Appellate Court Jeopardizes First Holding of Non-Willfulness in FBAR Penalty Case: Round Three of the *Bedrosian* Battle

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Getting a clear picture of what "willfulness" will mean at any given time is challenging because the rules are complex, the court decisions are not entirely consistent, and the IRS and the DOJ take different positions in different cases.

The tax community cheered in 2017 when, after the U.S. government had won a series of cases involving severe penalties for failures to disclose foreign accounts on FinCEN Forms 114 ("FBARs"), a District Court held in *Bedrosian* that a taxpayer had not acted "willfully" when he neglected to declare a large Swiss account and the income it generated.[1] This ruling, on which other taxpayers facing aggressive attacks by the IRS and Department of Justice (DOJ) have been heavily relying for some time, has recently been called into question by the Third Circuit Court of Appeals. In short, it ruled in December 2018 that the District Court might have applied an incorrect legal standard in deciding that the taxpayer in *Bedrosian* was not willful, by focusing on his "subjective" motives and how egregious his actions/inactions were in comparison to those of taxpayers in other FBAR penalty cases. The Third Circuit Court of Appeals sent the case back to the District Court, with instructions to apply the proper "objective" standard regarding willfulness.

This article addresses the duties triggered by holding a foreign account, the critical lessons about willfulness derived from a long list of prior FBAR penalty cases, the facts and rulings by the District Court in *Bedrosian*, and the issues of first impression recently analyzed by the Third Circuit Court of Appeals concerning jurisdiction over FBAR cases, the standard to apply in reviewing initial rulings by a District Court, and the proper test for determining willfulness.

Overview of the Law, Enforcement, and Penalties

To appreciate the arguments and issues in *Bedrosian*, one first needs some background.

A Short History

Congress enacted the Bank Secrecy Act in 1970.[2] One purpose of this legislation was to require the filing of certain reports, like the FBAR, where doing so would be helpful to the U.S. government in carrying out criminal, tax, and regulatory investigations.[3]

Concerned with widespread noncompliance, the U.S. government has taken certain actions in recent years. Notably, the Treasury Department transferred authority to enforce FBAR duties to the IRS in 2003.[4] 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.[5]

Congress, for its part, enacted more stringent FBAR penalty provisions in 2004 as part of the American Jobs Creation Act ("Jobs Act").[6] Under the law in existence before the Jobs Act, the government could only assert penalties against taxpayers where it could demonstrate that they "willfully" violated the FBAR rules.[7] If the government managed to satisfy this high standard, it could impose a relatively small FBAR penalty, ranging from $25,000 to $100,000, regardless of the size of the hidden account.[8]

Thanks to the Jobs Act, the IRS may now impose a civil penalty on any person who fails to file an FBAR when required, period.[9] In the case of non-willful violations, the maximum penalty is $10,000.[10] The Jobs Act calls for higher maximum penalties where willfulness exists. Specifically, in situations where a taxpayer willfully fails to file an FBAR, the IRS may assert a penalty equal to $100,000 or 50% of the balance in the undisclosed account at the time of the violation, whichever amount is larger.[11] Given the huge balances in some unreported accounts, FBAR penalties under the Jobs Act can be enormous.

Mandatory Disclosures

The relevant law mandates the filing of an FBAR in situations where (i) a U.S. person, including U.S. citizens, U.S. residents, and domestic entities, (ii) had a direct or 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.[12]

When it comes to U.S. individuals, they have several disclosures linked to holding a reportable interest in a foreign financial account, including the following:

- Checking the "yes" box in Part III (Foreign Accounts and Trusts) of Schedule B (Interest and Ordinary Dividends) to Form 1040 (U.S. Individual Income Tax Return) to disclose the existence of the foreign account.
- Identifying the foreign country in which the account is located, also in Part III of Schedule B to Form 1040.
- Declaring all income generated by the account (such as interest, dividends, and capital gains) on Form 1040.
- Reporting the account on Form 8938 (Statement of Specified Foreign Financial Assets), which is enclosed with Form 1040.
- Electronically filing an FBAR.[13]

Account Disclosures on Schedule B

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

- At any time during 2017, did you have a financial interest in or a signature authority over a financial account (such as a bank account, securities account, or brokerage account) located in a foreign country? See instructions.
- If "Yes," are you required to file FinCEN Form 114, Report of Foreign Bank and Financial Accounts (FBAR), to report that financial interest or signature authority? See FinCEN Form 114 and its instructions for filing requirements and exceptions to those requirements.
- If you are required to file a FinCEN Form 114, enter the name of the foreign country where the financial account is located.

"Willfulness"—Clues as to Its Current Meaning

Several courts have examined the issue of what constitutes "willfulness" in the

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1 Bedrosian, 120 AFTR 2d 2017-5671 (DC Pa., 2017).

2 Pub. L. No. 91-508, Title I and Title II (10/26/1970).

3 Id. at section 202.

4 68 Fed. Reg. 26489 (5/16/2003).

5 31 C.F.R. section 103.56(g); 68 Fed. Reg. 26489 (5/16/2003).

6 Pub. L. No. 108-357 (10/22/2004).

7 31 U.S.C. section 5321(a)(5)(A) (as in effect before 10/22/2004).

