FRAUD & NEGLIGENCE

Third Time's the Charm: Government Finally Collects 'Willful' FBAR Penalty in *Williams*

Author: By Hale E. Sheppard

Hale E. Sheppard is a shareholder in the Atlanta office of the law firm Chamberlain, Hrdlicka, White, Williams & Aughtry, and specializes in tax audits, tax appeals, tax litigation, and international tax disputes and compliance. He has frequently written for The Journal. ***Copyright © 2012, Hale E. Sheppard.***

One taxpayer's protracted litigation involving his concealment of an offshore account raised significant and novel questions, many of which remain unanswered. One thing is clear, though. The government finally won a major point by persuading the appellate court that the taxpayer was willful in failing to file a required FBAR.

The world of international tax enforcement is changing at a frenetic pace, especially when it comes to the rules about penalizing taxpayers who fail to file Forms TD F 90-22.1 (Report of Foreign Bank and Financial Accounts, known as FBARs). The latest installment in this area is *Williams,* 110 AFTR 2d 2012-5298 (CA-4, 2012) ("*Williams III*"), a recent decision holding that the taxpayer "willfully" violated his FBAR obligations and thus deserved maximum sanctions. This judicial opinion, already the subject of much criticism by the tax community, raises more questions than answers.

The *Williams* trilogy has been a long road, with stops in the U.S. Tax Court (131 TC 54 (2008); "*Williams I*"), the U.S. district court (106 AFTR 2d 2010-6150 (2010); "*Williams II*"), and, most recently, the Fourth Circuit in *Williams III.* To fully grasp the significance of this case, one must first have an appreciation of the relevant law.

FBAR RULES AND PENALTIES

Congress enacted the Bank Secrecy Act in 1970. [1] One purpose of this legislation was to require the filing of certain reports, like the FBAR, where doing so would be helpful to the U.S. government in carrying out criminal, tax, and regulatory investigations. [2] Among the important provisions of the Bank Secrecy Act was 31 U.S.C. section 5314. This statute, in conjunction with the underlying regulations and FBAR Instructions, requires the filing of an annual FBAR where (1) a U.S. person (2) had a financial interest in, signature authority over, or some other type of authority over (3) one or more financial accounts (4) located in a foreign country (5) and the aggregate value of such account or accounts exceeded $10,000 (6) at any time during the calendar year. [3]

Concerned with widespread noncompliance with the FBAR requirement, the U.S. government took certain actions. For instance, Treasury transferred authority to enforce the FBAR provisions from the Financial Crimes Enforcement Network ("FinCEN") to the IRS in April 2003. The Service is empowered to investigate potential violations, issue summonses, assess civil penalties, issue administrative rulings, and take "any other action reasonably necessary" to enforce the FBAR rules. [4]

Congress, for its part, enacted new FBAR penalty provisions in October 2004 as part of the American Jobs Creation Act (AJCA). [5] Under the old law, which was applicable to the *Williams* cases, the government could assert a civil penalty against taxpayers only where it could demonstrate that they "willfully" violated the FBAR rules. [6] If the government managed to satisfy this high evidentiary

standard, it was authorized to assert civil FBAR penalties ranging from $25,000 to $100,000, depending on the highest balance of the unreported foreign financial account(s). [7]

Thanks to the 2004 AJCA, the IRS may now impose a civil penalty on any person who fails to file an FBAR when required, period. [8] In the case of non-willful or unintentional violations, the maximum penalty is $10,000. [9] Notably, the IRS cannot assert this penalty if two conditions are met:

(1) The violation was due to "reasonable cause," and

(2) The balance in the account was properly reported. [10]

The AJCA calls for higher maximum penalties where willfulness exists. Where a taxpayer deliberately failed to file an FBAR, the IRS may assert a penalty equal to $100,000 or 50% of the balance in the account at the time of the violation, whichever amount is larger. [11] Given the astronomical balance in some unreported accounts, and the fact that the IRS often applies the penalty on a per-account-per-year basis, the penalties can be enormous.

KEY FACTS IN THE *WILLIAMS* CASES

A synthesis of various court documents and decisions yields the following facts underlying the *Williams* cases. [12] The taxpayer was a U.S. citizen at all relevant times. He earned an undergraduate degree from the University of North Carolina, followed by a law degree from one of the top law schools in the country, New York University. He began his legal career as an associate attorney with a major international firm, Shearman & Sterling LLP, in its corporate finance department. He later worked for Mobil Oil Corporation, where he held various legal and business positions over a span of some 25 years.

In 1991, the taxpayer, on Mobil's behalf, started exploring strategic business opportunities in the former republics of the Soviet Union. Two years later, in 1993, the taxpayer opened two accounts at Credit Agricole Indosuez, S.A. (then known as Banque Indosuez) in the name of ALQI Holdings, Ltd. (ALQI), a British Virgin Islands corporation controlled by the taxpayer.

The accounts were designed to hold funds received by the taxpayer from 1993 through 2000 in connection with his oil trading in Russia and his consulting for various companies under the guise of ALQI. The taxpayer deposited more than $7 million into the accounts during this eight-year period, and the funds generated approximately $800,000 in passive income (i.e., interest, dividends, capital gains).

A taxpayer has three main duties when he holds a financial interest in a foreign account:

(1) Report all income deposited into or generated by the account on the relevant federal income tax return (i.e., Form 1040),

(2) Check the "yes" box in Part III of Form 1040, Schedule B ("Foreign Accounts and Trusts"), to report the existence and location of the foreign account, and

(3) File an FBAR with Treasury by June 30 of the relevant year, supplying additional information about the account. [13]

The taxpayer in *Williams* violated all three duties.

With respect to the second duty, Line 7a in Part III of Schedule B of the 2000 Form 1040 contained the following inquiry and cross-reference: "At any time during 2000, did you have an interest in or a signature or other authority over a financial account in a foreign country, such as a bank account, securities account, or other financial account? See instructions for exceptions and filing requirements for Form TD F 90.22.1."

The Service's Instructions to the 2000 Form 1040 contained the following additional guidance regarding the FBAR: "Check the ‘Yes’ box on Line 7a if either 1 or 2 below applies to you. 1. You own more than 50% of the stock in any corporation that owns one or more foreign bank accounts. 2. At any time during the year you had an interest in or signature authority over a financial account in a foreign country (such as a bank account, securities account, or other financial account).... See Form TD F 90-22.1 to find out if you are considered to have an interest in or signature or other authority over a financial account in a foreign country (such as a bank account, securities account, or other financial account). If you checked the ‘Yes’ box on Line 7a, file Form TD F 90-22.1 by June 30, 2001, with the Department of the Treasury at the address shown on that form. Do not attach to Form 1040."

The taxpayer employed the same U.S. accountant for all the relevant years, 1993 to 2000. He did not discuss the foreign accounts

with his accountant. Moreover, the accountant sent him a questionnaire in early 2001, called a "tax organizer," to be completed by the taxpayer in order to assist the accountant in preparing the Form 1040 for 2000; the taxpayer checked the "no" box to indicate the he never had a reportable interest in a foreign account.

In August 2000, Swiss government officials notified the taxpayer of its desire to interview him with respect to the ALQI accounts. The Swiss authorities, who were apparently coordinating with their U.S. counterparts, interviewed the taxpayer on 11/13/00. The next day, the U.S. government directed Switzerland to freeze the accounts. It did so.

In early June 2001, the taxpayer retained U.S. tax attorneys at a reputable national firm to advise him with respect to the ALQI accounts and related tax issues. This firm did not provide the taxpayer any instructions or advice about the requirement to file an FBAR for 2000 by 6/30/01. The firm later met with IRS attorneys in January 2002 to discuss a possible resolution of this case on a noncriminal basis; no settlement was reached.

