Disputing FBAR Penalties: *Mendu* Case Clarifies How Much Taxpayers Must Pay to Play

*By Hale E. Sheppard**

I. Introduction

Substance is important, but procedure is often king when it comes to disputes with the Internal Revenue Service ("IRS"). This is what taxpayers facing significant penalties for not filing FinCEN Forms 114 ("FBARs") to report foreign accounts have recently discovered. FBAR duties are *not* contained in the tax code, yet the quintessential tax agency, the IRS, audits potential violations and asserts penalties. Such disconnect has sparked a number of questions, most of which center around whether FBAR penalties can be treated as a "tax" for certain purposes. This issue, as mind-numbing as it might seem to some, is critical in determining whether the Tax Court is empowered to handle FBAR disputes, whether FBAR penalties can be discharged in bankruptcy, and whether taxpayers must pay the entire amount, or merely a small portion, in order to trigger jurisdiction of the District Court. This article examines origins of the FBAR, delegations of power, key tax provisions, and four noteworthy cases providing guidance on how, when, and where to fight FBAR penalties.

II. Origins, Power Delegations, and Penalties

One first needs some background to appreciate the issues addressed in this article.

Congress enacted the Bank Secrecy Act, also known as the Currency and Foreign Transactions Reporting Act, in 1970.[1] It created new provisions in Title 31 (Money and Finance) of the U.S. Code. One purpose of this legislation was to require the filing of certain reports, like the FBAR, where doing so would be helpful to the U.S. government in carrying out criminal, tax, and regulatory investigations.[2]

For many decades, the main problem was that few U.S. taxpayers filed an FBAR, and they had little incentive do so. Compliance was not rewarded, and

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violations generally went unpunished. In terms of statistics, one congressional report indicated that from 1993 to 2002 the U.S. government only considered imposing FBAR penalties in 12 cases. Of those dozen, only two taxpayers ultimately received penalties, four received "letters of warning," and the remaining six were not pursued for various reasons.[3]

Annoyed by these figures, the U.S. government took action. For instance, in 2003, the Treasury Department transferred authority to enforce the FBAR provisions from its Financial Crimes Enforcement Network ("FinCEN") to the IRS.[4] Thanks to a Memorandum of Agreement between the two agencies, the IRS is empowered to investigate potential violations, issue summonses, assess and collect civil penalties, issue administrative rulings, and take "any other action reasonably necessary" to enforce the FBAR provisions.[5]

Current law dictates that the IRS can impose a civil penalty on any person who fails to file an FBAR when required, period.[6] In the case of *non-willful* violations, the maximum penalty is $10,000.[7] The IRS imposes higher penalties where willfulness exists. Specifically, in situations where a taxpayer *willfully* files a late, false, or incomplete FBAR, the IRS may assert a penalty equal to $100,000 or 50 percent of the balance in the undisclosed account at the time of the violation, whichever amount is larger.[8] Given the huge balances in some clandestine accounts abroad, FBAR penalties can be enormous.

III. Multiple Mandatory Disclosures

The relevant law mandates the filing of an FBAR in situations where (i) a U.S. person, including U.S. citizens, residents, and 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 was more than $10,000 (vi) at any point during the relevant year.[9]

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

- Checking the "yes" box in Part III (Foreign Accounts and Trusts) of Schedule B (Interest and Ordinary Dividends) to Form 1040 (*U.S. Individual Income Tax Return*) to disclose the existence of the foreign account,
- Identifying the foreign country in which the account is located, also in Part III of Schedule B to Form 1040,
- Declaring all passive income generated by the account on Forms 1040, such as interest, dividends, and capital gains, and
- Electronically filing an FBAR.[10]

IV. Issues Raised by Empowering the IRS

As explained above, certain U.S. persons must file annual FBARs, the IRS may assert civil penalties against those who violate FBAR duties, and, if the taxpayers do not voluntarily pay the penalties after the IRS assesses them, the Department of Justice ("DOJ") can start a collection action in federal court within two years of assessment.[11] The preceding duty and enforcement authorities all have one thing in common; that is, they derive from Title 31 of the U.S. Code, not Title 26 of the U.S. Code (*i.e.*, the Internal Revenue Code). Thus, the delegation of FBAR authority from FinCEN to the IRS in 2003 effectively transferred non-tax issues to a tax agency.

