ANALYSIS OF THE "REASONABLE CAUSE" DEFENSE IN NON-WILLFUL FBAR PENALTY CASE: TEACHINGS FROM *JARNAGIN*

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Although "reasonable cause" has recently been overshadowed by "willfulness" issues in FBAR cases, it remains critical to penalty defense, in both the domestic and international contexts.

A major focus in international tax in recent years has been "willfulness." This stems from the fact that the U.S. government has litigated, and mostly won, a series of cases involving willful violations of the duty to report foreign accounts by filing Form TD F 90-22.1 or FinCEN Form 114 (FBAR).[1] The concept of willfulness has also drawn attention lately because it represents the key eligibility criteria for two of the IRS's voluntary disclosure programs. Indeed, taxpayers cannot get penalty relief under the Streamline Foreign Offshore Procedure or the Streamline Domestic Offshore Procedure, unless they convince the IRS that their U.S. tax noncompliance was non-willful.

The notion of willfulness has overshadowed "reasonable cause" recently, but the latter remains critical to penalty defense, in both the domestic and international contexts. This is true for several reasons, one of which is that the existence of reasonable cause allows taxpayers to escape not only willful FBAR penalties, but non-willful penalties, too. Court cases on this topic are scarce, which is logical because: (1) the IRS generally asserts non-willful FBAR penalties only in audits occurring outside the existing voluntary disclosure programs; (2) FBAR penalties are often reduced to relatively small amounts through application of the pertinent "penalty mitigation guidelines;" and (3) the professional

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fees and other costs associated with judicially battling an FBAR assessment can easily outweigh the benefit of full penalty abatement. However, every once in a while, a determined taxpayer takes the U.S. government to task, as was the case with *Jarnagin*.[2]

This article analyzes *Jarnagin* and gleans lessons about the evolution of reasonable cause and its applicability to non-willful FBAR penalties and other international information-reporting sanctions.

Overview of Foreign Account Obligations

FBAR Duties and Penalties

Congress enacted the Bank Secrecy Act in 1970.[3] One purpose of this legislation was to require the filing of certain reports, like the FBAR, where doing so would help the U.S. government in carrying out criminal, tax, and regulatory investigations.[4] Applicable law requires the filing of an FBAR in cases where: (1) a U.S. person (2) has a direct financial interest in, has an indirect financial interest in, has signature authority over, or has some other type of authority over (3) one or more financial accounts (4) located in a foreign country (5) whose aggregate value exceeds $10,000 (6) at any point during the year.[5]

Concerned with widespread FBAR noncompliance, the Treasury Department transferred authority to enforce FBAR duties to the IRS in 2003.[6] The IRS is now empowered to investigate potential FBAR violations, issue summonses, assess civil penalties, issue administrative rulings, and take "any other action reasonably necessary" to enforce the FBAR rules.[7]

Congress, for its part, enacted new FBAR penalty provisions in 2004 as part of the American Jobs Creation Act (Jobs Act).[8] Under the old law, the government could only assert civil penalties where it could demonstrate that taxpayers "willfully" violated the FBAR rules.[9] If the government managed to satisfy this high evidentiary standard, it could impose relatively small FBAR penalties, ranging from $25,000 to $100,000.[10] Thanks to the Jobs Act, the IRS can now impose a civil penalty on any person who fails to file an FBAR when required.[11] In the case of non-willful violations, the maximum fine is $10,000,[12] but the law permits penalty waiver when taxpayers can demonstrate that there was "reasonable cause."[13]

The Jobs Act calls for higher maximum penalties where willfulness exists. Specifically, in situations where a taxpayer deliberately fails to file an FBAR, the IRS can assert a penalty equal to $100,000 or 50% of the balance in the account at the time of the violation, whichever amount is greater.[14] For instance, if a foreign account has a balance of $1 million, and a taxpayer intentionally refuses to disclose such account on an FBAR for two consecutive years, the IRS can sanction the taxpayer $1 million (i.e., $500,00 plus $500,000), thereby draining the entire account.

References to the FBAR on Form 1040

Generally, U.S. citizens and residents have four main duties when they hold a reportable interest in a foreign financial account: (1) report all income generated by the account on the federal income tax return (i.e., Form 1040); (2) check the "yes" box in Part III, Foreign Accounts and Trusts, of Schedule B to Form 1040 to disclose the existence and location of the foreign account; (3) report the foreign account on a Form 8938, Statement of Specified Foreign Financial Assets; and (4) electronically file an FBAR.[15]

With respect to the second duty described above, Schedule B to Form 1040 expressly mentions foreign accounts and cross-references the FBAR and its instructions. The IRS has slightly modified and expanded this language over the years, with the materials for 2016 stating the following:

> At any time during 2016, 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.

Effect of Executing Forms 1040

Taxpayers must execute their Forms 1040 in order for them to be valid. Unless they pay close attention to the small print, most taxpayers are clueless that they are making the following broad, sworn statement to the U.S. government:

> Under penalties of perjury, I declare that *I have examined this return and accompanying schedules [including Schedule B referencing the FBAR] and statements*, and to the best of my knowledge and belief,

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1 See *Williams*, 131 TC 54 (2008); *Williams*, 106 AFTR2d 2010-6150 (DC VA, 2010); *Williams*, 489 Fed. Appx. 655, 110 AFTR2d 2012-5298 (CA-4, 2012); *McBride*, 908 F.Supp.2d 1186, 110 AFTR2d 2012-6600 (DC Utah, 2012); *Bussell*, 699 Fed. Appx. 695, 117 AFTR2d 2016-439 (CA-9, 2015); *Bohanec*, 118 AFTR2d 2016-5537 (DC Calif., 2016); *Bedrosian*, 120 AFTR2d 2017-5671 (DC PA, 2017); *Kelley-Hunter*, 120 AFTR2d 2017-6778 (DC D.C., 2017).

2 120 AFTR2d 2017-6683 (Fed. Cl. Ct., 2017).

3 P. L. No. 91-508, Title I and Title II, 10/26/70.

4 P. L. No. 91-508, Title I and Title II, section 202, 10/26/70.

5 31 U.S.C. section 5314; 31 C.F.R. section 1010.350(a).

6 68 Fed. Reg. 26489 (5/16/03).

7 31 C.F.R. section 103.56(g), 68 Fed. Reg. 26489 (5/16/03).

8 P. L. No. 108-357, 10/22/04.

9 31 U.S.C. section 5321(a)(5)(A) (as in effect before 10/22/04).

10 31 U.S.C. section 5321(a)(5)(B)(ii) (as in effect before 10/22/04).

11 31 U.S.C. section 5321(a)(5)(A).

12 31 U.S.C. section 5321(a)(5)(B)(i).

13 31 U.S.C. section 5321(a)(5)(B)(ii).

14 31 U.S.C. section 5321(a)(5)(C)(i).