The IRS announced a tax amnesty program, the Offshore Voluntary Compliance Initiative (OVCI), in January 2003. [14] The OVCI offered lenient settlement terms to those taxpayers who came forward of their own free will. If a taxpayer was eligible for the OVCI, he effectively could resolve *all* past international tax noncompliance in a criminal-free manner, with relatively small civil penalties. In essence, a taxpayer was obligated to file amended federal income tax returns (i.e., Forms 1040X) for 1999, 2000, and 2001 reporting all foreign source income, pay the corresponding taxes and interest charges, and file all necessary information returns related to foreign entities and accounts, including the FBAR. Perhaps the most appealing aspect of participating in the OVCI was that the Service treated this as a "voluntary disclosure," which meant that the IRS generally would not pursue any criminal charges. [15]

The taxpayer in *Williams,* enticed by this offer, submitted his OVCI application in February 2003. The Service rejected his approach in April 2003, citing the fact that the OVCI was not available to taxpayers whose applications arrived after the IRS already had initiated a civil examination or criminal investigation of the taxpayer or a related entity, after the IRS had notified the taxpayer of its intent to start such an examination or investigation, or after the IRS received information from a third party, including another governmental agency, alerting the IRS to the offshore noncompliance. [16]

The Service first pursued criminal charges against the taxpayer. In May 2003, the taxpayer agreed to plead guilty to one count of criminal tax evasion and one count of criminal conspiracy to defraud the U.S. government. This plea agreement was confirmed on 6/12/03, when the taxpayer made the following allocution:

"In 1993, with the assistance of a banker at Bank Indosuez, I opened two bank accounts in the name of a corporation, ALQI Holdings, Ltd. ALQI was created at the time as a British Virgin Islands Corporation. The purpose of that account was to hold the funds and income I received from foreign sources during the years 1993 through 2000.

"Between 1993 and 2000, more than seven million dollars was deposited in the ALQI accounts and more than $800,000 income was earned on those deposits.

"I knew that most of the funds deposited into the ALQI accounts and all of the interest income were taxable to me. However, [on] the calendar year returns ’93 through 2000, I chose not to report the income to my—to the Internal Revenue Service in order to evade substantial taxes owed thereon, until I filed my 2001 tax return.

"I also knew that I had the obligation to report to the IRS and/or the Department of the Treasury the existence of the Swiss accounts, but for the calendar year tax returns 1993 through 2000, I chose not to in order to assist in hiding my true income from the IRS and evade taxes thereon, until I filed my 2001 tax return. [Emphasis added.]

"I knew what I was doing was wrong and unlawful. I, therefore, believe that I am guilty of evading the payment of taxes for the tax years 1993 through 2000. I also believe that I acted in concert with others to create a mechanism, the ALQI accounts, which I intended to allow me to escape detection by the IRS. Therefore, I am—I believe that I'm guilty of conspiring with the people would [sic] whom I dealt with regarding the ALQI accounts to defraud the United States of taxes which I owed."

The most crucial aspect of this allocution, from the perspective of the subsequent civil FBAR penalties in *Williams II* and *Williams III,* is the italicized sentence above.

At the criminal sentencing hearing in September 2003, the court imposed the following punishment on the taxpayer: nearly four years (i.e., 46 months) in jail, a $25,000 fine, over $3.5 million in restitution, and three years of supervised release. The court also ordered

that all the assets in the unreported Swiss accounts be transferred to the clerk of the court for payment of the fine, restitution, etc. Thus, more than $8 million was transferred to the U.S. government at that time.

The IRS then initiated a civil examination against the taxpayer approximately one year after the criminal sentence was handed down. The revenue agent assigned to the case asked the taxpayer, in January 2007, to file an FBAR for 2000. The taxpayer later claimed that this was the first time he learned of the FBAR filing requirement, notwithstanding that he retained a reputable law firm and new accountant in 2001 to assist him in rectifying past issues related to the ALQI accounts, and notwithstanding that he applied to participate in the OVCI in February 2003, a component of which was filing FBARs for past years. As part of the examination process, the revenue agent indicated that he would not conclude the matter until the taxpayer filed FBARs for all years going back to 1993. The taxpayer did so.

According to the taxpayer, the revenue agent initially threatened to assert FBAR penalties for *each* year from 1993 through 2000, unless the taxpayer agreed to execute the proposed examination report. The taxpayer refused to execute the examination report because he believed it was "grossly incorrect," but, after the taxpayer's counsel explained to the revenue agent that the IRS was precluded from asserting FBAR penalties for 1993 through 1999 because the six-year statute of limitations had passed, the revenue agent asserted FBAR penalties only for 2000.

In particular, in May 2007 the revenue agent asserted, under the FBAR law in effect for 2000, the maximum penalty of $100,000 per account for the two ALQI accounts on grounds that the taxpayer "willfully" violated the law twice. To be clear, the sanction imposed by the revenue agent was not $100,000 for failing to file an FBAR for 2000 reporting all accounts, but rather a fine of $100,000 for each undeclared account in 2000.

In addition to asserting the FBAR penalty for 2000, the IRS issued a notice of deficiency in October 2007, proposing significant federal income tax liabilities, accuracy-related penalties, and civil fraud penalties for all eight years, 1993 through 2000. Unlike with the FBAR, the IRS was able to attack the taxpayer on tax issues going back to the beginning because no statute of limitations exists in cases of fraudulent returns. [17]

Williams I—Novel Jurisdiction Issues in Tax Court

The taxpayer filed a timely petition with the Tax Court contesting all the proposed adjustments set forth in the notice of deficiency, as well as the FBAR penalties that were not included therein.

The IRS, predictably, filed a motion to dismiss for lack of jurisdiction as to the FBAR penalties. [18] The Service's theory was that the provision under which FBAR penalties are asserted (i.e., 31 U.S.C. section 5321) does not fall within the Tax Court's jurisdiction. This is based on Section 7442 , which provides that the Tax Court and its divisions "shall have such jurisdiction as is conferred on them by this title," i.e., 26 U.S.C.

The Tax Court began its opinion in *Williams I* by explaining that Section 6212(a) authorizes the IRS to issue a notice of deficiency in certain situations. For its part, Section 6213(a) provides that the tax in question may not be assessed until the Service has issued the requisite notice of deficiency. It further provides that the tax assessment must be delayed pending a possible redetermination by the Tax Court if the taxpayer files a timely petition.

The court pointed out, however, that these two provisions expressly state that the notice of deficiency is to be sent in the case of taxes imposed by Subtitle A of Title 26 (i.e., income taxes), by Subtitle B of Title 26 (i.e., estate and gift taxes), or Chapters 41, 42, 43, or 44 in Subtitle D of Title 26 (i.e., miscellaneous excise taxes). Therefore, by negative implication, any other taxes fall outside the limited jurisdiction of the Tax Court. Extending this logic, the court reasoned as follows with respect to FBAR penalties:

"The same conclusion must be reached as to the FBAR penalties imposed in Title 31: The Secretary of the Treasury is authorized by 31 U.S.C. sec. 5321(b)(1) to assess the FBAR penalty; no notice of deficiency is authorized by section 6212(a) nor required by section 6213(a) before that assessment may be made; and the penalty therefore falls outside our jurisdiction to review deficiency determinations."

Collection. The issue of whether the Tax Court would have jurisdiction over a subsequent action by the government to collect FBAR penalties was not raised in the taxpayer's petition in *Williams I,* and was not broached in the Service's motion to dismiss. Nevertheless, the Tax Court addressed this topic on its own.