Here is why that mattered. Code Sec. 6201(a) authorizes the IRS to makes determinations and assessments of all taxes, including penalties, "imposed by *title [26]* or accruing under *any former internal revenue law*." Likewise, Code Sec. 6301 states that the IRS "shall collect the taxes imposed *by the internal revenue laws*." These provisions do not account for any non-tax-related actions, which had some tax practitioners, including the author of this article, scratching their heads as early as 2006 about the application of quirky procedural issues.[12] The four cases examined below focus on such issues.

V. Power of Courts Over FBAR Penalty Disputes

One fundamental question is the extent to which federal courts have authority to resolve FBAR penalty disputes. The following cases supply some answers.

A. *Williams*—Tax Court Lacks Jurisdiction Over FBAR Penalty Cases

A Tax Court case from 2008, *J.B. Williams*, was the first to highlight jurisdictional limitations regarding FBAR penalties.[13]

1. Relevant Facts

The facts in *Williams* are somewhat convoluted, but those regarding the penalty issue are straightforward:

(i) The taxpayer had a reportable interest in two Swiss accounts; (ii) The taxpayer did not file a timely FBAR disclosing those accounts to the IRS; (iii) The IRS audited the taxpayer for multiple years; (iv) The IRS issued an Examination Report proposing additional income taxes, accuracy-related penalties, and civil fraud penalties; (v) The IRS also issued an FBAR Examination Report asserting the maximum penalty for each of the two accounts; (vi) The taxpayer filed a timely Protest Letter as to all matters; (vii) The taxpayer was unable to reach an acceptable settlement with the Appeals Office; (viii) The IRS issued a Notice of Deficiency regarding income taxes, accuracy-related penalties, and civil fraud penalties (but not FBAR penalties); and (ix) The taxpayer filed a Petition with the Tax Court contesting all aspects of the Notice of Deficiency, as well as the FBAR penalties.

2. No Jurisdiction Over FBAR Penalty Assessments

The IRS filed with the Tax Court a Motion to Dismiss the case for lack of jurisdiction, among other things. The IRS's theory was that the provision under which FBAR penalties are assessed (*i.e.*, 31 USC §5321), does not fall within the Tax Court's jurisdiction. This is based on Code Sec. 7422, which provides that the Tax Court and its divisions "shall have such jurisdiction as is conferred on them by this *title [26]* …."

The Tax Court began in *Williams* by explaining that Code Sec. 6212(a) authorizes the IRS to issue a Notice of Deficiency in certain situations. For its part, Code Sec. 6213(a) provides that the IRS cannot assess additional taxes until it issues 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 tax provisions expressly state that the Notice of Deficiency must 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 certain chapters in subtitle D of Title 26 (*i.e.*, miscellaneous excise taxes). Therefore, by negative implication, anything else falls outside the limited deficiency jurisdiction of the Tax Court.

In short, the Tax Court concluded that it lacked authority to resolve questions of *assessment* of FBAR penalties.

3. No Jurisdiction Over FBAR Penalty Collections

The taxpayer did not raise issues about *collection* of FBAR penalties in his Petition, nor did the IRS do so in its Motion to Dismiss. Nevertheless, the Tax Court addressed this issue on its own initiative. An overview of the normal tax collection process puts this issue into perspective.

Within five days after filing a lien, the IRS must provide the affected taxpayer a Notice of Federal Tax Lien informing him of the amount of the unpaid tax and his right to request a collection due process ("CDP") hearing.[14] Likewise, the IRS is required to send the taxpayer a Notice of Intent to Levy at least 30 days before it seizes his property to satisfy tax debts.[15] To request a CDP hearing under either scenario, the taxpayer must file a timely Form 12153 (*Request for a Collection Due Process Hearing*) with the IRS.[16] The Appeals Officer conducts the CDP hearing and ultimately issues a so-called Notice of Determination, which represents the IRS's final administrative decision regarding the propriety of the lien or levy. If the Notice of Determination upholds the collection action by the IRS, the taxpayer still has the right to seek further review, this time by a judge. He exercises this right by filing a Petition with the Tax Court.[17]

The Tax Court explained in *Williams* 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 to additions to tax, additional amounts, and penalties described in Code Secs. 6651 through 6751.[18] The Tax Court then made three points as to why it would lack jurisdiction over FBAR collection cases. First, there is no statute expanding the definition of "tax," as used in the lien and levy provisions of the Internal Revenue Code, to include FBAR penalties. Second, the collection mechanism in the applicable FBAR statute is not a lien or levy, but rather a "civil action to recover a civil penalty." Third, even if FBAR penalties were a tax subject to the IRS's lien and levy provisions, the Appeals Office did not issue the requisite Notice of Determination.

