

Court Overturns Legendary FBAR Case, *Bedrosian*, but Settlement Elsewhere Encourages Taxpayers with Foreign Account Issues

By Hale E. Sheppard*



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I. Introduction

Life has its ups and downs, and litigation over unreported foreign accounts does, too. The U.S. government, starting in 2012, has won a series of cases focused on severe penalties against taxpayers for “willfully” not filing FinCEN Forms 114 (“FBARs”). However, the tax community rejoiced in 2017 when a District Court determined in *Bedrosian* that the taxpayer might have been negligent, but not “willful,” when he failed to declare a large Swiss account.¹ The encouragement that this case generated for taxpayers was fleeting. Indeed, the same District Court, after having the case remanded to it by the Court of Appeals, changed its tune in late 2020. Applying a broader, objective standard established by other cases, the District Court held the second time around that the taxpayer had acted “recklessly,” which sufficed, and penalized him approximately \$1 million for the trouble.²

The widespread disappointment in the private sector did not last long, though, as the U.S. government decided less than a month later to settle a different FBAR penalty case at the last minute, *Jones*.³ Details of the settlement are confidential, but logic dictates that the U.S. government, after a long string of FBAR victories and a recent win in *Bedrosian*, would not concede anything, unless it had serious concerns about losing and setting precedent favorable to taxpayers.

This article describes the applicable law, analyzes the two most recent FBAR decisions of note, and summarizes where things stand.



HALE E. SHEPPARD, Esq. (B.S., M.A., J.D., LL.M., LL.M.T.) is a Shareholder in the Tax Controversy Section and Chair of the International Tax Section of Chamberlain Hrdlicka.

II. Overview of the Law, Enforcement, and Penalties

To appreciate the issues addressed in this article, one first needs some background.

A. Short History

Congress enacted the Bank Secrecy Act in 1970.⁴ 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.⁵ In 2003, the IRS was empowered to enforce FBAR duties.⁶ The IRS has been authorized since then to investigate potential FBAR violations, issue summonses, assess civil penalties, issue administrative rulings, and take “any other action reasonably necessary.”⁷

Under current law, the IRS can impose a civil penalty on any person who fails to file an FBAR when required, period.⁸ In the case of non-willful violations, the maximum penalty is \$10,000 per violation.⁹ The IRS imposes higher penalties where willfulness exists. Specifically, in situations where a taxpayer willfully files a late, false, or incomplete FBAR, the IRS may assert a penalty equal to \$100,000 or 50 percent of the balance in the undisclosed account at the time of the violation, whichever amount is larger.¹⁰ Given the huge balances in some clandestine accounts, FBAR penalties can be enormous.

B. Mandatory Disclosures

The relevant law mandates the filing of an FBAR in situations where (i) a U.S. person, including U.S. citizens, U.S. residents, and domestic entities, (ii) had a direct financial interest in, had an indirect financial interest in, had signature authority over, or had some other type of authority over (iii) one or more financial accounts (iv) located in a foreign country (v) whose aggregate value exceeded \$10,000 (vi) at any point during the relevant year.¹¹

When it comes to U.S. individuals, they have several obligations linked to holding a foreign financial account, including, but not limited to, the following:

- Checking the “yes” box in Part III (Foreign Accounts and Trusts) of Schedule B (Interest and Ordinary Dividends) to Form 1040 (*U.S. Individual Income Tax Return*) to disclose the existence of the foreign account,

- Identifying the foreign country in which the account is located, also in Part III of Schedule B to Form 1040,
- Declaring all income generated by the account (such as interest, dividends, and capital gains) on Form 1040, and
- Electronically filing an FBAR.¹²

One of the duties listed above is checking “yes” to the foreign-account inquiry found in Part III of Schedule B to Form 1040. The IRS has slightly modified and expanded this language over the years, with the materials for 2020 stating the following:

At any time during 2020, did you have a financial interest in or a 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.

If you are required to file FinCEN Form 114, enter the name of the foreign country where the financial account is located.

Caution: If required, failure to file FinCEN 114 may result in substantial penalties. See instructions.¹³

III. Discouraging Case—*Bedrosian*

Bedrosian was unique in that it constituted the first case in which a taxpayer, as opposed to the government, prevailed on the willfulness issue, at least initially. The pertinent aspects of the case are described below.¹⁴

A. Relevant Facts

The taxpayer started in the pharmaceutical industry in the late 1960s and he frequently traveled abroad on business early in his career. He opened an account in Switzerland at some point in the 1970s with the predecessor to UBS in order to facilitate payment of expenses during international trips. The balance started very small and grew over the years because of periodic deposits of funds *via* check and wire transfer from the United States,

a “loan” the taxpayer received from UBS of \$750,000, and passive income generated by the accounts.

The taxpayer, who holds an undergraduate degree and a law degree, was the chief executive officer of a large generic pharmaceutical company. As head of the company, he managed hundreds of people, routinely reviewed complex financial statements, approved corporate contracts, analyzed complex industry regulations, *etc.*

When UBS issued a “loan” of some \$750,000 to the taxpayer, it apparently opened a subaccount (“Large Account”) under the existing account (“Small Account”), deposited the funds in the Large Account, and began investing them on behalf of the taxpayer. Much of the case centers on what the taxpayer knew, and when, about the Large Account.

The taxpayer instructed UBS not to send him any mail. He kept abreast of the financial status by meeting periodically with a UBS representative when he visited the United States.

The taxpayer started working in 1972 with an accountant, Seymour Handelman (“Accountant Handelman”). Apparently, Accountant Handelman never specifically asked the taxpayer about foreign accounts, and the taxpayer never unilaterally raised the topic, until some point in the 1990s. At that time, Accountant Handelman allegedly advised the taxpayer, incorrectly, that he would not need to report income from the UBS accounts until he repatriated the funds or died. It is unclear whether Accountant Handelman notified the taxpayer of his duty to report the existence of foreign accounts on Schedule B of Form 1040 or to file an annual FBAR. What is certain, though, is that these things did not occur until many years later.

