FBAR Controversies Continue: Foreign Account Reporting, Compliance Requirements, and Litigation Update

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AGENDA

- Foreign Account Reporting Basics
- Potential Penalties for Noncompliance
- Voluntarily Fixing Prior Noncompliance
- Audits and Litigation
  - Tax Evasion
  - Recent Court Opinions
- Lessons Learned

1. Introduction to Foreign Account Reporting

FBAR Filing Requirements – Overview

- **What is FinCEN Form 114 ("FBAR")?**
  - Informational report required by the Bank Secrecy Act (31 USC § 5311 *et seq*.)
  - Required filers must report comprehensive information about all foreign bank and financial/investment accounts when they have:
    - A "financial interest" in, or
    - "Signature" or "other authority" over reportable financial accounts
  - Filing required when U.S. taxpayers (citizens, green card holders, residents – including "183 day substantial presence residents" – and U.S. entities):
    - For the calendar year,
    - Have one or more such financial accounts,
    - Whose *aggregate value* at "*any time*" during the year
    - Exceeds US$10,000

FBAR Filing Requirements – Overview (Cont.)

- **When is it due?**
  - Filed annually by Apr. 15 of the following year (or Oct. 15 with extension)
  - *Not* filed "with" the tax return, but separately and electronically with FinCEN (http://bsaefiling.fincen.treas.gov/main.html)
- **What are the penalties for not filing an FBAR?**
  - $12,921 per account per year (for "nonwillful" noncompliance), and worse…
  - Could go up to 50% of unreported account value(s)
- **Are there recordkeeping requirements?**
  - Required filers must retain records for a period of 5 years from the FBAR due date, which must be available for inspection.

FBARs

- **What are reportable foreign "financial accounts"?** Broadly defined to include non-US:
  - Bank, securities, checking accounts
  - Investment accounts, brokerage accounts
  - Commodity/futures accounts
  - Life insurance policies with a cash surrender value
  - Annuity policies with a cash value
  - Shares in mutual funds
  - Jointly-owned accounts
  - A foreign situs bank account at a foreign branch of a US bank
- NOTE: FinCEN has recently announced its intention to include cryptocurrency accounts/values as FBAR reportable in the future…

FBARs (cont.)

- FinCEN Form 114:
  - Only filed electronically now
  - Authorization (Form 114a) required to be signed by US person/filer
  - 5 Parts (only complete those that are relevant):
    - Part I – Filer Information
    - Part II – Accounts Owned Separately
    - Part III – Accounts Owned Jointly
    - Part IV – Signature or Other Authority, But No Financial Interest
    - Part V – “Consolidated” Filing Information for Certain Filers

FBARs (cont.)

- Who has to file an FBAR?
  - US persons (individuals, corporations, LLCs, partnerships, trusts, estates)
  - With record ownership of/legal title to the account or with signature or other authority over an account
  - Joint owners of a reportable account (if aggregate value of account > $10K)
  - An agent or nominee, POA, attorney, etc. acting with capacity on behalf of a US person
  - **A** corporation/partnership/trust, etc. over which **a** US person owns “more than 50%” of the value or vote, as appropriate
    - NOTE: this “control” authority filing requirement applies when any US person has that requisite control over a foreign entity that has its own foreign (e.g., home country, etc.) accounts

FBARs (cont.)

- What is signature or other authority?
  - The authority to act (alone or in conjunction with another)
  - To control the disposition, investment/reinvestment or transfer of assets
  - By direct communication
  - “Whether in writing or otherwise”
- Special “authority” considerations:
  - Can you pick up the phone and implement a transfer or disposition of the assets?
  - Are you “on” the financial institutions authorized “signature” card?
  - Are you a record co-owner of the account, and is *that,* alone, sufficient to give you control over the assets?
  - Do you have corporate authority (e.g., authorizing Board resolution) – and is *that*, alone, adequate for the bank/financial institution’s account control and authorization procedure?
  - Does the financial account/bank rules require two/more concurrent authorizing signatures before a requested transaction is authorized?
  - Do you have a POA that the financial institution will accept as proper authority over the account?

FBARs (cont.)

- Consider these situations:
  - A foreign person (NRA) moves to the US and becomes a resident or gets a green card
  - A US individual controls (> 50%) a US corporation with foreign accounts
  - A US individual controls (> 50%) a foreign corporation (e.g., a CFC) with foreign accounts
  - A US officer (e.g., CEO/CFO) of a widely held US corporation is included routinely as an authorized signatory on all the US corporation's foreign business accounts as well as those accounts of its foreign subsidiaries or affiliates
  - A joint account abroad where only one owner or signatory is a US person
  - The foreign accounts of aged "old country" parents who have put their US citizen/resident children "on" their "old country" accounts "just in case" something happens to the parents (e.g., medical emergencies, etc.)