B. *Simonelli*—Bankruptcy Does Not Eradicate FBAR Penalties

Another important, yet obscure case from 2008, *Simonelli*,[19] contributed to procedural issues concerning FBAR penalties.

1. Relevant Facts

The taxpayer in *Simonelli* had three accounts in the Bahamas, none of which he reported by filing an FBAR for 1999. The IRS later audited the taxpayer. As part of an administrative settlement, the taxpayer agreed to a penalty of $25,000. Approximately one month later, the IRS officially assessed the penalty and demanded full

payment. The taxpayer failed to pay the agreed amount. Consequently, the DOJ filed a timely Complaint against the taxpayer in District Court to collect the FBAR penalty.[20]

After the IRS assessed the FBAR penalty, but *before* the DOJ filed the collection suit in District Court, the taxpayer filed for bankruptcy and obtained a general discharge. During the later collection suit, the taxpayer theorized that the FBAR penalty had been discharged in bankruptcy already because it was either a dischargeable "tax" or a dischargeable "tax penalty." The DOJ disagreed, of course, and filed a Motion for Summary Judgment, asking the District Court to rule its favor without bothering with a trial. The District Court deemed it an issue of first impression.

2. First Argument by the Taxpayer

The taxpayer's first argument was that, regardless of what it is labeled in the pertinent statute and regulations, the FBAR "penalty" is actually a "tax" of the type that could be discharged in bankruptcy. The taxpayer suggested that the IRS uses FBARs to track foreign accounts of which it would otherwise have no knowledge. After reviewing the information in the FBAR, the IRS can determine how much a person owes in U.S. taxes and assesses a "tax" in this amount. The taxpayer goes on to state that the IRS is unable to calculate the amount of taxes due if a taxpayer fails to file an FBAR. Therefore, reasoned the taxpayer, instead of pursuing the taxes, the IRS asserts the FBAR penalty "as a rough approximation of those taxes it has lacked sufficient information to assess." The taxpayer concluded that the IRS assesses an FBAR penalty instead of taxes and thus is a "tax."

The taxpayer further argued that the FBAR "penalty" is really a "tax" based on judicial precedent. Citing a Supreme Court case involving the dischargeability of trust fund recovery penalties under Code Sec. 6672, the taxpayer contended that a pecuniary burden placed on a debtor can be characterized as a "tax" for bankruptcy purposes, even though the provision under which it is imposed refers to it as a "penalty." The taxpayer also advocated the application of a four-part test adopted by several courts. Such test provides that an item is a "tax" if it is an involuntary pecuniary burden on individuals or property, imposed by or under the legislature, for public purposes, under the police or taxing power of the government.[21]

The District Court offered three main reasons for rejecting the taxpayer's initial argument. First, it stated that the applicable law and regulations refer to the imposition of "civil penalties" and "civil monetary penalties," not taxes, in the case of FBAR violations.[22] Moreover, the District Court emphasized that these provisions "say nothing about the Bank Secrecy Act serving as a mechanism to collect otherwise uncollected taxes."

Second, the District Court concluded that the FBAR penalty does not constitute a "tax" under the four-part test advanced by the taxpayer. The District Court focused on the first element of the test, which requires the item to be an "involuntary pecuniary burden." The District Court reasoned that the FBAR penalty is not a "tax" because a taxpayer would not be subject to any "involuntary pecuniary burden" if he were to simply file the requisite FBAR.

Finally, the District Court found that the statutory and regulatory framework governing FBAR penalties has no traits of a "tax." For instance, it explained that there is a legal presumption that a tax assessment is correct, whereas the U.S. government has the burden of establishing the intent element in FBAR violation cases.

3. Second Argument by the Taxpayer

The taxpayer's second argument was that the FBAR penalty fell within the definition of "tax penalty" and was thus wiped away earlier. The key bankruptcy provision, 11 USC §523(a)(7), states that bankruptcy does not relieve an individual debtor from any debt "to the extent such debt is for a fine, penalty, or forfeiture payable to and for the benefit of a governmental unit … *other than a tax penalty* … imposed with respect to a transaction or event that occurred before three years before the date of the filing of the [bankruptcy] petition."

The taxpayer's second argument shared the fate of the first, rejection. According to the District Court, in order for the FBAR penalty to be considered a "tax penalty," it would have to be linked in some fashion to the underlying tax liability. Because there is no tax underlying the FBAR penalty, it should not be considered a dischargeable "tax penalty."

