United States v. Horowitz: Sixth Case Analyzing "Constructive Knowledge" as Determinant of FBAR Penalties

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I. Introduction

It is difficult for the U.S. government to prove that an individual taxpayer had "actual knowledge" of his duty to file a FinCEN Form 114 ("FBAR") to report foreign accounts and "willfully" violated such duty. Indeed, short of presenting incriminating emails by the taxpayer, presenting damning statements by an accountant, and the like, it is a challenge to demonstrate, to the satisfaction of a federal court, that a taxpayer knew of the FBAR obligation and deliberately defied it. This is particularly true when dealing with a sympathetic taxpayer, such as a first-time expatriate whose foreign presence is solely the result of a mandate by his employer, an immigrant to the United States who left behind in his home country certain after-tax savings or retirement accounts, or a U.S. citizen and resident who inherits a foreign account upon the death of a relative who lived abroad. Other examples with equally compelling facts abound.

Faced with this dilemma, the Internal Revenue Service ("IRS") and the Department of Justice ("DOJ") now regularly raise multiple theories for FBAR liability, employing the throw-everything-at-the-wall-and-see-what-sticks technique. This often includes allegations that the taxpayer knew about the FBAR duty, which is "actual knowledge," or, alternatively, he should have known about the FBAR duty, which is "constructive knowledge." The IRS and DOJ frequently rely on two separate facts in advancing the second positon, namely, the taxpayer signed his Form 1040 (*U.S. Individual Income Tax Return*) before filing it with the IRS, and the taxpayer neglected to check the "yes" box in response to the question at the very bottom of Schedule B (Interest and Ordinary Dividends) to Form 1040 about the existence of foreign accounts. This, contends the IRS and DOJ, constitutes "constructive knowledge" by the taxpayer and warrants a very large FBAR penalty for a "willful" violation. To make matters worse for taxpayers, several courts have accepted this argument in recent years. This article

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examines the cases focused on this topic, emphasizing the newest one, issued in January 2019, *Horowitz*.[1]

II. Overview of the Law, Enforcement, Duties, and Penalties

Some background on the evolution of the FBAR and the duties generally triggered by holding a foreign account is essential.

A. A Short History

Congress enacted the Bank Secrecy Act in 1970.[2] 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.[3]

Congress was concerned about widespread non-compliance; therefore, it enacted more stringent FBAR penalty provisions in 2004 as part of the American Jobs Creation Act ("Jobs Act").[4] Under the law in existence before the Jobs Act, the IRS could only assert penalties against taxpayers where it could demonstrate that they "willfully" violated the FBAR rules.[5] If the IRS managed to satisfy this high standard, it could impose a relatively small penalty, ranging from $25,000 to $100,000, regardless of the size of the hidden account.[6]

Thanks to the Jobs Act, the IRS may now impose a civil penalty on any person who fails to file an FBAR when required, period.[7] In the case of non-willful violations, the maximum penalty is $10,000.[8] The Jobs Act calls for higher penalties where willfulness exists. Specifically, in situations where a taxpayer willfully fails to file an 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.[9] Given the multi-million dollar balances in some unreported accounts, FBAR penalties under the Jobs Act can be enormous.

B. Disclosure of Foreign Accounts, Other Assets, and Income

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.[10]

When it comes to individuals, they have several duties, in addition to filing FBARs, linked to holding a reportable interest in a foreign financial account:

- They must check the "yes" box on Schedule B to Form 1040 to disclose the existence of the foreign account;
- They must identify the foreign country in which the account is located, also on Schedule B to Form 1040;
- They must declare all income generated by the account (such as interest, dividends, and capital gains) on Form 1040; and
- They generally must report the account on Form 8938 (*Statement of Specified Foreign Financial Assets*), which is enclosed with Form 1040.[11]

C. Questions and Cross-References on Schedule B

One of the duties listed above is checking "yes" to the foreign-account inquiry found on Schedule B to Form 1040. The IRS has slightly modified and expanded this language over the years, with the materials for 2017 stating the following:

> At any time during 2017, 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 a FinCEN Form 114, enter the name of the foreign country where the financial account is located.

D. The Significance of Signing Forms 1040

Taxpayers must sign and date their Forms 1040 in order for them to be valid. Unless they pay close attention to the small print, most taxpayers will be unaware that they are making the following broad, sworn statement to the IRS, which often comes back to haunt them in FBAR penalty cases:

> Under penalties of perjury, I declare that *I have examined this return and accompanying schedules [including Schedule B] and statements*, and to the best of my knowledge and belief, they are true, correct, and accurately list all amounts and sources of income I received during the tax year.

III. Main Cases and Positions Regarding Constructive Knowledge

A growing number of courts have examined the issue of what constitutes "willfulness" in the context of civil FBAR penalties.[12] Notable decisions include *Williams* in 2012,[13] *McBride* in 2012,[14] *Bussell* in 2015,[15] *Bohanec* in 2016,[16] *United States* in 2017,[17] *Kelley-Hunter* in 2017,[18] *Toth* in 2017,[19] *Colliot* in 2018,[20] *Wadhan* in 2018,[21] *Garrity* in 2018,[22] *Markus* in 2018,[23] *United States* in 2018,[24] *Flume* in 2018,[25] *Kimble* in 2018,[26] and, most recently, *Horowitz* in 2019.[27]

Several of the preceding cases center on whether the taxpayer had "constructive knowledge" of his FBAR filing duty. The argument presented by the IRS and DOJ in such cases can be summarized as follows: (i) The taxpayer signed his Form 1040 under penalties of perjury, thereby representing that he reviewed the entire Form 1040, including Schedule B; (ii) Schedule B put the taxpayer on notice of his potential FBAR duty; (iii) To the extent that the taxpayer had questions about the FBAR, Schedule B expressly directed the taxpayer to the Instructions to Form 1040, the FBAR itself, and the Instructions to the FBAR; (iv) If the taxpayer checked the "no" box in response to the foreign-account question on Schedule B, then he filed a false Form 1040, he was aware of the FBAR duty, and his FBAR violation was willful; and (v) If the taxpayer instead left the box blank, answering neither "yes" nor "no" about foreign accounts, and if the taxpayer professes not to have reviewed Form 1040 or Schedule B, then his FBAR violation was willful because he had constructive knowledge of the FBAR duty, he was on inquiry notice, he was "willfully blind," he showed "reckless disregard" for the rules, or some combination thereof. Set forth below is a review of the most noteworthy cases addressing the "constructive knowledge" issue.

A. *Williams*

Williams was a multi-year, multi-issue case, with stops in the Tax Court, District Court, and, ultimately, the Fourth Circuit Court of Appeals. Here, we address only the final decision, by the Fourth Circuit Court of Appeals, because of its focus on the issue of "willfulness."