FBARs (cont.)

- **What are the most common FBAR traps?**
  - Taxpayers must identify on Schedule B of Form 1040 if they have reportable foreign accounts *and* include foreign investment income there, too

Part III			Yes	No
Foreign Accounts and Trusts	7a	At any time during 2020, did you have a financial interest in or signature authority over a financial account (such as a bank account, securities account, or brokerage account) located in a foreign country? See instructions		
Caution: If required, failure to file FinCEN Form 114 may result in substantial penalties. See instructions.		If "Yes," are you required to file FinCEN Form 114, Report of Foreign Bank and Financial Accounts (FBAR), to report that financial interest or signature authority? See FinCEN Form 114 and its instructions for filing requirements and exceptions to those requirements		
	b	If you are required to file FinCEN Form 114, enter the name of the foreign country where the financial account is located ▶		
	8	During 2020, did you receive a distribution from, or were you the grantor of, or transferor to, a foreign trust? If "Yes," you may have to file Form 3520. See instructions		

For Paperwork Reduction Act Notice, see your tax return instructions. Cat. No. 17146N **Schedule B (Form 1040) 2020**

  - **BEWARE** overlap filing requirements with Form 8938…

Form **8938**
Department of the Treasury
Internal Revenue Service

Statement of Specified Foreign Financial Assets
▶ Go to *www.irs.gov/Form8938* for instructions and the latest information.
▶ Attach to your tax return.
For calendar year 2020 or tax year beginning , 2020, and ending , 20

OMB No. 1545-2195
2020
Attachment Sequence No. 938

Form 8938: Foreign Financial Asset Reporting

- Filed *with* U.S. tax return (including extensions) starting with 2011 Tax Year
- Despite overlap, may have to file both a Form 8938 and an FBAR
  - May not have to complete all of Form 8938 if the specified asset is otherwise reported on other international tax forms [e.g., Forms 5471 (CFCs), 3520 (Foreign Trusts), 8621 (PFICs)]
- "Specified foreign financial assets" must be reported:
  - Any financial account maintained by a foreign financial institution
  - If held for investment (and not in a financial account), any stock, securities or interest in a non-U.S. entity or issued by a non-U.S. issuer
  - Any financial instrument or contract with a non-U.S. issuer or counterparty
  - Interests in foreign estates or trusts
  - Interests in foreign pension plan or foreign deferred compensation plan (other than rights to social security or equivalent program of a foreign government)
  - Each joint owner must report the entire asset; valuation rules/conventions apply
- Various filing/valuation thresholds apply:
  - U.S. joint filers living in US: $100K on last day or $150K on any day during year
  - U.S. joint filers living abroad: $400K on last day or $600K on any day during year

FBARs (cont.)

- More FBAR filing traps:
  - Filing required if *all* such accounts aggregate at least US$10,000 value on *any day* of the year (all foreign are reportable, even the small ones…)
  - You co-own a reportable account with your spouse/other person; you each must report it (all) and identify the other co-owner
  - You are signatory on foreign business account(s) of your company or foreign affiliate (still reportable personally, but report under the "signature but no beneficial interest" category)
  - You are in "control" of the foreign entity, or of a domestic entity, that has foreign accounts even if you personally do *not* have official signature authority
  - You can pick up the phone and the foreign bank will follow your directions
  - The foreign bank requires two or more authorized signatories to direct the funds; each such (US) signatory must still report that account
  - The primary owner dies and has failed to disclose an FBAR reportable account…

FBARs (cont.)

- What happens if the taxpayer who owns the reportable FBAR account dies, but has failed to report it – and the IRS comes after his/her executor, estate, etc.?
  - Cases have held that the FBAR penalties like other tax penalties do not disappear with the death of the taxpayer
  - The executors/personal representatives may be substituted as defendants, as may co-owners who inherit the account (e.g., spouses) and the estate itself
  - Distribution of funds from undisclosed accounts as part of probate may also lead to assessment of penalties against the distributees, etc.
  - NOTE: the FBAR penalties are in addition to the failure to report investment earnings and failure to report entity ownership for income tax purposes

2. Penalties for Noncompliance

FinCEN Form 114: FBAR

- Civil penalty not to exceed $12,921 per violation (adjusted annually)
- Willful civil penalty equal to the greater of $129,210 or 50% of the balance in the account at the time of violation (adjusted annually)
- Mitigation guidelines exist for civil penalties
- Criminal penalties may also apply for willful violations

Willful versus Nonwillful

- Per the IRS, “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”
- What is willfulness?
  - Willfulness is shown by the person’s knowledge of the reporting requirements
  - The IRS has the burden of establishing willfulness
  - Schedule B: IRS has used this to establish willfulness
  - Willful blindness?