Accountant Handelman prepared Forms 1040 for the taxpayer from 1972 through 2006, after which he died. The taxpayer, in need of new help with return preparation, hired another accountant, Sheldon Bransky (“Accountant Bransky”). The content of the discussions with, and the type of documents provided to, Accountant Bransky by the taxpayer are ambiguous. However, there is no dispute that he prepared (i) a timely 2007 Form 1040 that omitted the \$220,000 in passive income generated by the UBS accounts that year, (ii) a Schedule B to the 2007 Form 1040 answering “yes” to the foreign-account question and identifying “Switzerland” as the location, and (iii) a late 2007 FBAR, reporting only the Small Account and noting that its highest balance ranged from \$100,000 to \$1 million.

UBS notified the taxpayer at some point in 2008 that he must close his accounts, presumably because of the criminal investigation by the U.S. government of UBS and its

dealing with U.S. clients. Therefore, in November 2008, the taxpayer sent a letter to UBS instructing it to close the Large Account, which had a balance of about \$2 million by that time, and transfer the funds to another Swiss bank, Hyposwiss. Soon thereafter, in December 2008, the taxpayer sent another letter to UBS, this time closing the Small Account, with a balance of about \$250,000, and domesticating the funds to his Wachovia account.

At some point in 2009, the taxpayer began to question the earlier advice from Accountant Handelman with respect to the UBS accounts. He consulted with his attorney, who, in turn, hired both a forensic accountant, to assist with return preparation, and a Swiss attorney, to obtain data from UBS. The Swiss attorney learned as part of his project that UBS had already provided data to the IRS about the accounts held by the taxpayer. This did not alter the taxpayer’s existing plan, which was to apply to resolve issues with the IRS through the Offshore Voluntary Disclosure Program (“OVDP”).

In connection with his proposed participation in the OVDP, the taxpayer filed in 2010 (i) Forms 1040X from 2003 through 2008, reporting the passive income generated by the UBS accounts, and (ii) a 2006 FBAR, an amended 2007 FBAR, and a 2008 FBAR, reporting both the Small Account and Large Account. The IRS rejected the taxpayer’s application for the OVDP because it had already received data directly from UBS about the unreported accounts.

B. Different Decisions Along the Way

The *Bedrosian* battle has generated inconsistent results, both by the IRS and the courts.

1. First Decision—First Revenue Agent

The IRS initiated an audit in April 2011. The taxpayer cooperated with the audit, responding to all Information Document Requests (“IDRs”) and participating in an interview with the Revenue Agent. The Revenue Agent determined that the FBAR violation for 2007 was non-willful and presented this finding to the appropriate “panel” within the IRS.

2. Second Decision—Second Revenue Agent

The first Revenue Agent later exited the scene for unexpected medical leave, and another Revenue Agent took over. In June 2013, the second Revenue Agent disagreed with the earlier conclusion about the character of the FBAR violation for 2007 and asserted a “willful” penalty. The second Revenue Agent sought the most extreme sanction, equal to 50 percent of the highest balance of

the Large Account. The highest balance in 2007 was \$1,951,578.34, triggering a penalty of \$975,789.19.

3. Third Decision—Appeals Office

The taxpayer administratively disputed the penalty, and the Appeals Office notified him that the IRS would not waive or otherwise mitigate the “willful” FBAR sanction.

4. Fourth Decision—District Court

In light of the intransigence by the Appeals Office, the taxpayer made a partial payment of \$9,757.89 (representing merely one percent of the FBAR penalty amount) and then he filed a Suit for Refund in District Court. The DOJ filed a counterclaim, contending that the taxpayer was liable for the remaining amount of the penalty.

The taxpayer and the DOJ presented legal and tax positions to the District Court through Cross-Motions for Summary Judgment, briefing, and a one-day bench trial. Most of the advocacy focused on the concept of willfulness.

a. Main Arguments by the Taxpayer. The taxpayer focused most of his time and attention to the critical question of whether his failure to report the Large Account on the original 2007 FBAR was willful, negligent, reasonable, or something in between. The taxpayer emphasized a number of points in this regard during the litigation, including the following: (i) He relied on erroneous advice from Accountant Handelman; (ii) He did not closely review the relevant Forms 1040 or FBARs before they were filed; (iii) Schedule B to the 2007 Form 1040 answered “yes” to the foreign-account question and identified “Switzerland” as the relevant country; (iv) At the time of filing the original 2007 FBAR, he was unaware that UBS had created a Small Account and a Large Account, and he simply considered it all to be just one account; (v) He did not have in his possession statements from UBS at the time he filed the original 2007 FBAR; (vi) He did not believe that the loan of approximately \$750,000 would be counted as part of the reportable balance, because that money essentially belonged to UBS, not the taxpayer; (vii) He retained legal counsel, a forensic accountant, and a Swiss attorney as part of an effort to voluntarily become compliant through the OVDP, even though his application was rejected; (viii) He filed Forms 1040X, FBARs, and an amended 2007 FBAR in August 2010, before the IRS started an audit; and (ix) He cooperated during the IRS audit. The taxpayer also attempted to distinguish the facts in his situation from those in prior FBAR cases, where the courts found willful actions and inactions.