8 31 U.S.C. section 5321(a)(5)(B)(ii) (as in effect before 10/22/2004).

9 31 U.S.C. section 5321(a)(5)(A).

10 31 U.S.C. section 5321(a)(5)(B)(i). This penalty cannot be asserted if the taxpayer was "non-willful" and there was "reasonable cause" for the violation. See 31 U.S.C. section 5321(a)(5)(B)(ii).

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

12 31 U.S.C. section 5314; 31 CFR section 1010.350(a).

13 For a detailed analysis of the Form 8938 filing requirement, see the following articles by this author: "The New Duty to Report Foreign Financial Assets on Form 8938: Demystifying the Complex Rules and Severe Consequences of Noncompliance," 38(3) Int'l Tax Journal 11 (2012); "Form 8938 and Foreign Financial Assets: A Comprehensive Analysis of the Reporting Rules after IRS Issues Final Regulations," 41(2) Int'l Tax Journal 25 (2015); "Specified Domestic Entities Must Now File Form 8938: Section 6038D, New Regulations in 2016, and Expanded Foreign Financial Asset Reporting," 42(3) Int'l Tax Journal 5 (2016); "Canadian Retirement Plans: What Does Revenue Procedure 2014-55 Mean for U.S. Tax Deferral, Form 8891, Form 8938, and the FBAR?" 41(6) Int'l Tax Journal 25 (2016); "Unlimited Assessment-Period for Form 8938 Violations: Ruling Shows IRS's Intent to Attack Multiple Tax Returns," 95(5) Taxes – The Tax Magazine 31 (2017).

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context of civil FBAR penalties.[14] Notable decisions include *Williams* in 2012,[15] *McBride* in 2012,[16] *Bussell* in 2015,[17] *Bohanec* in 2016,[18] *Bedrosian* in 2017,[19] *Kelley-Hunter* in 2017,[20] *Toth* in 2017,[21] *Colliot* in 2018,[22] *Wadhan* in 2018,[23] *Garrity* in 2018,[24] *Markus* in 2018,[25] *Norman* in 2018,[26] and, *Flume* in 2018.[27]

Getting a clear picture of what "willfulness" will mean at any given time is challenging because the rules are complex, the court decisions are not entirely consistent, the IRS and the DOJ take different positions in different cases, etc. In an effort to clarify and consolidate matters, below is a summary of critical issues learned from the FBAR cases listed above:

- The Tax Court lacks jurisdiction over FBAR penalty matters, in both pre-assessment and post-assessment (i.e., collection) cases, so FBAR litigation cannot occur there.
- The standard for asserting maximum FBAR penalties is "willfulness."
- The government is required to prove willfulness only 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 or her 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 Schedule B (like the FBAR).
- If the taxpayer makes a damaging admission during a criminal trial, the government will use such statement against him or her 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 IRS might adhere to its internal guidance, which limits the total willful FBAR penalty to 50% of the highest balance of the unreported account, spread over all open years.
- District Courts review the question of willfulness on a *de novo* basis, meaning that taxpayers generally cannot offer evidence at trial related to the IRS's administrative process in conducting the audit, determining whether willfulness existed, etc.
- Courts might reject as irrelevant, in an evidentiary sense, reports and testimony from experts who attempt to make a link between general ignorance of FBAR duties by the public and particular ignorance of the taxpayer under attack.
- Depending on the circumstances, the U.S. government might be able

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14 For more detailed information about the recent court battles regarding "willful" FBAR penalties, please see the following articles by this author: "What Constitutes a "Willful" FBAR Violation? Comprehensive Guidance Based on Eight Important Cases," 129 JTAX 24 (November 2018); "Court Bucks the Trend in Willful FBAR Penalty Cases: Merely Signing Tax Returns Does Not Establish Willfulness," 44(6) Int'l Tax Journal __ (2018); "Court Holds that Pervasive Ignorance Is No Defense to Willful FBAR Penalties: This and Other Lessons from *United States v. Garrity*," 44(4) Int'l Tax Journal 51 (2018); "Willful FBAR Penalty Case Shows Importance of Protecting Privileged Communications: What *Kelley-Hunter* Adds to the Foreign Account Defense Discussion," 44(1) Int'l Tax Journal 15 (2018); "Analysis of the Reasonable Cause Defense in Non-Willful FBAR Penalty Case: Teachings from *Jarnagin*," 128 JTAX 6 (April 2018); "First Taxpayer Victory in a 'Willful' FBAR Penalty Case: Analyzing the Significance of *Bedrosian* for Future Foreign Account Disputes (Part 1)," 128 JTAX 12 (February 2018); "First Taxpayer Victory in a 'Willful' FBAR Penalty Case: Analyzing the Significance of *Bedrosian* for Future Foreign Account Disputes (Part 2)," 128 JTAX 14 (March 2018); "Can Recent 'Willful' FBAR Penalty Cases against Taxpayers Help Tax Firms Fend Off Malpractice Actions?" 43(4) Int'l Tax Journal 33 (2017); "Government Wins Fourth Straight FBAR Penalty Case: Analyzing *Bohanec* and the Evolution of 'Willfulness,'" 126 JTAX 110 (March 2017); "Government Wins Second Willful FBAR Penalty Case: Analyzing What *McBride* Really Means to Taxpayers," 118 JTAX 187 (April 2013); "Third Time's the Charm: Government Finally Collects 'Willful' FBAR Penalty in *Williams* Case," 117 JTAX 319 (December 2012); "District Court Rules That Where There's (No) Will, There's a Way to Avoid FBAR Penalties," 113 JTAX 293 (November 2010).