Part III		You must complete this part if you **(a)** had over $1,500 of taxable interest or ordinary dividends; **(b)** had a foreign account; or **(c)** received a distribution from, or were a grantor of, or a transferor to, a foreign trust.	Yes	No
Foreign Accounts and Trusts (See instructions.)	7a	At any time during 2018, did you have a financial interest in or signature authority over a financial account (such as a bank account, securities account, or brokerage account) located in a foreign country? See instructions		
		If “Yes,” are you required to file FinCEN Form 114, Report of Foreign Bank and Financial Accounts (FBAR), to report that financial interest or signature authority? See FinCEN Form 114 and its instructions for filing requirements and exceptions to those requirements		
	b	If you are required to file FinCEN Form 114, enter the name of the foreign country where the financial account is located ►		
	8	During 2018, did you receive a distribution from, or were you the grantor of, or transferor to, a foreign trust? If “Yes,” you may have to file Form 3520. See instructions		

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Form 8938

- $10,000 with additional maximum of $50,000 for continuing failure to file.
- 40% accuracy-related penalty for underpayment of tax on undisclosed foreign financial assets
- Fraud and criminal penalties may also apply
- Statute of limitations: Remains open for all or a part of your income tax return until 3 years after the date on which you file form 8938

Other Forms and Penalties

Form	Penalty
8621 – Passive Foreign Investment Company Report	No monetary penalty Statute of limitations remains open
5471 – Foreign Corporations 5472 – Transactions of Foreign Corporations 8865 – Foreign Partnerships 926 – Transfers to Foreign Corporations	$10,000-$50,000 per form 10% reduction of foreign taxes available for credit 10% of value of property transferred to foreign corporation or partnership Statute of limitations remains open Potential Criminal Penalties
3520 – Foreign Trusts or Gifts from Non-U.S. Persons 3520-A – Foreign Trust with U.S. Owner	35% of gross reportable amount 25% of unreported gifts 5% of trust assets owned by U.S. person Statute of limitations remains open

Reasonable Cause

- Penalties for not timely filing FBARs, Forms 8938, 5471, 3520, etc. can be waived if the failure to file was due to reasonable cause and not willful neglect.
- Reasonable cause standard set forth in Treas. Reg. 1.6664-4(b)(1):
  - Whether a taxpayer acted with reasonable cause is a “case-by-case” determination, “taking into account all pertinent facts and circumstances.”
  - Most important factor: extent of the taxpayer's effort to assess the taxpayer's proper tax liability
  - Reasonable cause may be shown when there is “an honest misunderstanding of fact or law that is reasonable in light of all of the facts and circumstances,” including the “taxpayer’s experience, knowledge, and education.”
  - Reliance on a tax advisor *may* constitute reasonable cause if the accountant is aware of all of the pertinent facts, the reliance is reasonable, and the taxpayer acted in good faith.

3. Voluntarily Fixing Prior Noncompliance

Current Options

- Delinquent Filing Procedures
- Streamlined Filing Procedures
- Voluntary Disclosure Practice

Delinquent FBAR Submissions

- Eligibility:
  - have not filed a required Report of Foreign Bank and Financial Accounts
  - are not under a civil examination or a criminal investigation by the IRS, and
  - have not already been contacted by the IRS about the delinquent FBARs
- Include statement explaining why FBARs are late
- **No penalties if:**
  - **(a)** *no unreported income* from the financial accounts being reported and
  - **(b)** taxpayer has not previously been contacted by the IRS for years for which delinquent FBARs being submitted
- FBARs will not be automatically subject to audit (but *may* be selected for audit through existing audit selection processes)

Delinquent International Information Return Procedures

- Applies to Forms 8938, 5471, 3520, etc.
- Eligibility Requirements:
  - have not filed one or more required international information returns,
  - have reasonable cause for not timely filing the information returns,
  - are not under a civil examination or a criminal investigation by the IRS, and
  - have not already been contacted by the IRS about the delinquent information returns
- Must include "reasonable cause" statement with every return, if filed after the due date including extension or if filing an amended return
- "Reasonable cause" statement must include certification that any entity for which the information returns are being filed was not engaged in tax evasion.

Delinquent International Information Return Procedures (cont.)