C. *Bedrosian*—Full Payment Rule Applies to FBAR Penalty Refund Cases

A more recent and famous case, *Bedrosian*, was unique in that it constituted the first case in which a taxpayer, as opposed to the government, prevailed on the willfulness issue, at least initially.[23] The pertinent aspects of the case are described below.

1. Relevant Facts

The taxpayer started in the pharmaceutical industry in the late 1960s and he frequently traveled abroad on

business early in his career. He opened an account in Switzerland at some point with the predecessor to UBS to facilitate payment of expenses during international trips. The balance started very small and grew over the years because of periodic deposits of after-tax funds *via* check and wire transfer from the United States, a "loan" the taxpayer received from UBS of $750,000, and passive income generated by the accounts. When UBS issued the "loan" to the taxpayer, it apparently opened a subaccount ("Large Account") under the existing account ("Small Account"), deposited the funds in the Large Account, and began investing them on behalf of the taxpayer. Much of the case centers on what the taxpayer knew, and when, about the Large Account.

The taxpayer started working in 1972 with an accountant ("First Accountant"). Apparently, First Accountant never specifically asked the taxpayer about foreign accounts, and the taxpayer never unilaterally raised the topic, until some point in the 1990s. At that time, First Accountant allegedly advised the taxpayer, incorrectly, that he would not need to report income from the UBS accounts until he repatriated the funds or died. First Accountant prepared Forms 1040 for the taxpayer from 1972 through 2006.

First Accountant passed away soon after preparing the 2006 Form 1040, so the taxpayer was forced to hire a new one ("Second Accountant"). The content of the discussions with, and the type of documents provided to, Second Accountant by the taxpayer are ambiguous. However, there is no dispute that he prepared a 2007 Form 1040 omitting $220,000 in passive income from foreign accounts, and a 2007 FBAR reporting only the Small Account.

UBS notified the taxpayer that he must close his accounts, presumably because of the criminal investigation by the U.S. government of UBS and its dealing with U.S. clients. Therefore, in November 2008, the taxpayer sent a letter to UBS instructing it to close the Large Account, which had a balance of about $2 million by that time, and transfer the funds to another Swiss bank, Hyposwiss. Soon thereafter, in December 2008, the taxpayer sent another letter to UBS, this time closing the Small Account and sending the money to one of his U.S. accounts.

At some point in 2009, the taxpayer began to question the earlier advice from First Accountant with respect to the UBS accounts. He then hired attorneys and a forensic accountant to help him rectify matters. In connection with his application to participate in the Offshore Voluntary Disclosure Program ("OVDP"), the taxpayer filed various items with the IRS, including an amended 2007 FBAR disclosing both the Small Account and Large Account. The IRS rejected the taxpayer's OVDP application because it had already received data about him directly from UBS.

The IRS initiated an audit, at the conclusion of which it asserted a "willful" FBAR penalty for 2007 of approximately $975,000. The taxpayer administratively disputed the penalty, but the Appeals Office would not waive or mitigate the sanction. Accordingly, the taxpayer made a partial payment of about $9,750 (representing merely one percent of the total FBAR penalty amount), and then he filed a Suit for Refund in District Court. The DOJ filed an Answer and Counterclaim, contending that the taxpayer was liable for the remaining amount of the penalty.

2. Analysis by the Courts

After holding a one-day bench trial and reviewing the corresponding briefs, the District Court rendered a taxpayer-favorable decision, the first of its kind. The District Court held that the taxpayer's actions "were at most negligent" and the omission of the Large Account from the original 2007 FBAR was an "unintentional oversight or a negligent act" because there "is no indication that he did so with the requisite voluntary or intentional state of mind."[24]

The DOJ, of course, was unhappy about the District Court's decision in *Bedrosian*, so it sought review by higher judicial powers. The Third Circuit Court of Appeals issued an Opinion in late 2018 addressing what it described as "two issues of first impression in our court," one of which centered on jurisdiction over FBAR penalty disputes.

The Court of Appeals explained that in most FBAR cases the IRS assesses the penalty, the taxpayer refuses to pay it, and the DOJ files a collection suit for the entire penalty amount in District Court within two years of the date of assessment. *Bedrosian* is different in that the IRS assessed the FBAR penalty, but the taxpayer did not wait for the DOJ to bring the fight to him. Rather, he paid merely one percent of the total FBAR penalty and then filed a Complaint in District Court seeking a refund of his partial payment. The DOJ filed an Answer and a Counterclaim for the balance of the FBAR penalty, but it did not question whether the District Court had jurisdiction over the matter in the first place.