A brief overview on the normal tax collection process helps put this second issue in context. The IRS is required to send the taxpayer a notice of intent to levy at least 30 days before it seizes his property to satisfy tax debts. [19] To dispute the intended governmental taking, a taxpayer may file a Form 12153, which triggers a collection due process (CDP) hearing. [20] At the CDP hearing, the IRS settlement officer is charged with deciding whether the levy "balances the need for efficient collection of taxes with the legitimate concern of the person that any collection action be no more intrusive than necessary." [21] The settlement officer ultimately issues a notice of determination, which represents the Service's final administrative decision regarding the propriety of the levy. If the notice of determination upholds the levy, then the taxpayer may seek further review, this time from the judiciary. He exercises this right by filing a petition with the Tax Court. [22]

In *Williams I,* the Tax Court explained that the provisions under which the IRS may place a lien or effectuate a levy are narrow. They apply to only to "taxes," as well as the additions to tax, additional amounts, and penalties described in Chapter 68 of Title 26 (i.e., Sections 6651 through 6751). [23] The Tax Court then made three points as to why it would lack jurisdiction to address any FBAR-penalty-collection issue:

> (1) There is no statute expanding the definition of "tax" as used in the lien and levy provisions of the Code to include the FBAR penalty;
>
> (2) The collection mechanism in the applicable FBAR statute, 31 U.S.C. section 5321(b)(2), is not a lien or levy, but rather a "civil action to recover a civil penalty"; and
>
> (3) Even if the FBAR penalty were a tax subject to the Service's lien and levy provisions, the IRS had not issued a notice of determination, which is a prerequisite to filing a petition with the Tax Court.

In summary, the Tax Court set important precedent in *Williams I,* holding that it lacks jurisdiction to address FBAR issues at both the assessment stage and collection stage. [24]

WILLIAMS II—DISTRICT COURT DENIES FBAR PENALTIES

Not surprisingly, the taxpayer in *Williams* did not hand over $200,000 to the IRS after the revenue agent asserted the maximum penalty in May 2007. He took the position that he did not "willfully" fail to file an FBAR for 2000, so the penalty could not apply.

As a result, the government filed a complaint in district court in April 2009 "for the purpose of collection of outstanding civil penalties." The government did so pursuant to 31 U.S.C. section 5321(b)(2), which provides that the government may commence a civil action to recover an FBAR penalty within two years of the date on which it is assessed.

The government then filed a motion for summary judgment on the FBAR penalty issue, with the focus being whether the taxpayer "willfully" failed to file an FBAR for 2000. The government, citing *Ratzlaf v. U.S.,* 510 US 135, 126 L Ed 2d 615 (1994) (a case involving a criminal violation of the structuring provisions of the Bank Secrecy Act) and *U.S. v. Sturman,* 951 F2d 1466 (CA-6, 1991) (a criminal FBAR case), argued that it only had to prove that the taxpayer intentionally violated "a known legal duty" to prevail.

Referring to his earlier guilty plea back in 2003, the government maintained that the taxpayer already had admitted in the criminal trial that he knew he had an obligation to report the existence of the Swiss accounts, he knew that the foreign source income deposited into and generated by the accounts constituted taxable income to him, and he knew that he was conspiring with others to escape detection by the IRS. Thus, reasoned the government, the taxpayer acted "willfully" in not filing the FBAR.

In a subsequent brief on the issue, the government contended that the taxpayer's guilty plea to the criminal charges had the "collateral consequence" of subjecting him to a $200,000 civil FBAR penalty. The government also claimed that the taxpayer was trying to "have his cake and it eat too" by allocuting at the criminal trial to obtain a reduced sentence for acceptance of responsibility, and then attempting to avoid civil penalties by retracting his statements.

The district court was not persuaded by the government's argument. In rejecting its motion for summary judgment, the court made two main points. First, the court noted that the primary issue—whether the taxpayer "willfully" failed to file an FBAR with respect to his Swiss accounts existing in 2000—was an "inherently factual question" that was inappropriate for summary judgment.

Second, while acknowledging that the taxpayer generally cannot disaffirm in a subsequent civil action the facts underlying an earlier criminal guilty plea, the court explained that real issue in this case was defining which specific facts were actually part of the taxpayer's plea in 2003. The taxpayer previously admitted that he intentionally omitted income from his Forms 1040 for 1993 through

2000, but "there is a disconnect between this broad factual basis underlying his plea and the specific question at issue here: whether on June 30, 2001, [the taxpayer] willfully failed to submit [an FBAR] for tax year 2000."

The case thus advanced to trial. In its post-trial briefs, the government recognized that "willfulness" is rarely demonstrated with direct evidence since it involves the taxpayer's state of mind. Therefore, the government pointed toward the taxpayer's overall course of conduct, focusing on his guilty plea to tax evasion and conspiracy to defraud, his actions to conceal the unreported income, and his willful ignorance, i.e., his "conscious effort to avoid learning about reporting requirements."

Counsel for the taxpayer countered by arguing here, as he had in other briefs, that (1) he did not "willfully" fail to file the FBAR for 2000, (2) the government waived its right to assert the FBAR penalty when it took control of the accounts by having them frozen before the FBAR deadline of 6/30/01, (3) the government abused its administrative discretion in asserting the maximum FBAR penalty of $100,000 per account when congressional reports confirmed that thousands of other taxpayers in similar situations had received little to no penalties, and (4) even if penalties were appropriate, only one account (divided into sub-accounts for administrative purposes) instead of two accounts existed, thereby cutting the penalty to $100,000.

Court Finds Taxpayer Did Not Act 'Willfully'

The district court in *Williams II* issued its opinion in favor of the taxpayer in September 2010, basing its determination on two principal factors. [25]

First, the court indicated that the government did not adequately differentiate between simply failing and "willfully failing" to disclose an interest in foreign accounts. In this regard, the court explained that, after examining all the surrounding facts and circumstances presented during the trial process, it was not persuaded that the taxpayer was lying about his ignorance of the law and the contents of his Form 1040.

The district court acknowledged that the box on Schedule B of the taxpayer's Form 1040 for 2000 was checked "no" in response to the foreign-account question, and further understood that the taxpayer did not initially file an FBAR for 2000. Nevertheless, the court underscored that both of these actions (or inactions) occurred *after* the taxpayer discovered that the Swiss and U.S. authorities knew about the ALQI accounts. Indeed, the FBAR filing deadline for accounts existing in 2000 (i.e., 6/30/01) was approximately eight months after the interview with the Swiss authorities and the resulting freezing of the accounts. According to the district court, these "strongly indicate[d] to the Court that [the taxpayer] lacked any motivation to willfully conceal the accounts from authorities after that point."

The court also noted that subsequent disclosures by the taxpayer, through his representatives, corroborated his lack of willfulness with respect to 2000. In particular, the district court identified the disclosures made by the taxpayer's attorneys in their meeting with the IRS in January 2002 and the revelations made in the course of applying for the OVCI in February 2003. These disclosures, noted the district court, indicated the taxpayer's "consciousness of guilt for evading income taxes, which he never equated with the foreign banking disclosure."