b. Main Arguments by the DOJ. The DOJ, like the taxpayer, directed most of its energy to the issue of willfulness. It raised a long list of points through the litigation, many of which are summarized here: (i) The taxpayer is an accomplished, intelligent, experienced professional who understood, or should have taken the necessary steps to understand, his tax duties, FBAR duties, and facts related to funds held with UBS; (ii) Because he signed his annual Forms 1040, the taxpayer had at least constructive knowledge of, and was placed on inquiry notice about, his FBAR duties; (iii) The taxpayer cannot claim ignorance of his FBAR duty for 2007, because he actually filed one, even though it was late and incomplete; (iv) The fact that the taxpayer sent two separate letters to UBS to close the Large Account and the Small Account, and the fact that funds from the Large Account were transferred to another Swiss bank, while the funds from the Small Account were repatriated, indicates that the taxpayer knew he had two accounts at UBS, not one; (v) The taxpayer closed the Large Account merely two weeks after filing the original 2007 FBAR, which did not report the Large Account; (vi) The supposed reliance by the taxpayer on erroneous advice from Accountant Handelman is questionable because there is no written evidence or third-party testimony to support it, the advice was limited to income tax issues, not FBAR issues, and the taxpayer did not discuss with his new Accountant Bransky such advice when he took over return preparation starting with 2007; (vii) The taxpayer instructed UBS to hold all mail related to the accounts, and the taxpayer received only oral updates when he met periodically with UBS personnel; (viii) The taxpayer did not take any steps to voluntarily resolve non-compliance with the IRS until after he learned in 2009 that UBS had already remitted to the U.S. government data about his accounts; (ix) The taxpayer presented no evidence that the \$750,000 deposited into the Large Account constituted a “loan,” and even if it were, a loan amount cannot be excluded when calculating the highest balance for FBAR purposes; and (x) The non-compliance by the taxpayer was significant, lasting for several decades, and resulting in approximately \$375,000 in untaxed passive income from 2003 through 2007 alone.

c. Analysis by the District Court. After holding a one-day bench trial and reviewing the corresponding briefs, the District Court rendered a taxpayer-favorable decision, the first of its kind. The main points from the District Court are as follows.

The District Court identified some favorable facts for the taxpayer, namely, Schedule B to the 2007 Form 1040 checked the “yes” box in response to the foreign-account question and indicated “Switzerland” as the relevant country, the taxpayer filed a 2007 FBAR reporting at least one account, and the taxpayer approached his attorney to rectify matters with the IRS before he learned that UBS had already supplied his account data to the U.S. government and it had started an investigation.

It was not all positive, though. The District Court expressly acknowledged that the taxpayer is an educated and financially literate businessman, he took a “calculated risk” for many years before 2007 by not reporting the UBS accounts or the income they generated (but such years were not at issue during the trial), there is “no question” that the taxpayer could have easily discovered that UBS had split the funds into a Small Account and Large Account based on the annual statements and/or periodic meetings with UBS personnel, and the taxpayer filed the questionable 2007 FBAR showing one account just weeks before sending letters to UBS instructing it to close two accounts.

Despite all this, the District Court held that the taxpayer’s actions “were at most negligent” and the omission of the Large Account from the original 2007 FBAR was an “unintentional oversight or a negligent act” because there “is no indication that he did so with the requisite voluntary or intentional state of mind.”¹⁵

In distinguishing the facts in *Bedrosian*, the District Court emphasized that the unreported accounts in other FBAR penalty cases were part of a larger or complex “tax evasion scheme,” the taxpayers made no efforts to voluntarily disclose matters to the IRS, the taxpayers had already been convicted of a crime, and/or the taxpayers lied or otherwise failed to cooperate with the IRS audit.¹⁶

The District Court summarized its ultimate holding in the following manner:

In summary, the only evidence supporting a finding that [the taxpayer] willfully violated Section 5314 is: (1) the inaccurate [original 2007 FBAR] itself, lacking reference to the [Large Account], (2) the fact that he may have learned of the existence of the [Large Account] at one of his meetings with a UBS representative, which is supported by his having sent two separate letters closing the accounts, (3) [the taxpayer’s] sophistication as a businessman, and (4) [Accountant] Handelman’s having told [the taxpayer] in the mid-1990s that he was breaking the law by not reporting the UBS accounts. None of

these indicate “conduct meant to conceal or mislead” or a “conscious effort to avoid learning about reporting requirements,” even if they may show negligence.¹⁷

5. Fifth Decision—Court of Appeals

The DOJ, of course, was not happy about the decision by the District Court in *Bedrosian*, so it sought review by higher judicial powers. The Third Circuit Court of Appeals issued an Opinion in September 2018 addressing various legal issues, the most pertinent to this article being what, exactly, does willfulness mean in the FBAR context.

The Court of Appeals began by noting that it agreed with the District Court in that the usual standard of willfulness applies to civil FBAR penalties, meaning the inquiry focuses on whether the violation was either knowing or reckless. It then stated that recklessness, in the context of the FBAR, is an objective, not subjective, measure. The Court of Appeals clarified that a person recklessly fails to comply with an IRS filing requirement, like the FBAR duty, when (i) the person clearly ought to have known, (ii) that there was a grave risk that the FBAR duty was not being met, and (iii) the person was in a position to find out for certain very easily.

The Court of Appeals indicated that the District Court arrived at its decision in *Bedrosian* regarding willfulness primarily by comparing the taxpayer’s conduct to that of other individuals in previous FBAR cases that had been decided in favor of the U.S. government. It also stated that the discussion by the District Court implies that its conclusion of non-willfulness was based on findings related to the taxpayer’s “subjective motivations” and the “overall egregiousness” of his conduct. The Court of Appeals then pointed out that the District Court did not apply the objective recklessness standard, described above, as of the date on which the taxpayer was to file his 2007 FBAR. For these reasons, the Court of Appeals directed the District Court to give it another go:

Although we would afford clear error review to an ultimate determination [by a District Court] as to recklessness, we cannot defer to a determination we are not sure the District Court made based on our view of the correct legal standard. We therefore remand for further consideration and to render a new judgment.¹⁸

Because we are unsure whether the District Court evaluated [the taxpayer’s] conduct under this

objective standard, we remand the case for further proceedings consistent with this opinion.¹⁹

6. Sixth Decision—District Court, Again

In what likely constitutes the final round in this multi-year battle, the District Court, with the case in hands for a second time, decided in favor of the DOJ in December 2020. The rationale for this change of heart was the following.²⁰

The District Court began by noting that the Court of Appeals, in ruling on the standard for FBAR penalties, relied heavily on various cases in the taxation realm, including those centered on the concept of “willfulness” in employment tax disputes and the so-called trust fund recovery penalty under Code Sec. 6672. It further noted that the Court of Appeals followed guidance from earlier FBARs cases in other circuits.