Since the DOJ never raised the issue, the Court of Appeals unilaterally decided to do so, stating that it had

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an independent duty to ensure that jurisdiction exists, regardless of the positions, or lack of positions, by the parties to a case. To understand the reasoning of the Court of Appeals in *Bedrosian*, one must first understand two key provisions.

First, 28 USC §1346(a)(1) provides that Districts Courts and the Court of Federal Claims have jurisdiction over any civil action against the U.S. government for "any internal revenue tax" that was erroneously or illegally assessed or collected, any penalty that was collected without authorization, or any sum that was excessive or wrongfully collected under the "internal revenue laws." As explained further below, if a case falls under 28 USC §1346(a)(1), then the taxpayer generally must pay the *entire amount* at issue, before filing the Complaint, in order to create jurisdiction for District Courts or the Court of Federal Claims. This requirement, called the *Flora* Full Payment Rule, derives from a famous, longstanding Supreme Court decision.[25]

As this article demonstrates, in order to have a chance at prevailing against the IRS and DOJ in a multi-step FBAR battle, one needs to grasp the tricky procedural issues.

Second, 28 USC §1346(a)(2) grants jurisdiction over any other civil action against the U.S. government, of $10,000 or less, founded on a variety of things, including any law enacted by Congress or any regulation. The *Flora* Full Payment Rule does *not* apply here and would have little impact even it did, given the ceiling of $10,000.

The Court of Appeals explained that the taxpayer in *Bedrosian* argued that the refund suit qualified for jurisdiction under 28 USC §1346(a)(2) because it concerned a claim against the U.S. government (*i.e.*, the IRS), of $10,000 or less (*i.e.*, $9,750), founded on the laws passed by Congress (*i.e.*, the FBAR filing duty).[26] The taxpayer further contended that 28 USC §1346(a)(1) was inapplicable because FBAR penalties, derived from Title 31 instead of Title 26 (*i.e.*, the Internal Revenue Code), do not involve an "internal revenue tax."[27] The Court of Appeals was nonplussed, holding as follows:

> We are skeptical of this argument's elevation of form over substance, and, for the reasons stated in the margin, we are inclined to believe that [the taxpayer's] initial [refund] claim did *not* qualify for District Court jurisdiction at all.[28]

Then, in a footnote, the Court of Appeals expands on its thoughts about whether the IRS assesses FBAR penalties constitute an "internal revenue tax" or an amount collected under the "internal revenue laws."[29] According to the Court of Appeals, the contention that FBAR penalty cases cannot be brought under 28 USC §1346(a)(1) is flawed for several reasons. First, the relevant legislative history suggests that "internal revenue laws" are defined by their function, not by the Title of the U.S. Code in which they are located. Second, it ignores a Tax Court decision regarding compensable items for whistleblowers wherein it acknowledged that tax laws might be found beyond Title 26. Third, taxpayer actions to recover certain "assessable" penalties for late or incorrect international information returns are brought under the 28 USC §1346(a)(1). Fourth, entertaining FBAR penalty refund claims under 28 USC §1346(a)(2) permits taxpayers to seek a judicial ruling without first paying the entire penalty, which violates the *Flora* Full Payment Rule, a "first principle of tax litigation in federal district court."

The Court of Appeals explained, in the same lengthy footnote, that it was "inclined to believe" that the Complaint filed with the District Court in *Bedrosian* fell within 28 USC §1346(a)(1), such that the taxpayer should have been obligated to pay the full FBAR penalty as a precondition to litigation. However, in a display of resignation, the Court of Appeals stated that "given the procedural posture of this case, we leave a definitive holding on this issue for another day" and we "reserve the question of whether [jurisdiction] is established in the District Court when a taxpayer files suit to challenge a FBAR penalty before fully paying it."[30]

D. *Mendu*—Full Payment Rule Does Not Apply to FBAR Penalty Refund Cases

The most recent contender in the FBAR penalty jurisdictional ring is *Mendu*, decided in April 2021.[31]

The taxpayer in this case co-founded an investment company in Mauritius. It held two accounts, also located in Mauritius. As co-founder, the taxpayer had signature

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authority over these two accounts. He also held a personal account in India, into which he deposited rental income from a house located there. The taxpayer did not file an FBAR for 2009, such that none of three accounts was disclosed to the IRS.