15 Williams, 131 TC 54 (2008); Williams, No. 1:09-cv-437, 2010 WL 347221 (DC Va., 2010); Williams, 489 Fed. Appx. 655 (CA-4, 2012).

16 McBride, 908 F. Supp. 2d 1186 (DC Utah, 2012).

17 Bussell, 117 AFTR 2d 2016-439 (DC Cal., 2015).

18 Bohanec, 118 AFTR 2d 2016-5537 (DC Cal., 2016).

19 Bedrosian, 120 AFTR 2d 2017-5671 (DC Pa., 2017).

20 Kelley-Hunter, 120 AFTR 2d 2017-5566 (DC D.C., 2017).

21 Toth, 122 AFTR 2d 2018-6280 (DC Mass., 2018).

22 Colliot, 121 AFTR 2d 2018-1834 (DC Tex. 2018).

23 Wadhan, 122 AFTR 2d 2018-5208 (DC Colo., 2018).

24 Garrity, Case No. 3:15-cv-243 (DC Conn., 2018).

25 Markus, 122 AFTR 2d 2018-5166 (DC N.J., 2018).

26 Norman , 138 Fed. Cl. 189, 122 AFTR 2d 2018-5334 (2018).

27 Flume, 122 AFTR 2d 2018-5641 (DC Tex., 2018).

28 Bedrosian, 120 AFTR 2d 2017-5671 (DC Pa., 2017). In an effort to fully and fairly describe the facts, the author obtained from the District Court and reviewed the following documents: Complaint filed 10/27/2015, Answer and Counterclaim filed 2/26/2016, Reply to Counterclaim filed 3/21/2016, United States' Motion for Summary Judgment filed 11/30/2016, Memorandum of Law in Support of the United States' Motion for Summary Judgment filed 11/30/2016, United States' Statement of Undisputed Material Facts filed 11/30/2016, Plaintiff's Statement of Undisputed Material Facts filed 12/5/2016, Plaintiff's Motion for Summary Judgment filed 12/5/2016, Plaintiff's Response to Defendant's Statement of Undisputed Material Facts filed 12/19/2016, United States' Response to the Plaintiff's Motion for Summary Judgment filed 12/19/2016, Plaintiff's Response to Defendant's Motion for Summary Judgment filed 12/19/2016, United States' Reply to the Plaintiff's Response to Its Motion for Summary Judgment filed 12/23/2016, Order Denying Motions for Summary Judgment dated 4/13/2017, Memorandum Regarding Cross Motions for Summary Judgment dated 4/13/2017; Plaintiff's Trial Memorandum filed 8/28/2017; United States' Trial Brief filed 8/28/2017; Plaintiff's Post-Trial Memorandum and Proposed Findings of Fact and Conclusions of Law filed 9/14/2017; United States' Post-Trial Brief filed 9/14/2017; Order dated 9/20/2017; Findings of Fact and Conclusions of Law dated 9/20/2017.

to ensnare a taxpayer in three different, stressful, costly, and time-consuming cases at one time, including those for (i) income taxes, and accuracy or civil fraud penalties, in Tax Court, (ii) assessable international information return penalties, in District Court, and (iii) FBAR penalties, in District Court or the Court of Federal Claims.

- Courts might give credence to the argument that age-related mental conditions preclude a finding of willfulness.
- Courts might cap willful FBAR penalties at $100,000 per violation, unless and until the regulations are changed to match current law.
- If the U.S. government initiates a lawsuit to collect FBAR penalties assessed by the IRS, and if the taxpayer fails to timely respond to court pleadings and/or comply with pre-trial discovery orders, then the court might impose strong sanctions, including a ruling that (i) it will be deemed established that the taxpayer had a reportable interest in the relevant foreign accounts, the taxpayer had a duty to file an FBAR, and the taxpayer willfully violated his or her FBAR duty, and (ii) the taxpayer must pay the relevant fees and costs incurred by the U.S. government.

Below is coverage of the first two rounds in the *Bedrosian* battle, which will allow us to add to the preceding list of vital lessons from willful FBAR penalty cases.

Bedrosian—District Court Litigation—Round One

Bedrosian was unique in that it constituted the first case in which a taxpayer, as opposed to the government, prevailed on the willfulness issue.[28] The details and significance of the case are analyzed below.

Description of the Relevant Facts

Getting a clear understanding of the facts was particularly challenging in *Bedrosian*, despite a review of all documents lodged by the parties and three decisions by the court. The information below constitutes a best effort based on the available materials.

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 in the 1970s with the predecessor to UBS to facilitate payment of expenses during international trips. The balance was initially very small, but grew over the years as a result of three things: (i) periodic deposits of after-tax funds via check and wire transfer from the United States, (ii) a supposed loan that the taxpayer received from UBS of approximately $750,000, and (iii) passive income generated by the accounts.