The District Court then indicated that it was “supplementing” its earlier findings, after considering the precedents on which the Court of Appeals relied and reviewing the existing evidence from the perspective of whether the taxpayer’s conduct, when viewed objectively instead of subjectively, was reckless. The District Court acknowledged that it previously identified the following facts as indications of negligence, but not necessarily of willfulness, by the taxpayer: He omitted the Large Account from his original 2007 FBAR, learned about the Large Account during one of his meetings with UBS, was a sophisticated businessman, and learned from his accountant years ago that it was illegal not to report foreign accounts. After further reflection, the District Court “supplemented” its findings by recognizing that the following items tend to show that the taxpayer was reckless: (i) His cooperation with the IRS started only *after* his undisclosed accounts had been exposed to the IRS; (ii) Soon after filing his original 2007 FBAR on which he only reported the Small Account, he sent letters to UBS directing it to close both the Small Account and Large Account; (iii) He instructed UBS not to send any correspondence to the United States and paid a fee for this lack of communication; and (iv) He was aware of the total money on deposit with UBS.

The District Court summarized its reversal in the following manner:

In summary, this Court’s *prior* analysis was focused almost entirely on Bedrosian’s *subjective intent* and did not adequately consider whether the evidence warranted a conclusion, *from an objective point of*

view, whether Bedrosian acted either “knowingly or recklessly” in failing to file an FBAR.²¹

The District Court later explained that, applying the broad standard set by the Court of Appeals and the “supplemental” facts described above, the taxpayer engaged in a willful FBAR violation, at least objectively:

[T]his Court finds that [the taxpayer’s] actions were willful because he recklessly disregarded the risk that his FBAR was inaccurate. The Court notes that the concept of willfulness encompasses both knowing and reckless conduct. As the Third Circuit emphasized, in the law of taxation, reckless conduct can be violative of IRS statutes and/or rules, *from an objective point of view, even if not “willful” from a subjective point of view.*²²

This Court, after review of the evidence, concludes that *it must use a more expansive concept of willfulness that includes reckless conduct considered from an objective point of view.* Accordingly, this Court concludes that [the taxpayer’s] conduct was willful under settled case law.²³

In justifying its decision to saddle the taxpayer with a penalty of \$975,789.19 instead of \$0, the District Court explained that most cases applying the recklessness standard emphasize that a taxpayer’s general awareness of business operations affects the willfulness analysis. The cases, primarily in the employment tax area, indicate that when a taxpayer has the duty to review returns and issue checks, he is liable for all apparent errors on such items. In this case, reasoned the District Court, if the taxpayer in *Bedrosian* had looked at his Forms 1040 and FBARs before signing them, he should have noticed that the account balances indicated were inaccurate. Moreover, even if the taxpayer unaware that he held both a Small Account and Large Account at UBS, the low account balance should have caused him to investigate further, which he could have accomplished with ease by contacting UBS. Finally, the District Court explained that any claims by the taxpayer that he did not review his documents, and thus was ignorant of the low account balance reported, would not negate a holding of reckless.

IV. Encouraging Case—Jones

Two recent, interrelated cases are interesting in that they demonstrate that certain factors and risks might dissuade

the DOJ from pursuing willful FBAR penalties. These cases are styled *Jones and Jones, as Executor, J.L. Jones Est.*²⁴

A. Relevant Facts

Jeffrey Jones was born in New Zealand, lived there over 30 years, later relocated to Canada, and ultimately moved to California. His wife, Margaret Jones, was born in Canada and ultimately settled in California with Jeffrey. They both became U.S. citizens in 1969. They each had high school educations and worked for much of their lives as a dressmaker and secretary. Later, they started buying, repairing, and renting or selling properties.

Jeffrey held certain foreign accounts in his name, Margaret held some in hers, and they held others jointly. All foreign accounts, totaling 11, were located in countries with which they had a logical connection, New Zealand and Canada. The taxpayers did not report their passive income from the foreign accounts on their joint 2011 Form 1040, they checked the “no” box in response to the foreign-account question on Schedule B to the Form 1040, and they did not file a 2011 FBAR. Margaret indicated that she, and Jeffrey during his lifetime, believed that they would not be subject to U.S. income tax on the foreign funds until they repatriated them, which never occurred.

The accountant with whom the Jeffrey and Margaret had worked for over 25 years (“Accountant Burke”) indicated to the IRS that he knew the taxpayers had previously lived in Canada, he never asked them about foreign accounts or foreign income, he was not familiar with FBAR reporting duties because he had no clients with international activities, and he did not review the annual Schedule B with the taxpayers.

Jeffrey died in March 2013, when he was 93 years old. Margaret, as executor of his estate, then sought legal advice about how to handle estate issues in New Zealand. Margaret claimed that she first learned about Jeffrey’s personal accounts in New Zealand at that time, and started taking actions to correct matters. For instance, she filed a timely 2012 FBAR, filed delinquent FBARs for earlier years whose assessment-periods remained open, filed Forms 1040X for 2011 and 2012 reporting income from the foreign accounts, and later applied for the Streamline Domestic Offshore Procedure (“SDOP”). Margaret did not include the foreign accounts held individually by Jeffrey in the SDOP because of incomplete guidance from the IRS about post-death participation and her inability to make accurate sworn statements about the intent of a deceased person.

