

More FBAR Penalty Losses and Lessons: The Significance of *Rum* and *Ott*

By Hale E. Sheppard*

I. Introduction

People generally despise paying taxes. They take various steps to avoid this hated duty, including hiding funds in a foreign financial account. A decade ago, depending on their methodology, taxpayers had a fighting chance of avoiding detection by the Internal Revenue Service (“IRS”). They did not file Forms TD F 90-22.1 or FinCEN Forms 114 (“FBARs”) to alert the IRS, and they simply watched as their money grew abroad on a tax-free basis, with relatively little concern that their day of reckoning would someday come. Now, though, things have changed. The IRS has a long list of tools for finding unreported foreign accounts, and the Department of Justice (“DOJ”) is more than happy to assist by initiating lawsuits to collect unpaid FBAR penalties. While focused on similar issues, each FBAR case is unique, teaching valuable lessons about the evolving definition of “willfulness,” key procedural issues, *etc.* This article centers on the two most recent cases, *Rum* and *Ott*, and what they add to the dialogue on FBAR penalty defense.¹

II. Duties Related to Foreign Accounts

The relevant law mandates the filing of an FBAR in situations where (i) a U.S. person, including U.S. citizens, U.S. residents, and domestic entities, (ii) had a direct financial interest in, had an indirect financial interest in, had signature authority over, or had some other type of authority over (iii) one or more financial accounts (iv) located in a foreign country (v) whose aggregate value exceeded \$10,000 (vi) at any point during the relevant year.²

U.S. individuals have several duties when they hold a reportable interest in a foreign financial account, in addition to electronically filing an FBAR. These include the following:

- They must check the “yes” box in Part III (Foreign Accounts and Trusts) of Schedule B (Interest and Ordinary Dividends) to Form 1040 (*U.S.*



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Individual Income Tax Return) in order to disclose the existence of the account and provide other relevant information. The Schedule B for 2017 presented the following question: “At any time during 2017, did you have a financial interest in or a signature authority over a financial account (such as a bank account, securities account, or brokerage account) located in a foreign country?”

- They must declare on Form 1040 all income generated by the account, such as interest, dividends, and capital gains.
 - Depending on the balance, they must report the account on Form 8938 (*Statement of Specified Foreign Financial Assets*), which is enclosed with Form 1040.³
- In addition to the preceding duties, taxpayers must sign and date their Forms 1040 in order for them to be valid. Unless they pay very close attention to the small print, most taxpayers will be unaware that they are making the following broad, sworn statement to the IRS, which often comes back to haunt them:

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

III. Penalties for FBAR Violations

Congress enacted new FBAR penalty provisions in 2004.⁴ Since that time, the IRS has been able to penalize any U.S. person who fails to file an FBAR when required.⁵ In the case of non-willful violations, the maximum penalty is \$10,000, but the IRS will waive such penalty if the violation was due to “reasonable cause.”⁶

Higher penalties apply 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 percent of the balance in the account at the time of the violation, whichever amount is larger.⁷ Given the large balances in some unreported accounts, FBAR penalties can be enormous.

IV. Lessons Learned from Recent Cases

Several courts have examined what constitutes “willfulness” in the context of FBAR penalties.⁸ Notable

decisions include *Williams* in 2012,⁹ *McBride* in 2012,¹⁰ *Bussell* in 2015,¹¹ *Bohanec* in 2016,¹² *Bedrosian* in 2017,¹³ *Kelley-Hunter* in 2017,¹⁴ *Garrity* in 2018,¹⁵ *Markus* in 2018,¹⁶ *Cohen* in 2018,¹⁷ *Horowitz* in 2019,¹⁸ *Flume* in 2019,¹⁹ and *Boyd* in 2019.²⁰ Among the many lessons taught by these previous cases are the following:

- The Tax Court lacks jurisdiction over FBAR penalty matters, in both pre-assessment and post-assessment (*i.e.*, collection) cases, so FBAR litigation takes place in District Court or the Court of Federal Claims.
- The government is only required to prove willfulness by a preponderance of the evidence, not by clear and convincing evidence.
- The government can establish willfulness by showing that a taxpayer either knowingly or recklessly violated the FBAR duty.
- Recklessness might exist where a taxpayer fails to inform his accountant about foreign accounts.
- Recklessness might also exist where a taxpayer is “willfully blind” of his FBAR duties, which can occur when the taxpayer executes but does not read and understand every aspect of a Form 1040, including all Schedules attached to the Form 1040 (like Schedule B containing the foreign-account question) and any separate forms referenced in the Schedules (like the FBAR).
- Not reading the entire Form 1040 before signing it might also constitute “extreme recklessness” by taxpayers, primarily because the foreign-account question on Schedule B is “simple and straightforward and requires no financial or legal training.”
- It is “reckless” for taxpayers not to research the educational and professional credentials of the tax professionals on whom they are relying to prepare their U.S. returns.
- The IRS may impose FBAR penalties on a per-unreported-account-per-year basis, and it is not limited to just one penalty per FBAR.
- If the taxpayer makes a damaging admission during a criminal trial, the government will use such statement against him in a later civil FBAR penalty action.
- The taxpayer’s motives for not filing an FBAR are irrelevant, because nefarious, specific intent is not necessary to trigger willfulness.
- The government can prove willfulness through circumstantial evidence and inference, including actions by the taxpayer to conceal sources of income or other financial data.
- In determining whether an FBAR violation was willful, courts might consider after-the-fact

