ORANGE COUNTY BAR ASSOCIATION

TAX LAW
SECTION WEBINAR

The 2020 FBAR Litigation Update

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LITIGATING FBAR PENALTIES – NEW DEVELOPMENTS

NIXON PEABODY

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FBAR BASICS –

- **On Oct 26, 1970 – Congress passed the Bank Secrecy Act which contained a provision for filing and maintenance of records – provided statutory authority for regulations re: foreign accounts.**
- **The UBS Scandal brought renewed attention to the FBAR requirements.**
- **Under current law – an individual who has a financial interest or signature authority over a foreign financial accounts collectively exceeding $10,000 must electronically file FINCEN form 114.**

FBAR Civil Penalties

- **Non-willfulness penalty not to exceed $10,000**
- **Willfulness penalty equal to greater of $ 100,000 or 50% of balance of account at time of violation (FBAR due date).**
- **Non-willfulness penalty should not be imposed if violation due to reasonable cause and the balance in the account was property reported on an FBAR (IRM 4.26.16.4.4)**

IRS Process

- **Inconsistency in auditors –**
  - letter 3709 from examiner
- **Many auditors lack sophisticated international training**
  - Shocked by any meaningful foreign operations or structuring of operations in a manner that is consistent with foreign law but seems unusual in the US
- **IRS Appeals – similar inconsistency –**
- **When can taxpayer get adult review?**

Burden of Proof re: Willfulness

- **IRS has burden of proof re: “willfulness” – preponderance of evidence.**
- **IRM requires examiners to “take into account all the available facts and circumstances of a case” –IRM 4.26.16.4.7)**
- **Courts have consistently held that the standard of willfulness includes “recklessness.”**

Burden of Proof re: Willfulness

- **DOJ and IRS Confident Due to Several Victories**

Norman v. United States

Kimble v. United States

Bedrosian v. United States (DOJ victory on appeal)

United States v. Bohanec

United States v. Williams

United States v. McBride

United States v. Flume

United States v. Horowitz

Burden of Proof re: Willfulness

- **But then…**

United States v. Schwarzbaum, (S.D. Fla., March 20, 2020): The court declined to find willfulness against Isac Schwarzbaum for his failure to report his Swiss bank accounts for 2006. Schwarzbaum held those accounts because he previously lived in Switzerland. The court only held him willful for years after 2006, finding that he had reviewed the FBAR instructions after that date.

Jones v United States, (CD CA May 11, 2020): Resided in New Zealand and Canada before moving to US, and continued to maintain foreign accounts in those countries.

Along with Flume, these cases reject the DOJ's "constructive notice" argument from Schedule B.

Question: Has DOJ been padding its résumé with Swiss bank account cases?

Limitations on Penalty for Willful violations

- **31 USC 5321(a)(5)(C) purports to impose a “maximum” penalty of $ 100,000 or 50% of account value.**

First Two Cases:

United States v. Colliot (W.D. Tex., 2018) (Summary Judgment)

United States v. Wahdan (D. Colo. 2018) (Judgment on the Pleadings)

Limitations on Penalty for Willful violations

- **Subsequent Cases:**

Norman v. United States (Fed. Cl. 2018) aff'd by Fed. Cir. At No 18-2408, Nov. 8, 2019)

Kimble v. United States (Fed. Cl. 2018)

United States v. Garrity (D. Conn., 2019)

United States v. Jung Joo Park (N.D. Ill. 2019)

United States v. Horowitz (D. Md. 2019)

United States v. Schoenfeld (M.D. Fla. 2019)

Limitations on Penalty for Willful violations

- **Colliot (Reasoning Followed in Wahdan)**

"Despite this change, the regulations promulgated in reliance on the prior version of the statute remained unchanged. Thus, §103.57 continued to indicate the maximum civil penalty for willful failure to file an FBAR was capped at $100,000. FinCEN subsequently renumbered §103.57—it is now 31 C.F.R. §1010.820—as part of a large-scale reorganization of regulatory provisions. It also amended part of the regulation to account for inflation. Civil Monetary Penalty Adjustment and Table, 81 Fed. Reg. 42503, 42504 (2016). FinCEN did not, however, revise the regulation to account for the increased maximum penalty now authorized under §5321(a)(5). 31 C.F.R. §1010.820."

* * * * *

"In turn, the IRS argues §1010.820 is inconsistent with the 2004 amendments to §5321(a)(5)(C) and was therefore implicitly superseded or invalidated by those statutory revisions."

(Emphasis added.)