- If a reasonable cause statement is not attached to each delinquent information return filed, penalties may be assessed in accordance with existing procedures.
- All delinquent international information returns (other than Forms 3520 and 3520-A) should be attached to an amended return and filed according to the applicable instructions for the amended return.
- Information returns filed with amended returns will not be automatically subject to audit but may be selected for audit through the existing audit selection processes

Streamlined Filing Procedures

- To use these Procedures taxpayers:
  - Have failed to report foreign financial assets and/or pay tax due from them
  - Must certify that failure to report those foreign financial assets and pay tax was not a result of "willful conduct", and
  - Must not be under civil examination
- "Nonwillful 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"
- Contrary to the "Delinquent" Procedures, the Streamlined Procedures are used when there has been a failure to report foreign financial assets and/or a failure to report gross income, or pay required taxes, attributable to them, and the taxpayer can establish "nonwillfulness"

Streamlined Filing Procedures (cont.)

- Penalties associated with filings under the Streamlined Procedures for **successful** filers:
  - Will *not* be subject to failure-to-file and failure-to-pay penalties, accuracy-related penalties, information return penalties, or FBAR penalties. Taxpayers *will* be subject to interest on the late payment amount.
- *Streamlined Foreign Offshore Procedures:* file Form 14653
  - SFOP for taxpayers residing outside the US who establish they were physically OUS for at least 330 full days during one of the 3 years for which amended returns are being filed, file Form 14653
- *Streamlined Domestic Offshore Procedures*: file Form 14654
  - SDOP is only available to taxpayers who are amending previously-filed Forms 1040; non-filers are not eligible to use SDOP
  - **NOTE: Taxpayers filing under SDOP (only) *will* also be subject to a "miscellaneous offshore penalty" equal to 5% of the highest year's value of the taxpayer's noncompliant (nonreported) foreign assets**

Streamlined Filing Procedures (cont.)

Overview of filing submission under the Procedures:

- 3 years of delinquent tax returns (SFOP only) or 3 years of amended tax returns (SFOP or SDOP)
- 6 years of delinquent or amended FBARs (both)
- Submit Form 14654 (SDOP/taxpayers residing in US) or Form 14653 (SFOP/ taxpayers residing OUS), certifying that:
  1. Person is eligible for the streamlined procedures
  2. All required FBARs have been filed
  3. Explain in statement that failure to file tax returns, report income, pay tax and submit all required forms resulted from non-willful conduct (full narrative included in Forms)
  4. Applicable Form signed under penalties of perjury
- The IRS is very specific on:
  - How the tax returns are assembled for filing; it is a critical part of the process.
  - What should be included in the non-willfulness certification; incomplete certifications are risky.

Streamlined Filing Procedures (cont.)

- **Example** of 5% Miscellaneous Penalty determination for successful streamlined filers qualifying for SDOP*:

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6
Acct 1	$2,500	$4,500	$100	$2,500	$5,000	$3,500
Acct 2	$4,000	$3,000	$7,500	$1,500	$0	$0
Acct 3	$10,500	$7,500	$10,250	$200	$6,500	$3,500
Acct 4	$0	$0	$0	$2,500	$0	$0
Total	**$17,000**	**$15,000**	**$17,850**	**$6,700**	**$11,550**	**$7,000**

- *5% miscellaneous penalty*: High value *year* = Year 3
  - 5% x $17,750 = **$887.50** = Misc. 5% Penalty payable
  - Each *year* stands on its own for each account's value and aggregate total

*/ FX rate for each year applied as of 12/31

Voluntary Disclosure Program

- The (former) 2014 Offshore Voluntary Disclosure program closed on September 28, 2018; it applied to taxpayers who couldn't meet the eligibility criteria for either of the Delinquent Filing Procedures or either of the Streamlined Procedures
- New Voluntary Disclosure Practice (VDP) program covers both domestic and offshore disclosures when the criteria for the other Delinquent or Streamlined Procedures are not met (e.g., when actual intent, willful actions preclude claim of nonwillfulness, etc.)
  - *https://www.irs.gov/pub/foia/ig/spder/lbi-09-1118-014.pdf; see also* IRM 9.5.11.9
- Overview of VDP procedures:
  - Preclearance request submitted first to IRS Criminal Investigations (Form 14457, Part 1))
  - Once preclearance is granted, fill out/submit Form 14457 (Part 2)
  - IRS will review Part 2; if accepted, taxpayer receives "Preliminary Acceptance" letter
  - Case then assigned to LB&I for field examination; Civil resolution framework applied
  - 6 year disclosure period; Civil fraud penalty typically applied to year with highest tax liability
  - Willful FBAR penalties applied as per existing penalty guidelines

Taxpayers should seek legal advice

- Attorney-Client Privilege
  - Accountant/client privilege does not apply the following circumstances:
    - Criminal matters
    - State tax matters
    - NOTE: “Tax preparation” communications (only applies to “tax advice”)
  - **Evaluation and analysis of “non-willfulness” and of potential criminal exposure/intent issues should be protected by the attorney-client privilege**
  - Attorneys can engage accountants/preparers and other experts under a “*Kovel*” arrangement to protect their work product and communications under the attorney-client privilege
- Advice and analysis as to whether client qualifies for a Streamline Program or whether client eligible to file under the Delinquent Procedures
- Assistance with drafting non-willfulness/reasonable cause statement
- Research and analysis on reporting, correcting complex financial transactions
- Providing legal advice; continuity of relationship in the event litigation is required

4. Audits and Litigation

How do FBAR Penalty Cases Get Before the Courts?