The Fourth Circuit Court of Appeals began its analysis by criticizing the legal standards on which the District Court made its taxpayer-friendly decision. In particular, the Fourth Circuit Court of Appeals indicated that the District Court should not have focused on the taxpayer's motivation for not filing an FBAR.[28] Then, noting various judicial precedents in the *criminal* arena, the Fourth Circuit Court of Appeals went on to state what it considered the proper legal standard. It explained that (i) willfulness can be inferred from taxpayer conduct designed to conceal financial information, and (ii) willfulness can also 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.[29] In situations where willfulness is a condition for *civil* liability, the Fourth Circuit Court of Appeals indicated that this covers both knowing and reckless violations.[30] It then clarified that the taxpayer's actions or inactions in *Williams* constituted, at a minimum, "reckless conduct, which satisfies the proof requirement [for civil FBAR violations]."[31]

The Fourth Circuit Court of Appeals supported its decision on several grounds. It pointed out that the taxpayer signed the relevant 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 Fourth Circuit Court of Appeals then explained that taxpayers who execute a Form 1040 are deemed to have constructive knowledge of such Form 1040, and the taxpayer in *Williams* was no exception to that principle. According to the Fourth Circuit Court of Appeals, the questions and cross-references in Part III of Schedule B to Form 1040 put the taxpayer on inquiry notice of the FBAR duty.[32] The taxpayer in *Williams* testified that he did not review his Form 1040 in general or read the information in Schedule B in particular. The Fourth Circuit 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.[33]

The Fourth Circuit Court of Appeals also held that the taxpayer's admissions at the earlier criminal proceeding further confirmed that his failure to file a timely FBAR for 2000 was willful.[34] Seizing on one tiny portion of the taxpayer's allocution, the Fourth Circuit Court of Appeals concluded that the taxpayer admitted his knowledge of the FBAR duty because he used the phrase "Department of the Treasury." This line of reasoning was 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.[35]

B. *McBride*

The District Court in *McBride* cited the general rule that all taxpayers are charged with knowledge, awareness, and responsibility for all tax returns executed under penalties of perjury and filed with the IRS. The District Court next recognized that several cases stand for the proposition that the taxpayer's signature on a tax return does not, by itself, prove that the taxpayer had knowledge of the contents of the return. The District Court distinguished such cases, though, by emphasizing that the language therein about "knowledge of the contents of the return" refers to the taxpayer's awareness about specific figures/amounts on the return.

When dealing with the FBAR situation, the District Court pointed out that "knowledge of what instructions are contained within the form is directly inferable from the contents of the form itself, even if it were blank."[36] Fortifying its position, the District Court cited and quoted various criminal cases, including a criminal FBAR case, where the courts attributed to the taxpayer knowledge of the contents of a return based solely on the taxpayer's signature on the tax return.[37] The District Court, eliminating any ambiguity about its stance on constructive knowledge, rendered the following holding:

> Knowledge of the law, including knowledge of the FBAR requirements, is imputed to McBride. The knowledge of the law regarding the requirement to file an FBAR is sufficient to inform McBride that he had a duty to file [an FBAR] for any foreign account in which he had a financial interest. McBride signed his federal income tax returns for both the tax year 2000 and 2001. Accordingly, McBride is charged with having reviewed his tax return and having understood that the federal income tax return asked if at any time during the tax year he held any financial interest in a foreign bank or financial account. The federal income tax return contained a plain instruction informing individuals that they have the duty to report their interest in any foreign financial or bank accounts held during the taxable year. McBride is therefore charged with having had knowledge of the FBAR requirement to disclose his interest in any foreign financial or bank accounts, as evidenced by his statement at the time he signed the returns, under penalty of perjury, that he read, reviewed, and signed his own federal income tax returns for the tax years 2000 and 2001, as indicated by his signature on the federal income tax returns for both 2000 and 2001. As a result, McBride's willfulness is supported by evidence of his false statements on his tax returns for both the 2000 and the 2001 tax years, and his signature, under penalty of perjury, that those statements were complete and accurate.[38]

Although not entirely clear, it appears that Mr. McBride argued that he was aware of the FBAR filing requirement, but decided not to comply because of his belief, based in part on the analysis by his accountant, that he did not possess a sufficient interest in the foreign accounts under the peculiar FBAR ownership-attribution rules. As the culimination to its long analysis of the "willfulness" issue, the District Court took an extreme position that, if a taxpayer executes and files his Form 1040, then all failures to file FBARs, regardless of the validity of the taxpayer's rationale for not filing, are willful and vulnerable to maximum sanctions.

> [E]ven if the decision not to disclose McBride's interest in the foreign accounts was based on McBride's belief that he did not hold sufficient interest in those accounts to warrant disclosure, that failure to disclose those interests would constitute willfulness. Because McBride signed his tax returns, he is charged with knowledge of the duty to comply with the FBAR requirements. Whether McBride believed [that his accountant] had determined that a disclosure was not required is irrelevant in light of [the applicable case], which states that the only question

> is whether the decision not to disclose was voluntary, as opposed to accidental. The government does not dispute that McBride's failure to comply with FBAR [sic.] was the result of his belief that he did not have a reportable financial interest in the foreign accounts. However … the FBAR requirements did require that McBride disclose his interest in the foreign accounts during both the 2000 and 2001 tax years. As a result, McBride's failure to do so was willful.[39]

C. *Jarnagin*

The next case to address the constructive knowledge argument was *Jarnagin*.[40] There, the IRS assessed non-willful FBAR penalties, not willful ones. The issue, therefore, was whether the taxpayers had "reasonable cause" and the lower penalties should thus be mitigated. As demonstrated below, *Jarnagin* still adds to the debate around constructive knowledge, despite the fact that the penalty standards are different.

The Jarnagins bought property in Canada in the early 1980s and started operating a ranch there. They split their time between Canada and the United States. Larry and Linda opened an account at Canadian Imperial Bank of Commerce ("CIBC") in 1986. This account remained open during the years at issue, 2006 through 2010. The balance of the account reached approximately $3.5 million. It is unclear from the record whether all the passive income generated by the account was properly reported on the annual Forms 1040, but it is undisputed that (i) the Schedules B to Forms 1040 indicated "no" in response to the foreign-account question, and (ii) the taxpayers never filed an FBAR disclosing the Canadian account.

The DOJ contended that Larry and Linda lacked reasonable cause for their FBAR violations for several reasons. One was that they failed to exercise ordinary care and prudence when they did not review their Forms 1040, even though they signed them, thereby attesting that they had examined everything, including the Forms 1040 and Schedules B, and they were true, accurate, and complete. The DOJ presented this argument, citing and relying on *Williams* and *McBride*.

The Court of Federal Claims analyzed the concepts of constructive knowledge and "willful blindness." It stated that exercising ordinary care and prudence means, among other things, that taxpayers will "personally read and review their completed tax returns carefully." It also stated that the taxpayers were charged with constructive knowledge of the contents of Forms 1040, including references to the FBAR, by virtue of the fact that they executed Forms 1040. The Court of Federal Claims then explained that Larry and Linda had a "particular obligation" to review Schedule B because Larry was a dual U.S.-Canadian citizen, he had business activities in Canada, and he maintained a Canadian account with millions on deposit. The Court of Federal Claims speculated that, if Larry and Linda had taken the time to review their Forms 1040, then they would have discovered the "obvious error" that their U.S. tax professionals committed by checking the "no" box in response to the foreign-account question on Schedule B, and they would have seen the warning to consult the Instructions for more information about FBAR filing duties. The Court of Federal Claims summarized its thoughts in the following manner:

> A reasonable person, particularly one with the sophistication, investments, and wealth of the Jarnagins, would not have signed their income tax returns without reading them, would have identified the clear error committed by their accountants, and would have sought advice regarding their obligation to file [an FBAR].