Limitations on Penalty for Willful violations

- **Colliot (Reasoning Followed in Wahdan)**

OUTCOME:

“Unfortunately for the IRS, there is little reason to believe §5321(a)(5)(C) implicitly superseded or invalidated §1010.820. Section 5321(a)(5) sets a ceiling for penalties assessable for willful FBAR violations, but it does not set a floor.[2] 31 U.S.C. §5321(a)(5). Instead, §5321(a)(5) vests the Secretary of the Treasury with discretion to determine the amount of the penalty to be assessed so long as that penalty does not exceed the ceiling set by §5321(a)(5)(C). Id. And §1010.820—a regulation validly issued by the Treasury via notice-and-comment rulemaking—purports to cabin that discretion by capping penalties at $100,000.[3] 31 C.F.R. §1010.820. Thus, considered in conjunction with §5321, §1010.820 is consistent with §5321's delegation of discretion to determine the amount of penalties to be assessed. See U.S. Pipe & Foundry Co. v. Webb, 595 F.2d 264, 272 (5th Cir. 1979) (“Regulations are presumed valid unless they are shown to be unreasonable or contrary to the provisions of the enabling statute.”). Since §1010.820 can be applied consistent with §5321(a)(5), the Court concludes §5321(a)(5) does not implicitly invalidate or supersede §1010.820.”

Limitations on Penalty for Willful violations

- **Norman (Reasoning Followed in Subsequent Cases)**

"Congress'[s] use of the imperative, ‘shall,’ rather than the permissive, ‘may,’ ... removed the Treasury Secretary's discretion to regulate any other maximum.“

- **Schoenfeld (Most Recent – Collecting Cases)**

“In agreeing with this interpretation of § 5321, the Court recognizes that "[t]he statute does not require imposition of the maximum penalty," and that it "gives the Secretary discretion to impose penalties below the statutory cap." See Wahdan, 325 F. Supp. 3d at 1139. However, merely because the statute vested the Secretary with discretion on some matters, it does not follow that the statute necessarily vested the Secretary with the discretion to change the maximum penalty as established by Congress.”

JUDICIAL REVIEW – CHOICE OF FORUM

- **Tax Court won't review because it is empowered to only review matters under Title 26. See *Williams* and *Mcbride***
- **US Court of Claims and US District Court**
- **Tucker Act and Little Tucker Act**
- **US Court of Claims historically has more meaningful experience trying tax cases – may be a preferred venue.**

JURISDICTION FOR ILLEGAL EXACTION?

- ***Contrast: Flora* and full payment rule and Little Tucker Act**

28 U.S.C. § 1346(a)(1) grants the Court of Federal Claims jurisdiction, concurrent with federal district courts, over civil actions "against the United States for the recovery of any internal-revenue tax alleged to have been erroneously or illegally assessed or collected, or any penalty claimed to have been collected without authority or any sum alleged to have been excessive or **in any manner wrongfully collected under the internal-revenue laws**." (Emphasis added.)

7422(a):No suit or proceeding shall be maintained in any court for the recovery of any internal revenue tax alleged to have been erroneously or illegally assessed or collected, or of any penalty claimed to have been collected without authority, or of any sum alleged to have been excessive or in any manner wrongfully collected, until a claim for refund or credit has been duly filed with the Secretary, according to the provisions of law in that regard, and the regulations of the Secretary established in pursuance thereof.

28 U.S.C. § 1346(a)(2), which follows paragraph (a)(1) and opens with the limiting phrase "[a]ny other civil action," allows a person may sue for the return of an illegally exacted amount under $10,000 in certain circumstances, but only if the claim is not one which falls under Section 1346(a)(1).

BEDROSIAN

- Court concluded that they did not have jurisdiction over Mr. Bedrosian's claim for refund because he had not fully paid
- Adopted broad and functional view of "internal revenue law"- *Wyodak* (10th Cir.) and *Whistleblower* 21276-13W - (IRS acknowledged that internal revenue laws could be outside of title 26). If it walks like a duck and talks like a duck…
- Court **concluded** that they did not have jurisdiction over Plaintiff's claim – arguably not dicta
- Jurisdiction saved because under 28 USC 1291 – i.e. they had jurisdiction over government's counterclaim

Mendu v. US

- **Very unsophisticated auditor – irrational findings**
- **Willful FBAR Penalties imposed and challenged in US Court of Claims**
- **$ 1000 paid – not full payment**
- **Case brought well before Third Circuit holding in Bedrosian**
- **Claims Court does not have original jurisdiction over counterclaim**
  - If claim fails then counterclaim fails
- **Statute has run for DOJ to file suit in District Court**
- **Taxpayer brought Motion to Dismiss own case and counterclaim– based upon 3rd Circuit holding in Bedrosian**

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Mr. Malik is the principal author of the 2nd edition of Taxation Of Securities Transactions, a comprehensive U.S. federal income tax treatise. Mr. Malik previously presented for the OCBA Tax Section on conflicts of interest in tax controversies. He earned his J.D. and B.S. from the University of Ottowa and earned an LL.M. from New York University.

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Mr. Layton is a graduate of the University of Chicago Law School. He earned his LL.M. in Taxation from Golden Gate University in San Francisco.