15 For a detailed analysis of the Form 8938 filing requirement, see Sheppard, "The New Duty to Report Foreign Financial Assets on Form 8938: Demystifying the Complex Rules and Severe Consequences of Noncompliance," 38(3) International Tax Journal 11 (2012); Sheppard, "Form 8938 and Foreign Financial Assets: A Comprehensive Analysis of the Reporting Rules after IRS Issues Final Regulations," 41(2) International Tax Journal 25 (2015); and Sheppard, "Specified Domestic Entities Must Now File Form 8938: Section 6038D, New Regulations in 2016, and Expanded Foreign Financial Asset Reporting," 42(3) International Tax Journal 5 (2016).

> they are true, correct, and accurately list all amounts and sources of income I received during the tax year.

Even if taxpayers review and generally appreciate the preceding statement, it is doubtful that they anticipate how it might be used against them in a future FBAR penalty dispute.

Analysis of the Case

The description below of the facts, issues, and arguments in *Jarnagin* constitutes a best effort based on a review of the documents filed with the district court, supplemented by practical experience.[16] To enhance readability, certain aspects have been summarized, paraphrased, omitted, or translated from legalese into plain English.

General Background and Non-Compliance

Larry and Linda Jarnagin are U.S. citizens by birth. Their highest level of formal education is high school, but a lack of college degrees seems to have caused few impediments. In fact, Larry and Linda had diverse careers and successful business ventures over the years. Larry owned and operated several barber shops, worked as a licensed chiropractor, held multiple agricultural properties, worked as a cattle farmer, and bought, sold, and leased mineral rights. Additionally, Larry and Linda owned and managed various apartment complexes, as well as a nightclub.

Larry bought property in Canada in the early 1980's and started operating a ranch there. He later became a Canadian citizen, making him a dual U.S.-Canadian citizen. For her part, Linda became a Canadian permanent resident, while maintaining her U.S. citizenship. They split their time between Canada and Oklahoma.

Because they live in Canada part of the year and operate a ranch there, Larry and Linda opened an account at Canadian Imperial Bank of Commerce (CIBC) in 1986. This account remained opened during the years at issue, 2006 through 2010. The balance of the account reached approximately $3.5 million during this period. 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: (1) the Schedules B to Forms 1040 indicated "no" in response to the foreign-account question, and (2) the taxpayers never filed an FBAR disclosing the Canadian account. The reasons for this noncompliance are the focus of the case.

Reliance on Various Tax Professionals

The taxpayers engaged and relied on various U.S. tax professionals. They had Canadian tax advisors, too. The taxpayers first hired a bookkeeper (Bookkeeper) to help manage the financial aspects of their businesses and to coordinate with the accountants, who were tasked with preparing Forms 1040. Bookkeeper started in 1997, when she was still in college. She initially assisted with the apartment complexes by inputting income and expenses for each property. Her duties later expanded to preparing annual financial statements for the taxpayers, as well as handling other daily financial-management and bookkeeping tasks. Bookkeeper graduated from college with an accounting degree, she later earned a master's degree in business administration, and she ultimately became a CPA. Bookkeeper continued working for the taxpayers during this entire period. In 2004, Bookkeeper accepted a job as a comptroller for a bank, but she continued helping the taxpayers on a part-time basis, doing certain bookkeeping and accounting-type work.

According to the affidavit that Bookkeeper provided the court in connection with the cross-motion for summary judgment filed by the taxpayers, she: (1) was aware of the ranching business in Canada; (2) knew that the U.S. accountants were sending copies of the annual Forms 1040 and other tax-related data to the Canadian accountants in March or April each year, so that they could file timely returns in Canada; (3) assumed that the Canadian accountants were properly handling all duties related to Canadian accounts and businesses; and (4) "was not aware of any requirements for filing forms with the [IRS] or United States government regarding the Canadian operations or bank accounts."

In addition to employing Bookkeeper, the taxpayers hired, before the years at issue in this case, an accountant who had previously worked for the IRS (Former-IRS-Accountant). He died in 2005, and another accountant in the same firm assumed the return preparation duties. When he also died a year later, in 2006, the widow of Former-IRS-Accountant stepped in and prepared the 2006 Form 1040 and 2007 Form 1040.

The taxpayers changed course starting with the 2008 Form 1040, hiring Bookkeeper's sibling (Brother-Accountant). He holds an undergraduate degree in accounting and a master's degree in business administration, he worked for accounting firms for approximately six years after graduation, and he then opened his own practice, focusing on bookkeeping, payroll, and tax return preparation. Brother-Accountant indicated the following in the affidavit he supplied to the court as part of the taxpayers' cross-motion for summary judgment: (1) Because he previously assisted his sister, Bookkeeper, with her work for the taxpayers, he was aware that the taxpayers owned and operated a ranch in Canada and lived there a portion of each year; (2) He sent copies of the Forms 1040 to the Canadian accountants each year with the expectation that they would "handle all of the filing requirements for the Canadian businesses, accounts, and operations;" (3) In preparing the 2008 Form 1040 and 2009 Form 1040, he never specifically asked the taxpayers if they had a foreign bank account; (4) He was provided each year by the taxpayers or Bookkeeper annual financial statements, which indicated that the taxpayers held a Canadian account in Canadian dollars; (5) He did not affir-

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[16] The author obtained and reviewed the following documents related to *Jarnagin*: Complaint filed 12/16/15; Answer filed 4/18/16; Motion and Brief of the United States for Summary Judgment filed 3/24/17; Opposition to Defendant's Motion for Summary Judgment and Cross-Motion for Summary Judgment for Plaintiffs filed 5/10/17; Response Brief in Opposition to Plaintiffs' Cross-Motion for Summary Judgment and Reply Brief in Further Support of the United States' Motion for Summary Judgment filed 6/16/17; Reply to Government's Opposition to Plaintiffs' Motion for Summary Judgment filed 6/20/17; Opinion and Order filed 11/30/17.

[17] *Moore*, 115 AFTR2d 2015-1375 (DC WA, 2015).

matively check the "no" box in response to the foreign-account question on Schedule B to Forms 1040; this was the default function of the return-preparation software; and (6) He did not learn about the FBAR filing requirement until late 2010, when he attended a continuing education conference.

The taxpayers never directly informed Bookkeeper, Former-IRS Accountant, or Brother-Accountant about the Canadian account and they never provided copies of Canadian bank statements. Nevertheless, the taxpayers assumed that all three were aware of the account because their Canadian business and residence were common knowledge, the annual financial statements showed the existence and balance of the Canadian account, and the Forms 1040 were sent each year to the Canadian accountants for use in preparing Canadian returns.

The taxpayers played a limited role in the return preparation process. They supplied what they believed was the relevant tax data; however, they did not complete a questionnaire, review the completed Form 1040, ask any questions, or meet with the U.S. tax professionals to walk through the Form 1040. The taxpayers, like most people, were focused on the bottom line, primarily asking whether they had a tax liability or refund due.