D. *Norman*

In *Norman*, the IRS assessed a willful FBAR penalty for 2007 in connection with a Swiss account at UBS, the taxpayer unsuccessfully challenged the sanction with the Appeals Office, the taxpayer fully paid the penalty and filed a refund lawsuit with the Court of Federal Claims, the DOJ tried to dispense with the matter by filing a Motion for Summary Judgment, and the parties ultimately conducted a trial whose sole witness was the taxpayer herself.[41]

Despite the existence of the Offshore Voluntary Disclosure Program ("OVDP"), the taxpayer made a "quiet disclosure" by directly filing with the IRS Forms 1040X and FBARs for 2003 through 2008. At trial, the taxpayer's theory was that she did not willfully hide the UBS account. The Court of Federal Claims underscored that the taxpayer presented no evidence whatsoever to support her theory, other than her memory, and it was inconsistent with the written proof offered by the DOJ.

The Court of Federal Claims pointed out that the taxpayer could not remember (i) whether she opened the UBS account or received it through inheritance, (ii) meeting with a UBS representative in Switzerland to open the account, (iii) when she opened the account, and (iv) if she made withdrawals from the account. Moreover, explained the Court of Federal Claims, during the trial, the taxpayer indicated that she did not (i) know the account number, (ii) understand what a numbered account was, or (iii) recognize documents related to the opening and management of the account, the stamped signature of her private banker at UBS, her note to UBS instructing it to close the account, or the invoice from her accountant for assisting her with the "quiet disclosure."

The Court of Federal Claims also indicated that the taxpayer lacked credibility because she made false and/or inconsistent statements regarding the foreign account in her Form 1040 for 2007, her audit interview with the Revenue Agent, her letters to the IRS through her accountant and her attorney, the Complaint to start the refund lawsuit, and her testimony at trial.

In contrast to the "questionable testimony" provided by the taxpayer, the DOJ presented evidence that (i) the taxpayer signed documents to open a numbered account, (ii) she instructed UBS not to invest in U.S. securities, (iii) she personally visited UBS in Switzerland, (iv) she met on a yearly basis with UBS representatives, (v) she withdrew $100,000 from the account, (vi) she was informed by UBS in 2008 that it was working with the U.S. government regarding disclosure of its U.S. clients, and (vii) she then closed her account at UBS and transferred the funds to Wegelin & Co., the first foreign bank to ever plead guilty to U.S. tax law violations.

Based on the preceding, the Court of Federal Claims explained that, while the taxpayer might lack sophistication in financial matters, it could not believe that she could manage the account containing a large sum of money for over a decade without once reading any documents or realizing that the account had U.S. tax implications. Citing to *Williams*, the Court of Federal Claims concluded as follows:

> Indeed, at a minimum, Ms. Norman was put on inquiry notice of the FBAR requirement when she signed her tax return for 2007, but she chose not to seek more information about the reporting requirements. Although one of the few consistent pieces of Ms. Norman's testimony was that she did not read her tax return, simply not reading the return does not shield Ms. Norman from the implications of its contents. The Court finds that Ms. Norman acted to conceal her income and financial information, and also that she either recklessly or consciously avoided learning of her reporting requirements. Therefore, the Court finds that Ms. Norman willfully violated §5314.

E. *Kimble*

Alice Kimble is a U.S. citizen by birth, as were her late parents. At some point before 1980, the parents opened an account with UBS in Switzerland, designating Alice as a joint owner. In 1983, Alice married Michael, and they had a son, David. All three knew about the UBS account. The parents supposedly told them to keep it a secret because they might need the funds one day to flee the country in the event of religious persecution. In 1998, as joint owner of the UBS account, Alice signed a "numbered account agreement," instructed UBS to hold all correspondence, and authorized UBS to invest the funds in time-deposits. Alice and Michael met with UBS representatives in the United States at least six times over the years, and Alice also met with them at least once by herself in Switzerland.

Around 1998, Alice and Michael opened an account with HSBC in France in order to pay expenses associated with their apartment there.

The couple divorced in 2000. Alice did not disclose the foreign accounts in any documents filed in connection with the divorce. Soon after the divorce, Alice hired Steven Weinstein ("Accountant Weinstein") to prepare her individual Forms 1040 and state tax returns. Accountant Weinstein never asked her about foreign accounts, and she never pro-actively disclosed them. Moreover, Alice never asked Accountant Weinstein if the investment income generated by the UBS and HSBC accounts needed to be reported on Forms 1040.

Alice filed timely Forms 1040 for 2003 through 2008, but she never reported any income from the UBS and HSBC accounts, and she answered "no" in response to the foreign-account question on Schedule B. She also neglected to file FBARs.

Alice claimed to have first learned of her duty to report foreign accounts in 2008 from reading a newspaper article about issues surrounding UBS. She then hired legal counsel. The balance in the UBS account as of the 2007 FBAR filing deadline (*i.e.*, June 30, 2008) was $1,365,662, while the balance of the HSBC account at the same time was $134,130.

In April 2009, Alice applied for the OVDP, and she was accepted. She filed Forms 1040X and FBARs for 2003 through 2008 as part of the OVDP. The IRS presented her a Closing Agreement at the end of the OVDP process, which showed an "offshore" penalty of $377,309. Alice then "opted-out" of the OVDP in order to "take her chances" with the IRS.

The IRS started an audit in 2013, at the end of which the Revenue Agent determined that Alice's FBAR violations were "willful." The Revenue Agent based this conclusion on the following facts and circumstances: (i) Alice had a direct financial interest in the accounts; (ii) She checked "no" to the foreign-account question on Schedule B to every Form 1040; (iii) She made no efforts to inform herself about any U.S. obligations associated with inheriting a Swiss account exceeding $1 million; (iv) Alice never reported any passive income generated by the accounts on her Forms 1040 for decades; (v) Alice only approached the IRS through the OVDP after UBS notified her that it would be remitting data about all U.S. accountholders to the IRS; (vi) Alice made efforts to conceal the account; (vii) Alice had active management of both foreign accounts; (viii) Alice has no business or family connections with Switzerland, where the UBS account was located; (ix) Fear of potential religious persecution is not an acceptable justification for non-compliance with U.S. law; (x) Alice was non-compliant with U.S. tax law even after entering into, and later opting-out of, the OVDP; (xi) Alice had significant involvement with Accountant Weinstein but did not disclose the foreign passive income; and (xii) The income generated by the foreign accounts was relatively significant, constituting more than half of Alice's overall income in certain years.

In July 2016, the IRS assessed a willful FBAR penalty, which Alice fully paid. She then filed a claim for refund; the IRS denied it. Alice filed a Complaint in the Court of Federal Claims seeking a refund of the FBAR penalty. Both the DOJ and Alice ultimately each filed a Motion for Summary Judgment, focused on the issue of "willfulness." Alice later conceded the issues related to the HSBC account, such that all attention was on the UBS account.

In its Motion for Summary Judgment, the DOJ basically repeated and expanded on the grounds for willfulness that the Revenue Agent had previously identified during the audit. The DOJ contended that an FBAR violation is willful where a taxpayer (i) violates the law voluntarily rather than accidentally, (ii) is willfully blind to a duty, or (iii) engages in conduct that is in "reckless disregard" of a legal duty.

Alice disagreed with the DOJ, of course. Her main defenses can be summarized as follows. The DOJ's interpretation of "willful" is so broad that every taxpayer who fails to file an FBAR does so willfully, which is contrary to the multi-tiered system of penalties designed by Congress. She never read her Forms 1040 and had no actual knowledge of the FBAR filing duty until 2008, so she could not have made a conscious choice to violate her duty. All cases cited by the DOJ involve taxpayers involved in significantly more egregious behavior than her. Finally, Congress created the large FBAR penalty for willful violations in order to punish "bad actors," and she is not one of those; she did not use the UBS account for any illegal activities.