The IRS started an audit of the SDOP submission, rejected Margaret’s certification of non-willfulness, and, ultimately, assessed the highest possible penalties for “willful” FBAR violations, against Jeffrey and Margaret, in March 2019. By that time, Jeffrey had already been dead for six years. Margaret paid a portion of all penalties, both individually and as executor of Jeffrey’s estate, submitted Claims for Refund with the IRS, and then started refund lawsuits in District Court, at which time she was 90 years old.

B. Motions for Summary Judgment

After a considerable amount of legal maneuvering, each party filed a Motion for Summary Judgment with the District Court.

1. Positions of the Parties

Margaret emphasized the following points in her defense: (i) The FBAR violation was unintentional, inadvertent, and a mistake based on a good faith misunderstanding of applicable law; (ii) All unreported foreign accounts were held countries with which she and Jeffrey had a lifelong connection, Canada and New Zealand, not in some random tax haven; (iii) She only has a high school education, never attended college, and has no formal tax, accounting, legal, or financial training; (iv) She held all foreign accounts in her personal name, not through a foreign entity or agent; (v) She had never heard of an FBAR during the relevant years; (vi) She believed that the foreign funds would only become an issue from a U.S. perspective when they were repatriated; (vii) She relied on Accountant Burke, who was aware of her Canadian background but never asked her about foreign accounts or income, never mentioned the FBAR, and never reviewed with her the foreign-account question on Schedule B to the annual Forms 1040; (ix) When she first learned about her FBAR duties in connection with her due diligence as executor of Jeffrey’s estate, she took pro-active steps to rectify matters with the IRS, including filing a timely 2012 FBAR, hiring legal counsel, applying for the SDOP, and paying the corresponding “offshore” penalty; (x) She reported the foreign accounts on the Form 706 (*U.S. Estate Tax Return*) that she filed for Jeffrey’s estate; and (xi) Jeffrey had died years ago, in 2013, and she was over 90 years old and in poor health.

The DOJ presented the following counterarguments: (i) Margaret responded “no” to the question about foreign accounts on Schedule B of the Forms 1040;

(ii) Schedule B specifically references the FBAR, such that she had at least constructive notice of her duty; (iii) Margaret never told Accountant Burke about foreign accounts or income, and never provided him any statements from the banks; (iv) The DOJ only needs to show that Margaret acted “recklessly,” and signing an inaccurate Form 1040 is *prima facie* evidence of recklessness; (v) Even if Margaret lacked actual notice of her FBAR duties, such ignorance was attributable to her efforts to remain “willfully blind;” (vi) Margaret cannot raise the reasonable-reliance defense with respect to Accountant Burke because he was not fully informed; and (vii) Even if all the criteria for the reasonable-reliance defense were satisfied, it would still not help Margaret because it is only a potential defense to non-willful FBAR penalties, not willful ones.

2. District Court Decision

The Motions for Summary Judgment raised various issues, one of which was whether Margaret had “willfully” violated her FBAR duty. The District Court made the following observations and rulings on this issue. First, alluding to earlier FBAR cases, the District Court held that signing a Form 1040 and the related declaration of its accuracy is *prima facie* evidence that a taxpayer had constructive knowledge of the FBAR requirements. However, the District Court underscored that a taxpayer, like Margaret, can rebut this legal presumption, and the undisputed facts in her case cut both ways. It further stated, categorically, that “signing a tax return on its own cannot automatically make the taxpayer’s violation ‘willful’ as that would collapse the willfulness standard to strict liability.”²⁵ Second, the District Court rejected the DOJ’s position that the reasonable-reliance defense is inapplicable to willful FBAR penalty disputes. Third, the District Court also rebuffed the argument by the DOJ that Margaret’s actions *after* the FBAR violation (such as pro-actively filing a timely 2012 FBAR, applying for the SDOP, *etc.*) cannot affect a willfulness determination, explaining that Margaret’s behavior provides circumstantial support for the notion that the earlier FBAR violation was non-willful. Finally, the District Court ruled that granting summary judgment on the willfulness issue was impossible because a trial was necessary to clarify unresolved material facts.²⁶

C. DOJ Settles Case Before Trial

Several months after the District Court ruled on the Motions for Summary Judgment, but before the start

of the trial, the DOJ decided to settle the case, on terms which one would assume were quite favorable to Margaret and Jeffrey’s Estate.²⁷

V. Conclusion

Many courts have examined the issue of what constitutes “willfulness” in the context of civil FBAR penalties in recent years.²⁸ Notable decisions include, but are certainly not limited to, *Williams* in 2012,²⁹ *McBride* in 2012,³⁰ *Bussell* in 2015,³¹ *Bohanec* in 2016,³² *Kelley-Hunter* in 2017,³³ *Toth* in 2017,³⁴ *Colliot* in 2018,³⁵ *Wadhan* in 2018,³⁶ *Garrity* in 2018,³⁷ *Markus* in 2018,³⁸ *Norman* in 2018,³⁹ *Flume* in 2018,⁴⁰ *Kimble* in 2018,⁴¹ *Horowitz* in 2019,⁴² *Rum* in 2019,⁴³ *Schwarzbaum* in 2020,⁴⁴ *Bernstein*,⁴⁵ *Ott* in 2020,⁴⁶ *Zimmerman* in 2020,⁴⁷ *DeMauro* in 2020.⁴⁸

The preceding decisions are not entirely consistent in their legal standards and reasoning, and the IRS and DOJ have taken different positions over time, all of which makes getting a clear, comprehensive understanding of “willfulness” challenging. However, the cases yield the following general guidance:

- The Tax Court lacks jurisdiction over FBAR penalty matters, in both pre-assessment and post-assessment (*i.e.*, collection) cases, so FBAR litigation cannot take place there.
- The standard for asserting maximum FBAR penalties is “willfulness.”
- The government is only required to prove willfulness by a preponderance of the evidence, not by clear and convincing evidence.
- The government can establish willfulness by showing that a taxpayer either knowingly or recklessly violated the FBAR duty.
- The concept of willfulness in the FBAR arena is expansive and encompasses reckless conduct, considered from an objective point of view, even if such conduct is not willful from a subjective perspective.
- In gauging whether conduct is reckless, and thus willful for FBAR purposes, courts turn to employment tax cases focused on trust fund recovery penalties for guidance.
- Recklessness might exist where a taxpayer fails to inform his accountant about foreign accounts.
- Recklessness might also exist where a taxpayer is “willfully blind” of his FBAR duties, which can occur when he executes but does not read every aspect of

Form 1040, including all Schedules attached to Form 1040 (e.g., Schedule B containing the foreign-account question) and any separate forms referenced in Schedule B (e.g., the FBAR).

- If the taxpayer makes a damaging admission during a criminal trial, the government can use such statement against him in a later civil FBAR penalty action.
- The government can prove willfulness through circumstantial evidence and inference, including actions by the taxpayer to conceal sources of income or other financial data.
- In determining whether an FBAR violation was willful, courts might consider after-the-fact unprivileged communications between taxpayers and their tax advisors.
- District Courts review the question of willfulness on a *de novo* basis, meaning that taxpayers generally cannot offer evidence at trial related to the IRS's administrative process in conducting the audit, determining whether willfulness existed, *etc.*
- Courts might reject as irrelevant, in an evidentiary sense, reports and testimony from experts who attempt to make a link between general ignorance of FBAR duties by the public and particular ignorance of the specific taxpayer under attack.
- Courts might give credence to the argument that age-related mental conditions preclude a finding of willfulness.

- If the DOJ starts a lawsuit to collect FBAR penalties, and if the taxpayer fails to respond to court pleadings and/or comply with pre-trial discovery orders, then the court might impose strong sanctions, including a ruling that the taxpayer had a reportable interest in the relevant foreign accounts, he had a duty to file FBARs, he willfully violated his duty, he must pay the maximum penalty, and he also must pay the fees and costs incurred by the DOJ in conducting the lawsuit.

The recent decision in *Bedrosian* adds to this list, demonstrating that more courts are employing a broader definition of willfulness, one that says that reckless conduct from an objective standpoint, even if not willful from a subjective point of view, is sufficient to uphold the most severe FBAR penalties.

On a more positive note for non-compliant taxpayers, *Jones* also contributes to the debate. It reveals that the DOJ, despite many hand-picked victories in recent years, is cautious about which FBAR cases it litigates for fear of allowing any taxpayer victories. The case further demonstrates that certain courts still reject the notions that merely signing a Form 1040 can trigger a willful FBAR violation, reasonable cause defenses are futile, and post-violation behavior by taxpayers should be ignored. *Jones* provides encouragement to those taxpayers, with strong facts in their favor, who await their chance to demonstrate that their FBAR violations were reasonable or, at worst, negligent.

ENDNOTES

* Hale specializes in tax audits, tax appeals, and tax litigation. You can reach Hale by phone at (404) 658-5441 or by email at hale.sheppard@chamberlainlaw.com.

¹ *Bedrosian*, DC-PA, 120 AFTR 2d 2017-5671.

² *Bedrosian*, CA-3, 122 AFTR 2d 2018-7052, 912 F3d 144; *Bedrosian*, DC-PA, 126 AFTR 2d 2020-7067.

³ *Jones*, DC-CA, 125 AFTR 2020-2067.

⁴ The Bank Secrecy Act, P.L. 91-508, Title I and Title II (Oct. 26, 1970).

⁵ The Bank Secrecy Act, P.L. 91-508, Title I and Title II (Oct. 26, 1970) at §202.

⁶ 68 FR 26489 (May 16, 2003).

⁷ 31 CFR §103.56(g), 68 FR 26489 (May 16, 2003).

⁸ 31 USC §5321(a)(5)(A).

⁹ 31 USC §5321(a)(5)(B)(i). The IRS cannot assert this penalty if the FBAR violation not only was "non-willful," but also due to "reasonable cause." See 31 USC §5321(a)(5)(B)(ii).

¹⁰ 31 USC §5321(a)(5)(C)(i).

¹¹ 31 USC §5314; 31 CFR §1010.350(a).

¹² In addition to these duties, taxpayers holding foreign financial accounts generally must report them on Form 8938 (*Statement*

of Specified Foreign Financial Assets). For a detailed analysis of the Form 8938 filing requirement, see Hale E. Sheppard, *The New Duty to Report Foreign Financial Assets on Form 8938: Demystifying the Complex Rules and Severe Consequences of Noncompliance*, INT'L TAX J., 2012, at 11; Hale E. Sheppard, *Form 8938 and Foreign Financial Assets: A Comprehensive Analysis of the Reporting Rules After IRS Issues Final Regulations*, INT'L TAX J., 2015, at 25; Hale E. Sheppard, *Specified Domestic Entities Must Now File Form 8938: Section 6038D, New Regulations in 2016, and Expanded Foreign Financial Asset Reporting*, INT'L TAX J., 2016, at 5; Hale E. Sheppard, *Canadian Retirement Plans: What Does Revenue Procedure 2014-55 Mean for U.S. Tax Deferral, Form 8891, Form 8938, and the FBAR?*, INT'L TAX J., 2016, at 25; and Hale E. Sheppard, *Unlimited Assessment-Period for Form 8938 Violations: Ruling Shows IRS's Intent to Attack Multiple Tax Returns*, TAXES, 2017, at 31.