Audit, FBAR Penalties, and Refund Action

In 2011, the IRS started an audit of the 2008 and 2009 Forms 1040. The audit revealed two large wire transfers from the Canadian account to Great Plains National Bank to pay a mortgage on an apartment complex that the taxpayers owned in Oklahoma. Since Schedule B to Forms 1040 said "no" in response to the foreign-account question, the Revenue Agent became suspicious. This triggered a Summons to Great Plains National Bank, which yielded various items, including copies of personal financial statements that the taxpayers had provided as a requirement to getting the loan. These statements showed the Canadian account, with a balance ranging from $3.5 million to $4 million. The Revenue Agent started an FBAR investigation based on this information.

In June 2012, the IRS sent separate letters to Larry and Linda proposing FBAR penalties. The IRS asserted a penalty of $10,000 per spouse, per open year (i.e., 2006, 2007, 2008, 2009, and 2010). This resulted in total penalties of $100,000, which were later reduced to $80,000 when the IRS conceded the matter for 2010. It conceded because Brother-Accountant had learned of the FBAR requirement before the deadline for 2010 but did not address the issue with the taxpayers because of his ongoing, erroneous belief that the Canadian accountants were in charge of all filings related to the Canadian ranch and account.

The concept of willfulness has also drawn attention lately because it represents the key eligibility criteria for two of the IRS's voluntary disclosure programs.

In August 2012, the taxpayers administratively disputed the penalties. In October 2015, the IRS sent a letter to each of Larry and Linda to "demand payment" of the FBAR penalties. They paid. Shortly thereafter, in November 2015, the taxpayers filed Forms 843, Claim for Refund and Request for Abatement, seeking a refund of $80,000. A few days later, the Appeals Office sent a letter indicating that it was upholding the penalties. There is disagreement in the record about whether the Appeals Officer was simply supporting the earlier decision by the Revenue Agent (at least with respect to 2006, 2007, 2008, and 2009) or disallowing the Claim for Refund. What is clear, though, is that the taxpayers filed a suit for refund with the Court of Federal Claims in December 2015, and jurisdiction was not challenged by the DOJ.

The complaint filed by the taxpayers contained one count, titled "Wrongful Assessment and Collection of Penalties." It states that the IRS "illegally or unlawfully" disallowed the claims for refund for FBAR penalties. The parties then engaged in discovery, consisting of requests for admissions, depositions, and other information-gathering mechanisms. In March 2017, the DOJ filed a motion for summary judgment, asking the court to determine that the taxpayers lacked "reasonable cause" for the FBAR violations, such that penalties should be upheld, without the need for a trial. The taxpayers filed their cross-motion for summary judgment in May 2017, essentially requesting that the court conclude the polar opposite. Briefing ensued.

The DOJ's Main Positions

The main positions of the DOJ were the following.

Applicable Standard: Ordinary Care and Prudence. Citing legislative history and an earlier non-willful FBAR penalty case, *Moore*,[17] the DOJ argued that the court, in analyzing the "reasonable cause" defense for FBAR purposes, should consider case law, regulations, and other guidance addressing the concept of "reasonable cause" in the context of delinquency penalties under Section 6651. Referencing the regulations under Section 6651, the DOJ indicated that the key is whether Larry and Linda "exercised ordinary care and prudence" with respect to their FBAR duties.

Failure to Meet the Reporting Prong. The DOJ explained that the relevant FBAR provision, 31 USC section 5321(a)(5)(B)(ii), states that the IRS is prohibited from imposing the non-willful penalty only if: (1) the FBAR violation was due to reasonable cause, *and* (2) "the amount of the transaction or the balance in the account at the time of the transaction was properly reported." Because Larry and Linda failed to meet the second element (i.e., properly reporting the balance in the Canadian account) by filing late FBARs, they cannot meet the penalty exception, and it is un-

necessary for the court to even consider whether the taxpayers had reasonable cause. The DOJ presented this argument in the following manner:

> Because the Jarnagins failed to report the income from the CIBC account on their tax returns and failed to timely or even belatedly file FBARs to report the CIBC account, their defense necessarily fails, and the Court need not consider whether the Jarnagins meet the reasonable cause element.[18]

The court highlighted that the regulations under Section 6664 indicate that the most important factor in gleaning reasonable cause is a taxpayer's effort to ascertain the proper tax liability.

> [The Jarnagins] could have submitted delinquent FBARs in late 2010 or early 2011, after [Brother-Accountant] and [Bookkeeper] learned about the FBAR filing obligations and first alerted the Jarnagins to the obligations. But, [they] failed to disclose their account either on the FBAR or during their audit and still have not done so to this day. Accordingly, [the Jarnagins] have failed to meet the 'reporting' element, and are not entitled to relief from the FBAR penalties.[19]

No Reasonable Cause Because Constructive Notice and Willful Blindness. The DOJ contended that, even if the court were to analyze the reasonable cause issue, it should conclude that Larry and Linda lacked reasonable cause for several reasons. One was that they failed to exercise ordinary care and prudence when they did not review their Forms 1040, despite the fact that they attested as follows to the IRS by executing Forms 1040:

> Under penalties of perjury, I declare that *I have examined this [Form 1040] and accompanying schedules [including Schedule B referencing the FBAR] 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.

The DOJ presented this argument, citing and relying on two willful FBAR penalty cases in which the DOJ triumphed, *Williams*[20] and *McBride*.[21] The relevant portions of each are described below.

The Court of Appeals in *Williams* pointed out that the taxpayer in that case 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 Court of Appeals then explained that taxpayers who execute a tax return are deemed to have constructive knowledge of such return. According to the Court of Appeals, the instructions on Line 7a in Part III of Schedule B to Form 1040 (i.e., "see instructions and exceptions and filing requirements for Form TD F 90-22.1") put a taxpayer on inquiry notice of the FBAR duty.[22] 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 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.[23]

The district court in *McBride* analyzed various issues, including the taxpayer's level of knowledge of the FBAR filing requirement. Its ultimate conclusion on this issue is remarkably clear, but the district court's analysis meandered somewhat. The court 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. It then summarized the government-favorable holdings in *Williams*. 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. It 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 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."[24]

Fortifying its position, the district court went on to cite and quote 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.[25] 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.[26]

No Reasonable Reliance Because No International Tax Experience. The DOJ also argued that reasonable cause does not exist because Larry and Linda's reliance on their U.S. tax professionals (i.e., Bookkeeper, Former-IRS-Accountant, and Brother-Accountant) was unwarranted because they lacked international tax training or experience, they did not learn of the FBAR filing duty until late 2010 and never filed one until 2011, and they were unclear about the division of labor with the Canadian accountants until they finally asked in 2011.

No Reasonable Reliance Because No Advice Requested or Given. Finally, the DOJ maintained that reasonable cause did not exist because the U.S. tax professionals never actually gave Larry and Linda any "advice" regarding FBARs on which they could rely. If anything, the U.S. tax professionals failed to give any advice whatsoever, and this, argued the DOJ, was the direct result of the fact that the taxpayers never specifically disclosed the Canadian account and never provided Canadian bank statements. The DOJ phrased this argument in the following manner: "The Jarnagins never asked their accountants to provide advice on international or cross-border issues, including FBAR filings . . . their accountants provided no such advice, and [the Jarnagins] cannot rely on advice that, through their own fault, they never received."[27]

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[18] *Jarnagin*, Note 2, *supra,* Motion and Brief of the United States for Summary Judgment filed 3/24/17, p. 24.