The Court of Federal Claims reduced the case to its essence, identifying just four facts as "relevant" to the determination: (i) Alice did not disclose the UBS account to Accountant Weinstein; (ii) Alice never asked Accountant Weinstein how to properly report the passive income generated by the UBS account; (iii) Alice did not review her Forms 1040 for accuracy during the relevant years; and (iv) Alice answered "no" in response to the foreign-account question on Schedule B to Form 1040, thereby "falsely representing under penalties of perjury that she had no foreign bank accounts."

The Court of Federal Claims found that Alice had acted willfully, resuscitating earlier judicial reasoning about constructive knowledge, willful blindness, and reckless disregard. Deciding that it was not even necessary to conduct a trial to fully develop the facts, the Court of Federal Claims granted the Motion for Summary Judgment filed by the DOJ, ruling as follows:

> In the court's judgment, [the fact that Alice did not review her Forms 1040 for accuracy, she answered "no" in response to the foreign-account question on Schedule B to Form 1040, and she signed Form 1040 under penalties of perjury] evidence conduct by [Alice], as a co-owner of the UBS account, that exhibited a "reckless disregard" of the legal duty under federal tax law to report foreign bank accounts to the IRS by filing a FBAR. Although [Alice] had no legal duty to disclose information to her accountant or to ask her accountant about IRS reporting requirements, these additional undisputed facts do not affect the court's determination that [Alice's] conduct in this case was "willful." For these reasons, the court has determined, viewing the evidence in the light most favorable to [Alice], that there is no genuine issue of material fact that [Alice] violated 31 U.S.C. §5314 and that her conduct was "willful."

F. *Horowitz*

The most recent case centered on this issue, *Horowitz*, was issued in January 2019 by the District Court of Maryland.

The main facts in the case are as follows. In 1984, Peter Horowitz and his wife, Susan, moved from the United States to Saudi Arabia for work reasons; he accepted a job with a local hospital. In 1988, Peter and Susan opened a joint account with the Foreign Commerce Bank in Switzerland, which they funded with earnings from Saudi Arabia. A few years later, in 1992, they moved back to the United States, but left the account at Foreign Commerce Bank open.

Peter and Susan decided to head back to Saudi Arabia in 1994, again for professional reasons. They closed the account at Foreign Commerce Bank that same year, using the funds to open a new joint account, also in Switzerland, but this time at UBS. This new account was a "hold mail" account whose funds were invested in income-producing assets, such as bonds, certificates of deposit, and investment funds. In 2001, Peter and Susan made the long voyage back to the United States, seemingly for good, but left the UBS account open. Peter apparently monitored the account from afar by calling UBS every year or two.

In November 2008, soon after U.S. news sources began reporting that UBS was under investigation, Peter traveled to Switzerland, met with UBS representatives to close the joint account, and transferred the funds from UBS to another Swiss institution, Finter Bank. The balance in the account at that time of the switch was about $1.95 million. The confidentiality level at Finter Bank was slightly higher, featuring a numbered account, with a "hold mail" designation.

Peter and Susan intended the Finter Bank account, like the UBS account before that, to be jointly held. However, that did not initially occur, because Finter Bank would not permit it without Susan being physically present. Peter tried an alternative, which consisted of designating Susan as power of attorney on the account. This did not work either, though, because Susan was not there to provide her "specimen signature" on the form called "List of Authorized Signatories and Powers of Attorney for Natural Persons."

The specific reasons are unclear, but, in 2010, the Horowitzes closed the account at Finter Bank, repatriated the funds, and then applied to resolve their past international tax non-compliance through the OVDP. They filed Forms 1040X and FBARs for 2003 through 2008 as part of the OVDP. In December 2012, likely after learning the size of the proposed "offshore" penalty, the Horowitzes officially "opted-out" of the OVDP, in hopes of reducing the sanctions during the audit process.

The Horowitzes used the same accounting firm from the 1970s until 2006 to prepare their annual Forms 1040. The methodology consisted of the following steps. The Horowitzes sent the accounting firm self-prepared summaries of financial and tax-related information (none of which included passive income generated by the foreign accounts), they waited to receive the completed Form 1040, and then they signed and filed it with the IRS without much further thought. Peter, who communicated with the accounting firm, never asked about potential U.S. duties related to foreign accounts. The Horowitzes apparently changed accounting firms, starting with the 2007 Form 1040, but used essentially the same procedure. In addition to omitting the foreign passive income, the Forms 1040 were incorrect in that the "no" box was checked on Schedule B in response to the question about the existence of foreign accounts. Finally, the Horowitzes never filed FBARs during the relevant years.

In May 2014, at the conclusion of the audit triggered by the "opt-out" from the OVDP, the Revenue Agent sent the Horowitzes an Examination Report showing, among other things, proposed FBAR penalties for 2007 and 2008. The Revenue Agent informed the Horowitzes that, if they wanted to seek review by the Appeals Office, they would first need to execute a Consent to Extend the Time to Assess Civil Penalties Provided by 31 USC §5321 ("FBAR Penalty Assessment Period Extension"). They did so.

Nevertheless, before the Horowitzes got their opportunity to file a Protest Letter and have a conference with the Appeals Office, the IRS "assessed" FBAR penalties against each of Peter and Susan for 2007 and 2008 on June 13, 2014, and sent demand letters. Together, the penalties totaled 50 percent of the highest balance in the UBS account, which was transferred to the Finter Bank account in 2008.

On June 23, 2014, the Horowitzes filed a Protest Letter disputing the FBAR penalties. The Appeals Officer assigned to the case noticed that the Horowitzes had previously executed the FBAR Penalty Assessment Period Extension, such that the IRS had until December 31, 2015, to make an assessment. Under these circumstances, the Appeals Officer took steps to get the FBAR penalties "removed/reversed," such that she could deal with the Horowitzes on a pre-assessment, less urgent basis. These steps included raising the issue with the Appeals FBAR Coordinator, who instructed the FBAR Penalty Coordinator to "remove/reverse" the penalties. She initially reported that she had carried out the order. Later, though, in a trial-related declaration, the FBAR Penalty Coordinator changed her story, claiming that she never "removed/reversed" anything.

The Horowitzes did not reach an acceptable settlement with the Appeals Officer and they did not voluntarily pay the FBAR penalties of approximately $1 million. Therefore, the DOJ started a collection action in District Court.

Regarding the key issue in the case, whether the FBAR violations for 2007 and 2008 were "willful," the principal contentions of the parties were as follows. The Horowitzes denied that they had "actual knowledge" of their FBAR duty because (i) they had spoken to other expatriates who told them, incorrectly, that income earned in Saudi Arabia was only taxed there, (ii) they did not even know what an FBAR was, and (iii) their accountants did not specifically ask about foreign accounts or explain the foreign-account question on Schedule B to Forms 1040. The DOJ, on the contrary, argued that the Horowitzes were willful because they executed the Forms 1040, Schedule B contained "simple instructions" and asked a "simple question" about the existence of foreign accounts, and the Horowitzes nonetheless checked "no" in response to the foreign-account inquiry.