Second, consistent with its earlier comments in rejecting the government's motion for summary judgment, the district court stressed that a guilty plea to *certain* charges in a previous criminal trial does not necessarily support *all* civil penalties in a subsequent matter. The District Court held the following on this score:

"The Government argues that Williams' guilty plea should estop him from arguing that he did not willfully violate §5314 for the tax year 2000. However, the evidence introduced at trial established that the scope of the facts established by Williams' 2003 guilty plea are not as broad as the Government suggests, and there remains a factual incongruence between those facts necessary to his guilty plea to tax evasion and those establishing a willful violation of §5314. That Williams intentionally failed to report income in an effort to evade income taxes is a separate matter from whether Williams specifically failed to comply with disclosure requirements contained in §5314 applicable to the ALQI accounts for the year 2000. As Williams put it in his testimony at trial, 'I was prosecuted for failing to disclose income. To the best of my knowledge I wasn't prosecuted for failing to check that box.'"

WILLIAMS III—THE ARGUMENTS ON APPEAL

The government, dissatisfied with the taxpayer-favorable decision by the district court, filed a notice of appeal in November 2010, followed by its opening brief filed with the Fourth Circuit on 2/25/11. The government raised just two issues in its brief:

(1) The government asked the appellate court to determine whether the taxpayer, after making various admissions in his prior criminal case, was estopped (judicially, collaterally, or both) from arguing in the subsequent civil case that his failure to file an FBAR for 2000 was not willful.

(2) Assuming that the taxpayer was not estopped from raising such arguments, the government urged the Fourth Circuit to decide that the district court erred in ruling that the taxpayer did not act willfully.

Given the nature of its analysis and holding, the court of appeals never addressed the government's first issue. [26]

The government's primary argument was that the district court erred, as a matter of law, in determining which elements had to be present to prove "willfulness" in the context of a civil FBAR violation, as opposed to a criminal one. Citing various decisions from the Supreme Court and appellate courts, the government maintained that, where willfulness is a condition of civil liability, (1) the concept of willfulness is broad enough to cover both reckless and knowing violations, (2) it is not necessary to prove that a taxpayer had an improper motive or bad purpose to show willfulness, and (3) evidence of a taxpayer's actions to conceal income, in conjunction with the taxpayer's failure to seek information about foreign account reporting requirements, suffices to show willfulness.

The government contended that the district court arrived at its conclusion that the taxpayer did not willfully violate the FBAR rules because of its belief that the taxpayer lacked "motivation to willfully conceal" the foreign accounts after November 2000, i.e., after the Swiss authorities had interviewed the taxpayer and frozen the ALQI accounts at the request of the U.S. government. According to the government, the issue of whether the taxpayer had an improper motive for not filing a timely FBAR for 2000 is not determinative of the willfulness question, so the district court erred in basing its findings on the supposed absence of improper motivation.

After suggesting that the district court applied the wrong legal standard, the government then attacked the facts on which the district court rendered its decision. The government began by emphasizing that the taxpayer's plea in his earlier criminal case was a strong indication of willfulness on the FBAR matter, which the district court wrongly elected to downplay. The government seized on the following language from the allocution:

"*I also knew that I had the obligation to report to the IRS and/or the Department of the Treasury the existence of the Swiss accounts,* but for the calendar year tax returns 1993 through 2000, I chose not to in order to assist in hiding my true income from the IRS and evade taxes thereon, until I filed my 2001 tax return." (Emphasis added.)

In essence, the government argued that a Form 1040 goes to the IRS, while an FBAR gets sent to a special Treasury office in Detroit. Thus, contended the government, when the taxpayer previously acknowledged in the criminal case that he knew of his obligation to report the existence of the Swiss accounts "to ... the Department of the Treasury," logic dictates that he was referring to the FBAR.

The government next argued that, even if the taxpayer's motivation were the proper standard in determining willfulness in the civil FBAR context, the district court failed to recognize that the taxpayer had a significant reason for not disclosing the foreign accounts—to hide the pre-tax funds deposited into the foreign accounts and to hide the passive income generated by such accounts.

Interestingly, the government then suggested that, despite all the public fanfare to the contrary, the Service may not be all that effective at identifying foreign accountholders. The taxpayer indicated at various stages of the case that he had no reason whatsoever to conceal anything from the IRS after he met with Swiss authorities about the accounts and his accounts were frozen by the Swiss authorities in November 2000 at the insistence of the U.S. government. Stated more colloquially, the taxpayer professed that he had no reason to further hide anything from the IRS once the jig was up. Nevertheless, in its opening brief the government strained to suggest that (1) because the taxpayer was using a nominee (ALQI) to hold the account, "there was no guaranty that the IRS would be able to connect the dots," and (2) there was no specific evidence in the record as to whether the taxpayer admitted to the Swiss authorities in November 2000 that the ALQI accounts belonged to him or whether he continued to distance himself from such accounts.

The government then argued that the district court's conclusion that the taxpayer had no motive to further conceal the foreign accounts after November 2000 could not be reconciled with his interactions with his accountant. In particular, the government pointed out that the taxpayer's accountant sent him the 2000 tax organizer in January 2001 (i.e., two months after the meeting in Switzerland and the freezing of the accounts), yet the taxpayer checked the "no" box in response to the question about foreign accounts. This, argued the government, showed the taxpayer's ongoing intent to hide the accounts.

The taxpayer's high level of sophistication was the next target for the government. It noted that the taxpayer was a well-educated

attorney and international businessman, who had practiced law at a prominent New York law firm, worked as a high-level oil executive, and enjoyed multiple opportunities to learn about the duty to file annual FBARs. Against this backdrop, the government suggested that it was "highly improbable" that the taxpayer was unaware of his FBAR duties.

Finally, the government tried to downplay some taxpayer behaviors and highlight others, depending on whether they hurt or helped the government's case. Certain actions by the taxpayer in later years could be viewed as favorable to the taxpayer. These included meeting with IRS representatives, applying for the OVCI, filing Forms 1040X for past years, and ultimately filing FBARs as part of the examination process. The government tried to completely disregard such events, underscoring that the case only involved the duty to file an FBAR as of 6/30/01, and that "disclosures in 2002 and 2003 [had] no bearing on that question." Just two pages later in its opening brief, though, the government noted that "although this case involves just one tax year (2000), [the taxpayer] had been hiding his income since 1993." [27]

Rebuttal by the Taxpayer

The taxpayer was remarkably brief in his rebuttal to the government's two main arguments, filed 4/28/11. Regarding the government's principal contention that the district court erred, as a matter of law, in determining that a taxpayer's motivation is a factor in gauging willfulness, the taxpayer dismissed this as meritless. Citing various legal authorities, the taxpayer reasoned that, while willfulness does not require the taxpayer to have an improper motive, a taxpayer's incentives to conceal or disclose information to the IRS are indeed relevant to determining his subjective intent.

The government's secondary argument was that, even if the district court used the correct legal standard, its decision not to uphold the FBAR penalty was clearly erroneous as a factual matter for various reasons. The taxpayer countered this argument as follows. The taxpayer first explained that the taxpayer's actions in later years (i.e., hiring reputable attorneys and accountants, meeting with IRS attorneys, applying for the OVCI, filing Forms 1040X, etc.) should factor into the analysis. The taxpayer's attorney framed his argument as a rhetorical question:

"If, as the government postulates, [the taxpayer] knew of the FBAR requirement in June 2001 and willfully failed to comply with it, why did he not backfile FBAR reports in the succeeding two years when he and his advisors executed every other conceivable government disclosure, including an amnesty application? Only one reason makes sense: [The taxpayer] had no knowledge of the FBAR requirement, and his advisors never informed him of it."

Next, the taxpayer posited that his allocution in the criminal case nearly a decade earlier, in 2003, never specifically mentioned the FBAR filing duty or his knowledge thereof. Consequently, it could not be, as the government contended, highly probative of his willfulness.