The taxpayer, who holds an undergraduate degree and a law degree, is the chief executive officer of a large generic pharmaceutical company. He is, by all accounts, a sophisticated and financially savvy businessperson. As head of the company, he manages hundreds of people, routinely reviews and signs complex financial statements, approves corporate contracts, analyzes complex industry regulations, etc.

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

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

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

Several courts have examined the issue of what constitutes "willfulness" in the context of civil FBAR penalties.

Accountant Handelman prepared Forms 1040 for the taxpayer from 1972 through 2006, after which he died. The taxpayer, in need of new help with return preparation, hired another accountant, Sheldon Bransky ("Accountant Bransky"). The content of the discussions with, and the type of documents provided to, Accountant Bransky by the taxpayer are ambiguous, but there is no dispute that he prepared the following: (i) A timely 2007 Form 1040 that omitted the $220,000 in passive income generated by the UBS accounts that year, (ii) a Schedule B to the 2007 Form 1040 answering "yes" to the foreign-account question and identifying "Switzerland" as the location, and (iii) a late 2007 FBAR, filed in October 2008 (instead of by the deadline of June 30, 2008), reporting only the Small Account at UBS and noting that the highest balance in this account ranged from $100,000 to $1 million. The taxpayer did not convey to Accountant Bransky the erroneous advice that he previously received from Accountant Handelman, which was that he was not required to report passive income from UBS until repatriation or death. Nevertheless, it is evident that the taxpayer continued to follow this flawed guidance, because the UBS income did not appear on the original 2007 Form 1040.

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

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

In connection with his proposed participation in the OVDP, the taxpayer filed with the IRS in August 2010 (i) Forms 1040X from 2003 through 2008, reporting the passive income generated by the UBS accounts that was not shown on the original Forms 1040, and (ii) a 2006 FBAR, an amended 2007 FBAR, and a 2008 FBAR, reporting both the Small Account and Large Account at UBS. The IRS rejected the taxpayer's application for the OVDP because it had already received data directly from UBS about the unreported accounts.

In April 2011, the IRS initiated an audit, starting with 2007. The taxpayer cooperated with the audit, fully responding to all Information Document Requests (IDRs) and participating in an interview with the Revenue Agent. The Revenue Agent determined that the FBAR violations were non-willful and presented this finding to the appropriate "panel" within the IRS.

The Revenue Agent later exited the scene for unexpected medical leave, during which time, the case was reassigned to another Revenue Agent. In June 2013, the second Revenue Agent disagreed with the earlier conclusion about the character of the FBAR violation for 2007 and asserted a "willful" penalty. The second Revenue Agent sought the highest sanction, equal to 50% of the highest balance of the Large Account. The highest balance in 2007 was $1,951,578.34, triggering a penalty of $975,789.19.

The taxpayer administratively disputed the penalty. After receiving notice from the IRS that clemency would not be granted, he made a partial payment of $9,757.89 (representing merely 1% of the FBAR penalty amount), and then filed a Suit for Refund in District Court. The DOJ filed a counterclaim, contending that the taxpayer was liable for the remaining amount of the penalty.

Positions by the Parties

The taxpayer and the U.S. government, represented by the DOJ, presented legal and tax positions to the District Court primarily through cross-motions for summary judgment, which were denied, followed by briefing before and after a one-day bench trial. Many of these positions were not new; they have been addressed by earlier courts, often in great detail. Therefore, the focus below is solely on the key issue, willfulness.

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

2. Main arguments by the DOJ. The DOJ, like the taxpayer, directed most of its energy to the issue of willfulness. It raised a long list of points through the litigation, many of which are summarized here: (i) The taxpayer is an accomplished, intelligent, experienced professional who understood, or should have taken the necessary steps to understand, his tax duties, FBAR duties, and facts related to funds held with UBS; (ii) because he signed his annual Forms 1040, the taxpayer had at least constructive knowledge of, and was placed on inquiry notice about, his FBAR duties; (iii) the taxpayer cannot claim ignorance of his FBAR duty for 2007, because he actually filed one, even though it was late and incomplete; (iv) the fact that the taxpayer sent two separate letters to UBS to close the Large Account and the Small Account, and the fact that funds from the Large Account were transferred to another Swiss bank, while the funds from the Small Account were repatriated, indicates that the taxpayer knew he had two accounts at UBS, not one; (v) the taxpayer closed the Large Account merely

NOTES

29 Findings of Fact and Conclusions of Law, dated 9/20/2017, pp. 7-8.

30 Findings of Fact and Conclusions of Law, dated 9/20/2017, pp. 13-14.

31 Findings of Fact and Conclusions of Law, dated 9/20/2017, p. 10.

32 Id.

33 Findings of Fact and Conclusions of Law, dated 9/20/2017, pp. 11-13.

34 Findings of Fact and Conclusions of Law, dated 9/20/2017, pp. 13-14.

two weeks after filing the original 2007 FBAR, which did not report the Large Account; (vi) the supposed reliance by the taxpayer on erroneous advice from Accountant Handelman is questionable because there is no written evidence or third-party testimony to support it, the advice was limited to income tax issues, not FBAR issues, and the taxpayer did not discuss with his new Accountant Bransky such advice when he took over return preparation starting with 2007; (vii) the taxpayer instructed UBS to hold all mail related to the accounts, and the taxpayer received only oral updates when he met periodically with UBS personnel; (viii) the taxpayer did not take any steps to voluntarily resolve non-compliance with the IRS until after he learned in 2009 that UBS had already remitted to the U.S. government data about his accounts; (ix) the taxpayer presented no evidence that the $750,000 deposited into the Large Account constituted a "loan," and even if it were, a loan amount cannot be excluded when calculating the highest balance for FBAR purposes; and (x) the non-compliance by the taxpayer was significant, lasting for several decades, and resulting in approximately $375,000 in unreported and untaxed passive income from 2003 through 2007 alone.