[19] *Jarnagin*, Motion and Brief of the United States for Summary Judgment filed 3/24/17, p. 25.

[20] *Williams*, 131 TC 54 (2008); *Williams*, 106 AFTR2d 2010-6150 (DC Va., 2010); *Williams*, 489 Fed. Appx. 655, 110 AFTR2d 2012-5298 (CA-4, 2012).

[21] *McBride*, Note 1, *supra*.

[22] *Williams*, Note 20, *supra.*

[23] *Id*.

[24] *McBride*, Note 1, *supra,* Slip Opinion, at pp. 36-37.

[25] *McBride*, Note 1, *supra,* Slip Opinion, at pp. 37-38.

[26] *McBride*, Note 1, *supra,* Slip Opinion, at pp. 38-39 (internal citations omitted).

[27] *Jarnagin*, Note 2, *supra,* Motion and Brief of the United States for Summary Judgment filed 3/24/17, p. 31.

[28] *Neonatology Associates*, 115 TC 2000, *aff'd* 299 F.3d 221, 90 AFTR2d 2002-5442 (CA-3, 2002).

Response by Taxpayers in Cross-Motion for Summary Judgment

Larry and Linda, through their counsel, raised several arguments in their cross-motion for summary judgment, the two most important of which were that they had "reasonable cause" for the FBAR violations and the reporting requirement advanced by the DOJ is nonsensical. These arguments are explained further below.

Reasonable Cause Standard and Inconsistent Governmental Positions. The taxpayers agreed that "reasonable cause" is the right standard for FBAR penalty waiver, but disagreed about its interpretation. They cited to *Neonatology Associates* for the proposition that there is a three-part test for reasonable cause: (1) the advisor was a competent professional with sufficient expertise to justify reliance by taxpayer; (2) the taxpayer provided the necessary data; and (3) the taxpayer actually relied in good faith.[28]

With respect to the first issue, counsel for Larry and Linda emphasized an inconsistency in the DOJ's line of reasoning. On one hand, the DOJ urged the court to believe that the FBAR filing duty is easy to understand, the foreign-account question on Schedule B puts all taxpayers on inquiry notice, and if taxpayers make the inquiry by reading the IRS's Instructions to Schedule B, then they would easily understand the FBAR duties. On the other hand, the DOJ asks the court to conclude that Larry and Linda cannot benefit from the reasonable-reliance-on-a-tax-professional defense because their U.S. tax professionals, working in small town Oklahoma, lacked sufficient experience with international tax issues, including FBARs, to justify reliance. Larry and Linda essentially ask the court to acknowledge that the DOJ cannot have its cake and eat it, too. The DOJ must decide whether it believes that: (1) the FBAR filing duty is so clear that any taxpayer who signs a Form 1040 should be able to understand it with minimal effort, or (2) the FBAR is so complex that taxpayers cannot rely on tax professionals (who have accounting degrees, many years of return-preparation experience, licenses from the appropriate accountancy board, annual continuing education requirements, etc.), unless they have previous experience with foreign account issues.

Debunking the Reporting Requirement. Larry and Linda also challenged the DOJ's position that the reasonable cause analysis was a non-starter because they never filed late FBARs for the relevant years. They argued that: (1) as demonstrated by their earlier Tax Court case, all income from the unreported Canadian account was declared on the annual Forms 1040, which constitutes a type of reporting of the account; (2) the tax provision requiring "proper reporting" of "the amount of the transaction or the balance in the account at the time of the transaction" makes no sense, is inconsistent with legislative history, and leads to "absurd results;" and (3) in all events, Brother-Accountant advised them that they could not file late FBARs when they discovered the problem because they were already under audit by the IRS by then.

The District Court's Decision

The court began its analysis by summarizing the primary argument presented by Larry and Linda as follows: (1) they hired competent U.S. accountants; (2) the accountants were aware of the Canadian account because of the financial statements provided each year in connection with preparation of Form 1040; and (3) they relied in good faith on the accountants.

The court agreed with the parties in that the term "reasonable cause" is not defined in the applicable FBAR statute or regulations, such that the court should consider interpretations in the context of Section 6651 (related to late-filing and late-payment penalties) and Section 6664 (related to accuracy-related penalties). The court indicated that it found these tax provisions, their underlying regulations, and related precedent "instructive" in its quest to define "reasonable cause" for FBAR purposes. The court then set the following standard: "[I]n order to show reasonable cause [for FBAR purposes] the Jarnagins must establish that they exercised ordinary business care and prudence with respect to their ob-

ligation to file FBARs for tax years 2006 through 2009."

Interestingly, the court indicated that, solely for purposes of rendering a decision about summary judgment, it would make two assumptions in favor of Larry and Linda, namely, that the U.S. tax professionals were competent to prepare all required tax and information returns, and that they were aware that the taxpayers had a bank account in Canada from 2006 through 2009. Despite these two favorable notions, the court still concluded that the taxpayers "did not exercise ordinary business care and prudence in the handling of their reporting obligations."

The court raised several points in supporting this conclusion. For example, the court highlighted that the regulations under Section 6664 indicate that the most important factor in gleaning reasonable cause is a taxpayer's effort to ascertain the proper tax liability. The court then questioned Larry and Linda's efforts by pointing out that, while they have owned a number of different businesses in many states and two countries, they did not have any substantive discussions with their U.S. tax professionals about their taxes, review their Forms 1040, specifically disclose the Canadian account, or seek advice with respect to such account. The court also noted that, while Larry and Linda relied on their U.S. tax professionals to complete Forms 1040, they did not otherwise seek "advice (legal or otherwise) concerning any obligations that they might have had to file reports or make disclosures concerning their foreign assets or businesses."

Consistent with the terminology and reasoning in two earlier "willful" FBAR penalty cases, *Williams* and *McBride*, the court then focused on the concepts of constructive knowledge and "willful blindness." The court 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 then explained that Larry and Linda had a "particular obligation" to review Schedule B because Larry is a dual U.S.-Canadian citizen, he has business activities in Canada, and he maintains a Canadian account with millions on deposit. The court speculated that, if Larry and Linda had taken the time to review their Forms 1040, 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 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].

Finally, the court acknowledged that the tax and legal authorities generally allow for penalty waiver in cases of reasonable reliance on a qualified, independent, informed tax professional. The court noted, though, that this would not apply in situations when taxpayers did not request or receive any actual advice. The court put it the following way:

> But the Jarnagins neither requested nor received any advice one way or the other from their accountants regarding whether they were required to file FBARs — that is, their accountants conducted no analysis and drew no conclusions concerning the obligation, nor did they communicate any such conclusion to the Jarnagins. In fact, [Brother-Accountant's] testimony shows that he himself was unaware of the FBAR requirement and so could not have provided the Jarnagins any advice at all regarding their obligations to file one. The Jarnagins, in other words, cannot use as a shield reliance upon advice that they neither solicited nor received.