unprivileged communications between taxpayers and their tax advisors.

- The courts review the question of willfulness on a *de novo* basis, meaning that taxpayers generally cannot offer evidence at trial related to the IRS's administrative process in conducting the audit, determining whether willfulness existed, *etc.*
- Courts might reject as irrelevant, in an evidentiary sense, reports and testimony from experts who attempt to link general public unawareness of FBAR duties to ignorance of the specific taxpayer under attack.
- In assessing FBAR penalties, the IRS can disregard its published guidance in the Internal Revenue Manual ("IRM"), such as the instructions about equitably allocating penalties related to foreign accounts with two or more co-owners.

V. Contributions by Two New FBAR Cases

The IRS continues to gather information about U.S. persons with unreported foreign accounts from many sources. These include, but are certainly not limited to, cross-referencing of Form 8938 and FBAR data, Foreign Account Tax Compliance Act reporting by foreign financial institutions, data compilation from millions of voluntary disclosures made over the past decade, deferred-prosecution agreements with foreign banks, requests under tax treaties and information exchange agreements, whistleblowers, the Panama Papers, and more. As information flows to the IRS, FBAR actions continue to grow. Below is an analysis of the two most recent cases.

A. Rum

1. Overview of the Facts

Rum, like most FBAR cases, has interesting aspects, if one is willing to dig for them.²¹ Mr. Rum is a U.S. citizen who operated several businesses, including a deli, pet supply store, and convenience store. In 1998, he opened an account with UBS in Switzerland, sending \$1.1 million from a domestic account. He opened a numbered account with UBS, such that his name did not appear, and he instructed UBS to hold the mail related to the account. Mr. Rum actively communicated with UBS regarding investment strategies. He filed annual Forms 1040 with the IRS, but he omitted the passive income from the UBS account, he checked "no" in response to

the foreign-account question on Schedule B, and he did not file any FBARs.

On October 6, 2009, UBS sent Mr. Rum a letter indicating that it planned to disclose his data to the IRS. Shortly thereafter, on October 15, 2009, Mr. Rum filed his first FBAR ever, for 2008. Then, on October 26, 2008, Rum closed the UBS account and transferred the funds to another foreign institution, Arab Bank, also located in Switzerland.

The IRS, after receiving the information from UBS, started an audit of Mr. Rum. Apparently, the first Revenue Agent assigned to the case did not even raise the FBAR issues; the audit focused on the unreported income related to the UBS account. The first Revenue Agent proposed an income tax liability and civil fraud penalties. Upon review, a second Revenue Agent identified the FBAR oversight and proposed a non-willful penalty. This was approved by her Manager. The case was then elevated for review by an IRS attorney, who wrote a memo indicating that (i) the failure by the first Revenue Agent to address the FBAR issue would not be relevant to a later collection lawsuit by the DOJ, and (ii) the second Revenue Agent and her Manager should reconsider whether a non-willful penalty sufficed given the facts in the case.

The second Revenue Agent and her Manager heeded the advice from the IRS attorney, further analyzed the situation, and asserted a willful penalty equal to 50 percent of the balance of the UBS account. They also determined that Mr. Rum was not eligible for potential penalty reduction under the IRS's "mitigation guidelines" for two reasons. First, the balance in the account exceeded the \$1 million threshold.²² Second, Mr. Rum did not meet all four of the eligibility criteria, because the IRS asserted civil fraud in the income tax audit. In order to reap the benefits of the "mitigation guidelines," all the following must be satisfied: (i) The taxpayer has no history of criminal tax or Bank Secrecy Act convictions for the preceding 10 years and no history of FBAR penalty assessments; (ii) No money passing through any of the unreported foreign accounts was from an illegal source or used to further a criminal purpose; (iii) The taxpayer cooperated during the examination, which means that the IRS was not obligated to issue a Summons, the taxpayer responded to reasonable requests for documents, meetings, and interviews, and the taxpayer filed all necessary returns and FBARs; and (iv) The IRS "did not determine a civil fraud penalty" or "did not sustain a civil fraud penalty" against the taxpayer for an income tax underpayment for the year in question due to the failure to report income related to any amount in a foreign account.²³

The second Revenue Agent prepared a Summary Memo explaining why the penalty had been changed from non-willful to willful, in which she specifically noted that the penalty “mitigation guidelines” were inapplicable because of the civil fraud penalties asserted during the income tax audit. The FBAR Examination Lead Sheets authored by the second Revenue Agent contain similar information.