¹³ Schedule B (Form 1040) (2020).

¹⁴ In an effort to accurately describe the facts and rulings, the author obtained and reviewed the following documents related to *Bedrosian*, DC-PA, 120 AFTR 2d 2017-5671: Complaint filed October 27, 2015, Answer and Counterclaim filed February 26, 2016, Reply to Counterclaim filed March 21, 2016, United States' Motion for Summary Judgment filed November 30, 2016, Memorandum of Law in Support of the United States' Motion for Summary Judgment filed November 30, 2016, United States' Statement of Undisputed Material Facts filed November 30, 2016, Plaintiff's Statement of Undisputed Material Facts filed December 5, 2016, Plaintiff's Motion for Summary Judgment filed December 5, 2016, Plaintiff's Response to Defendant's Statement of Undisputed Material Facts filed December 19, 2016, United States' Response to the Plaintiff's Motion for Summary Judgment filed December 19, 2016, Plaintiff's Response to Defendant's Motion for Summary Judgment filed December 19, 2016, United States' Reply to the Plaintiff's Response to Its Motion for

Summary Judgment filed December 23, 2016, Order Denying Motions for Summary Judgment dated April 13, 2017, Memorandum Regarding Cross Motions for Summary Judgment dated April 13, 2017; Plaintiff's Trial Memorandum filed August 28, 2017; United States' Trial Brief filed August 28, 2017; Plaintiff's Post-Trial Memorandum and Proposed Findings of Fact and Conclusions of Law filed September 14, 2017; United States' Post-Trial Brief filed September 14, 2017; Order dated September 20, 2017; and Findings of Fact and Conclusions of Law dated September 20, 2017. In addition, the author obtained and reviewed the following documents related to *Bedrosian*, CA-3, 122 AFTR 2d 2018-7052, 912 F3d 144: Brief for the Appellants filed April 24, 2018; Brief for the Appellee filed May 24, 2018; and Opinion issued December 21, 2018. Finally, the author obtained and reviewed *Bedrosian*, DC-PA, 126 AFTR 2d 2020-7067.

¹⁵ *Bedrosian*, DC-PA, 120 AFTR 2d 2017-5671.

¹⁶ *Bedrosian*, DC-PA, 120 AFTR 2d 2017-5671.

¹⁷ *Bedrosian*, DC-PA, 120 AFTR 2d 2017-5671.

¹⁸ *Bedrosian*, CA-3, 122 AFTR 2d 2018-7052, 912 F3d 144.

¹⁹ *Bedrosian*, CA-3, 122 AFTR 2d 2018-7052, 912 F3d 144.

²⁰ *Bedrosian*, DC-PA, 126 AFTR 2d 2020-7067; see also Amanda Athanasiou, *As FBAR Litigation Evolves, Willful Standard Raises Concerns*, 2020 TAX NOTES FEDERAL 243-247 (Dec. 18, 2020).

²¹ *Bedrosian*, DC-PA, 126 AFTR 2d 2020-7067 (emphasis added).

²² *Bedrosian*, DC-PA, 126 AFTR 2d 2020-7067 (emphasis added).

²³ *Bedrosian*, DC-PA, 126 AFTR 2d 2020-7067 (emphasis added).

²⁴ *Jones*, DC-CA, 125 AFTR 2020-2067. The author obtained and reviewed the following documents in preparing this article: Complaint for Illegal Exaction, filed June 16, 2019; Answer and Counterclaim, filed August 12, 2019; Answer to Counterclaim and Demand for Jury Trial, filed September 3, 2019; Notice of Partial Concession by the United States, filed March 31, 2020; Notice of Motion and Motion for Summary Judgment, or in the Alternative, Partial Summary Judgment by Plaintiff, filed April 6, 2020; Memorandum of Points and Authorities in Support of Motion for Summary Judgment, or in the Alternative, Partial Summary Judgment by Plaintiff, filed April 6, 2020; Notice of Motion and Motion for Summary Judgment by the United States, filed April 6, 2020; Memorandum of Points and Authorities in Support of Motion for Summary Judgment by United States, filed April 6, 2020; Plaintiff's Opposition to the Motion for Summary Judgment by United States, filed April 13, 2020; Response by United States to Plaintiff's Motion for Summary Judgment, filed April 13, 2020;

Reply to the Opposition by the United States to Plaintiff's Motion for Summary Judgment, and in the Alternative, Partial Summary Judgment, filed April 20, 2020; Reply by the United States in Support of its Motion for Summary Judgment, filed April 20, 2020; Order Regarding Motions for Summary Judgment, issued May 11, 2020; Plaintiff's Memorandum of Contentions of Fact and Law, filed July 20, 2020; Memorandum of Contentious Fact and Law by United States, filed July 20, 2020; Stipulation for Dismissal, filed December 21, 2020. See also *Jones, J.L. Jones Est.*, DC-CA, Case 2:19-cv-00173. The author obtained and reviewed the following documents in preparing this article: Complaint for Illegal Exaction, filed January 8, 2019; Answer and Counterclaim, filed April 15, 2019; Answer to Counterclaim and Demand for Jury Trial, filed May 3, 2019; Order Regarding Motions for Summary Judgment, filed May 11, 2020; and Stipulation for Dismissal, filed December 21, 2020.

²⁵ *Jones*, DC-CA, 125 AFTR 2020-2067. Order Regarding Motions for Summary Judgment, issued May 11, 2020.

²⁶ Amanda Athanasiou, *FBAR Penalty Arbitrary and Capricious, U.S. Court Finds, Tax Analysts Doc. 2020-18568*, 2020 TAX NOTES TODAY FEDERAL 94-10 (May 14, 2020).

²⁷ *Jones*, DC-CA, 125 AFTR 2020-2067. Stipulation for Dismissal, filed December 21, 2020.