- FBAR litigation follows a different path than traditional tax litigation
  - Traditional tax matters: Internal Revenue Code (Title 26)
  - FBAR reporting matters: Anti-Money Laundering Statute (Title 31)
- FBAR controversy facts:
  - IRS has a 6-year statute of limitations for assessing penalties.
  - Taxpayer cannot sue the IRS in Tax Court for FBAR penalties.
  - Taxpayer can pay the penalty and then sue for refund in federal district court.
  - More typically, the IRS sues the taxpayer in federal district court and the taxpayer counter-claims.

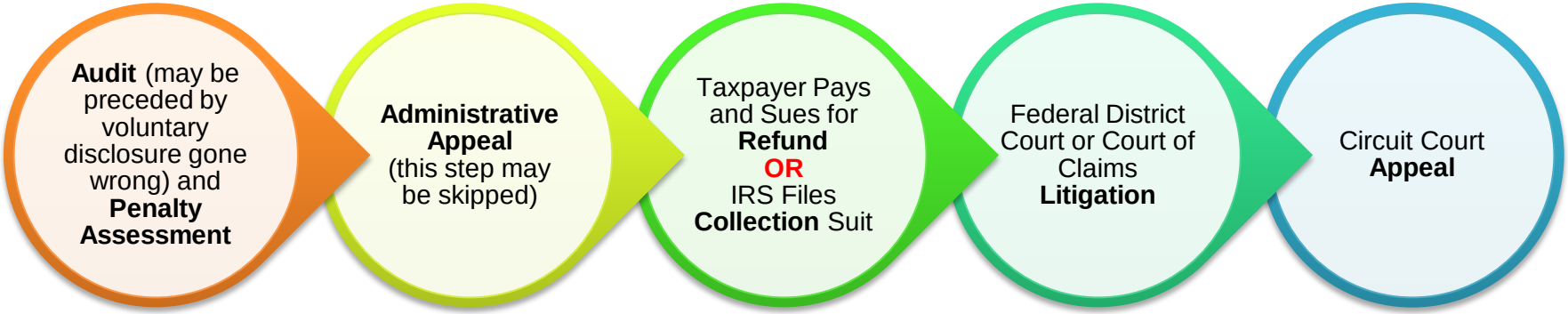
Common Audit Triggers

- UBS data theft
- Information received from foreign partners by way of FATCA
- Information exchanges from foreign treaty partners per tax treaty
- Cross-referenced information from other tax return forms or information
  - Reporting foreign income
  - Filing Form 8938 but not FBAR
- Voluntary disclosure or Streamline filing gone wrong
  - Opt out
  - Kicked out
- Ordinary income tax return audit

Recent Audit Example:

- Facts
  - Taxpayer is from China (has lived in U.S. for several decades)
  - She had HSBC account in Hong Kong (likely audit trigger)
  - Received substantial gifts from her mother (Chinese citizen and resident)
  - Several other financial assets in China, including a life insurance policy
  - Did not previously realize any of this was reportable
- Auditor agreed taxpayer was non-willful and recommended no penalties on failure to file Form 3520 and recommended a cap on FBAR penalties
- Ultimate decision made by “centralized offshore team”
  - FBAR penalties capped at $5,000
  - Form 3520 penalties assessed at $109,000
  - Form 8938 penalty of $10,000
  - Form 1040 substantial understatement penalties
- Case is pending before Appeals

FBAR Penalty Path from Audit to Litigation



Tax Evasion and Foreign Accounts

Tax Evasion and Foreign Accounts

- Robert Brockman is CEO of automotive software-maker Reynolds & Reynolds (which acquired his firm, Universal Computer Systems), and is worth billions…
- He was the sole investor in the first PE fund managed by Vista Equity Partners, co-founded by Robert Smith (it has $73 Billion under mgt.)
- Brockman used undisclosed foreign accounts/income to funnel money (some $2 Billion) over the years into that PE fund
  - Brockman's software industry knowledge helped Smith's fund make significant profits, and Smith became a billionaire personally
  - Smith did not report substantial income from his offshore fees and investments

Tax Evasion and Foreign Accounts (cont.)