In rendering its decision, the District Court looked primarily to the earlier holdings in *Williams* and *McBride*, identifying similarities and differences in the facts and circumstances of each case. Focusing on the Horowitzes, the District Court underscored several points. First, they executed their Forms 1040 for 2007 and 2008 declaring, under penalties of perjury, that they had reviewed them and they were true, accurate, and complete. Second, Schedule B on Forms 1040 contained the foreign-account question, followed by a cross-reference to instructions explaining the filing requirements and exceptions for FBARs. Third, while the Horowitzes might have listened to friends who opined, erroneously, about U.S. tax duties for expatriates, the District Court lacked information to determine whether it was reasonable to accept such opinions, and, in all events, the views of friends cannot trump the "clear instructions" on Schedule B. Fourth, the fact that the Horowitzes discussed international tax matters with friends demonstrates their awareness of potential issues. Fifth, the failure by the Horowitzes to have a similar conversation with their accountants shows "a conscious effort to avoid learning about [FBAR] reporting requirements," from which "willfulness blindness" can be inferred.

The District Court concluded that the Horowitzes "recklessly disregarded" the FBAR filing requirement, which "suffices for a finding of willfulness." The District Court summarized its rulings as follows:

> The Horowitzes have filed a cross-motion for summary judgment, arguing that the IRS reversed the [FBAR] penalties, such that the penalties the [DOJ] is trying to collect were not assessed until 2016, at which time they were untimely. They also argue that their failure to disclose was not willful—a point that would reduce the maximum penalties from 50% of the amount in the foreign account at the time of the violation to $10,000. Because the Horowitzes have not shown that the IRS actually reversed the penalties in 2014, they have not established that the statute of limitations ran before the penalties were assessed. Further, the undisputed facts show that their failure to disclose the UBS account on their 2007 tax return was willful, and that Peter's failure to disclose the Finter account on their 2008 tax return also was willful.

IV. Going Beyond the Main Holding in *Horowitz*

Horowitz contains some interesting issues, aside from the main holding about "willfulness," which might affect future FBAR cases involving other taxpayers. A few of these issues are addressed below.

A. Potential $100,000 FBAR Penalty Cap

Relying mainly on *Colliot*, the Horowitzes insist that, even if their FBAR violations were willful, the penalties cannot exceed $100,000 per violation because, while Congress changed the applicable law in 2004 to increase the maximum penalty to 50 percent of the highest balance in the undisclosed account, the IRS never updated the applicable regulation (*i.e.*, 31 CFR §103.27, which later became 31 CFR §1010.820(g)(2)) to implement this enhancement.

The District Court swiftly dismissed this contention, citing two recent cases, *Norman* and *Kimble,* which had "persuasively rejected" the earlier reasoning in *Colliot*. The District Court also referenced the portion of the current version of Internal Revenue Manual, stating that the maximum FBAR penalty for violations after 2004 is $100,000 or 50 percent of the balance in the account at the time of the violation, whichever amount is higher. Hedging somewhat on its need to give weight to the Internal Revenue Manual, the District Court, citing precedent, acknowledged that the Internal Revenue Manual does not have the force of law and it is not binding for the IRS, but it "has been used, on a limited basis, to provide guidance in interpreting terms in regulations." The District Court concluded that the outdated regulation cannot be enforced in light of the conflict with the law in existence since 2004 and with the Internal Revenue Manual.

B. Quirky Issue Concerning FBAR Penalty Assessment Periods

The DOJ and the Horowitzes agreed on a couple things, namely, that the IRS assessed FBAR penalties for 2007 and 2008 in a timely manner on June 13, 2014, and that, because the Horowitzes signed the FBAR Penalty Assessment Period Extension, the deadline for assessing such penalties was pushed to December 31, 2015. Nevertheless, the Horowitzes contend that the FBAR penalties should be rebuffed by the District Court on summary judgment because (i) the penalties first assessed on June 13, 2014, were later "removed/reversed" by the IRS, and (ii) they were not assessed again until May 20, 2016, which was long after the extended deadline of December 31, 2015, had passed. For its part, the IRS concedes that the FBAR Penalty Coordinator took certain actions pursuant to the instructions of the IRS Appeals FBAR Coordinator, but argues that such actions were not tantamount to a removal/reversal of penalties.

The District Court held in favor of the IRS based on the following reasoning. Reviewing three different types of communications on the issue (*i.e.*, internal IRS emails, declarations submitted to the District Court, and statements during a deposition), the District Court pointed out that the FBAR Penalty Coordinator was inconsistent. Because "undisputed facts" regarding the statements and actions of the FBAR Penalty Coordinator did not exist, the issue was not appropriate for resolution *via* summary judgment. Next, the District Court explained that the statute of limitations is an affirmative defense for the Horowitzes, meaning that they have the burden of proof on the issue. The District Court noted that the Horowitzes had not demonstrated that, even if the FBAR Penalty Coordinator had removed/reversed the initial FBAR penalties, that she had the authority to do so. Moreover, the District Court underscored that applicable law, regulations, and the Internal Revenue Manual all provide that an agency, like the IRS, must obtain approval from the DOJ before compromising a claim of the U.S. government of more than $100,000. Such prior DOJ approval was not obtained by the FBAR Penalty Coordinator.

The District Court summarized its holding as following:

> [The Horowitzes] have not proven that the timely FBAR assessments were reversed or removed when [the FBAR Penalty Coordinator] altered the data, nor have they established that she had the authority to reverse an assessment. Consequently, they have not met their burden of proving that the statute of limitations ran before the FBAR penalties were assessed.

C. No Liability for Susan for 2008

One must understand the following crucial points to understand how Susan escaped an FBAR penalty for 2008.

First, in *Horowitz*, the IRS assessed four separate FBAR penalties: (i) A penalty for 2007 against Peter for the UBS account; (ii) A penalty for 2007 against Susan for the UBS account; (iii) A penalty for 2008 against Peter for the Finter Bank account; and (iv) A penalty for 2008 against Susan for the Finter Bank account.

Second, applicable law dictates that the FBAR penalty is based on the amount in the unreported account at the "time of the violation." This is contrasted by the fact that, when completing an FBAR, a taxpayer must disclose the highest balance in each foreign account at any point during the relevant calendar year. During the years at issue in *Horowitz*, 2007 and 2008, the deadline for filing an FBAR was June 30 of the year following the relevant calendar year. Thus, the 2007 FBAR had to be filed by June 30, 2008, and the 2008 FBAR by June 30, 2009. Any FBAR violations would have occurred only on those two dates, such that maximum FBAR penalties would have been calculated using such dates.

Third, the Horowitzes closed the UBS account in November 2008 and transferred all the funds to Finter Bank. Accordingly, as of the filing deadline for the 2008 FBAR (*i.e.*, June 30, 2009), the balance in the UBS account was $0. This means that, while the IRS could impose FBAR penalties for the joint UBS account for 2007 (because there were funds in such account on June 30, 2008), it was precluded from assessing large penalties concerning the UBS account for 2008.

Fourth, the IRS did not assess an FBAR penalty against Susan with respect to the UBS account for 2008, and it was not part of the District Court collection action initiated by the DOJ.

