer believed in good faith that he was not required to file a return[65] or believed in good faith that another statute removed the obligation to file a return,[66] even if unreasonable, would be a defense to the finding of willfulness. Similarly, a taxpayer's belief that he does not have to file a return if he is unable to pay, although clearly unreasonable, is a defense to the finding of willfulness.[67]

In other words, it is crucial that the mistake, regardless of whether it is objectively reasonable or unreasonable, was subjectively[68] a bona fide misunderstanding of the law regarding the legal duty to file a return.[69] This naturally means that a less educated person is better situated to benefit from this exception.[70]

Conclusion

As a general rule, a taxpayer can establish nonwillfulness by asserting that, based on a good-faith personal diligent reading of the law, there was a bona fide misunderstanding of the filing requirements and that the taxpayer genuinely believed he was not required to file the forms at issue.

Note, however, that a good-faith misunderstanding of the law does not constitute reasonable cause for the purpose of avoiding penalties under the delinquent international informational return procedures or delinquent FBAR filing procedures. ◆

[62] *See U.S. v. Kahl*, 583 F.2d 1351 (5th Cir. 1978).

[63] *See U.S. v. Massey*, 419 F.3d 1008 (9th Cir. 2005).

[64] *See Cheek*, 498 U.S. at 192; *Aitken*, 755 F.2d at 188; *U.S. v. Wells*, 790 F.2d 73 (10th Cir. 1986); *U.S. v. Edgington*, 727 F. Supp. 1083 (E.D. Tex. 1989), *aff'd*, 897 F.2d 527 (5th Cir. 1990).

[65] *See Mann*, 884 F.2d at 532.

[66] *See Powell*, 955 F.2d at 1206.

[67] *See Pinner*, 561 F.2d at 1203.

[68] *See Edgington*, 897 F.2d at 527.

[69] *See U.S. v. McCorkle*, 511 F.2d 482 (7th Cir. 1975); *U.S. v. Murdock*, 290 U.S. 389 (1933).

[70] *See U.S. v. Collins*, 457 F.2d 781 (6th Cir. 1972).