The second Revenue Agent, in a display of clemency, helped Mr. Rum in two different ways. She first offered to reduce the FBAR penalty from 50 percent of the account balance to 20 percent, if he would concede the civil fraud penalty. Moreover, she only assessed the FBAR penalty for one year, 2007, when she could have sanctioned him for every year whose assessment-period had not expired.²⁴

Mr. Rum rejected the second Revenue Agent’s offer. Consequently, in June 2013, the IRS sent a letter indicating that it was assessing a willful FBAR penalty. Mr. Rum, defiant, filed a Protest Letter disputing willfulness. The Appeals Officer sustained not only the willful FBAR penalty, but also the civil fraud penalties from the related income tax audit.

The IRS later filed a Notice of Deficiency concerning the income tax issues, and Mr. Rum filed a Petition with the Tax Court. Mr. Rum ultimately settled the Tax Court case, without a trial, by submitting a Decision Document. It stated that Mr. Rum was not required to pay any civil fraud penalties for the relevant years, including 2007.²⁵

The next day, the DOJ filed the collection suit against Mr. Rum in District Court to recoup the willful FBAR penalty for 2007.

2. Analysis by the Court

The District Court addressed several issues, two of which are addressed below.

a. Was the FBAR Violation Willful? Usually, FBAR cases contain facts that go both ways, with some favoring the IRS, and others supporting the taxpayer’s version of events. This was not so in *Rum*, where nearly all items identified by the District Court supported the IRS’s position that the violations were willful. The District Court reviewed the definition of willfulness in the FBAR context, citing to *Williams*, *Bedrosian*, *Bohanec*, and *McBride*. It then determined that there was no genuine dispute as to willfulness based on the following facts: (i) Mr. Rum opened a numbered account with UBS; (ii) He instructed UBS to hold all mail; (iii) He gave contradictory answers about the rationale for opening the

account in Switzerland; (iv) He actively communicated with UBS regarding investment decisions; (v) He did not report income from the UBS account on his Forms 1040; (vi) He checked the “no” box in response to the foreign account question on Schedule B; (vii) He signed his annual Forms 1040 under penalties of perjury declaring that they were true, accurate, and complete; (viii) He did not file any FBARs until 2009, and only after UBS informed him that it was revealing his account to the IRS; (ix) He transferred the funds from UBS to Arab Bank, instead of repatriating them; (x) He never mentioned the account at Arab Bank during the audit; (xi) He did not inform his accountant about the UBS account; (xii) He did not participate in a voluntary disclosure program; (xiii) He omitted his UBS account on his federal student aid application, to appear as if he had fewer assets and income, yet he disclosed the UBS account on his mortgage application, to demonstrate that he had more assets and income; and (xiv) He claimed that he believed that income from the UBS account would not be taxable until he repatriated it, but, inconsistent with that theory, he did not report any income on his 2009 Form 1040, when he brought the money back.

As indicated above, one of many reasons that the District Court upheld the willfulness penalty was the inconsistent information provided by Mr. Rum throughout the dispute process. The District Court offered three examples. With respect to why he sent the money from the United States to Switzerland in the first place, Mr. Rum said that he wanted to put his funds out of reach of judgment creditors. However, he initially said the lawsuit was related to a car accident, but later claimed that the lawsuit stemmed from a slip-and-fall incident in one of his businesses. Regarding why Mr. Rum did not repatriate the money after the supposed threat of judgment creditors had passed, he said that he feared a significant penalty by UBS for closing the account, and then changed his story to he was satisfied with the rate of return. Lastly, concerning who prepared the annual Forms 1040, which stated “self-prepared” on their face, Mr. Rum identified two different accountants.

