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TAX LITIGATION ISSUES

Non-Willful FBAR Penalties: A (Temporary) Reprieve for Taxpayers?

By
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For over a dozen years, the Internal Revenue Service and the Department of Justice have targeted the use of offshore accounts to evade U.S. income taxes. In testimony before Congress last month, IRS Commissioner Charles P. Rettig made it clear that this crackdown on offshore tax evasion will continue unabated.

Taxpayers who willfully fail to disclose their offshore accounts on complete and accurate Reports of Foreign Bank and Financial Accounts (FBARs) are subject to criminal investigation and prosecution. However, as this column has previously chronicled, taxpayers who willfully violate their reporting requirements, but are fortunate enough to avoid prosecution, are still subject to civil penalties of up to 50% of the value of their undisclosed accounts. See Jeremy H. Temkin, *Civil FBAR Penalty Litigation: No Reprieve for Taxpayers*, N.Y.L.J. (March 18, 2021) and *The Next Frontier: Civil Penalties for Undisclosed Offshore Accounts*, N.Y.L.J. (Jan. 18, 2018). But not every FBAR violation is the product of willful conduct. Rather, some taxpayers fail to comply with their reporting obligations, not knowingly or recklessly but out of negligence or as the result of a good faith mistake.

By statute, the IRS is authorized to impose a penalty of up to $10,000 for "any [non-willful] violation" of FBAR provisions. 31 U.S.C. §5321. In recent years, district courts have disagreed regarding whether this provision authorized a separate $10,000 penalty for each undisclosed account or limited the IRS to a single $10,000 penalty, regardless of the number of accounts at issue.

In late March, the Ninth Circuit became the first Circuit Court of Appeals to address this issue. In *United States v. Boyd*, 991 F.3d 1077 (9th Cir. 2021), a split panel limited the IRS to a single $10,000 penalty per FBAR violation. While additional Courts of Appeals will likely weigh in on this issue in the upcoming months, the Ninth Circuit's opinion in *Boyd* provides a useful roadmap for practitioners representing taxpayers.

Statutory and Regulatory Framework

Pursuant to 31 U.S.C. §5314(a) and the corresponding regulations, each year U.S. taxpayers are required to file FBARs disclosing their financial interest in or signature authority over foreign financial accounts. Prior to 2004,

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the statute authorized a fine of the greater of $25,000 or the balance in the account at the time of the violation, not to exceed $100,000. 31 U.S.C. §5321(a)(5)(B)(ii) (2000). In 2004, Congress amended the statute to increase the penalties for willful violations to the greater of $100,000 or 50 percent of the value of the foreign account, 31 U.S.C. §5321(a)(5)(C)-(D), and to authorize the imposition of a civil penalty up to $10,000 on any "person who violates, or causes any violation of, any provision of" §5314, 31 U.S.C. §5321(a)(5)(B). This latter provision is generally understood to apply to non-willful FBAR violations.

The Internal Revenue Manual provides that, "[a]fter May 12, 2015, in most cases, examiners will recommend one [$10,000] penalty per open year, regardless of the number of unreported foreign accounts," but gives examiners discretion to impose a single $10,000 penalty for multiple years with non-willful violations. IRM §4.26.16.6.4.1(1), (2). Notwithstanding this language, the IRS taken the view that the statute authorizes the imposition of a separate $10,000 penalty for each unreported foreign account, as opposed to a single $10,000 penalty for the failure to comply with the FBAR requirements in a given year. The imposition of non-willful penalties for each unreported account can lead to substantial financial exposure, albeit far less than the penalties that could be imposed in the case of a willful violation. For example, in one case, the IRS assessed a total of $160,000 in non-willful penalties based on the taxpayer's failure to disclose four separate accounts over four years. *United States v. Giraldi*, No. CV202830S-DWLDW, 2021 WL 1016215, at *3 (D.N.J. March 16, 2021).

'United States v. Boyd'

Not surprisingly, taxpayers have challenged these extreme results and the Ninth Circuit recently became the first Court of Appeals to consider the scope of the civil penalties that can be imposed for non-willful FBAR violations. In *United States v. Boyd*, the taxpayer had undisclosed financial interests in 13 offshore accounts. In 2012, she participated in the IRS's Offshore Voluntary Disclosure Program, but she ultimately opted out of that program's penalty structure. After an examination, the IRS concluded that her failure to comply with the FBAR requirement was non-willful but, under the applicable mitigation guidelines, imposed a $47,279 civil penalty—$5,000 for each of the seven foreign accounts she held with values over $50,000, plus 10% of the highest balance in each of the remaining six undisclosed accounts.