Analysis by the District Court

The taxpayer and the DOJ each filed a Motion for Summary Judgment, and the court, predictably, rejected them. In doing so, the court noted that the "precise contours" of the concept of willfulness in the civil FBAR penalty context "have not been clearly established by statute or precedent." The court also stated that the issue of whether the taxpayer in *Bedrosian* willfully failed to file a timely, accurate, and complete 2007 FBAR is an "inherently factual question" that is inappropriate for resolution through summary judgment. Thus, the case proceeded to trial.

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

In terms of standards, the District Court held that for civil FBAR purposes (i) "willful intent is satisfied by a finding that the [taxpayer] knowingly or recklessly violated the statute," (ii) "the government need not prove improper or bad purpose" by the taxpayer, (iii) "willful blindness" by the taxpayer meets the standard, and (iv) the government can prove willfulness through circumstantial evidence and through inference, including the conduct of the taxpayer to conceal or mislead sources of income or other financial data.[29]

The District Court identified some favorable facts for the taxpayer, namely, Schedule B to the 2007 Form 1040 checked the "yes" box in response to the foreign-account question and indicated "Switzerland" as the relevant country, the taxpayer filed a 2007 FBAR reporting at least one account, whose balance ranged from $100,000 to $1 million, and the taxpayer approached his attorney to rectify matters with the IRS before he learned that UBS had already supplied his account data to the U.S. government, which had started an investigation.[30]

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

Despite all this, the District Court held that the taxpayer's actions "were at most negligent," and the omission of the Large Account from the original 2007 FBAR was an "unintentional oversight or a negligent act" because there "is no indication that he did so with the requisite voluntary or intentional state of mind."[31]

The District Court reached this determination by comparing the facts in *Bedrosian* to those in earlier FBAR penalty cases decided in favor of the government. It stated the following in this regard: "[W]e cannot conclude, *based on a comparison of the facts of this case compared with those of cases in which a willful FBAR penalty was imposed*, that the government has proved, by a preponderance of the evidence, that [the taxpayer's] violation of Section 5314 was willful."[32]

In distinguishing the facts in *Bedrosian*, the District Court emphasized that the unreported accounts in the other cases were part of a larger or complex "tax evasion scheme," the taxpayers made no efforts to voluntarily disclose matters to the IRS, the taxpayers had already been convicted of a crime, and/or the taxpayers lied or otherwise failed to cooperate with the IRS audit.[33]

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

> In summary, the only evidence supporting a finding that Bedrosian willfully violated Section 5314 is: (1) the inaccurate [original 2007 FBAR] itself, lacking reference to the [Large Account], (2) the fact that he may have learned of the existence of the [Large Account] at one of his meetings with a UBS representative, which is supported by his having sent two separate letters closing the accounts, (3) Bedrosian's sophistication as a businessman, and (4) [Accountant] Handelman's having told Bedrosian in the mid-1990s that he was breaking the law by not reporting the UBS accounts. None of these indicate "conduct meant to conceal or mislead" or a "conscious effort to avoid learning about reporting requirements," even if they may show negligence.[34]

Reasons Why the District Court Holding Is Interesting

Irrespective of the ultimate outcome, *Bedrosian* mainly will be known for its impact on the concept of willfulness, or better said, the lack thereof. However, the case contains other interesting and important aspects, some of which are described below.

Potential Applicability of Trust Fund Recovery Cases

The DOJ argued that the District Court should interpret willfulness for purposes of civil FBAR penalties by considering this same term in the context of trust fund recovery penalties under Section 6672.[35] Except for those few diehards who obtain and read all court filings related to an important case, like *Bedrosian*, everyone else will miss the fact that the District Court agreed with this, in theory. Because the District Court decided in favor of the taxpayer based solely on its review and comparison of the four civil FBAR penalty cases on record, it did not turn its attention to any cases decided under Section 6672. However, it did note the following:

> *[W]hile the court's analysis of willfulness in the context of Section 6672 of the Internal Revenue Code is surely relevant to the instant determination*, as it arises in the civil tax penalty context, we find the specific FBAR penalty cases more persuasive because they deal with the same unique requirement at issue here.[36]

This statement indicates a clear willingness, by at least certain courts, to look to other civil cases, outside the narrow context of FBAR penalties, for guidance about "willfulness." To understand the significance of this, one must first understand how broadly the IRS and the courts define "willfulness" in the field of employment tax withholding.

Section 6672(a) and Treas. Reg. section 301.6672-1 contain the following general rule:

> Any person required to collect, truthfully account for, and pay over any tax imposed by [the Internal Revenue Code] who *willfully* fails to collect such tax, or truthfully account for and pay over such tax, or *willfully* attempts in any manner to evade or defeat any such tax or the payment thereof, shall, in addition to other penalties provided by law, be liable to a penalty equal to the total amount of the tax evaded, or not collected, or not accounted for and paid over.