Why *Jarnagin* Is Noteworthy

Jarnagin, like most cases involving FBAR issues, is replete with interesting and impactful aspects, most of which escape notice. Below is a review of just a few of those aspects.

Earlier Non-Willful FBAR Cases

Jarnagin is interesting because it is among the earliest cases addressing non-willful FBAR penalties. There have been a few cases, but they are easily distinguishable. For example, *Hom*[29] involved a non-willful FBAR penalty, but the main issue there was whether certain accounts held or used by the taxpayer in connection with his online gambling should be considered reportable "foreign financial accounts" for FBAR purposes.

Another case was *Moore*, which is more akin to *Jarnagin* in that the primary question focused on the actions, inactions, knowledge, and intentions of the taxpayer. In *Moore*, the taxpayer moved to the Bahamas in 1989, formed a Bahamian corporation in connection with an investment in a resort there, opened an account with a Bahamian bank in the name of the corporation, and then moved the funds to an account at the Bahamian branch of a Swiss bank, again in the name of the Bahamian corporation. The taxpayer moved back to the U.S. in 1990, but left the Bahamian corporation and account intact. The Swiss bank closed the Bahamian branch in 2003, at which time the money was transferred to Switzerland, where it remained. The balance in the account ranged from $300,000 to $550,000 during the relevant years.

The taxpayer claimed to have learned of his U.S. tax noncompliance after the IRS announced the 2009 Offshore Voluntary Disclosure Program (OVDP). It is not entirely clear from the court record, but it appears that the taxpayer applied for the OVDP, filed the required U.S. tax and information returns for 2003 through 2009 (including Forms 1040X and late FBARs), paid the required taxes, and then "opted-out" of the OVDP to seek a reduced penalty on grounds that

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[29] 45 F.Supp.3d 1175, 113 AFTR2d 2014-2325 (DC Calif., 2014); *Hom*, 657 Fed. Appx. 652, 118 AFTR2d 2016-5222 (CA-9, 2016).

[30] *Williams*, Note 20, *supra*, 106 AFTR2d 2010-6150 (DC VA, 2010), United States Proposed Findings of Fact and Conclusions of Law filed 4/26/10.

his violations were not only non-willful, but also due to reasonable cause. The Revenue Agent conducted a phone interview with the taxpayer as part of the "opt-out" process and then proposed non-willful FBAR penalties for the open years, totaling $40,000. Because the assessment period was close to expiring for 2005, the IRS then assessed the FBAR penalty for that year. The taxpayer paid the $10,000 penalty for 2005, unsuccessfully disputed the decision by the Revenue Agent with the Appeals Office, and then filed a suit for refund with the appropriate district court. The U.S. government cross-claimed for the remaining $30,000 in FBAR penalties for 2007, 2008, and 2009, and filed a motion for summary judgment.

The court began its analysis by discussing the proper legal standard. As with other FBAR cases, including *Jarnagin*, the court in *Moore* acknowledged that the term "reasonable cause" was not defined in the FBAR statute or regulations. Therefore, the court needed to turn elsewhere for guidance. In this instance, the court cited to the notion of reasonable cause under Section 6664 (dealing with accuracy-related penalties), Section 6651 (late-filing and late payment penalties), and Section 6677 (penalties related to unreported foreign trusts). The court justified these references as follows:

> There is no reason to think that Congress intended the meaning of "reasonable cause" in the Bank Secrecy Act to differ from the meaning ascribed to it in tax statutes . . . If it intended Treasury to interpret 'reasonable cause' differently in the newer statute, it left no clues to which any party has pointed. The court thus takes guidance from tax statutes and authority interpreting them, and concludes that a person has "reasonable cause" for an FBAR violation when he committed that violation despite an exercise of ordinary business care and prudence.

The taxpayer in *Moore* first professed reliance on advice from the Bahamian law firm that assisted with the formation of the Bahamian corporation in developing his erroneous understanding that he was relieved of his duty to report the foreign account simply because it was held in the name of the Bahamian corporation. The problem, stated the court, was that the taxpayer had no "objective basis for such belief." The court went on to point out that: (1) the taxpayer admitted at trial that the Bahamian firm did not give him any specific advice about U.S. law, including advice about foreign account reporting; (2) the taxpayer conceded that he had no idea since 2003 whether the Bahamian corporation was still in existence; (3) when the account moved from the Bahamas to Switzerland, the taxpayer met with bank representatives but failed to ask any questions about any potential U.S. duties associated with the account; (4) the taxpayer prepared his own Forms 1040 before 2006 and he ignored the foreign-account question in Part III of Schedule B; and (5) when the taxpayer began working with a return preparer starting in 2006, he falsely responded to the question in the annual tax organizer about foreign accounts, stating that "no" he did not have any reportable accounts.

The court emphasized the following points in deciding that non-willful FBAR penalties were appropriate, if not generous. First, clinging to advice, from a foreign law firm, which the taxpayer admitted was unrelated to U.S. law, is not an exercise of ordinary business care and prudence. Second, ignoring the foreign-account question in Part III of Schedule B when the taxpayer self-prepared his Forms 1040 was not an exercise of ordinary care and prudence. Third, the foreign-account question on Schedule B placed the taxpayer on "inquiry notice," and his failure to read the relevant IRS Instructions was not an exercise of ordinary business care and prudence. Finally, suggesting that non-willful penalties represented a light punishment, the court stated that "[e]vidence that a taxpayer ignored relevant questions on Schedule B and in tax organizers is evidence of willful conduct [and] in this court's view, it suffices as a matter of law to demonstrate a lesser FBAR violation—one made without 'reasonable cause.'"

Changing Views of Reasonable Reliance in the FBAR Context

Jarnagin provides an opportunity to reflect on the courts' differing views about the reasonable-reliance-on-a-tax-professional defense in the FBAR context.

Supposed Reasonable Reliance in *Williams*. The reasonable-reliance-on-a-tax-professional defense was unique in *Williams*. The government presented evidence that the taxpayer never provided any information to his accountant about the foreign accounts or foreign source income from 1993 through 2000. The government also demonstrated that the accountant sent the taxpayer a questionnaire/organizer each year, which specifically asked whether he had an interest in or authority over a foreign account. The taxpayer completed it for 2000, affirmatively checking the "no" box to the foreign-account inquiry.[30]

Jarnagin, like most cases involving FBAR issues, is replete with interesting and impactful aspects, most of which escape the notice.

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

> [T]o the extent [the taxpayer] asserts he was unaware of the FBAR requirement because his attorneys or accountants never informed him, his ignorance also resulted from his own recklessness. [The taxpayer] concedes that from 1993-2000 he never informed his accountant of the exis-

> tence of the foreign accounts even after retaining counsel and with the knowledge that authorities were aware of the existence of the accounts.[31]

Supposed Reasonable Reliance in *McBride*. Most taxpayers facing tax adjustments or penalties often look outward to justify their transgressions, and Mr. McBride was no different. He maintained that he reasonably relied on three different persons, such that FBAR penalties should be mitigated.