The District Court made a few specific determinations of interest regarding willfulness. First, citing to another list of previous cases, including *Kimble*, *Williams*, *Norman*, and *Jarnagin*, the District Court held that a taxpayer’s signing of his Form 1040 without reviewing it “in and of itself supports a finding of ‘reckless disregard’ to report under the FBAR.”²⁶ Second, the District Court explained that, by signing Form 1040, taxpayers are placed on “inquiry notice” of the FBAR obligation and thus have “constructive knowledge” thereof. Third,

the District Court indicated that, even if Mr. Rum had genuinely believed that the passive income accumulating in the UBS account were not taxable by the IRS until repatriation, this would not affect the FBAR issue: “[I]t was irrelevant whether Rum actually believed that his income was not taxable—the question [in Schedule B] simply asked if such account existed.”²⁷ Finally, the District Court described Mr. Rum’s behavior as a “pattern” of non-compliance, because he filed annual Forms 1040, which he self-prepared, and invariably declared “no” to the foreign account question on Schedule B.

b. Did the IRS Exceed Its Authority? Mr. Rum argued that the IRS had violated the Administrative Procedures Act (“APA”) because its assessment of the willful FBAR penalty was “arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with the law.”²⁸ The District Court refined the issue, asking whether the IRS, whose actions are entitled to significant deference, can show a rational basis between the facts in the case and its penalty decision.²⁹

The District Court identified a number of reasons why the IRS’s imposition of a willful penalty did not violate the APA. First, in describing the FBAR penalty “mitigation guidelines,” the Internal Revenue Manual expressly states that, if the balance of the unreported account exceeds \$1 million, then the willful penalty applies, period. The amount in Mr. Rum’s account surpassed that figure.

Second, the Internal Revenue Manual states that mitigation is inapplicable if, among other things, the IRS “determined” or “sustained” a civil fraud penalty. After referencing all the willfulness factors previously identified, the District Court concluded that there were “numerous badges of fraud,” which show that the IRS had adequate grounds for assessing the highest FBAR penalty.³⁰

Third, Mr. Rum argued that he was eligible for the FBAR “mitigation guidelines” because, at the time that the IRS reviewed the issue, the civil fraud penalty had been merely “proposed,” but not “determined” or “sustained,” as required by the Internal Revenue Manual. The District Court rejected this position for several reasons. The second Revenue Agent “determined” the penalty, and the Appeals Officer later “sustained” it. The language in the Internal Revenue Manual refers to the IRS, not the Tax Court, doing something. The District Court explained that “[a]nything that occurred subsequently is irrelevant within the IRS context, such as the Tax Court Order—indeed, if anything beyond the IRS examination and appeals process would prove pertinent, it would render the very mitigation guidelines moot as

the IRS would be unable to consider them when deciding a penalty.”³¹

Fourth, Mr. Rum claimed the bargaining by the second Revenue Agent and her offer to make a deal (*i.e.*, reducing the FBAR penalty from 50 percent to 20 percent of the account balance in exchange for a concession of the civil fraud penalty related to the income issues) shows “bad faith” and “improper conduct” by the IRS. In support of this argument, Mr. Rum cited a segment of the Internal Revenue Manual, which states that penalties should be imposed in a fair and consistent manner, and should not be used as a bargaining chip. The District Court, unmoved, concluded that, even if bargaining did occur, it would only be relevant to a bad faith contention if the penalty had been imposed based on such bargaining. This was not the case with Mr. Rum, who declined the offer. Moreover, said the District Court, the record shows that second Revenue Agent actually tried to help Rum throughout the entire process, rather than punish him.

Fifth, Mr. Rum claimed that changing the penalty from non-willful (as approved by the second Revenue Agent and her Manager) to willful (after seeking guidance from the IRS Attorney) illustrates “bad faith” by the IRS. The District Court rejected this contention because (i) the second Revenue Agent and her Manager only proposed non-willful penalties initially because they thought, incorrectly, that they were not permitted to assert willful penalties when the first Revenue Agent, who conducted the income tax audit, did not even raise FBAR issues, (ii) the second Revenue Agent and her Manager reconsidered the matter after getting approval from the IRS Attorney, (iii) the second Revenue Agent prepared a Summary Memo containing the facts and law supporting a willful penalty, (iv) Mr. Rum pointed to no rule or IRS policy prohibiting reconsideration of a penalty before assessment, and (v) the second Revenue Agent only assessed an FBAR penalty for one year, when she could have done so for all open years.

3. Similar Position and Similar Ruling in Previous Case

As indicated above, Mr. Rum claimed in *Rum* that the IRS had acted in “bad faith” and thus breached the APA by changing the penalty from non-willful to willful during the audit process. The District Court rejected such argument.

A variation of this argument has been raised by taxpayers, unsuccessfully, in other FBAR cases. For example, in *Bedrosian*, the taxpayer opened an account in Switzerland at some point in the 1970s with the predecessor to UBS

in order to facilitate payment of expenses during international business trips.³² The balance started small and grew over the years as a result of periodic deposits of after-tax funds from the United States, a supposed loan that the taxpayer received from UBS of approximately \$750,000, and passive income generated by the accounts.

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

The taxpayer was notified by UBS at some point in 2008 that he must close his accounts, presumably as a result of the criminal investigation by the U.S. government of UBS and its dealing with U.S. clients. Therefore, in November 2008, the taxpayer closed the Large Account and transferred the funds to another Swiss bank, Hyposwiss.