Fifth, a U.S. individual taxpayer, like Susan, can trigger an FBAR reporting duty if she had a direct financial interest in, an indirect financial interest in, or signature or some other type of authority over an undisclosed foreign account. These, of course, are all terms of art, with specific meanings within the FBAR context. A U.S. person would be considered to have a "direct financial interest" in all accounts for which she is listed as the owner of the account (including situations where she is a joint owner with one or more other persons) and all accounts for which she has legal title, regardless of whether she holds the accounts for her personal benefit or for the benefit of others.[42] In addition, a U.S. person has an "indirect financial interest" in each foreign account for which the owner of record or the holder of legal title of the account is any of the following: (i) a person acting as an agent, nominee, attorney, or in some other capacity on behalf of the U.S. person with respect to the account; (ii) a corporation in which the U.S. person owns directly or indirectly more than 50 percent of the voting power or the total value of the shares; (iii) a partnership in which the U.S. person owns directly or indirectly more than 50 percent of the interest in profits or capital; (iv) any other entity (other than certain trusts described below) in which the U.S. person owns directly or indirectly more than 50 percent of the voting power, total value of the equity interest or assets, or interest in profits; (v) a trust, if the U.S. person is the trust grantor and has an ownership interest in the trust for U.S. tax purposes; and (vi) a trust in which the U.S. person either has a present beneficial interest in more than 50 percent of the assets or from which such person receives more than 50 percent of the current income.[43] Finally, a U.S. person has "signature or other authority" over a foreign account if she has the ability (either alone or acting jointly with another person or persons) to control the disposition of money, funds, or assets held in a financial account by communicating (either orally or in writing) with the institution where the account is maintained.[44]

Sixth, although the Horowitzes intended for Susan to be a joint accountholder on the Finter Bank account, just as she was on the earlier UBS account, she was not officially listed as an accountholder and she did not provide the requisite "specimen signature" on the power of attorney form because she was not present in Switzerland, with Peter, when he opened the Finter Bank account.

Now, with the preceding key points in mind, it is time to turn to the analysis by the District Court on the issue of Susan's liability. The IRS assessed an FBAR penalty against Susan for the Finter Bank account for 2008, the DOJ sought to collect it through the District Court, and Susan filed a Motion for Partial Summary Judgment on grounds that she was not legally obligated to file an FBAR for the Finter Bank account for 2008.

The DOJ argued that Susan had both a financial interest and signature authority over the Finter Bank account based on the "intent" of the Horowitzes to designate her as an accountholder, or, alternatively, as a power of attorney. The DOJ further contended that Peter, the accountholder, was acting on behalf of Susan when he opened the Finter Bank account and transferred funds thereto from the joint UBS account, which suffices to give her an indirect financial interest in the Finter Bank account. This position was based on the relevant FBAR regulation, summarized above, indicating that a U.S. person has an indirect financial interest in a foreign account if the accountholder, in this case Peter, was "acting as an agent, nominee, attorney, or in some other capacity on behalf of [Susan] with respect to the [Finter Bank] account."

Susan countered that, despite their intent, the simple fact is that, because she did not travel to Switzerland and complete the necessary paperwork, she was not an accountholder, she was not a signatory, she did not have a duty to file an FBAR for 2008 reporting the Finter Bank account, and she could not be sanctioned for not doing so.

The District Court sided with Susan on this issue. It started by stating that "[t]aking money [from the UBS account] that was in Susan's name and placing it in an account [at Finter Bank] that was not in her name cannot, in any light, be seen as acting on her behalf." Then, the District Court pointed out that the question would be whether Peter acted on Susan's behalf "with respect to the [Finter Bank] account," which means "*after* the Finter account existed." This did not occur, explained the District Court, because Peter did not make any additional deposits, withdraw funds, or take any other actions concerning the Finter Bank account in 2008. The District Court thus concluded that "even if [Peter and Susan] intended for Susan to have a financial interest in the [Finter Bank] account and she ultimately gained that interest in 2009, she did not have a financial interest in the account in 2008."

The District Court also held that Susan did not have signature or other authority over the Finter Bank account. The DOJ acknowledged that Susan could not exercise any power until she completed and supplied the "signature specimen," which she did not do in 2008. Consequently, the District Court held that Susan lacked authority over the Finter Bank account because she could not write to, or otherwise communicate with, Finter Bank to control the disposition of money or other assets.

The DOJ raised an alternative argument in a footnote, namely, if the District Court were to decide that Susan had no duty to report the Finter Bank account on the 2008 FBAR, she should still be penalized with respect to the UBS account for 2008, which she jointly owned with Peter until they closed it in November 2008. The District Court demonstrated little sympathy to the DOJ on this point. It first emphasized that the IRS never assessed an FBAR penalty against Susan for the UBS account for 2008, and the collection action by the DOJ does not seek to collect such a penalty. The District Court next recognized that the DOJ's desire to pursue penalties on the Finter Bank account was logical, because the balance in the UBS account at the time of the violation (*i.e.*, June 30, 2009) was $0, and 50 percent of this amount is still $0. The penalty against Susan for the undisclosed UBS account, therefore, would have been capped at $100,000. The District Court noted that the IRS essentially missed the boat by not realizing that it could not collect large FBAR penalties from Susan for 2008.

> Essentially, [the IRS] could have assessed approximately the same total penalty for 2008 ($494,060) by assessing a penalty of 50% of the account balance against Peter instead of an approximately 25% penalty against each of [Peter and Susan]. This would have been a logical approach, given that before October 2008 and after October 2009, these were joint funds but Susan was not a Finter account owner in 2008. The outcome would have been that the couple, who jointly paid their taxes and maintained joint accounts for years, would, together, have had to pay the same amount of penalty that the [IRS] sought to recover by assessing a $247,030 penalty against Susan for 2008. The [IRS] did not take this approach, however, and it cannot now collect on a penalty it did not assess.

D. Illustration of Recent IRS Penalty Policy

Horowitz is also interesting because it shows the IRS's relatively new philosophy with respect to FBAR penalties.

As indicated above, the highest balance in the UBS account, which was transferred to the Finter Bank account in November 2008, was about $1.95 million. The IRS assessed total FBAR penalties equal to 50 percent of the balance, arriving at this figure by imposing penalties on Peter of $247,030 for 2007 and $247,030 for 2008, and identical yet separate penalties on Susan. This is consistent with Memorandum SBSE-04-0515-0025, called "Interim Guidance for Report of Foreign Bank and Financial Accounts (FBAR) Penalties." The official purposes of such "Interim Guidance" were to improve the administration of the FBAR compliance program, ensure fairness and consistency in penalty amounts, and obligate IRS personnel to take into account all available facts and circumstances of each case.

The "Interim Guidance" provides the following instructions about situations involving willful FBAR violations. The portions most applicable to *Horowitz* have been marked.

> For cases involving willful violations over multiple years, examiners will recommend a penalty for each year for which the FBAR violation was willful. *In most cases, the total penalty amount for all years under examination will be limited to 50 percent of the highest aggregate balance of all unreported foreign financial accounts during the years under examination*. In such cases, the penalty for each year will be determined by allocating the total penalty amount to all years for which the FBAR violations were willful based upon the ratio of the highest aggregate balance for each year to the total of the highest aggregate balances for all years combined, subject to the maximum penalty limitation in 31 U.S.C. §5321(a)(5)(C) for each year.
>
> **Example.** Assume highest aggregate balances of $50,000, $100,000, and $200,000 for 2010, 2011, and 2012, respectively. The total penalty amount is $100,000 (50 percent of the $200,000 highest aggregate balance during the years under examination). The total of the highest aggregate balances for all years combined is $350,000. The penalty for 2010 is $14,286 ($50,000/$350,000 × $100,000). The penalty for 2011 is $28,571 ($100,000/$350,000 × $100,000). The penalty for 2012 is $57,143 ($200,000/$350,000 × $100,000). The penalty amounts for each year are subject to the maximum penalty limitation in 31 USC §5321(a)(5)(C).