Mr. McBride began by arguing that he reasonably relied on Accountant Stayner with respect to his Form 1040 for 2000. The district court quickly dispensed with this argument because Mr. McBride did not fully inform Accountant Stayner about his foreign entities, activities, and accounts.[32]

Mr. McBride then contended that he relied on the promoter and its attorneys, presumably the ones that prepared the legal opinion about the foreign structure. The district court also swiftly rejected this position because such advisors lacked the necessary financial independence.[33]

Lastly, Mr. McBride maintained that he relied on Accountant Taylor with respect to his Form 1040 for 2001. The court found that Accountant Taylor had sent Mr. McBride a memo years earlier expressing concerns about the foreign structure and enclosing an article addressing legal and compliance issues related to foreign bank accounts. The district court came to the following conclusion about the supposed dependence on Accountant Taylor:

> Even if [Accountant] Taylor was fully aware of the [foreign structure] scheme yet failed to properly advise McBride to report his interests in the foreign accounts, this would not excuse McBride. The taxpayer, not the preparer, has the ultimate responsibility to file his or her return and to pay the tax due. This duty generally cannot be avoided by relying on an agent. McBride knew, or at least made himself willfully blind, about the need to report his interests in the foreign accounts when he signed his 2000 return.[34]

This holding raises questions for two main reasons. First, the broad opening statement (i.e., that no reasonable cause

would exist even if Accountant Taylor were "fully aware" of the offshore issues and failed to properly advise Mr. McBride) seems inconsistent with well-established law. The regulations recognize that a taxpayer's reasonable reliance on an independent, informed, qualified tax professional often reaches the level of reasonable cause.[35] For purposes of the reasonable reliance defense, the regulations also broadly define the concept of "advice" to cover "any communication" from a qualified advisor and clarify that "[a]dvice does not have to be in any particular form."[36] The Supreme Court, for its part, has concluded that the IRS must liberally construe the reliance defense, stating that "[w]hen an accountant or attorney advises a taxpayer on a matter of tax law . . . it is reasonable for the taxpayer to rely on that advice" and further acknowledging that "[m]ost taxpayers are not competent to discern error in the substantive advice of an accountant or attorney."[37]

Second, in stating that Mr. McBride could not rely on others to file a return and pay the proper tax, the court seems to blur the long line of tax cases distinguishing between reliance on tax advice (which can constitute "reasonable cause") and reliance on others to perform nondelegable ministerial tasks (which cannot constitute "reasonable cause").[38] The Tax Court has previously explained this distinction, which seemed to escape the district court in *McBride:*

> In general, a taxpayer's duty to file a return when due is a personal, nondelegable duty. Thus, reliance upon an accountant to file is ordinarily no excuse for filing a return beyond the due date. However, the Supreme Court has distinguished between the case in which a taxpayer reasonably relies on the substantive tax advice of an accountant or attorney that no return need be filed . . . Similarly, this Court has held that reasonable cause . . . can be shown by proof that the taxpayer supplied all relevant information to a competent tax adviser and relied in good faith on the incorrect advice of the adviser that no return was required to be filed.[39]

Supposed Reasonable Reliance in *Jarnagin*. The DOJ argued that reliance by Larry and Linda on their U.S. tax professionals (i.e., Bookkeeper, Former-IRS-Accountant, and Brother-Accountant) was unwarranted because they lacked international tax training or experience, they did not learn of the FBAR filing duty until late 2010 and never filed one until 2011, and they were unclear about the division of labor with the Canadian accountants until they finally asked in 2011. The DOJ also maintained that reasonable reliance did not exist because the U.S. tax professionals never knew about the Canadian account, and thus never actually gave Larry and Linda any "advice" regarding FBARs on which they could rely. The DOJ put it the following way: "The Jarnagins never asked their accountants to provide advice on international or cross-border issues, including FBAR filings . . . their accountants provided no such advice, and [the Jarnagins] cannot rely on advice that, through their own fault, they never received."[40]

The court agreed with the DOJ, explaining that while penalty waiver is appropriate when there is reasonable reliance on a qualified, independent, informed tax professional, this would not apply to Larry and Linda because they did not request or receive advice:

> But the Jarnagins neither requested nor received any advice one way or the other from their accountants regarding whether they were required to file FBARs — that is, their accountants conducted no analysis and drew no conclusions concerning the obligation, nor did they communicate any such conclusion to the Jarnagins. In fact, [Brother-Accountant's] testimony shows that he himself was unaware of the FBAR requirement and so could not have provided the Jarnagins any advice at all regarding their obligations to file one. The Jarnagins, in other words, cannot use as a shield reliance upon advice that they neither solicited nor received.

Still No Clarity about Significance of Reporting Requirement

Positions by the Parties; Non-Decision by the Court. As indicated above, the DOJ explained that the relevant FBAR provision, 31 USC section 5321(a)(5)(B)(ii), states that the IRS is prohibited from imposing the nonwillful penalty only if two criteria have been met: (1) the FBAR violation was due to reasonable cause, *and* (2) "the amount of the transaction or the balance in the account at the time of the transaction was properly reported." According to the DOJ, because Larry and Linda failed to meet the second element (i.e., properly reporting the balance in the Canadian account) by filing late FBARs at any point (such as during the audit), they cannot meet the penalty exception, and it is unnecessary for the court to even consider whether Larry and Linda had reasonable cause. The position espoused by the DOJ is consistent with the guidance from the IRS in the Internal Revenue Manual (IRM), which states that no FBAR penalties should be asserted if "[t]he violation was due to reasonable cause, *and the person files any delinquent FBARs and properly reports the previously unreported account.*"[41]

Counsel for Larry and Linda dismissed the position advanced by the DOJ and the IRS, arguing, among other things, that: (1) all income from the unreported Canadian account was declared on the annual Forms 1040, which should satisfy the reporting requirement; (2)

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[31] *Williams*, Note 20, *supra,* 489 Fed. Appx. 655 (CA-4, 2012), at footnote 6.

[32] *McBride,* Note 1, *supra,* Slip Opinion, at pp. 45-46.

[33] *McBride*, Note 1, *supra,* Slip Opinion, at p. 47.

[34] *McBride*, Note 1, *supra,* Slip Opinion, at p. 48 (internal citations omitted).

[35] Reg. 1.6664-4(c)(1).

[36] Reg. 1.6664-4(c)(2).

[37] *Boyle*, 469 U.S. 241, 55 AFTR2d 85-1535, 251 (1985).

[38] *McMahan*, 114 F.3d 366, 79 AFTR2d 97-2808 (CA-2, 1997).

[39] *Zabolotny*, 97 TC 385, 400-401 (1991) (internal citations omitted)(holding that reasonable cause existed where two certified public accountants, fully informed of the facts, led the taxpayer to believe that no taxable event was created by the relevant transactions for which any federal excise tax returns would be required to be filed).

[40] *Jarnagin*, Note 2, *supra,* Motion and Brief of the United States for Summary Judgment filed 3/24/17, p. 31.