The taxpayer applied to resolve issues with the IRS through the Offshore Voluntary Disclosure Program (“OVDP”). The IRS rejected the taxpayer’s application for the OVDP because it had already received data directly from UBS about the unreported accounts.

The IRS later initiated an audit, starting with 2007. The first Revenue Agent determined that the FBAR violations were non-willful and presented this finding to the appropriate “panel” within the IRS. The first Revenue Agent later exited the scene for unexpected medical leave, during which time the case was reassigned. The second Revenue Agent disagreed with the earlier conclusion about the character of the FBAR violation for 2007 and asserted a “willful” penalty. The second Revenue Agent sought the highest sanction, equal to 50 percent of the highest balance of the Large Account.

The taxpayer administratively disputed the penalty, he lost, he made a partial payment, and then he filed a Suit for Refund in District Court.

The taxpayer attempted to present evidence and testimony to the District Court concerning the procedures, actions, analyses, and viewpoints of the Revenue Agents and other IRS personnel regarding willfulness. The DOJ opposed this by filing a Motion in Limine.³³

The DOJ relied on two principal arguments in the Motion in Limine. First, it maintained that the proposed evidence and testimony would be irrelevant because the issue of whether the taxpayer willfully failed to file a timely and accurate 2007 FBAR is determined by the District Court *de novo*, which means that the decision is based solely on the merits of the case presented to the District Court, and not on any record developed at the

administrative level. More specifically, the DOJ maintained that “what occurred at the administrative level is irrelevant because the enforcement action is not a review of an existing administrative record.”³⁴

The DOJ expanded on its position, claiming that the principles that guide judicial review of tax assessments are instructive, even though the FBAR penalty, which is assessed under Title 31 of the U.S. Code instead of under Title 26 (*i.e.*, the Internal Revenue Code), is not a tax penalty. The DOJ went on to analyze the holdings in various tax refund cases and to highlight that the same conclusion about the irrelevance of the administrative record has been reached by courts addressing trust fund recovery penalty issues, where one key matter is whether the taxpayer acted “willfully.”³⁵ The DOJ summarized its position as follows:

This trial, however, is not about what the [IRS] believed or did not believe years after Bedrosian failed to comply with the FBAR requirements, the facts considered and not considered, nor alleged flaws in its analysis. Nor is this trial about whether the [IRS] could have reached a different conclusion. Even evidence that [IRS] employees disagreed about the facts and analysis prior to the final administrative determination is not probative of whether Bedrosian’s noncompliance was willful. It is for this [District] Court to determine based on the evidence before it at trial if Bedrosian willfully kept [the Large Account] secret, not to review an administrative record. Consistent with tax cases and other civil actions in which courts conduct a *de novo* review, the Court should exclude as irrelevant evidence of the [IRS’s] factual and legal analysis regarding Bedrosian’s intent in failing to comply with the FBAR requirements.³⁶

The second main argument utilized by the DOJ in its Motion in Limine was that, even if evidence of the IRS’s administrative record regarding the 2007 FBAR penalty and willfulness were relevant, it should still be excluded from trial because it would cause undue delay, a waste of time and resources, and the needless presentation of cumulative evidence. The DOJ urged the District Court to consider that the taxpayer was simply attempting to convert a one-day bench trial into a multi-day affair focused not on the key legal issues (*i.e.*, the taxpayer’s actions and intent), but rather on the IRS’s administrative procedures, actions, analyses, and conclusions.³⁷

The District Court quickly and completely sided with the DOJ on this issue. In doing so, the District Court

explained that the cases cited by the taxpayer were inapplicable, while those identified by the DOJ, particularly with respect to the preclusion of the administrative record in tax refund cases, were precedential and supportive of the DOJ's arguments. The District Court offered the following reasoning for deciding that the evidence and testimony that the taxpayer desired to present was inadmissible under the Federal Rules of Evidence:

Bedrosian cannot show that documents relating to the underlying IRS investigation and penalty assessment are relevant to the only question that remains in this case—whether he acted willfully when he failed to report one of his foreign accounts on his 2007 FBAR ... [T]hat determination solely requires our consideration of Section 5321 and evidence pertaining to Bedrosian's state of mind in failing to accurately file his 2007 FBAR ... The IRS's analysis of Bedrosian's case, its preliminary conclusions regarding his FBAR violation, and the viewpoints of its personnel plainly do not go to Bedrosian's willfulness in failing to list one of his foreign accounts on his 2007 FBAR.³⁸

B. Ott

Ott is, perhaps, one of the shortest FBAR cases around.³⁹

1. Overview of the Facts

In 1993, Dennis and Tracey Ott opened two joint brokerage accounts in Canada. They deposited additional funds into the accounts later. They withdrew significant amounts over the years, too, to invest in real estate and business opportunities, cover private school tuition for their child, and pay miscellaneous personal expenses. Around 2005, Dennis started actively trading the investments held in the accounts; he spoke with his broker daily.