The IRS audited the taxpayer, ultimately concluding that he willfully violated his FBAR duty and assessing the highest possible penalty. The taxpayer disputed matters with the Appeals Office, which held that a willful penalty was warranted under the circumstances. In light of this rejection, the taxpayer paid just $1,000 to the IRS and then filed a Complaint with the Court of Federal Claims ("CFC") seeking a refund. The DOJ, of course, submitted an Answer and a Counterclaim, demanding the remaining $752,000 of the FBAR penalty.

After some strange procedural matters, the CFC was ready to rule on a series of Motions filed by the parties. It summarized the key jurisdictional issue as follows:

> At issue in the present case is whether FBAR penalties are internal-revenue taxes. If FBAR penalties are internal-revenue taxes, then the *Flora* full payment rule applies, and [the CFC] lacks jurisdiction since [the taxpayer] has not paid the full FBAR penalty assessed against him. Conversely, if FBAR penalties are not internal-revenue taxes, then the *Flora* full payment rule does not apply, and [the CFC] has jurisdiction over [the taxpayer's] $1,000 illegal exaction claim.

Citing the famous Supreme Court case *Flora*, the CFC confirmed that it is well established that, before a tax refund suit can be brought, the relevant taxpayer must first pay the tax in full. It further explained that both the taxpayer and the DOJ agree in *Mendu* that the *Flora* Full Payment Rule only applies if a case involves an "internal revenue tax," as defined in 28 USC §1346(a)(1). The CFC went on to hold that an FBAR penalty is not an "internal revenue tax" for two main reasons.

The CFC first explained that the structure of the Bank Secrecy Act, from which the FBAR penalty derives, indicates that it does not constitute an "internal revenue tax." The CFC underscored that the FBAR penalty is authorized by Title 31 of the U.S. Code, not Title 26, which is the Internal Revenue Code. This, according to the CFC, "is not a mere technicality" and "Congress's placement of FBAR penalties outside Title 26 distinguishes FBAR penalties from internal revenue laws." The CFC further explained that FBAR penalties are not subject to various provisions of Title 26 that equate certain "penalties" with "taxes," particularly in the context of assessment and collection procedures. The CFC found additional comfort in its position given that, at oral argument, both parties conceded that they could not find any penalty outside of those in Title 26 that have been subjected to the *Flora* Full Payment Rule.

Next, the CFC disagreed with reliance on commentary by the Third Circuit Court of Appeals in *Bedrosian*. The CFC began by noting that the discussion in *Bedrosian* about jurisdictional issues was found in a footnote, constituted mere *dictum*, and was not persuasive anyway. It pointed out, additionally, that the Third Circuit expressly stated that it was not rendering a "definitive holding" on the issue. The CFC then criticized various assumptions on which the footnote was based, emphasizing that two of the cases cited by the Third Circuit actually favor classifying FBAR penalties as non-tax items, and that FBAR penalties are "not textually or functionally similar to" international information return penalties assessed under Code Sec. 6038.

The CFC summarized its holding as follows:

> It may be accurate that every internal-revenue law is not necessarily contained in Title 26. However, Congress's specific placement of the FBAR in Title 31, the stated purpose of [the Bank Secrecy Act in Title 31], and the fact that Congress chose not to employ traditional tax collection procedures to recover FBAR penalties collectively demonstrate that Congress did not intend to subject FBAR penalty suits to the *Flora* full payment rule.

VI. Conclusion

To engage successfully in an FBAR dispute, one must have a deep understanding of the substantive law in this area.[32] Comprehending the substance is not enough, however. As this article demonstrates, in order to have a chance at prevailing against the IRS and DOJ in a multi-step FBAR battle, one needs to grasp the tricky procedural issues. Indeed, a taxpayer cannot realistically expect to win if he lacks sufficient knowledge about how, when, and where to defend himself.

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ENDNOTES

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[1] Currency and Foreign Transactions Reporting Act, P.L. 91-508, Title I and Title II (Oct. 26, 1970).

[2] Currency and Foreign Transactions Reporting Act, P.L. 91-508, Title I and Title II (Oct. 26, 1970) at §202.

[3] U.S. Treasury Department. A Report to Congress in Accordance with §361(b) of the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (Apr. 26, 2002) at 9–10.

[4] 68 FR 26489 (May 16, 2003).

[5] 31 CFR §103.56(g), 68 FR 26489 (May 16, 2003).