[41] IRM 4.26.16.6.4 (11/06/15) (emphasis added).

the language in 31 USC section 5321(a)(5)(B)(ii) ostensibly requiring "proper reporting" of "the amount of the transaction or the balance in the account at the time of the transaction" makes no sense, is inconsistent with legislative history, and leads to "absurd results;" and (3) Larry and Linda wanted to file late FBARs during the audit, but Brother-Accountant advised against this.

The court took neither side, leaving the issue of the reporting requirement unresolved. Here is how the court explained its decision to punt on this thorny issue:

> In light of the Court's conclusion that the Jarnagins' failure to file FBARs was not due to reasonable cause, it does not address the question of whether the Jarnagins have satisfied the additional criteria for the exception to the FBAR penalty i.e., that "the amount of the transaction or the balance in the account at the time of the transaction was properly reported."[42]

Identification of the Issues More than a Decade Ago. The fact that no court has yet ruled on the reporting requirement and its impact on FBAR penalty waiver is particularly interesting given its age. Indeed, the author of this article wrote a long piece about various FBAR issues, including open questions concerning the reporting requirement, more than a decade ago. Below is an excerpt from the earlier article, portions of which were evidently used by counsel in *Jarnagin:*

> As explained above, the law related to the FBAR dramatically changed with the enactment of the Jobs Act in October 2004. The new law dictates that, in cases of *non-willful* violations, the IRS may impose a maximum penalty of $10,000. However, the IRS cannot impose such a penalty if two conditions are met: (i) the violation was due to "reasonable cause," *and* (ii) the amount of the "transaction" *or* the balance in the account at the time of the "transaction" was properly reported. This exception appears relatively simple, but it is fraught with complexities and uncertainties.
>
> Even if the IRS relies on the Penalty Handbook and the taxpayer is thereby able to persuade the IRS that "reasonable cause" exists, that is only one-half of the equation. In order to meet the exception to the new FBAR penalty, the taxpayer must also meet the second condition. Specifically, the taxpayer must show that the amount of the "transaction" *or* the balance in the account at the time of the "transaction" was properly reported. Simply put, in its current form, the second condition seems difficult to satisfy. This argument, which is predicated on theory that the new Section 5321(a)(5)(B)(ii)(II) contains erroneous language, is explained in further detail below.
>
> To benefit from the penalty exception, the new law requires the taxpayer to demonstrate that either "the amount of the *transaction*" or "the *balance* in the account *at the time of the transaction*" was properly reported. Meeting this second condition of the exception is troublesome for the following reasons.
>
> First, in the case of a person who simply holds a foreign financial account, there is no "transaction" to report. To grasp this argument, one must understand that, for purposes of the FBAR, the terms "transaction" and "relation" (or "relationship") are distinct. This distinction is clear from Section 5314(a), which requires certain persons to file reports when they either "make a transaction" with a foreign financial agency or "maintain a relation" for any person with a foreign financial agency. The distinction is also clear from 31 C.F.R. § 103.24, which mandates the filing of an FBAR where a certain "relationship" exists with respect to a foreign financial account. Lest there be any doubt in this regard, the instructions to the FBAR require certain persons to report their "relationship" with certain accounts. The relevant regulations generally define the term "transaction" as a "purchase, sale, loan, pledge, gift, transfer, delivery or other disposition." In other words, to be a "transaction" for FBAR purposes, something beyond merely holding a foreign financial account must occur. Accordingly, for taxpayers who engage in no actions involving an account, it seems unfeasible to properly report the amount of the "transaction."
>
> Second, forcing the taxpayer to report the balance of the account "at the time of the transaction" makes no sense. Clearly, the language in new Section 5321(a)(5)(B)(ii)(II) is erroneous and incompatible with legislative history. This conclusion finds support in two places. New Section 5321(a)(5)(D)(ii) determines *when* the penalty amount is calculated. In cases involving failures to file FBARs, the amount is figured at the time of the "violation," not at the time of the "transaction." Former Section 5321(a)(5)(B)(ii) also set the maximum penalty for FBAR violations. It, too, based its calculation on the balance in the account at the time of the "violation," not the "transaction."
>
> Third, even if the language in new Section 5321(a)(5)(B)(ii)(II) were corrected to require the taxpayer to properly report "the balance in the account *at the time of the violation*," this would still not be enough to allow taxpayers to satisfy the second condition. Indeed, more legislative changes would have to be made. The "balance" of a foreign financial account is *not* reported on a taxpayer's individual tax return. As explained earlier, Part III of Schedule B to the individual income tax return (*i.e.*, Form 1040) asks whether the taxpayer had an interest in or authority over a foreign financial account at any time during the calendar year. If so, the taxpayer must check the "yes" box and then disclose the name of the foreign country in which the account is located. Nowhere on the tax return is the taxpayer obligated to indicate the "balance" of the account. The *only* place where the "balance" of a foreign financial account must be revealed is on the FBAR, which asks for the maximum value of the account. As discussed above, both the GAO Report and the House Report make the rationale for the penalty exception clear: the IRS should not penalize taxpayers who maintain foreign financial accounts, properly report the income generated by such accounts on their annual income tax returns, yet fail to

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[42] *Jarnagin*, Note 2, *supra,* Footnote 5 of Opinion and Order filed 11/30/17.

[43] Sheppard, "Evolution of the FBAR: Where We Were, Where We Are, and Why It Matters," 7 Hous. Bus. & Tax L. J. 1, __ (2006-2007) (internal citations omitted).

[44] IRM 4.26.16.4.4 (11/6/15). See also Financial Crimes Enforcement Network. "BSA Electronic Filing Requirements for Report of Foreign Bank and Financial Accounts (FinCEN Form 114)," (January 2017), pp. 6, 16, and 17.

[45] *Williams*, 131 TC 54 (2008).

submit an FBAR because they are unaware of this filing requirement. Based on these two reports, it is evident that new Section 5321(a)(5)(B)(ii)(II) should not focus on the "balance" of the account at the time of the violation. Doing so makes sense in new Section 5321(a)(5)(D)(ii), which determines the *amount* of the penalty. However, having such a focus in new Section 5321(a)(5)(B)(ii)(II), which deals with the conditions under which penalty waiver is appropriate, is completely illogical.

In sum, to fulfill legislative intent, new Section 5321(a)(5)(B)(ii)(II) should be amended such that the IRS shall not impose FBAR penalties in cases where there is reasonable cause and the taxpayer properly reported the income from the foreign financial account (not the "balance" in the account) on his annual income tax return (not "at the time of the transaction"). Congress recently passed the Tax Technical Corrections Act of 2005. This curative legislation contained many modifications to the Jobs Act; however, changes related to the FBAR provisions were not among them. Accordingly, taxpayers must await further congressional action.