In other words, before the IRS may assert penalties on an individual under Section 6672, it must show that (i) the individual was a "responsible person," and (ii) the individual "willfully" failed to collect, truthfully account for, and pay over certain taxes, such as payroll taxes. It is clear that the IRS must meet *both* of these elements. Indeed, the IRS's own official policy provides that "the trust fund recovery penalty may be asserted against those determined to have been responsible and willful in failing to pay over the tax. *Responsibility and willfulness must both be established.*"[37]

Trust fund recovery penalties are one of the most commonly litigated tax issues in the federal courts; they are fact-intensive, and results vary depending on the court hearing the case. According to some courts, "willfulness" in the context of Section 6672 exists where either (i) the responsible person was aware that the taxes were unpaid and, possessing the power to pay them with funds of the entity, signed checks paying another creditor, or (ii) the responsible person acted "grossly negligent" or in "reckless disregard" of the fact that the taxes were due and would not be paid.[38] Other courts have held that where a responsible person lacks knowledge that the trust fund taxes are not being paid to the IRS, "willfulness" does not exist, unless the responsible person's ignorance is the result of recklessness.[39] Finally, various courts have determined that mere negligence by an individual is not considered "willfulness" for purposes of Section 6672.[40]

It is also helpful to turn to the IRS's own internal guidance on the issue. According to the Internal Revenue Manual, the term "willfulness" means "intentional, deliberate, voluntary, reckless, knowing" failure to pay employment taxes.[41] The Internal Revenue Manual goes on to say that, in order to prove willfulness, the government generally must demonstrate that "a responsible person was aware, or should have been aware, of the outstanding taxes and either intentionally disregarded the law or was plainly indifferent to its requirements."[42]

It will be interesting to see the evolution of the "willfulness" standard in civil FBAR penalty cases if future courts, following the dicta in *Bedrosian*, decide to consider Section 6672.

It will be interesting to see the evolution of the "willfulness" standard in civil FBAR penalty cases if future courts, following the dicta in *Bedrosian*, decide to consider Section 6672.

Refund Action Instead of Collection Action

Until *Bedrosian*, all previous civil FBAR penalty cases were collection actions, initiated by the DOJ against the taxpayer, pursuant to the FBAR statute, 31 U.S.C.

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35 United States' Post-Trial Brief filed 9/14/2017, pp. 6-7.

36 Findings of Fact and Conclusions of Law, dated 9/20/2017, p. 13.

37 IRS Policy Statement P-5-60. IRM section 1.2.1.5.14 (2/2/1993) (emphasis added). See also IRM section 5.7.3.3 (4/1/2005), IRM section 5.17.7.1 (9/20/2000).

38 See, e.g., Muck, 3 F.3d 1378 (CA-10, 1993); Blais, 612 F. Supp. 700 (DC Mass., 1985).

39 Honey, 963 F.2d 1083 (CA-8, 1992), *cert. den.*, 506 U.S. 1028 (1992).

40 See, e.g., Kalb, 505 F.2d 506, 511 (CA-2, 1974); Dudley, 428 F.2d 1196, 1200 (CA-9, 1970); Calderone, 799 F.2d 254 (CA-6, 1986).

41 IRM section 5.7.3.3.2 (4/1/2005).

42 Id.

43 Flora, 362 U.S. 145 (1960); Tracy, 226 F. Supp. 708 (DC Cal., 1963); Kearney v. A'Hearn, 210 F. Supp. 10 (DC N.Y., 1961), *aff'd* 309 F.2d 487 (CA-2, 1962); Magnone, 733 F. Supp. 613 (DC N.Y., 1989).

44 See Memorandum of Law in Support of the United States' Motion in Limine filed 8/11/2017, Memorandum of Law of Plaintiff in Opposition to Defendant's Motion in Limine filed 8/18/2017, and Memorandum Regarding Motion in Limine dated 9/5/2017 (Slip Op, at 2017 WL 3887520), and Andrew Velarde, "Taxpayer, Government Fighting Over Evidence in FBAR Case," 2017 Tax Notes Today 161-5 (8/22/2017).

45 Memorandum of Law in Support of the United States' Motion in Limine filed 8/11/2017.

46 Id.

47 Id.

48 Id.

49 Memorandum Regarding Motion in Limine dated 9/5/2017.

section 5321(b)(2). This provision allows the DOJ to commence a civil action to recover FBAR penalties within two years of the date of assessment. Interestingly, *Bedrosian* was the first case where the taxpayer went on the offensive, paying a portion of the FBAR penalty and then filing a Suit for Refund, instead of waiting for the DOJ to attack. This strategy would seem to have some advantages for the taxpayer, including the ability to accelerate the fight, deprive the DOJ of additional time to develop its case, and limit the accumulation of the late-payment penalties and interest charges associated with unpaid FBAR penalties.