The taxpayer then challenged the notion that his denial of the existence of foreign accounts in the 2000 tax organizer given to his accountant in January 2001 constituted evidence of his willfulness to conceal the accounts, even after the Swiss authorities interviewed him and even after the U.S. authorities had frozen his Swiss accounts. The taxpayer had already retained new tax attorneys at the time his accountant was preparing the 2000 Form 1040 and he understood that he should not discuss the foreign account matters with anyone other than the attorneys. The taxpayer also suggested that, at that time, he already was assembling a team to rectify all issues concerning the foreign accounts.

Finally, the taxpayer took issue with the government's assertion that he had some reason for not disclosing the foreign accounts after November 2000. The taxpayer pointed out that (1) the application and other documents related to the accounts for ALQI specifically identified the taxpayer as the beneficial owner of the accounts, (2) the Swiss authorities specifically summoned the taxpayer to Switzerland to discuss the accounts, and (3) if the taxpayer were such an educated and sophisticated person, as the government contended, he certainly would have known that the U.S. government would readily link him to ALQI and the accounts held in its name. [28]

THE FOURTH CIRCUIT DROPS THE FBAR HAMMER

The court of appeals began its analysis by criticizing the legal standards on which the district court had made its taxpayer-friendly decision. In particular, the Fourth Circuit indicated in footnote 5 of its opinion that the district court should not have focused on the taxpayer's motivation for not filing a timely FBAR for 2000 and, inasmuch as it did, the district court made an impermissible leap:

"In making its determination, the district court emphasized [the taxpayer's] motivation rather than the relevant issue of his intent.... To the extent the district court focused on motivation as proof of the lack of intent, it simply drew an unreasonable inference from the record. In November 2000, Swiss authorities met with [the taxpayer] to discuss the ALQI accounts and thereafter froze them at the request of the United States Government. Although the [U.S.] Government knew of the existence of the accounts, nothing in the record indicates that, when the accounts were frozen, the [U.S.] Government knew the extent, control, or degree of [the taxpayer's] interest in the accounts or the total funds held in the accounts. As [the taxpayer] admitted in his allocution [at the criminal trial], his decision not to report the accounts was part of his tax evasion scheme that continued until he filed his 2001 tax return. Thus, his failure to disclose information about the ALQI accounts on his 2000 tax return in May 2001 was motivated by his desire not to admit his interest in the accounts, even after authorities had been aware of them for over six months. Rarely does a person who knows he is under investigation by the [U.S.] Government immediately disclose his wrongdoing because he is not sure how much the [U.S.] Government knows about his role in that wrongdoing. Thus, without question, when [the taxpayer] filed in May of 2001, he was clearly motivated not to admit his interest in the ALQI accounts."

Then, noting various judicial precedents in the *criminal* arena, the court of appeals went on to explain what it considered the proper legal standard to be applied. In this regard, the court stated that (1) willfulness can be inferred from taxpayer conduct designed to conceal financial information, and (2) willfulness also can be inferred from a taxpayer's conscious effort to avoid learning about reporting requirements, i.e., "willful blindness" exists where a taxpayer knew of a high probability of a tax liability yet intentionally avoided the pertinent facts.

Where willfulness is a condition for *civil* liability, the court of appeals indicated that this covers both knowing and reckless violations of a standard. It then clarified that the taxpayer's actions or inactions in this case constituted, at a minimum, "reckless conduct, which satisfies the proof requirement [for civil FBAR violations under 31 U.S.C. 5314.]" [29]

Pulling no punches, the Fourth Circuit stated that "the evidence as a whole leaves us with a *definite and firm conviction* that the district court clearly erred in finding that [the taxpayer] did not willfully violate [the FBAR rules for 2000]." (Emphasis added.) The court supported its decision on the following grounds.

First, the court pointed out that the taxpayer signed his 2000 Form 1040 under penalties of perjury, thereby swearing that he had examined the Form 1040, as well as all schedules and statements attached to such Form 1040, and that all items were true, accurate, and complete. The court of appeals then explained that taxpayers who execute a tax return are deemed to have constructive knowledge of such return, and the taxpayer in this case was no exception to that principle.

According to the Fourth Circuit, the instructions on Line 7a in Part III of Schedule B of the 2000 Form 1040 (i.e., "see instructions and exceptions and filing requirements for Form TD F 90-22.1") put the taxpayer on notice of the FBAR duty. The taxpayer testified that he did not review his 2000 Form 1040 in general or read the information in Schedule B in particular. The court of appeals interpreted this inaction as conduct designed to conceal financial information, a conscious effort to avoid learning about reporting requirements, and "willful blindness" to the FBAR requirement.

Second, the court of appeals held that the taxpayer's allocution at the criminal proceeding further confirmed that his failure to file a timely FBAR for 2000 was willful. Seizing on one tiny portion of the taxpayer's allocution back in 2003, the Fourth Circuit seemingly concluded that the taxpayer admitted his knowledge of the FBAR duty because he used the phrase "Department of the Treasury." This tenuous line of reasoning was set forth as follows:

"During that allocution, [the taxpayer] acknowledged that he willfully failed to report the existence of the ALQI accounts to the IRS or Department of the Treasury as part of his larger scheme of tax evasion. This failure to report the ALQI accounts is an admission of violating [the FBAR rules], because a taxpayer complies with [the FBAR rules] by filing an FBAR with the Department of the Treasury."

WHY THE *WILLIAMS* TRILOGY IS IMPORTANT

The world seems to get busier each day, and technology, while great at rapidly disseminating large amounts of unfiltered information, results in many people being unable to contextualize and appreciate important cases, like the *Williams* trilogy. Therefore, the reasons that this case is important to taxpayers are examined below.

Tax Court Lacks Jurisdiction Over Civil FBAR Matters

In *Williams I,* the taxpayer attempted to dispute not only the tax issues under Title 26 of the U.S. Code (i.e., the federal income taxes, accuracy-related penalties, and civil fraud penalties for 1993 through 2000 identified by the IRS in its notice of deficiency) but also the FBAR penalty for 2000 under Title 31 of the U.S. Code. The Tax Court held that it lacked authority to hear FBAR issues, both at the assessment stage and the collection stage.

As simply put by the court itself, "[t]he Tax Court has no jurisdiction to review the [Service's] determination as to [taxpayers'] liability for FBAR penalties."

Burden of Proof in Civil FBAR Cases

In rendering its decision in *Williams II,* the district court noted that the case was one of first impression regarding the proper legal standard to be applied in reviewing FBAR penalty cases. The statute under which the government initiated the collection suit, 31 U.S.C. section 5321(b), permits the government to commence an action to recover FBAR penalties that already have been assessed. The district court noted that this provision is silent as to the relevant legal standard in such actions.

Forging new ground, the district court in *Williams II* held that the *de novo* standard applies, such that the government must prove its case by a preponderance of the evidence. The district court indicated that the *de novo* standard is particularly appropriate in this case, given that the provision authorizing the civil FBAR penalty, 31 U.S.C. section 5321, "provides for no adjudicatory hearing before an FBAR penalty is assessed."

FBAR Cases Generally Require a Trial

Williams II shows that actions to collect FBAR penalties asserted by the IRS do not lend themselves to early resolution on brief. The district court emphasized in rejecting the government's motion for summary judgment that the question of whether the taxpayer "willfully" failed to file an FBAR for a certain year is an "inherently factual question," which generally needs to be developed through the trial process.