²⁸ For more detailed information about the recent court battles regarding "willful" FBAR penalties, please see the following articles by the same author: Hale E. Sheppard, *Taxpayers Die but Their International Penalties Live On: Recent Cases Addressing Broad Scope of Post-Death Assessment and Collection*, 31 J. INT'L TAXATION 36 (2020); Hale E. Sheppard, *Second Court Rejects "Constructive Knowledge" Theory for Willful FBAR Penalties*, INT'L TAX J., 2020, at 29; Hale E. Sheppard, *More FBAR Penalty Losses and Lessons: The Significance of Rum and Ott, Flume, Boyd and Cohen: Three Recent FBAR Cases Yielding Important Lessons*, INT'L TAX J., 2019, at 31; Hale E. Sheppard, *United States v. Horowitz: Sixth Case Analyzing Constructive Knowledge as Determinant of FBAR Penalties*, INT'L TAX J., 2019, at 23; Hale E. Sheppard, *Constructive Knowledge and FBAR Penalties: Does Merely Filing a Form 1040 Suffice to Establish "Willfulness?"*, TAXES, 2019, at 41; Hale E. Sheppard, *Court Bucks the Trend in Willful FBAR Penalty Cases: Merely Signing Tax Returns Does Not Establish Willfulness*, TAXES, 2019, at 23; Hale E. Sheppard, *What Constitutes a "Willful" FBAR Violation? Comprehensive Guidance Based on Eight Important Cases*, 129 J. TAXATION 24 (2018); Hale E. Sheppard, *Court Holds that*

Pervasive Ignorance Is No Defense to Willful FBAR Penalties: This and Other Lessons from United States v. Garrity, INT'L TAX J., 2018, at 51; Hale E. Sheppard, *Willful FBAR Penalty Case Shows Importance of Protecting Privileged Communications: What Kelley-Hunter Adds to the Foreign Account Defense Discussion*, INT'L TAX J., 2018, at 15; Hale E. Sheppard, *Analysis of the Reasonable Cause Defense in Non-Willful FBAR Penalty Case: Teachings from Jarnagin*, 128 J. TAXATION 6 (2018); Hale E. Sheppard, *First Taxpayer Victory in a Willful FBAR Penalty Case: Analyzing the Significance of Bedrosian for Future Foreign Account Disputes (Part 1)*, 128 J. TAXATION 12 (2018); Hale E. Sheppard, *First Taxpayer Victory in a Willful FBAR Penalty Case: Analyzing the Significance of Bedrosian for Future Foreign Account Disputes (Part 2)*, 128 J. TAXATION 14 (2018); Hale E. Sheppard, *Can Recent "Willful" FBAR Penalty Cases against Taxpayers Help Tax Firms Fend Off Malpractice Actions?*, INT'L TAX J., 2017, at 33; Hale E. Sheppard, *Government Wins Fourth Straight FBAR Penalty Case: Analyzing Bohanec and the Evolution of "Willfulness"*, 126 J. TAXATION 110 (2017); Hale E. Sheppard, *Government Wins Second Willful FBAR Penalty Case: Analyzing What McBride Really Means to Taxpayers*, 118 J. TAXATION 187 (2013); Hale E. Sheppard, *Third Time's the Charm: Government Finally Collects "Willful" FBAR Penalty in Williams Case*, 117 J. TAXATION 319 (2012); Hale E. Sheppard, *District Court Rules That Where There's (No) Will, There's a Way to Avoid FBAR Penalties*, 113 J. TAXATION 293 (2010).

²⁹ *J.B. Williams*, 131 TC 54, Dec. 57,547; *J.B. Williams*, No. 1:09-cv-437, 2010 WL 347221 (E.D. Va. 2010); *J.B. Williams*, CA-4, 2012-2 USTC ¶15,475, 489 FedAppx 655.

³⁰ *J. McBride*, DC-UT, 2012-2 USTC ¶15,666, 908 FSupp2d 1186.

³¹ *Bussell*, DC-CA, 117 AFTR 2d 2016-439.

³² *Bohanec*, DC-CA, 118 AFTR 2d 2016-5537.

³³ *Kelley-Hunter*, DC-CO, 120 AFTR 2d 2017-5566.

³⁴ *Toth*, DC-MA, 122 AFTR 2d 2018-6280; *Toth*, DC-MA, 126 AFTR 2d 2020-6065.

³⁵ *Colliot*, DC-TX, 121 AFTR 2d 2018-1834.

³⁶ *Wadhan*, DC-CO, 122 AFTR 2d 2018-5208.

³⁷ *Garrity*, DC-CT, Case No. 3:15-cv-243 (2018).

³⁸ *Markus*, DC-NJ, 122 AFTR 2d 2018-5166.

³⁹ *Norman*, 138 FedCl 189 (2018), 122 AFTR 2d 2018-5334.

⁴⁰ *Flume*, DC-TX, 122 AFTR 2d 2018-5641.

⁴¹ *Kimble*, 122 AFTR 2d 2018-7109, 141 FedCl 373 (2018).

⁴² *Horowitz*, DC-MD, 123 AFTR 2d 2019-500; *Horowitz*, CA-4, 126 AFTR 2d 2020-6551.

⁴³ *Rum*, DC-FL, 124 AFTR 2d 2019-5389.


⁴⁴ *Schwarzbaum*, DC-FL 125 AFTR 2d 2020-1323.

⁴⁵ *Bernstein*, DC-NY, 126 AFTR 2d 2020-6053.

⁴⁶ *Ott*, DC-MI, 125 AFTR 2d 2020-1073.

⁴⁷ *Zimmerman*, DC-CA, 126 AFTR 2d 2020-6128.

⁴⁸ *DeMauro*, DC-NH, 126 AFTR 2020-6230.



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