[6] 31 USC §5321(a)(5)(A).

[7] 31 USC §5321(a)(5)(B)(i). The IRS cannot assert this penalty if the FBAR violation was not only "non-willful," but also due to "reasonable cause." *See* 31 USC §5321(a)(5)(B)(ii).

[8] 31 USC §5321(a)(5)(C)(i).

[9] 31 USC §5314; 31 CFR §1010.350(a).

[10] In addition to these duties, taxpayers holding foreign financial accounts generally must report them on Form 8938 (*Statement of Specified Foreign Financial Assets*). For a detailed analysis of the Form 8938 filing requirement, *see* Hale E. Sheppard, *The New Duty to Report Foreign Financial Assets on Form 8938: Demystifying the Complex Rules and Severe Consequences of Noncompliance*, Int'l Tax J., 2012, at 11; Hale E. Sheppard, *Form 8938 and Foreign Financial Assets: A Comprehensive Analysis of the Reporting Rules after IRS Issues Final Regulations*, Int'l Tax J., 2015, at 25; Hale E. Sheppard, *Specified Domestic Entities Must Now File Form 8938: Section 6038D, New Regulations in 2016, and Expanded Foreign Financial Asset Reporting*, Int'l Tax J., 2016, at 5; Hale E. Sheppard, *Canadian Retirement Plans: What Does Revenue Procedure 2014-55 Mean for U.S. Tax Deferral, Form 8891, Form 8938, and the FBAR?*, Int'l Tax J., 2016, at 25; and Hale E. Sheppard, *Unlimited Assessment-Period for Form 8938 Violations: Ruling Shows IRS's Intent to Attack Multiple Tax Returns*, Taxes, 2017, at 31.

[11] 31 USC §5314, 31 USC §5321(a)(5)(A), and 31 USC §5321(b)(2).

[12] These questions, raised years ago, remained for many years. *See* Hale E. Sheppard, *New Penalties for Undisclosed Foreign Accounts: Putting the Cart before the Horse?*, J. Tax Practice Procedure, 2006, at 47.

[13] *J.B. Williams*, 131 TC 54, Dec. 57,547 (2008).

[14] Code Sec. 6320(a).

[15] Code Sec. 6330(a).

[16] Conference Report 105-599, 105th Cong., 2d Sess., June 24, 1998, at 263; Code Sec. 6330(c)(3)(C).

[17] Code Sec. 6330(d); U.S. Tax Court Rule 331(b). This petition is called a "Petition for Lien or Levy Action Under Section 6320(c) or 6330(d)."

[18] Code Secs. 6301, 6230, 6231, 6330, 6331, and 6665.

[19] *Simonelli*, 2008 WL 4479265 (D. Conn. Sept. 30, 2008), 102 AFTR 2d 2008-6577.

[20] The DOJ filed suit under 31 USC §5321(b)(2)(A), which authorizes the U.S. government to commence a civil collection action within two years of the IRS assessing the FBAR penalty.

[21] The taxpayer also argued that the negotiated FBAR penalty to which he agreed incorporated his tax liabilities. The District Court dispensed with this argument without analysis because the taxpayer provided "no authority or evidence in support of this assertion."

[22] The District Court referred to 31 USC §5321(a)(5), 31 CFR §103.56, and 31 CFR §103.57.

[23] *Bedrosian*, DC-PA, 120 AFTR 2d 2017-5671: *Bedrosian*, CA-3, 122 AFTR 2d 2018-7052, 912 F3d 144; *Bedrosian*, DC-PA, 126 AFTR 2d 2020-7067.

[24] *Bedrosian*, DC-PA, 120 AFTR 2d 2017-5671.

[25] *Flora*, SCt, 60-1 ustc ¶9347, 362 US 145, 164, 80 SCt 630.

[26] *Bedrosian*, CA-3, 122 AFTR 2d 2018-7052, 912 F3d 144 (referencing 28 USC §1346(a)(2)).

[27] *Bedrosian*, CA-3, 122 AFTR 2d 2018-7052, 912 F3d 144 (referencing 28 USC §1346(a)(1)).

[28] *Bedrosian*, CA-3, 122 AFTR 2d 2018-7052, 912 F3d 144 (emphasis added).

[29] *Bedrosian*, CA-3, 122 AFTR 2d 2018-7052, 912 F3d 144, footnote 1.

[30] *Bedrosian*, CA-3, 122 AFTR 2d 2018-7052, 912 F3d 144, footnote 1.