The "Interim Guidance" also features instructions for cases involving unreported foreign accounts with more than one U.S. owner. Again, the portions applicable to *Horowitz* have been marked.

> Where there are multiple owners of an unreported foreign financial account, examiners must make a separate determination with respect to each co-owner of the foreign financial account as to whether there was a violation and, if so, whether the violation was willful or non-willful. *For each co-owner against whom a penalty is determined, the penalty will be based on the co-owner's percentage ownership of the highest balance of the foreign financial account. If examiners are unable to determine a co-owner's percentage ownership, the penalty will be based on the amount determined by dividing the highest account balance equally among the co-owners*.

In summary, *Horowitz* illustrates the application of the "Interim Guidance" on FBAR penalties, which was not available to help taxpayers involved in earlier cases.

E. District Court Gives No Credence to Contrary Decision in Flume

The docket sheet for *Horowitz* indicates that last action in the case, before the District Court issued its opinion, was the filing of a Notice of Subsequent Authority by the Horowitzes, informing the District Court about a new, relevant case, *Flume*.[45]

The relevant facts in *Flume* were as follows. Mr. Flume ("Husband") and Mrs. Flume ("Wife") were U.S. citizens who moved to Mexico in 1993. Husband and Wife formed several foreign corporations while living in Mexico, one of which was Wilshire Holdings, Inc. ("Wilshire Belize"). In 2005, Wilshire Belize opened an account at UBS in Switzerland. The District Court concluded that Husband and Wife had a reportable interest in the account because they opened it using Articles of Association showing Husband and Wife as equal owners of Wilshire Belize, they were listed as the "beneficial owners" of the account, they controlled the investment activity in the account, and they signed the wire-transfer orders in 2008 and 2009, as "Directors" of Wilshire Belize, to empty UBS account and remit all funds to a U.S. account.

In the early 2000s, Husband hired a U.S. return preparer with offices in the United States and Mexico to prepare his Forms 1040. They prepared Forms 1040 for the relevant years, 2007 and 2008, disclosing only the existence of Husband's account in Mexico, but not the larger account at UBS. Moreover, Husband did not file timely FBARs for 2007 or 2008. He filed them late, in June 2010, and even then, he seriously understated the value of the UBS account, missing the mark by approximately $600,000 one year.

There was conflicting testimony about whether, or precisely when, Husband told the accountants about the UBS account, but they all agreed that Husband never supplied any documents regarding such account. The accountants said that they first notified Husband about his FBAR obligation around 2003 or 2004, and sent him an annual letter thereafter reminding him. Husband, on the other hand, claimed that the accountants never informed him of FBAR duties until many years later, in 2010.

> *It is likely that the IRS and DOJ, buoyed by the recent victories in* Williams, McBride, Jarnagin, Norman, Kimble, *and, now,* Horowitz, *will continue raising multiple legal theories to justify "willful" FBAR penalties, including that "constructive knowledge" suffices.*

Husband acknowledged to the District Court that he was not particularly diligent about his tax considerations. Indeed, he did not read his Form 1040 "word for word" and he did not take the time to read the instructions from the IRS, expressly referenced in Schedule B, about FBAR filing requirements. He simply checked the income amount, which seemed appropriate, signed the Forms 1040, and trusted that the accountants had prepared them accurately.

After an audit and assessment of willful FBAR penalties by the IRS, litigation ensued in District Court. The DOJ filed a Motion for Summary Judgment, asking the District Court to rule that Husband willfully violated his duty to file FBARs for 2007 and 2008, because he (i) knowingly disregarded the FBAR duty, or (ii) recklessly ignored a high probability that he was breaking the law, even if he lacked specific knowledge about his FBAR duty.

The District Court indicated that the definition of "willfulness" in the civil FBAR context had only been thoroughly analyzed by a limited number of cases. The District Court then went on to examine the concept of "willfulness" under three different legal theories: actual knowledge, constructive knowledge, and reckless disregard. We focus only on the second here.

Relying largely on *McBride*, the DOJ argued that Husband at least had constructive knowledge of his FBAR duty, because he signed his Forms 1040, which contained instructions to consult the FBAR filing requirements. The District Court refused to follow *McBride* for several reasons, including the following. First, the District Court indicated that the constructive-knowledge theory ignores the distinction that Congress drew between willful and non-willful FBAR violations: "*If every taxpayer, merely by signing a tax return, is presumed to know the need to file an FBAR, it is difficult to conceive of how a violation could be non-willful.*"

Second, the District Court announced that the constructive-knowledge theory is "rooted in faulty policy arguments." The DOJ argued that ruling in favor of Husband would encourage taxpayers to sign Forms 1040 without reading them in hopes of later avoiding any negative consequences from inaccuracies and would permit taxpayers to escape liability by simply claiming that they did not read what they were signing. The District Court flatly rejected the DOJ's position, calling it "incorrect," because the IRS can still impose a $10,000 penalty for each non-willful FBAR violation, and the IRS can still pursue taxpayers under a reckless-disregard theory. The District Court concluded as follows:

> [T]here is no policy need to treat constructive knowledge as a substitute for actual knowledge … Accordingly, the Court will not hold that [Husband] had constructive knowledge—and that he owes the Government more than half a million dollars—merely because he signed his tax returns under penalties of perjury. The Government has thus failed to conclusively establish that [Husband] was willful on the ground that he knowingly disregarded his FBAR obligations.

The District Court in *Horowitz* did not mention *Flume* in its analysis, despite the fact that the case was brought to its attention about five months before it issued its opinion in January 2019.

V. Conclusion

The IRS and DOJ are busy these days reviewing large volumes of potential FBAR penalty cases in connection with taxpayers who opted-out of the OVDP, claimed that their FBAR violations were innocuous in their applications for the Streamline Domestic Offshore Procedure or Streamline Foreign Offshore Procedure, or got selected for audit after their previously-undisclosed account data was supplied to the IRS by a foreign bank, whistleblower, a former "trusted" advisor looking to cut a deal, or someone else. It is likely that the IRS and DOJ, buoyed by the recent victories in *Williams*, *McBride*, *Jarnagin*, *Norman*, *Kimble*, and, now, *Horowitz*, will continue raising multiple legal theories to justify "willful" FBAR penalties, including that "constructive knowledge" suffices. Accordingly, for taxpayers facing current or future FBAR disputes, it is critical to stay apprised of all relevant cases, strengthen their factual and legal defenses, get experienced representation, and prepare for a protracted battle.

ENDNOTES

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[1] *Horowitz*, 123 AFTR 2d 2019-XXXX (D.C. Maryland Jan. 18, 2019).

[2] P.L. 91-508, Title I and Title II (Oct. 26, 1970).

[3] P.L. 91-508, Title I and Title II (Oct. 26, 1970) at section 202.

[4] P.L. 108-357 (Oct. 22, 2004).

[5] 31 USC §5321(a)(5)(A) (as in effect before Oct. 22, 2004).

[6] 31 USC §5321(a)(5)(B)(ii) (as in effect before Oct. 22, 2004).

[7] 31 USC §5321(a)(5)(A).