The Otts did not tell their tax return preparer about the Canadian accounts or the income that they produced. Therefore, such income was not reflected on the annual Forms 1040, which the Otts signed each year declaring their accuracy under penalties of perjury.

The record is unclear, but it appears that the Otts participated in the OVDP or a predecessor, were displeased with the size of the proposed "offshore" penalty, and decided to "opt-out" to seek penalty reduction. This did not go particularly well for the Otts. The IRS determined that Tracey's FBAR violations were non-willful, whereas Dennis had acted willfully. The Otts administratively

challenged these findings, of course, but the Appeals Officer refused to waiver.

Let's break this down. There were two unreported Canadian accounts, penalized for three separate years (*i.e.*, 2007, 2008, and 2009), against two married accountholders, Dennis and Tracey. The non-willful penalty against Tracey was \$10,000 per account, per year, for a total of \$60,000. The willful penalty against Dennis was significantly higher, calculated as follows: 50 percent of the highest balance of the unreported accounts (*i.e.*, \$329,415), multiplied by per account, per year, reaching \$1,976,490.

The DOJ eventually filed a collection lawsuit against the Otts in District Court. Notably, as part of this process, the DOJ decided to only seek one FBAR penalty per year from Dennis (instead of two), thereby decreasing the amount from \$1,976,490 to \$988,245.

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The DOJ later filed a Motion for Summary Judgment with respect *only* to Tracey, asking the District Court to confirm that the non-willful penalties were appropriate, without the need for a trial. Despite the resolution of the case as it relates to Tracey, as detailed below, matters regarding Dennis are still pending.

2. Quick Decision by the District Court

Tracey, in an effort to fend off the Motion for Summary Judgment, claimed that she exercised ordinary business care and prudence, relied on her accountant, lacked training and expertise regarding U.S. tax law (as a mere high school graduate), and participated in the OVDP as soon as she learned of her international duties in 2011.

The District Court rejected Tracey's position swiftly, in an Opinion comprised of just eight pages. The District Court said that Tracey did not meet her burden of establishing a material question of fact as to whether she had reasonable cause for her FBAR violations:

Critically, she has not shown that she took any steps to learn whether she was required to report her foreign financial accounts. To the contrary, she notes

that she hired an advisor to complete her tax returns, but fails to even suggest that she informed the advisor of these accounts. This certainly does not constitute ordinary business care and prudence. [Tracey's] limited education and experience does not excuse this misstep.⁴⁰

The District Court went on to explain that Tracey was too lackadaisical in defending herself. It noted that Tracey's primary argument was she has not yet had a chance to present evidence on the reasonable cause issue. The District Court underscored the flaw in this reasoning, explaining that "the time for [Tracey] to present facts and evidence demonstrating a genuine issue for trial was now [in response to the Motion for Summary Judgment filed by the DOJ], and unfortunately, that opportunity has passed."⁴¹

Interestingly, although not mentioned in the FBAR penalty collection suit, the Otts were also involved in Tax Court litigation involving nearly the same three years. They filed a Petition in February 2015, and nothing of substance occurred for more than three years. In July

2018, they concluded the case with the IRS by filing a Decision Document with the Tax Court. They had a total income tax liability of approximately \$275,000, and hefty negligence penalties. However, the IRS agreed to concede the civil fraud penalties.⁴² Unlike the taxpayer in *Rum*, Tracey did not take the position with the District Court that this concession by the IRS in the income tax dispute should have some bearing on the related, yet separate, FBAR penalty issue.

VI. Conclusion

As the world becomes more intertwined, an increasing percentage of U.S. persons likely will hold foreign financial accounts. Some of these will go unreported, intentionally or unintentionally, and the IRS will be on the prowl, using an expanding number of tools to find those in violation. Thus, the number of FBAR cases, like *Rum* and *Ott*, will continue to grow in the future, and taxpayers and their advisors the world over will be watching for more guidance.

ENDNOTES

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¹ *Rum*, 124 AFTR 2d 2019-XXXX (Middle District of Florida, 8/2/2019); *Ott*, 124 AFTR 2d 2019-XXXX (Eastern District of Michigan, 8/7/2019).

² 31 USC §5314; 31 CFR §1010.350(a).

³ 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; 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.

⁴ American Jobs Creation Act, P.L. 108-357 (Oct. 22, 2004).

⁵ 31 USC §5321(a)(5)(A).