[31] *Mendu*, 127 AFTR 2d 2021-XXXX (Apr. 7, 2021); *see also* Andrew Velarde, *Flora Full Payment Rule Inapplicable in FBAR Case*, 2021 Tax Notes Federal 68–69 (Apr. 9, 2021).

[32] This is why the author has been following all FBAR developments assiduously for nearly two decades. *See, e.g.*, Hale E. Sheppard, *Taxpayers Die but Their International Penalties Live On: Recent Cases Addressing Broad Scope of Post-Death Assessment and Collection*, 31 J. Int'l Taxation 36 (2020); Hale E. Sheppard, *Second Court Rejects "Constructive Knowledge" Theory for Willful FBAR Penalties*, Int'l Tax J., 2020, at 29; Hale E. Sheppard, *More FBAR Penalty Losses and Lessons: The Significance of Rum and Ott*, Int'l Tax J., 2019, at 17; Hale E. Sheppard, *Flume, Boyd and Cohen: Three Recent FBAR Cases Yielding Important Lessons*, Int'l Tax J., 2019, at 31; Hale E. Sheppard, *United States v. Horowitz: Sixth Case Analyzing Constructive Knowledge as Determinant of FBAR Penalties*, Int'l Tax J., 2019, at 23; Hale E. Sheppard, *Constructive Knowledge and FBAR Penalties: Does Merely Filing a Form 1040 Suffice to Establish 'Willfulness?*, Taxes, 2019, at 41; Hale E. Sheppard, *Court Bucks the Trend in Willful FBAR Penalty Cases: Merely Signing Tax Returns Does Not Establish Willfulness*, Taxes, 2019, at 23; Hale E. Sheppard, *What Constitutes a "Willful" FBAR Violation? Comprehensive Guidance Based on Eight Important Cases*, 129 J. Taxation 24 (2018); Hale E. Sheppard, *Court Holds that Pervasive Ignorance Is No Defense to Willful FBAR Penalties: This and Other Lessons from United States v. Garrity*, Int'l Tax J., 2018, at 51; Hale E. Sheppard, *Willful FBAR Penalty Case Shows Importance of Protecting Privileged Communications: What Kelley-Hunter Adds to the Foreign Account Defense Discussion*, Int'l Tax J., 2018, at 15; Hale E. Sheppard, *Analysis of the Reasonable Cause Defense in Non-Willful FBAR Penalty Case: Teachings from Jarnagin*, 128 J. Taxation 6 (2018); Hale E. Sheppard, *First Taxpayer Victory in a Willful FBAR Penalty Case: Analyzing the Significance of Bedrosian for Future Foreign Account Disputes (Part 1)*, 128 J. Taxation 12 (2018); Hale E. Sheppard, *First Taxpayer Victory in a Willful FBAR Penalty Case: Analyzing the Significance of Bedrosian for Future Foreign Account Disputes (Part 2)*, 128 J. Taxation 14 (2018); Hale E. Sheppard, *Can Recent "Willful" FBAR Penalty Cases against Taxpayers Help Tax Firms Fend Off Malpractice Actions?*, Int'l Tax J., 2017, at 33; Hale E. Sheppard, *Government Wins Fourth Straight FBAR Penalty Case: Analyzing Bohanec and the Evolution of "Willfulness,"* 126 J. Taxation 110 (2017); Hale E. Sheppard, *Government Wins Second Willful FBAR Penalty Case: Analyzing What McBride Really Means to Taxpayers*, 118 J. Taxation 187 (2013); Hale E. Sheppard, *Third Time's the Charm: Government Finally Collects "Willful" FBAR Penalty in Williams Case*, 117 J. Taxation 319 (2012); Hale E. Sheppard, *District Court Rules That Where There's (No) Will, There's a Way to Avoid FBAR Penalties*, 113 J. Taxation 293 (2010); Hale E. Sheppard, *Two More Blows to Foreign Account Holders: Tax Court Lacks FBAR Jurisdiction and Bankruptcy Offers No Relief from FBAR Penalties*, J. Tax Practice Procedure, 2009, at 27; Hale E. Sheppard, *New Penalties for Undisclosed Foreign Accounts: Putting the Cart before the Horse?*, J. Tax Practice Procedure, 2006, at 29; Hale E. Sheppard, *Evolution of the FBAR: Where We Were, Where We Are, and Why It Matters*, 7 University of Houston Business & Tax Law J. 1 (2006).

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