Appreciation of Differing Assessment Periods

Although not overly highlighted, the *Williams* cases illustrate the importance of appreciating differing assessment periods. As explained above, the IRS conducted a civil audit and proposed adjustments to income and various civil penalties with respect to 1993 through 2000, including FBAR penalties. In the case of fraudulent tax returns, the IRS faces no time constraints on assessment. [30]

Where FBAR violations are concerned, however, the IRS must assess the penalty within six years of the violation. [31] Accordingly, while the taxpayer in *Williams* might have "admitted" his noncompliance by filing delinquent FBARs for 1993 through 2000 with the revenue agent in 2007, the IRS was able to assert an FBAR penalty for only one year—2000—because the six-year statute had already expired for the preceding years.

FBAR Penalties in Cases With Sub-Accounts

The taxpayer raised a variety of arguments in its briefs in *Williams II,* one of which concerned the appropriate number of FBAR penalties. In this regard, the taxpayer argued that the maximum penalty should be $100,000 instead of $200,000 because he only opened one foreign account, which just happened to have been divided into sub-accounts later by the bank (one for cash and the other for equities) for administrative purposes. The taxpayer, in his words, had only "a single banking relationship." In support of this theory, the taxpayer cited a bank document called "General Conditions," minutes from a meeting of the ALQI board of directors, and an ALQI corporate resolution, each of which expressly mentions one account.

Given its decision in *Williams II* that the taxpayer did not act willfully, the district court did not need to address the issue, and the taxpayer did not seem to advance the sub-account issue before the court of appeals during *Williams III.* Thus, the issue of just how many punishable unreported foreign accounts exist in a sub-account scenario remains unanswered. Foreign institutions commonly create numerous sub-accounts for clients; therefore, this issue will surely gain attention in future cases.

Reasonable Reliance on Qualified Tax Professionals

The "reasonable reliance on a qualified tax professional" defense was unique in *Williams II.* The government presented evidence that the taxpayer never provided any information whatsoever about the foreign accounts or foreign source income to his accountant from 1993 through 2000. The government also demonstrated that the accountant sent the taxpayer an organizer each year, which specifically asked whether he had an interest in or authority over a foreign account during the year. The taxpayer completed the organizer for 2000, affirmatively checking the "no" box to the foreign-account inquiry. [32] Distancing himself from this reality, the taxpayer focused on the fact that he hired U.S. tax attorneys with a reputable national firm in early June 2001, who failed to advise him to file an FBAR by 6/30/01.

The district court did not address the reliance issue in its decision in *Williams II,* centering the discussion instead on the taxpayer's motives and the distinction between not reporting income on Forms 1040 and not reporting foreign accounts on FBARs. The Fourth Circuit, however, made short order of the reliance defense, underscoring the following in footnote 6:

"[T]o the extent [the taxpayer] asserts he was unaware of the FBAR requirement because his attorneys or accountants never informed him, his ignorance also resulted from his own recklessness. [The taxpayer] concedes that from 1993-2000 he never informed his accountant of the existence of the foreign accounts—even after retaining counsel and with the knowledge that authorities were aware of the existence of the accounts."

IRS-DOJ Interaction

Williams II gives a glimpse into the interaction and complications between the IRS (in asserting the FBAR penalty, and then handling any Tax Court litigation related to the tax deficiencies and penalties found in Title 26) and the Department of Justice (in spearheading the collection actions in district court and/or appellate court to recover FBAR penalties under Title 31).

In *Williams I* before the Tax Court, the IRS attorney apparently stipulated to the fact that the taxpayer's meeting with Swiss authorities, followed by the freezing of his accounts, occurred in November 2000; that is, approximately seven months *before* the deadline for filing the FBAR for 2000. The taxpayer later stated (mistakenly) at trial in the Tax Court that such actions occurred in November 2001, and the DOJ tried to capitalize on this by suggesting that the taxpayer could not have thought that the U.S. government already had information about his accounts as of the filing deadline for the FBAR, i.e., 6/30/01.

In doing so, the DOJ attorney tried to distance himself from his IRS colleagues, stating in the government's post-trial brief in *Williams II* that "[t]he United States concedes that IRS counsel in Williams' Tax Court case entered into a stipulation that this meeting occurred on November 14, 2000.... As neither the U.S. Department of Justice, nor undersigned counsel, were involved in the Tax Court proceeding in any way, the United States should not be bound by any stipulations agreed to in that matter."

While the district court in *Williams II* ultimately determined the meeting and the account levy occurred in late 2000 based on the taxpayer's testimony, it expressly noted the attempt by the DOJ to disavow deals made by other government attorneys in a different jurisdiction. Issues triggered by this overlap in duties between the two tax enforcers—the IRS and the DOJ Tax Division—may arise in other cases, too.

Questioning the FBAR Penalty Amount

The scope of FBAR "collection actions" was examined and clarified in *Williams II.* The parties had divergent opinions on the role of the district court.

The government argued that the *amount* of the FBAR penalty asserted by the IRS is not subject to judicial review, and that there is no authority for the proposition that a district court, hearing a "collection action" under 31 U.S.C. section 5321(b)(2), can review the Service's administrative record or the factors considered by the IRS in determining the penalty amount. As summarized by the government in the post-trial brief, "[a]s this case simply concerns the United States' effort to collect a debt, the Court's review is limited to determining whether or not the FBAR penalty is a valid debt."

In other words, the government maintained that the district court's sole job is to determine, on a *de novo* basis, whether a taxpayer "willfully" failed to file the FBAR. The taxpayer, on the other hand, repeatedly argued that the court had the authority under the Administrative Procedures Act to review decisions by administrative agencies, such as the IRS, for abuse of discretion and with respect to arbitrary and capricious actions. In his response to the government's post-trial brief, the taxpayer further suggested that, if the court were to hold that he acted willfully, it should schedule a separate briefing to address the proper amount of the penalty.

Because the district court held that the taxpayer did not "willfully" fail to file the FBAR and no penalties were thus sustained, this issue was not specifically addressed in *Williams II.* Moreover, the taxpayer did not seem to renew this issue in *Williams III.* This issue remains important for the following reasons.

Since the IRS was delegated the authority to assert FBAR penalties back in 2003, it has had discretion about whether a particular taxpayer should be penalized. The relevant provision—31 U.S.C. section 5321(a)(5)(A)—expressly states that the IRS "may" (not "shall" or "must") assert an FBAR penalty in certain cases. The Service's discretion has expanded in recent years, covering both the existence and amount of the penalty. The relevant provision in effect in 2000 only penalized "willful" violations, and the penalty amount was the larger of $25,000 or the highest balance in the unreported account (not to exceed $100,000). [33]

Under the AJCA provisions that became effective after 10/22/04, the IRS may use its discretion in determining the penalty amount in cases of non-willful violations. Lest there be any doubt in this regard, the Service's own *Internal Revenue Manual* outlines the following parameters for its agents: "Examiners are expected to exercise discretion, taking into account the facts and circumstances of each case, in determining whether penalties should be asserted and the total amount of penalties to be asserted." [34] This requires the IRS to decide whether the FBAR violation was attributable to "reasonable cause," which lends itself to judicial review. [35]

Impact on Voluntary Disclosure Participants

The taxpayer's success in *Williams II,* followed by the taxpayer's defeat in *Williams III,* will trigger additional uncertainty for taxpayers who are currently participating in one of the Service's pseudo-amnesty programs, such as the offshore voluntary disclosure program (OVDP).

Generally speaking, those participating in the OVDP must:

(1) File Forms 1040X for the last eight years,

(2) Pay the back taxes, 20% accuracy penalties, and interest charges with respect to the Forms 1040X,

(3) File all appropriate information returns, including FBARs, for the last eight years, and

(4) Pay a catch-all/FBAR penalty equal to 27.5% of the highest aggregate balance in the unreported foreign accounts during the eight-year period.