⁶ 31 USC §5321(a)(5)(B)(ii).

⁷ 31 USC §5321(a)(5)(C)(i). As of July 2018, there is uncertainty regarding the maximum FBAR penalty, because two District Courts issued opinions stating that the willful FBAR penalty is capped at \$100,000 per violation because the IRS failed to update the operable regulations after Congress amended the law to increase penalties. See *Colliot*, Cause No. AU-16-CA-01281-SS (W.D. Texas May 16, 2018), and *Wadhan*, Civ. Action No. 17-CV-1287-MSK (Colo. July 18, 2018).

⁸ For more detailed information about the recent court battles regarding "willful" FBAR penalties, please see the following articles by the same author: Hale E. Sheppard, *Flume, Boyd, and Cohen: Three Recent FBAR Cases Yielding Important New Lessons*, INT'L TAX J., 2019, at 35; Hale E. Sheppard, *What Garrity Teaches About FBARs, Foreign Trusts, "Stacking" of International Penalties, and Simultaneously Fighting the U.S. Government on Multiple Fronts*, J. TAX PRACTICE & PROCEDURE, 2019, at 27; 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?"* INT'L TAX J., 2019, at 35; Hale E. Sheppard, *Appellate Court Jeopardizes First Holding of Non-Willfulness*

in FBAR Penalty Case: Round Three of the Bedrosian Battle, 30 J. INTERNATIONAL TAXATION 37 (2019); 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).
- ⁹ *J.B. Williams III*, 131 TC 54, Dec. 57,547 (2008); *Williams*, No. 1:09-cv-437, 2010 WL 347221 (E.D. Va. 9/1/2010); *Williams*, CA-4, 2012-2 USTC ¶150,475, 489 FedAppx 655.
- ¹⁰ *McBride*, U.S. District Court for the District of Utah Central Division, Case No. 2:09-cv-378, Findings of Fact, Conclusions of Law, and Order (Nov. 8, 2012). See also *J. McBride*, DC-UT, 2012-2 USTC ¶150,666, 908 FSupp2d 1186.
- ¹¹ *Bussell*, 117 AFTR 2d 2016-439 (District Court, C.D. California 12/8/2015).
- ¹² *Bohanec*, 118 AFTR 2d 2016-5537 (District Court, C.D. Cal. 12/8/2016).
- ¹³ *Bedrosian*, 120 AFTR 2d 2017-5671 (D.C. PA 2017).
- ¹⁴ *Kelley-Hunter*, 120 AFTR 2d 2017-5566 (D.C. Dist. Col.), Dec. 12, 2017.
- ¹⁵ *Garrity*, Case No. 3:15-cv-243 (D.C. Conn.).
- ¹⁶ *Markus*, D.C. New Jersey, Civil No. 16-2133, Opinion, July 17, 2018.
- ¹⁷ *Cohen*, 2018 WL 6318837 (C.D. California, Oct. 23, 2018).
- ¹⁸ *Horowitz*, 123 AFTR 2d 2019-500 (D.C. Maryland 1/18/2019).
- ¹⁹ *Flume*, 123 AFTR 2d 2019-XXXX (S.D. Texas, June 11, 2019).
- ²⁰ *Boyd*, 123 AFTR 2d 2019-1651 (D.C. California, Apr. 23, 2019).
- ²¹ *Rum*, 124 AFTR 2d 2019-XXXX (Middle District of Florida, 8/2/2019); Defendant's Supplemental Brief in Support of His Motion for Summary Judgment, June 7, 2019; United States' Supplemental Authority in Support of Its Motion for Summary Judgment, June 7, 2019; Report and Recommendation, August 8, 2019, Andrew Velarde, *FBAR Litigant Fights for Review Beyond Administrative Record*, TAX NOTES, Doc. 2019-22651, June 11, 2019; Amanda Athanasiou, *U.S. Magistrate Backs Government in FBAR Penalty Case*, TAX NOTES, Doc. 2019-29953, August 5, 2019.
- ²² IRM Exhibit 4.26.16-1.
- ²³ IRM §4.26.16.6.1 (11/6/2015); IRM Exhibit 4.26.16-1.
- ²⁴ *Rum*, 124 AFTR 2d 2019-XXXX (Middle District of Florida, 8/2/2019). The District Court noted the following: "While [the Revenue Agent] had the authority to recommend assessment of the willful FBAR penalty against Rum for several tax years, she exercised her discretion to recommend the imposition solely for tax year 2007."
- ²⁵ *Rum*, Tax Court Docket 20328-15, Decision Document, April 6, 2017.
- ²⁶ *Rum*, 124 AFTR 2d 2019-XXXX (Middle District of Florida, 8/2/2019); Report and Recommendation, August 8, 2019, *Rum*, Case No. 8:17-cv-826-T-35 AEP, at 17.
- ²⁷ *Rum*, 124 AFTR 2d 2019-XXXX (Middle District of Florida, 8/2/2019); Report and Recommendation, August 8, 2019, *Rum*, Case No. 8:17-cv-826-T-35 AEP, at 18.