- Smith used his accumulated, undeclared funds to establish a sizable charitable foundation, which funded many worthwhile activities:
  - National Parks, breast cancer research, Carnegie Hall renovations, foster children and underprivileged youth assistance, etc.
- Robert Smith maintained accounts at UBS; when the bank advised in 2014 that it was complying with DOJ requests to disclose accounts of US taxpayers, he submitted but was rejected for the OVDP program…
- Robert Smith's Plea Deal (Oct. 2020) with DOJ:
  - He admitted willful evasion of $43 Million in Federal taxes, and will continue to cooperate in the Robert Brockman investigation
  - He will pay $139 Million in fines/penalties, will withdraw refund requests for $182 Million
- The case against Robert Brockmam continues…

Tax Evasion and Foreign Accounts (cont.)

- So, who is Robert Smith?
  - He's been called "America's Wealthiest African American"
  - He moved to Switzerland in 2010
  - In 2014, he married the 2010 Playmate of the Year
  - In 2016, he was elected Chairman of the Carnegie Hall Board of Directors
  - Charles Rettig was one of his earliest lawyers, and…
  - … at the 2019 Commencement at Moorhead College in Atlanta, he pledged to, and did, pay off all student debt held by all those graduates and their parents, a total of $34 Million…

Recent Court Opinions

Recent Court Opinions – Intent

- *U.S. v. Bedrosian*, 126 AFTR 2d 2020-7067 (E.D. Penn. 2020)
  - Following remand from 3d Cir. to apply a definition of "willful" that includes recklessness, the Court found that omission of one of two foreign accounts from FBAR was willful because
    - (i) shortly after filing the inaccurate FBAR, taxpayer directed the foreign bank to close both accounts;
    - (ii) amounts in account were significant and unlikely to be overlooked;
    - (iii) taxpayer's cooperation began only after the unreported account was revealed.
- *U.S. v. Horowitz*, 978 F.3d 80 (4th Cir. 2020)
  - Court granted the Gov't's summary judgment motion to collect willful FBAR penalties.
  - Court defined willful to include reckless.
  - Court defined reckless as: acting, or not acting when there is a duty to act, despite an unjustifiably high risk of harm that is known or so obvious it should be known (cited 3d Cir. from *Bedrosian*).
  - Found taxpayers acted recklessly because
    - (i) knew they held significant savings in a foreign interest-bearing account;
    - (ii) knew income they earned in Saudi Arabia was taxable;
    - (iii) knew interest income was taxable for domestic accounts;
    - (iv) foreign account was a numbered account with "hold mail" service; and
    - (v) accountant sent taxpayers their tax returns to review and sign.

Recent Court Opinions – Intent (Cont.)

- *Alice Kimble v United States*, No. 17-421 (Ct. Cl. 2018), *aff'd*, No. 19-1590 (Fed. Cir. 2021)
  - Taxpayer was willful because
    - Did not review her individual income tax returns for accuracy for tax years 2003 through 2008
    - Signed 2007 income tax return without reading it
    - Return indicated "no" to question whether she had any foreign bank accounts (Schedule B, Question 7(a)), falsely representing under penalty of perjury that taxpayer had no foreign bank accounts.
  - Therefore, she was in "reckless disregard" of the legal duty to file FBAR reports.
  - To be "willfully blind," "a [person] must subjectively believe that there is a high probability that a fact exists and the [person] must take deliberate actions to avoid learning that fact."
  - A taxpayer who signs a tax return is charged with constructive knowledge of its contents and thus cannot claim lack of knowledge.
  - Acknowledging that Kimble was not obligated to inform her accountant of the offshore accounts or to ask him about reporting requirements, this did "not affect the court's determination that Plaintiff's conduct in this case was 'willful.'"
  - Appellate Court upheld penalties and affirmed taxpayers' constructive knowledge of signed tax returns:

    "Ms. Kimble had a secret foreign account, she had constructive knowledge of the requirement to disclose that account, and she falsely represented that she had no such accounts. Under these facts, it was not clear error for the Court of Federal Claims to hold that she committed a willful violation."

Recent Court Opinions – T/P Sophistication

- *U.S. v. Schwarzbaum*, 125 AFTR 2d 2020-1323 (S.D. Fla. 2020) [Naturalized U.S. citizen from Germany]
  - Taxpayer received incorrect accounting and legal advice that FBAR reporting depended on a "U.S. connection."
  - Taxpayer self-prepared returns.
  - Held: taxpayer willfully violated FBAR requirement
    - Self-prepared FBARs rather than just signing returns prepared by a professional advisor and reasonably relying on professional advice.
    - Acknowledged taxpayer's English may have been somewhat limited, but taxpayer admitted to never signing documents in English without knowing what they said and admitted to not hiring a translator.