The IRS released a series of frequently asked questions (FAQs) to clarify common issues related to the OVDP. FAQ 51 addresses the limited options available to taxpayers who are displeased with the proposed penalties by the IRS, including the potentially enormous FBAR-related penalty. The main path for dissatisfied taxpayers is to "opt out" of the OVDP under FAQ 51. Among the risks associated with opting out are facing a full-blown audit for all relevant years, the assessment of FBAR penalties higher than those offered within the OVDP, and potential criminal charges. FAQs 51 and 51.3 state the following about the potential criminal issues:

"Taxpayers are reminded that, even after opting out of the Service's civil settlement structure, they remain within Criminal Investigation's Voluntary Disclosure Practice. Therefore, taxpayers are still required to cooperate fully with the examiner by providing all requested information and records and must still pay or make arrangements to pay the tax, interest, and penalties they are ultimately determined to owe. If a taxpayer does not cooperate and make payment arrangements, or if after examination, issues exist that were not disclosed prior to opt out, the case may be referred back to Criminal Investigation.

"[T]o the extent that issues are found upon a full scope examination that were not disclosed by the taxpayer, those issues may be the subject of review by Criminal Investigation.

"If I opt out of the OVDP and undergo a regular examination, is there a chance my case could be referred back to Criminal Investigation for penalties and prosecution? Yes. Criminal Investigation's Voluntary Disclosure Practice provides a recommendation that you not be prosecuted for violations up to the date of your disclosure. If your disclosure is ultimately determined to have not been complete, accurate, and truthful, or if you commit a crime after the date of your voluntary disclosure, you are potentially subject to penalties and prosecution."

After the taxpayer victory in *Williams II,* people speculated that many taxpayers would be emboldened to opt out and roll the proverbial dice with the Service's Examination Division and Appeals Office. As one article put it, a possible outcome of *Williams II* was that "some taxpayers will be encouraged to opt out of the voluntary disclosure initiative and take their chances with the normal FBAR

penalty regime." [36] That sentiment has rapidly changed, of course, with more recent articles hypothesizing that *Williams III* may discourage borderline taxpayers from leaving the set terms of the OVDP, regardless of how distasteful they may find those terms. [37] Gauging the impact of *Williams III* on opt out decisions will be interesting, yet difficult to quantify.

Assessing the Weight of Unpublished Decisions

Williams III, as the first case to wrangle with tricky civil FBAR penalty issues, is important. The Fourth Circuit, however, decided to issue it as an "unpublished" opinion, expressly noting in the decision itself that "[u]npublished opinions are not binding precedent in this circuit." Many taxpayers and practitioners would like nothing better than to ignore or demote the case on this basis. Doing so would be imprudent, however, because the potential use and value of "unpublished" decisions is surprisingly broad.

Rule 32.1(a) of the Federal Rules of Appellate Procedure generally provides that a court may not prohibit or restrict the citation of federal judicial opinions, orders, judgments, or other written dispositions that have been designated as "unpublished," "not for publication," "non-precedential," "not precedent," or the like. Moreover, the Advisory Committee Notes to Rule 32.1 state the following:

"Rule 32.1 is extremely limited. It does not require any court to issue an unpublished opinion or forbid any court from doing so. It does not dictate the circumstances under which a court may choose to designate an opinion as "unpublished" or specify the procedure that a court must follow in making that determination. It says nothing about what effect a court must give to one of its unpublished opinions or to the unpublished opinions of another court.... Under Rule 32.1(a), a court of appeals may not prohibit a party from citing an unpublished opinion of a federal court for its persuasive value or for any other reason. In addition, under Rule 32.1(a), a court may not place any restriction on the citation of such opinions. For example, a court may not instruct parties that the citation of unpublished opinions is discouraged, nor may a court forbid parties to cite unpublished opinions when a published opinion addresses the same issue."

This procedural rule and the related commentary create ambiguity regarding how much weight *Williams III* will carry in the future. One thing is for sure, though—the case will not quietly disappear, as the Service's FBAR enforcement efforts continue to rise.

Varying Interpretations of Willfulness

Other cases have previously addressed the concept of "willfulness" in the context of criminal issues, including criminal FBAR violations. Those cases stand for the proposition that willfulness means a "voluntary, intentional violation of a known legal duty." [38] *Williams II* and *Williams III* are important because they are the first in which the courts have interpreted the concept of "willfulness" in the civil FBAR context.

The Fourth Circuit in *Williams III* indicated that the taxpayer's conduct (i.e., checking the "no" box in response to the foreign-account question on Schedule B of his Form 1040 for 2000, not reviewing the Schedule B or its cross-references to the FBAR filing requirement, etc.) constituted "reckless conduct" and "willful blindness" to his FBAR duty. Interestingly, the legal standard applied by the court in *Williams III* is significantly lower than that previously indicated by the IRS. In other words, even the Service believes that it must reach a higher level to impose the civil FBAR penalty, as demonstrated by the following IRS materials. [39]

The Service issued a legal memorandum in 2006, CCA 200603026 , in connection with two of its international enforcement programs. One of the issues addressed was the proper interpretation of the "willfulness" standard in the context of civil FBAR penalties. The Service's directness on this point was remarkable: "The first question is whether the phrase ‘willful violation (or willfully causes any violation)’ has the same definition and interpretation under 31 U.S.C. §5321 (the *civil* penalty) and §5322 (the *criminal* penalty). *The answer is yes.* " (Emphasis added.)

Lest any doubt remain, CCA 200603026 goes on: "Both section 5321(a)(5), providing for a civil penalty, and section 5322(a), providing for criminal penalties, contain a similar ‘willfulness’ requirement.... The same word, willful, is used in both of these sections. Statutory construction rules would suggest that the same word used in related sections should be consistently construed."

In referring to Justice Blackmun's dissenting opinion in the Supreme Court's decision in *Ratzlaf,* the IRS then explained the following in CCA 200603026: "[W]e agree with his conclusion that in the case of the FBAR penalty, in order for there to be a voluntary intentional violation of a known legal duty, the accountholder would just have to have knowledge that he had a duty to file an FBAR, since knowledge of the duty to file an FBAR would entail knowledge that it is illegal not to file the FBAR. *A corollary of this principle is that there is no willfulness if the accountholder has no knowledge of the duty to file the FBAR.*" (Emphasis added.)

Similar to CCA 200603026, the IRS acknowledges in its own *Internal Revenue Manual* that, in the context of willful FBAR penalties, the test is whether "there was a voluntary, intentional violation of a known legal duty" and "willfulness is shown by the person's knowledge of the [FBAR] reporting requirements and the person's conscious choice not to comply with the requirements." [40]

To be fair, the *Manual* suggests that "willful blindness" might rise to the level of willfulness. [41] Even in these situations, though, the IRS clarifies that "[t]he mere fact that a person checked the wrong box, or no box, on a Schedule B is not sufficient, by itself, to establish that the FBAR violation was attributable to willful blindness." [42]

CONCLUSION

Alarmists might conclude that *Williams III* stands for the proposition that (1) the standard for asserting civil FBAR penalties is willfulness, (2) in this context, the government can establish willfulness by showing that the taxpayer was merely reckless, (3) recklessness exists where a taxpayer does not read and understand every aspect of a complex tax return, including all schedules and statements attached to the return (including Schedule B), as well as any separate forms (including the FBAR) alluded to in the schedules, and (4) the taxpayer's motive for not filing an FBAR is not relevant.