Meanwhile, taxpayers accused of FBAR violations may still be able to avail themselves of the "reasonable cause" exception based on statutory construction principles. Where a statute and a legislative committee report are consistent, the statute generally governs. There are, of course, exceptions to the general rule. For instance, statutory language does not govern where the legislative history contains unequivocal evidence of Congress's purpose for enacting a particular provision. Additionally, portions of a statute may be disregarded when paying them an amount of inordinate attention would lead to "absurd" results. Finally, statutory verbiage may be devalued when it is the result of an error in the drafting process. This article is not the place for a lengthy analysis of statutory interpretation, but it appears that, when put to the judicial test, taxpayers may qualify for the reasonable cause exception despite the erroneous statutory language.[43]

IRS Penalizes Husband and Wife Separately

Jarnagin is interesting in that, while the IRS decided to pursue only non-willful penalties, it elevated the financial pain to the greatest extent possible. First, the IRS asserted FBAR penalties for each year whose assessment period had not expired (i.e., 2006 through 2010) and it asserted the $10,000 twice for each year, imposing it once on Larry, and again on Linda. This seems acceptable from a technical perspective, as each Larry and Linda, as joint holders of the same unreported Canadian account, generally had a separate duty to file an FBAR.

It is interesting to note that, if they had filed in a timely manner, Larry and Linda could have elected to file just one, joint FBAR. According to the IRM and the FBAR Instructions, foreign accounts jointly held by spouses can be filed on just one FBAR, in situations where: (1) all the reportable financial accounts held by the non-filing spouse are jointly owned by the filing spouse; (2) the filing spouse electronically files a "timely" FBAR; and (3) both spouses complete and sign Part I of FinCEN Form 114a, Record of Authorization to Electronically File FBARs.[44]

Jarnagin provides an opportunity to reflect on the courts' differing views about the reasonable-reliance-on-a-tax-professional defense in the FBAR context.

Jurisdiction: Where to Launch an FBAR Battle

The appropriate place to mount an FBAR dispute has been an evolving issue.

Tax Court Recognizes its Limitations. The first significant guidance in this regard came in 2012, when the Tax Court in *Williams* explained why it had neither pre-assessment nor post-assessment jurisdiction over civil FBAR penalty cases. In that case, the taxpayer filed a timely petition with the Tax Court contesting all the proposed adjustments set forth in the notice of deficiency, as well as the FBAR penalties that were not included therein. The IRS, predictably, filed a motion to dismiss the case for lack of jurisdiction as to the FBAR penalties. The IRS's theory was that the provision under which FBAR penalties are asserted (i.e., 31 U.S.C. section 5321) does not fall within the Tax Court's jurisdiction. This is based on Section 7442, which provides that the Tax Court and its divisions "shall have such jurisdiction as is conferred on them by this title [26] . . . ."

No Pre-Assessment Tax Court Jurisdiction. The Tax Court began the opinion in *Williams* by explaining that Section 6212(a) authorizes the IRS to issue a notice of deficiency in certain situations. For its part, Section 6213(a) provides that the tax in question may not be assessed until the IRS has issued the requisite notice of deficiency. It further provides that the tax assessment must be delayed pending a possible redetermination by the Tax Court if the taxpayer files a timely petition. The Tax Court pointed out, however, that these two provisions expressly state that the notice of deficiency is to be sent in the case of taxes imposed by subtitle A of Title 26 (i.e., income taxes), by subtitle B of Title 26 (i.e., estate and gift taxes), or by chapters 41, 42, 43 or 44 in subtitle D of Title 26 (i.e., miscellaneous excise taxes). Therefore, by negative implication, any other taxes and items fall outside the limited jurisdiction of the Tax Court. Extending this logic, the Tax Court reasoned as follows with respect to FBAR penalties:

> The same conclusion must be reached as to the FBAR penalties imposed in Title 31: The Secretary of the Treasury is authorized by 31 U.S.C. Sec. 5321(b)(1) to assess the FBAR penalty; no notice of deficiency is authorized by Section 6212(a) nor required by Section 6213(a) before that assessment may be made; and the penalty therefore falls out-

side our jurisdiction to review deficiency determinations.[45]

No Post-Assessment Tax Court Jurisdiction. The issue of whether the Tax Court would have jurisdiction over a subsequent action by the government to collect FBAR penalties was not raised in the taxpayer's petition in *Williams*, nor was it broached in the IRS's motion to dismiss. Nevertheless, the Tax Court addressed this topic on its own.

In *Williams*, the Tax Court explained that the provisions under which the IRS may place a lien or effectuate a levy are narrow. They apply only to "taxes," as well as the additions to tax, additional amounts, and penalties described in Chapter 68 of Title 26 (i.e., Sections 6651 through 6751 of the Code).[46] The Tax Court then made three points as to why it would lack jurisdiction to address any FBAR-penalty-collection issue: (1) There is no statute expanding the definition of "tax," as used in the lien and levy provisions of the Code, to include the FBAR penalty; (2) The collection mechanism in the applicable FBAR statute, 31 U.S.C. section 5321(b)(2), is not a lien or levy, but rather a "civil action to recover a civil penalty;" and (3) Even if the FBAR penalty were a tax subject to the lien and levy provisions, the IRS had not issued a notice of determination, which is a prerequisite to filing a petition with the Tax Court.[47]

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[46] Sections 6301, 6230, 6231, 6330, 6331, and 6665.

[47] *Williams*, 131 TC 54 (2008).

Tax Court Recognizes its Limitations

In *Jarnagin*, counsel for the Larry and Linda alleged in the complaint that the Court of Federal Claims had jurisdiction under a provision of the Code, Section 7422(a), which states the following:

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

The DOJ immediately rejected jurisdiction under Section 7422, later indicating in its motion for summary judgment, without explanation, that the Court of Federal Claims had jurisdiction to this FBAR refund case thanks to 28 USC section 1491(a)(1), which states this:

> The United States Court of Federal Claims shall have jurisdiction to render judgment upon any claim against the United States founded either upon the Constitution, or any Act of Congress or any regulation of an executive department, or upon any express or implied contract with the United States, or for liquidated or unliquidated damages in cases not sounding in tort.

The court indicated that, since the parties did not substantively address jurisdiction in their legal briefs, it was obligated to unilaterally clarify this important, threshold matter. Citing a line of cases as far back as 1954, the court noted that, under 28 USC section 1491(a)(1), it had authority to hear cases alleging an illegal exaction by the U.S. government, provided that they involve money that was improperly paid, exacted, or taken in contravention of the U.S. Constitution, a statute, or a regulation. The court determined that that the assessment and collection of the civil FBAR penalties is well within these parameters:

Here, the Jarnagins assert that the government's assessment and collection of FBAR penalties was unlawful because 31 U.S.C. section 5321(a)(5) contains a prohibition on penalties where, inter alia, the taxpayer has reasonable cause for failing to file an FBAR. Thus, because the government based its exaction upon an asserted statutory power and because the Jarnagins claim that the penalty was exacted in contravention of that statute, the Jarnagins' claim is one for an illegal exaction and the court has subject matter jurisdiction over it.

Conclusion

International tax disputes are fact-driven, and no two cases are the same. However, success in defending against FBAR penalties, whether willful or non-willful, requires one to closely follow the shifting legal/tax positions raised by the IRS and all precedent, like *Jarnagin*. Given the continued focus by the IRS and DOJ on international tax enforcement in general, and on unreported foreign accounts in particular, *Jarnagin* and its FBAR brethren will assume greater importance in the future. ●