After Boyd declined to pay the penalty, the government brought an action in federal district court to collect the penalty. The district court sided with the government, *United States v. Boyd*, No. CV 18-803-MWF (JEMX), 2019 WL 1976472, at *4 (C.D. Cal. April 23, 2019), and Boyd appealed. On March 24, 2021, the Ninth Circuit reversed. Writing for a 2-1 majority, Judge Michael J. Bennett first observed that federal law permits a $10,000 civil penalty for "any violation of, any provision of section 5314." 31 U.S.C. §5321. Thus, the key question is, what constitutes a "violation" of §5314?

Judge Bennett then noted that the applicable regulations require taxpayers to file a timely report accurately disclosing their foreign bank accounts. See 31 C.F.R. §§1010.350(a), 1010.306. Observing that Boyd had filed an accurate FBAR two years later than required by law, the majority concluded that "Boyd committed a single non-willful violation—the failure to timely file the FBAR." As a result, the majority held that the IRS could only impose one $10,000 penalty for this single violation. In doing so, the court rejected the government's argument that Congress's use of the phrase "any violation" supports the conclusion that a single report can result in multiple violations, finding instead

that the word "any" refers to the ways in which the statute can be violated.

Citing *Bradley v. United States*, 817 F.2d 1400, 1402-03 (9th Cir. 1987), the majority supported its holding by noting that Circuit precedent requires strict construction of tax provisions imposing penalties. It then examined the legislative history, noting that when Congress added the non-willful civil penalties in 2004, the statute specified that penalties for willful violations should be calculated on a per account basis. See 31 U.S.C. §5321(a)(5)(B)(ii) (2000) (referring to the "balance in the account at the time of the violation"). The court inferred that by omitting similar per account language for non-willful violations, Congress signaled its intent that the IRS would only impose a single, $10,000 penalty per violation.

In her dissenting opinion, Judge Sandra S. Ikuta argued that the relevant regulations impose two separate requirements on taxpayers: (1) to "report [their] relationship [with foreign banks] to the Commissioner of Internal Revenue for each year in which such relationship exists" and (2) to file an FBAR. 31 C.F.R. §1010.350(a). She explained that even if Boyd had timely filed an FBAR disclosing only one of her foreign accounts, she still would have violated the regulation's requirement that she report *each* foreign bank account she held. Because federal law permits a $10,000 penalty for "any violation of, any provision of section 5314," she would permit the IRS to impose a penalty for each bank account she failed to disclose. 991 F.3d at 1091.

Judge Ikuta dismissed the circuit precedent requiring strict construction of the provision at issue as inapplicable given the requirement that the court adopt the most natural reading of the statute. She further rejected the relevance of the provision for willful penalties being applied on a per account basis noting that because a willful "violation" was already defined on a per account basis, when Congress used the term "violation" in the non-willful context, it must have also meant to define non-willful "violation[s]" on a per account basis.

Conclusion

While the Ninth Circuit was the first of the Courts of Appeals to address the issue, district courts in Connecticut, New Jersey and Texas have all agreed with the taxpayers that non-willful FBARs penalties are predicated on the FBAR form as opposed to individual unreported accounts. See *United States v. Kaufman*, No. 3:18-CV-00787 (KAD), 2021 WL 83478, at *8 (D. Conn. Jan. 11, 2021); *United States v. Giraldi*, No. CV202830SDWLDW, at *4 (D.N.J. March 16, 2021); *United States v. Bittner*, 469 F. Supp. 3d 709, 719 (E.D. Tex. 2020). The Fifth Circuit will soon have an opportunity to weigh in on the issue as the government has appealed the district court's decision in *Bittner*. If the taxpayer prevails there too, it will provide a growing consensus for a common-sense reading of the statutory scheme and will obviate time-consuming and expensive litigation in a manner consistent with the IRS's determination that the taxpayer's failure to comply with their FBAR obligation was a function of negligence, as opposed to intentional or reckless conduct. In the meantime, *Boyd* and the applicable Internal Revenue Manual provisions give ample ammunition to practitioners representing taxpayers who mistakenly failed to report their offshore accounts.