By contrast, pragmatists might see *Williams III* as an aberration, based on narrow facts, with little precedential value, and with questionable real-world applicability. Most people likely will fall somewhere in between. Regardless of the viewpoint, it is undeniable that the *Williams* trilogy introduced issues critical to the FBAR debate, many of which remain unresolved. Taxpayers and their advisors would be wise to follow the evolving issues, as the incidence of FBAR and other international tax enforcement issues will continue to rise in the future.

Practice Notes

After the taxpayer victory in *Williams II,* people speculated that many taxpayers would be emboldened to opt out of the voluntary disclosure program and roll the proverbial dice with the Service's Examination Division and Appeals Office. That sentiment has rapidly changed, of course, with more recent articles hypothesizing that *Williams III* may discourage borderline taxpayers from leaving the set terms of the OVDP, regardless of how distasteful they may find those terms. Gauging the impact of *Williams III* on opt out decisions will be interesting, yet difficult to quantify.

[1] P.L. 91-508, Title I and Title II, 10/26/70.

[2] *Id.,* section 202.

[3] 31 U.S.C. section 5314; 31 C.F.R. section 103.24.

[4] 31 C.F.R. section 103.56(g), 68 Fed. Reg. 26489 (5/16/03).

[5] P.L. 108-357, 10/22/04.

[6] 31 U.S.C. section 5321(a)(5)(A) (as in effect before 10/23/04).

[7] 31 U.S.C. section 5321(a)(5)(B)(ii) (as in effect before 10/23/04). Prior law stated that "in the case of violation of [31 U.S.C. section 5314] involving a failure to report the existence of an account or any identifying information required to be provided with respect to such account, [the penalty shall be] the greater of (I) an amount (not to exceed $100,000) equal to the balance in the account at the time of the violation, or (II) $25,000."

[8] 31 U.S.C. section 5321(a)(5)(A) (as in effect after 10/22/04).

[9] 31 U.S.C. section 5321(a)(5)(B)(i) (as in effect after 10/22/04).

[10] 31 U.S.C. section 5321(a)(5)(B)(ii) (as in effect after 10/22/04). The second condition means that the taxpayer agrees to file

delinquent FBARs with the revenue agent as part of the audit. I.R.M. section 4.26.16.4.4 (7/01/08).

11

31 U.S.C. sections 5321(a)(5)(C)(i) and (D)(ii) (as in effect after 10/22/04).

12

The facts were derived from various pleadings, briefs, and other documents filed by the parties in the trilogy, as well as the official decisions in Williams, TC Memo 2009-81, RIA TC Memo ¶2009-081 (granting the Service's motion for partial summary judgment on the issue of whether the taxpayer's guilty plea to tax evasion in the earlier criminal trial collaterally estopped him from contesting in the subsequent civil tax litigation that he fraudulently underpaid his federal income taxes for 1993 through 2000), and Williams, TC Memo 2011-89, RIA TC Memo ¶2011-089 (upholding the determination of federal income taxes and civil penalties for 1993 through 2000). All of these documents are on file with the author.

13

Beginning in 2011, the taxpayer also may need to report the foreign account on Form 8938 ("Statement of Specified Foreign Financial Assets"), depending on the facts. The Williams cases involved 2000, so the Form 8938 requirement was not applicable.

14

Rev. Proc. 2003-11, 2003-1 CB 311, section 1. See generally Ostrander, "The Offshore Credit Card and Financial Arrangement Probe: Fraught With Danger for Taxpayers," 99 JTAX 113 (August 2003) .

15

Rev. Proc. 2003-11, *supra* note 14, section 2.

16

Id., section 4.

17

Section 6501(c)(1).

18

The motion raised other issues that are beyond the scope of this article.

19

Section 6330(a).

20

Sections 6330(a) through (c).

21

Section 6330(c)(3)(C). See also H. Rep't No. 105-599, 105th Cong., 2d Sess. 263 (1998).

22

Section 6330(d); U.S. Tax Court Rule 331(b).

23

Sections 6301, 6230 , 6231 , 6330 , 6331 , and 6665 .

24

The Tax Court later issued an opinion on the substantive tax issues, holding that the taxpayer, for 1993 through 2000, was liable for federal income taxes on the net consulting income deposited into the ALQI accounts, federal income taxes on the investment income generated by the ALQI accounts, civil fraud penalties on both the consulting income and investment income, and accuracy-related penalties related to tax underpayments resulting from disallowed charitable contribution deductions. See Williams, TC Memo 2011-89, RIA TC Memo ¶2011-089 .

25

See also generally Sheppard, "District Court Rules That Where There's No Will, There's a Way to Avoid FBAR Penalties," 113 JTAX 293 (November 2010) .

26

This article follows suit, focusing solely on the "willfulness" issue.

27

The government raised some other minor arguments in its opening brief, which are beyond the scope of this article.

28

The taxpayer raised some other minor arguments in his opening brief, which are beyond the scope of this article.

29

The Fourth Circuit included, in footnote 6, another reason for reversing the district court. It explained that, to the extent that the taxpayer was claiming ignorance of the FBAR filing requirement in connection with reasonable reliance on qualified tax professionals, such ignorance was a result of his own recklessness. This is because the taxpayer never informed his accountant of the existence of the foreign accounts from 1993 to 2000, "even after retaining counsel [in early 2001] and with the knowledge [in November 2000] that the authorities were aware of the existence of the accounts."

30

Sections 6501(c)(1) and (2).

31

31 U.S.C. section 5321(b)(1).

32

U.S. Proposed Findings of Fact and Conclusions of Law, filed 4/26/10; U.S. Post-Trial Brief, filed 7/1/10.

33

31 U.S.C. section 5321(a)(5) (in effect before 10/23/04).

34

I.R.M. 4.26.16.4 (7/01/07).

35

31 U.S.C. section 5321(a)(5) (in effect before 10/23/04). See, e.g., Kansas City Southern Industries, Inc., 98 TC 242 (1992) (holding that "[i]n this case, as in others, the remedy for abuse of discretion is to disregard the consequences of the Commissioner's action or refusal to act, not to order the Commissioner to perform an act").

36

Coder, "U.S. Government Position on FBAR Penalties Called Into Question," 2010 Worldwide Tax Daily 174-4 (9/9/10).

37

Coder, "FBAR Penalty Case Reversal Raises Questions About Civil Willfulness Standard," 2012 TNT 142-2 (7/24/12).

38

Cheek, 67 AFTR 2d 91-344, 498 US 192, 112 L Ed 2d 617, 1991-1 CB 259 (1991); U.S. v. Sturman, 951 F2d 1466 (CA-6, 1991); Bishop, 32 AFTR 2d 73-5018, 412 US 346, 36 L Ed 2d 941, 1973-2 CB 417 (1973).

39

Several articles explain how the legal standard for "willfulness" developed by the court of appeals in Williams III would conflict not only with published guidance from the IRS on the civil FBAR issue but also with various court decisions. See, e.g., Skarlatos and Sardar, "The Fourth Circuit Goes Too Far by Imposing a Willful FBAR Penalty on Reckless Conduct in the *Williams* Case," 14 J. Tax Practice & Procedure No. 4 (2012), pages 9-12; Sardar, "What Constitutes ‘Willfulness’ for Purposes of the FBAR Failure-to-File Penalty?," 113 JTAX 183 (September 2010) .

40

I.R.M. 4.26.16.4.5.3 (7/1/08).

41

See also Stadtmauer, 106 AFTR 2d 2010-6206, 620 F3d 238 (CA-3, 2010) (holding, among other things, that a willful blindness instruction that applies to a taxpayer's knowledge of the law in a criminal tax case did not violate the precedent created by the Supreme Court in Cheek, *supra* note 38).

42

See note 40, *supra.*

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