NOTE: Court noted that merely signing a tax return should not constitute "constructive knowledge"/willfulness because holding otherwise would collapse the distinction between non-willful and willful FBAR violations.

Recent Opinions – T/P Sophistication (cont.)

- *U.S. v. Bittner*, 126 AFTR 2d 2020-5051 (E.D. Tex. 2020) [Romanian-American dual citizen living abroad]
  - Taxpayer claimed reasonable cause because he was educated outside the U.S. with no studies in accounting, tax law, etc.
  - Court rejected taxpayer's reasonable cause because taxpayer (i) "was and is a sophisticated businessman" generating millions in income; and (ii) admitted he took no affirmative steps to learn about FBAR.
    - *"Mr. Bittner cannot claim with a straight face, that as an American citizen generating millions of dollars in income abroad, he was so unaware that he might have United States reporting obligations that he did not even feel compelled to investigate the matter."*

Recent Opinions – T/P Sophistication (cont.)

- *U.S. v. Bernstein*, 126 AFTR 2d 2020-6207 (E.D. N.Y. 2020) [U.S. citizens with foreign accounts]
  - Court granted Gov't summary judgment that taxpayers' failure to disclose was willful, noting that including reckless in definition of willfulness was not worrisome:
    - Taxpayers used "off-shore bank accounts in tax havens – not exactly something undertaken by the unsophisticated taxpayer. Taxpayers like the Bernsteins have access to, and in this case they actually used, professional investment and tax advisors to tell them not only the requirements of the law but to help them make decisions on how to comply (or not) with it."
  - On the advice of a U.S. tax attorney, taxpayers had retained a white-collar defense attorney who advised taxpayers to file an FBAR; they invoked 5th Amendment privilege against self-incrimination. Court noted that this was a choice, and while it may have helped taxpayers avoid criminal liability, it was still "most definitely a voluntary, deliberate, and willful choice."

Recent Court Opinions – Criminal vs. Civil Proceedings

- *U.S. v. Bernstein*, 126 AFTR 2d 2020-6207 (E.D. N.Y. 2020)
  - The Court found taxpayers acted willfully because they "had a clear choice: disclose the required information and risk a criminal prosecution . . . or abstain from disclosing with a good-faith assertion of their privilege . . . they appear to have avoided criminal liability despite what is almost certainly criminal conduct in prior years. But it was most definitely a voluntary deliberate choice."
- *U.S. v. Kerr*, 127 AFTR 2d 2021-XXXX (D. Ariz. 2021)
  - The Court held that taxpayer was precluded from arguing FBAR violations were not willful because the jury in prior criminal proceedings found taxpayer acted willfully.

Recent Court Opinions – Voluntary Disclosure Issues

- *U.S. v. Schwarzbaum*, 125 AFTR 2d 2020-1323 (S.D. Fla. 2020) [Naturalized U.S. citizen from Germany]
  - After years of bad accounting/legal advice, new counsel advised taxpayer to enter the OVDI program. Taxpayer entered the OVDI program but ultimately decided to opt out.
  - Court found subsequent FBAR penalty assessment was valid, but amount of penalty was improper because the Gov't's calculations used improper account amounts for its calculations.
    - The Gov't used the amounts taxpayer provided during OVDI program, which were the highest aggregate balances instead of the account balances as of June 30 of each year.

Recent Court Opinions – Voluntary Disclosure Issues (cont.)

- *U.S. v. Boyd*, 123 AFTR 2d 2019-1651 (C.D. Cal. 2019), *rev'd*, No. 19-55595 (9th Cir. 2021) [U.S. citizen with foreign accounts]
  - Taxpayer entered the OVDP program in 2012 but opted out in 2014.
  - Gov't assessed mitigated non-willful FBAR penalties on a per-account basis.
  - District Court upheld the FBAR penalties on a per-account basis.
    - District Court found the non-willful provision ambiguous and, without much explanation, said that the phrase "balance in the account" in the reasonable cause exception and the willful violations provision made the argument that non-willful violations accrue per account.
  - 9th Circuit *reversed*, finding that the penalties should have been assessed per FBAR form instead of per foreign bank account.
    - (1) the FBAR regulations require (a) reporting accurate information; and (b) filing an FBAR on time; and (2) Boyd only violated the second requirement and hence committed a single non-willful FBAR violation