- ²⁸ 5 USC §706(2)(A).
- ²⁹ *Rum*, 124 AFTR 2d 2019-XXXX (Middle District of Florida, 8/2/2019); Report and Recommendation, August 8, 2019, *Rum*, Case No. 8:17-cv-826-T-35 AEP, at 21.
- ³⁰ *Rum*, 124 AFTR 2d 2019-XXXX (Middle District of Florida, 8/2/2019); Report and Recommendation, August 8, 2019, *Rum*, Case No. 8:17-cv-826-T-35 AEP, at 27.
- ³¹ *Rum*, 124 AFTR 2d 2019-XXXX (Middle District of Florida, 8/2/2019); Report and Recommendation, August 8, 2019, *Rum*, Case No. 8:17-cv-826-T-35 AEP, at 32.
- ³² *Bedrosian*, 120 AFTR 2d 2017-5671 (D.C. PA 2017). The case summary is based on the following documents: Complaint filed October 27, 2015; Answer and Counterclaim filed February 26, 2016; Reply to Counterclaim filed March 21, 2016; United States' Motion for Summary Judgment filed November 30, 2016; Memorandum of Law in Support of the United States' Motion for Summary Judgment filed November 30, 2016; United States' Statement of Undisputed Material Facts filed November 30, 2016; Plaintiff's Statement of Undisputed Material Facts filed December 5, 2016; Plaintiff's Motion for Summary Judgment filed December 5, 2016; Plaintiff's Response to Defendant's Statement of Undisputed Material Facts filed December 19, 2016; United States' Response to the Plaintiff's Motion for Summary Judgment filed December 19, 2016; Plaintiff's Response to Defendant's Motion for Summary Judgment filed December 19, 2016; United States' Reply to the Plaintiff's Response to Its Motion for Summary Judgment filed December 23, 2016; Order Denying Motions for Summary Judgment dated April 13, 2017; Memorandum Regarding Cross Motions for Summary Judgment dated April 13, 2017; Plaintiff's Trial Memorandum filed August 28, 2017; United States' Trial Brief filed August 28, 2017; Plaintiff's Post-Trial Memorandum and Proposed Findings of Fact and Conclusions of Law filed September 14, 2017; United States' Post-Trial Brief filed September 14, 2017; Order dated September 20, 2017; Findings of Fact and Conclusions of Law dated September 20, 2017.
- ³³ *Bedrosian*, Memorandum of Law in Support of the United States' Motion in Limine filed August 11, 2017, Memorandum of Law of Plaintiff in Opposition to Defendant's Motion in Limine filed August 18, 2017, and Memorandum Regarding Motion in Limine dated September 5, 2017 (Slip Opinion, at 2017 WL 3887520), and Andrew Velarde, *Taxpayer, Government Fighting over Evidence in FBAR Case*, 2017 TAX NOTES TODAY 161-5 (Aug. 22, 2017).
- ³⁴ *Bedrosian*, Memorandum of Law in Support of the United States' Motion in Limine filed August 11, 2017.
- ³⁵ *Bedrosian*, Memorandum of Law in Support of the United States' Motion in Limine filed August 11, 2017.
- ³⁶ *Bedrosian*, Memorandum of Law in Support of the United States' Motion in Limine filed August 11, 2017.
- ³⁷ *Bedrosian*, Memorandum of Law in Support of the United States' Motion in Limine filed August 11, 2017.
- ³⁸ *Bedrosian*, Memorandum Regarding Motion in Limine dated September 5, 2017.
- ³⁹ The facts were derived from the filing documents. *Ott*, 124 AFTR 2d 2019-XXXX (Eastern District of Michigan, 8/7/2019); Complaint, filed July 12, 2018; United States' Motion for Partial Summary Judgment, filed June 20, 2019; Defendants' Response to Motion for Partial Summary Judgment, filed July 11, 2019; Kristen A. Parillo, *Limited Education No Excuse for FBAR Violations*, *Court Says*, TAX NOTES, Doc. 2019-30515, Aug. 9, 2019.
- ⁴⁰ *Ott*, 124 AFTR 2d 2019-XXXX (Eastern District of Michigan, 8/7/2019).
- ⁴¹ *Ott*, 124 AFTR 2d 2019-XXXX (Eastern District of Michigan, 8/7/2019).
- ⁴² *Ott*, Tax Court Docket No. 4458-15, Decision Document, July 17, 2018.

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