[8] 31 USC §5321(a)(5)(B)(i). This penalty cannot be asserted if the taxpayer was "non-willful" and there was "reasonable cause" for the violation. *See* 31 USC §5321(a)(5)(B)(ii).

[9] 31 USC §5321(a)(5)(C)(i).

[10] 31 USC §5314; 31 CFR §1010.350(a).

[11] For a detailed analysis of the Form 8938 filing requirement, *see* the following articles by the same author: 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; Hale E. Sheppard, *Extended Assessment Periods and International Tax Enforcement: Rafizadeh v. Commissioner,*

Unreported Foreign Assets, and Use of FATCA Weapons, TAXES, 2018, at 35 and 44 J. INT'L TAXATION 25 (2018).

[12] For more detailed information about recent court battles regarding "willful" FBAR penalties, *see* the following articles by the same author: Hale E. Sheppard, *Constructive Knowledge and FBAR Penalties: Does Merely Filing a Form 1040 Suffice to Establish Willfulness?* INT'L TAX J., 2019, at 35 and TAXES 41 (2019); Hale E. Sheppard, *Appellate Court Jeopardizes First Holding of Non-Willfulness in FBAR Penalty Case: Round Three of the Bedrosian Battle*, __ J. INT'L TAXATION ___ (2019) and ___ J. TAXATION ___ (2019); Hale E. Sheppard, *Courts Hold that U.S. Government Can Pursue Executors, Representatives, Fiduciaries, Beneficiaries, Distributees, and Others for FBAR Penalties Assessed Against Deceased Taxpayers*, __ J. INT'L TAXATION ___ (2019) and ___ J. TAXATION ___ (2019); 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 Bucks the Trend in Willful FBAR Penalty Cases: Merely Signing Tax Returns Does Not Establish Willfulness*, TAXES, 2018, at 29; 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. Shepard, *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).

[13] *J.B. Williams*, 131 TC 54, Dec. 57,547 (2008); *Williams*, No. 1:09-cv-437, 2010 WL 347221 (E.D. Va. 2010); *Williams*, CA-4, 2012-2 USTC ¶50,475, 489 FedAppx 655.

[14] *J. McBride*, DC-UT, 2012-2 USTC ¶50,666, 908 FSupp2d 1186.

[15] *Bussell*, 117 AFTR 2d 2016-439 (D.C. C.D. Cal. 2015).

[16] *Bohanec*, 118 AFTR 2d 2016-5537 (D.C. C.D. Cal. 2016).

[17] *Bedrosian*, 120 AFTR 2d 2017-5671 (D.C. Pa. 2017).

[18] *Kelley-Hunter*, 120 AFTR 2d 2017-5566 (D.C. Dist. Col. 2017).

[19] *Toth*, 122 AFTR 2d 2018-6280 (D.C. Mass. 2018).

[20] *Colliot*, 121 AFTR 2d 2018-1834 (D.C. Tx. 2018).

[21] *Wadhan*, 122 AFTR 2d 2018-5208 (D.C. Co. 2018).

[22] *Garrity*, Case No. 3:15-cv-243 (D.C. Conn. 2018).

[23] *Markus*, 122 AFTR 2d 2018-5166 (D.C. N.J. 2018).

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

[25] *Flume*, 122 AFTR 2d 2018-5641 (D.C. S.D. Tex. 2018).

[26] *Kimble*, Case No. 17421, 122 AFTR 2d 2018-XXXX (Ct. Fed. Cl. Dec. 27, 2018).

[27] *Horowitz*, 123 AFTR 2d 2019-XXXX (D.C. MD 1/18/2019).

[28] *Williams*, CA-4, 2012-2 USTC ¶50,475, 489 FedAppx 655, at footnote 5.

[29] *Williams*, CA-4, 2012-2 USTC ¶50,475, 489 FedAppx 655.

[30] *Williams*, CA-4, 2012-2 USTC ¶50,475, 489 FedAppx 655.

[31] *Williams*, CA-4, 2012-2 USTC ¶50,475, 489 FedAppx 655.

[32] *Williams*, CA-4, 2012-2 USTC ¶50,475, 489 FedAppx 655.

[33] *Williams*, CA-4, 2012-2 USTC ¶50,475, 489 FedAppx 655.

[34] *Williams*, CA-4, 2012-2 USTC ¶50,475, 489 FedAppx 655.

[35] *Williams*, CA-4, 2012-2 USTC ¶50,475, 489 FedAppx 655.

[36] *McBride* Slip Opinion, at 36–37.

[37] *McBride* Slip Opinion, at 37–38.

[38] *McBride* Slip Opinion, at 38–39 (internal citations omitted).

[39] *McBride* Slip Opinion, at 48–49 (internal citations omitted).

[40] *L.D. Jarnagin*, FedCl, 2017-2 USTC ¶50,426, 134 FedCl 368; 120 AFTR 2d 2017-6683 (Ct. Fed. Cl. Nov. 30, 2017). The author obtained and reviewed the following documents related to this case: Complaint filed December 16, 2015; Answer filed April 18, 2016; Motion and Brief of the United States for Summary Judgment filed March 24, 2017; Opposition to Defendant's Motion for Summary Judgment and Cross-Motion for Summary Judgment for Plaintiffs filed May 10, 2017; Response Brief in Opposition to Plaintiffs' Cross-Motion for Summary Judgment and Reply Brief in Further Support of the U.S.' Motion for Summary Judgment filed June 16, 2017; Reply to Government's Opposition to Plaintiffs' Motion for Summary Judgment filed June 20, 2017; Opinion and Order filed November 30, 2017.

[41] *Norman*, FedCl, 138 FedCl 189 (2018), 122 AFTR 2d 2018-5334. The author obtained and reviewed the following documents related to this case: Complaint filed August 3, 2015; Answer filed April 21, 2016; Memorandum of Law in Support of Defendant's Motion for Summary Judgment filed November 9, 2017; Memorandum in Opposition filed February 7, 2018; Order Denying Motion for Summary Judgment issued February 14, 2018; Defendant's Reply in Support of its Motion for Summary Judgment regarding Legal Issues to be Addressed at Trial filed March 16, 2018; Opinion and Order issued July 31, 2018.

[42] 31 CFR §1010.350(e)(1).

[43] 31 CFR §1010.350(e)(2).

[44] 31 CFR §1010.350(f)(1).

[45] *E.S. Flume*, 113 TCM 1097, Dec. 60,822(M), TC Memo. 2017-21. The author derived the key facts by reviewing the following documents related to this case: Petition filed July 7, 2014 (enclosing Notice of Determination); Answer by IRS filed August 27, 2014; First Stipulation of Facts filed September 30, 2015; First Supplemental Stipulation of Facts filed September 30, 2015; Pre-Trial Memorandum by Taxpayer filed September 11, 2015; Pre-Trial Memorandum by IRS filed September 30, 2015; Opening Brief by IRS filed January 15, 2016; Answering Brief by Taxpayer filed March 9, 2016; and Reply Brief by IRS filed April 8, 2016. The author also reviewed the Memorandum and Order issued by the U.S. District Court (S.D. Texas) dated August 22, 2018 (Civil Action No. 516-CV-73) related to the Motions for Summary Judgment focused on FBAR penalties. Finally, the author reviewed the decision from the related FBAR penalty case, *Flume*, Civil Action No. 516-CV-73 (S.D. Texas Aug. 22, 2018), Memorandum and Order.