Recent Court Opinions – Non-Willful Violations

- *U.S. v. Bittner*, 126 AFTR 2d 2020-5051 (E.D. Tex. 2020)
  - Court held that non-willful FBAR violations accrue *per FBAR form* rather than per bank account.
  - Court considered the District Court result in *Boyd*, but instead took Congress's use of the phrase "balance in the account" elsewhere as "persuasive evidence that it intended for the non-willful penalties not to relate to specific accounts."
  - Court emphasized avoiding results where a willful violator with 20 accounts totaling $180K would owe $100K but a non-willful violator in the same situation would owe up to $200K
  - Court also noted that (i) this result makes intuitive sense to tie the penalty to the obligation of filing one report per year; and (ii) the FBAR instructions focus on the aggregate account balance, not the number of accounts
  - Although the reasonable cause exception to non-willful violations discusses the "balance in the account," the Court said this is fine because "Congress can forgive non-willful FBAR violations any way it likes – even in ways that have nothing to do with the underlying violation."

Recent Court Opinions – Non-Willful Violations (Cont.)

- *U.S. v. Kaufman*, 127 AFTR 2d 2021-502 (D. Conn. 2021)
  - Court agreed with the reasoning in *Bittner* and held that non-willful FBAR violations are *per form* rather than per bank account.
  - Court rejected the argument that applying violations per form is wrong as applied to the reasonable cause exception, because although the reasonable cause exception can be applied per account if it does not apply to all accounts at issue the taxpayer "would still have violated Section 5314 . . . [and] would be liable for civil monetary penalties because he does not have a complete reasonable cause defense as to every account."
  - This result capped the penalty at $30,000 compared to the initial total assessment of approximately $144,000.

Recent Court Opinions – Non-Willful Violations (Cont.)

- *U.S. v. Giraldi*, No. 20-2830 (D. N.J. 2021)
  - Court agreed with the reasoning in *Bittner* and *Kaufman* and held that non-willful FBAR *violations are per form* rather than per bank account
  - Court acknowledged that the per form approach equates failing to report one account with failing to report multiple accounts, but since the number of accounts does not affect whether a taxpayer must file an FBAR the number of accounts need not automatically affect the penalties without clear Congressional intent.
  - This result capped the penalty at $40,000 compared to the initial total assessment of $160,000

Recent Court Opinions – Excessive Fines

- *U.S. v. Schwarzbaum*, 125 AFTR 2d 2020-2109 (S.D. Fla. 2020) ("Schwarzbaum II")
  - IRS assessed an aggregate penalty amount of $12.9M for 2007-2009. The aggregate account balances were approximately $7M to $8M each year.
  - Court observed that tax penalties are traditionally found to be remedial and not punitive for Eighth Amendment purposes.
    - Primary purpose of the BSA was remedial because its goal was to require taxpayers to make certain reports that are useful in criminal, tax, and regulatory investigations/proceedings.
    - FBAR penalties reimburse the Gov't for investigation costs.

Recent Opinions – Excessive Fines (cont.)

- *U.S. v. Collins*, 127 AFTR 2d 2021-854 (W.D. Penn. 2021)
  - The IRS assessed an aggregate penalty of $308K for 2007 and 2008. The Aggregate account balances were approximately $900K each year.
  - The Court found the penalty was not excessive citing the factors used by SCOTUS in *Bajakaijan*:
    - (1) penalties were Congressionally authorized;
    - (2) Taxpayer within class of persons for whom the statute was designed (ppl with large off-shore accounts);
    - (3) Nature of taxpayer's actions was willful;
    - (4) Taxpayer's actions harmed the "tax system" "irrespective of the size of any correlated tax loss;"
    - (5) penalties are not excessive compared to criminal sanctions of up to 5 years imprisonment and a fine of up to $250K
  - In dicta, the Court remarked that civil FBAR penalties are not "fines" under the Eighth Amendment because they are not a "punishment for some offense" (defined as an underlying criminal conviction).

Lessons from the IRS and the Cases

Lessons from the IRS

- FBAR filing date is independent of tax return due date
- FBAR exposures survive the death of the owner/signatory
- Joint account owners must each report their interest
- IRS information on foreign account holders comes from many sources…
- A check of the “no” answer to the foreign account question is highly problematic for the filer if they do have a reportable foreign account
- FBAR filings include requirement for “control” filings of foreign entities
- Corporate/entity officers with business signature authority over foreign business accounts must include those accounts on personal FBARs
- “You can’t be nonwillful forever…”

Lessons from Court Opinions

- Whether a taxpayer's failure to report accounts was willful or not willful is not a simple inquiry with significant consequences. Consider the following:
  - Recklessness
  - Constructive knowledge
  - Willful blindness
  - Impact of Schedule B, Question 7(a)
  - Criminal consequences
- IRS is assessing FBAR penalties on a per account basis (note that courts are leaning toward a per FBAR form basis)
- Courts have not been sympathetic to "excessive fines" arguments.

Questions?

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