An interesting tidbit, which surely passed unnoticed by most, is the small amount that the taxpayer paid in *Bedrosian* to get this started. The IRS asserted an FBAR penalty for 2007 of $975,789.19, and the taxpayer paid merely $9,757.89 (representing just 1% of the total penalty) to gain access to the District Court. This will strike many tax professionals as odd, because in tax and tax penalty cases, the courts generally adhere to the full-payment requirement, as set forth in 28 U.S.C. section 1346(a)(1). This is commonly known as the "*Flora* full-payment rule."[43]

Motion in Limine – Evidence about Administrative Actions

As explained above, the taxpayer contended that, at the conclusion of the audit, the Revenue Agent and his Group Manager agreed that the FBAR violation was not willful, garnered support for this conclusion from the appropriate "panel" within the IRS, and expected to close the case on these terms. However, after the Revenue Agent unexpectedly took medical leave, a second Revenue Agent was assigned to the case, and she independently decided to elevate the FBAR penalty to willful status. The taxpayer attempted to address this issue at trial by presenting evidence and eliciting testimony concerning the procedures, actions, analyses, and viewpoints of IRS personnel at the administrative level regarding willfulness. The DOJ opposed this by filing a Motion in Limine.[44]

The DOJ relied on two principal arguments in the Motion in Limine. First, it argued 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."[45]

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 under Section 6672, where one key matter is whether the taxpayer acted "willfully."[46] 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 his $2 million UBS 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.[47]

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.[48]

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 irrelevant and thus 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.[49]
>
> Bedrosian additionally argues that the fact that Section 5321 did not afford him an adjudicatory hearing sways in favor of admitting evidence relating to the IRS's administrative findings because he did not have "an adequate opportunity to be heard at the administrative level before the willful FBAR penalty was imposed." We disagree. Bedrosian has the chance before this [District] Court to put forth any relevant, admissible evidence of the only issue left to be adjudicated—his state of mind in not filing an accurate 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.[50]

Bedrosian – Appellate Court Review – Round Two

The DOJ, of course, was not happy about the decision by the District Court in *Bedrosian*, so it sought review by higher judicial powers. The Third Circuit Court of Appeals issued an Opinion in September 2018, addressing several "issues of first impression."[51]

Federal Court Jurisdiction Over FBAR Penalties Assessed by the IRS

As explained above, all civil FBAR penalty cases before *Bedrosian* were collection actions, initiated by the DOJ against the taxpayer, under 31 U.S.C. section 5321(b)(2). This statute authorizes the DOJ to start a collection suit within two years of the date on which the IRS assesses the FBAR penalties, and the DOJ normally waits to file until immediately before the two-year period expires, perhaps to give the taxpayer a chance to pay voluntarily, or perhaps to allow additional penalties and interest charges to accrue.

In all events, *Bedrosian* was the first case where the taxpayer went on the offensive, by paying the FBAR penalty and then filing a Suit for Refund with the District Court, instead of waiting for the DOJ to launch the attack. The situation gets even more interesting because, in place of paying the entire penalty amount (i.e., $975,789.19) in accordance with the full-payment requirement derived from 28 U.S.C. section 1346(a)(1), the taxpayer paid just 1% of the penalty (i.e., $9,757.89), supposedly pursuant to 28 U.S.C. section 1346(a)(2). Finally, the issue is notable because the DOJ never challenged it with the District Court, simply filing a counterclaim to recoup the payment shortfall.

District Court Lacked Jurisdiction under 28 U.S.C. section 1346(a)(2)

In order to understand the issue and the analysis by the Court of Appeals, one must first review the relevant provisions.

With respect to jurisdiction, 28 U.S.C. section 1346(a)(1) states the following:

> The district courts shall have original jurisdiction, concurrent with the United States Court of Federal Claims, of any civil action against the United States *for the recovery of any internal-revenue tax* alleged to have been erroneously or illegally assessed or collected, *or any penalty* claimed to have been collected without authority *or any sum* alleged to have been excessive or in any manner wrongfully collected *under the internal-revenue laws*.

For its part, 28 U.S.C. section 1346(a)(2) states the following:

> The district courts shall have original jurisdiction, concurrent with the United States Court of Federal Claims, *of any other civil action or claim against the United States, not exceeding $10,000 in amount, 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, except . . . .

The taxpayer and the DOJ apparently were unified in their belief that the District Court properly heard the case under 28 U.S.C. section 1346(a)(2) because (i) it constituted a claim against the U.S. government, other than one falling under 28 U.S.C. section 1346(a)(1), as it did not involve an "internal revenue tax" or "internal revenue laws," (ii) the refund claim was not greater than $10,000, and (iii) it was founded on an act of Congress, namely, the FBAR duties set forth in 31 U.S.C. section 5314 and 31 U.S.C. section 5321.

The Court of Appeals disagreed, stating that "we are inclined to believe that [the taxpayer's] initial claim did *not* qualify for district court jurisdiction at all."[52] It identified a number of reasons for disagreeing that the District Court ever had jurisdiction under 28 U.S.C. section 1346(a)(2). First, the Court of Appeals explained that the position of the taxpayer and the DOJ is premised on the notion that the phrase "internal revenue laws," found in 28 U.S.C. section 1346(a)(1), only applies to laws codified in Title 26 of the U.S. Code; that is, the Internal Revenue Code. However, the Court of Appeals underscored that such notion does not follow precedent, which indicates that "internal revenue laws" are defined by their function, not by where they are located in the U.S. Code. Second, the Court of Appeals explained that the jurisdictional argument by the taxpayer and DOJ was previously rejected by the Tax Court in a recent whistleblower action. Third, the Court of Appeals drew an analogy to refund claims brought by taxpayers for penalties for failing to file Forms 5471 (Information Returns of U.S. Persons with Respect to Certain Foreign Corporations) under Section 6038(b), "a statute nearly identical to the FBAR statute, except addressing foreign business holdings rather than foreign bank accounts." The Court of Appeals pointed out that Form 5471 penalty cases generally are brought under the tax refund statute, 28 U.S.C. section 1346(a)(1), not under 28 U.S.C. section 1346(a)(2). Fourth, the first principle of tax litigation in federal court is to pay first and fight later, and this would be circumvented if taxpayers were allowed to bring partial-payment FBAR claims. Based on the preceding, the Court of Appeals arrived at the following conclusion:

> We are inclined to believe the initial claim of Bedrosian was within the scope of 28 U.S.C. section 1346(a)(1) and thus did *not* supply the District Court with jurisdiction at all because he did not pay the full penalty before filing suit, as would be required to

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50 Id.

51 Bedrosian , 122 AFTR 2d 2018-7052 (CA-3, 2018), p.2. The author obtained and reviewed the following documents in preparing this portion of the article: Brief for the Appellants filed 4/24/2018; Brief for the Appellee filed 5/24/2018; Opinion issued 12/21/2018.

52 Bedrosian, 122 AFTR 2d 2018-7052 (CA-3, 2018), n. 1 (emphasis added).

53 Bedrosian, 122 AFTR 2d 2018-7052 (CA-3, 2018), n. 1.

54 Bedrosian, 122 AFTR 2d 2018-7052 (CA-3, 2018), p. 10.

55 Bedrosian, 122 AFTR 2d 2018-7052 (CA-3, 2018), p. 11.

56 Bedrosian, 122 AFTR 2d 2018-7052 (CA-3, 2018), p. 13.

57 Bedrosian, 122 AFTR 2d 2018-7052 (CA-3, 2018), pp.13-14 (internal citations omitted).

> establish jurisdiction under [28 U.S.C. section 1346(a)(1)]. But given the procedural posture of this case, we leave a definitive holding on this issue for another day.[53]

Alternative Grounds for District Court Jurisdiction

Despite the fact that the District Court might have lacked jurisdiction over the partial-payment FBAR refund claim filed by the taxpayer under 28 U.S.C. section 1346(a)(2), the Court of Appeals held that the District Court nonetheless was authorized to hear the case under 28 U.S.C. section 1345 because the DOJ filed a counterclaim seeking the 99 percent of the penalty still outstanding. This provision generally states that "the district courts shall have original jurisdiction of all civil actions, suits or proceedings commenced by the United States, or by any agency or officer thereof expressly authorized to sue by Act of Congress."

Analyzing Whether the Third Circuit Court of Appeals Can Review

Given the potential involvement of 28 U.S.C. section 1346(a)(2), the Court of Appeals next wanted to be satisfied that it had authority to review the District Court ruling in *Bedrosian.* To analyze this issue, it turned to 28 U.S.C. section 1295(a)(2), which provides that the U.S. Court of Appeals for the Federal Circuit, and *not* the Third Circuit Court of Appeals, has "exclusive jurisdiction" over an appeal from a final decision of a District Court, if the jurisdiction of the District Court was based, in whole or in part, on 28 U.S.C. section 1346, except (i) in cases involving 28 U.S.C. section 1346(a)(1) and certain other provisions, or (ii) in cases involving 28 U.S.C. section 1346(a)(2), when the claim is founded upon an act of Congress or a regulation of an executive department "providing for internal revenue."

Citing cases that have previously interpreted the phrase "providing for internal revenue" in other contexts, the Court of Appeals determined that it broadly encompasses "all federal statutes and regulations that are part of the machinery for the collection of federal taxes."[54] The Court of Appeals then underscored that (i) the FBAR provisions, enacted as part of the Bank Secrecy Act of 1970, were intended to promote several things, including collection of federal taxes, (ii) the IRS was delegated authority to enforce the FBAR rules, and (iii) Congress amended and increased the FBAR penalties in 2004 as part of the Jobs Act, a piece of tax legislation. Based on the preceding, the Court of Appeals concluded that it had the power to review the earlier decision by the District Court in *Bedrosian:*

> Our take is the FBAR statute is part of the IRS's machinery for the collection of federal taxes; thus it is an act "providing for internal revenue" within the meaning of 28 U.S.C. section 1295(a)(2). Accordingly, we conclude the Federal Circuit would *not* have exclusive jurisdiction over this appeal, even if the District Court's jurisdiction were based in part on [28 U.S.C. section 1346(a)(2)]. Although we leave open whether Bedrosian's initial claim created original jurisdiction in the District Court, we are satisfied it had jurisdiction to render the judgment under review and we have appellate jurisdiction . . . .[55]

Standard of Review Applied by the Court of Appeals

The taxpayer contended that the Court of Appeals should review the decision by the District Court that he was nonwillful for "clear error," because such decision was essentially a factual determination. The DOJ, by contrast, urged the Court of Appeals to review the matter "de novo," from scratch, because the decision by the District Court was solely a legal one.

The Court of Appeals explained that (i) with respect to other civil penalties, it has held that decisions by District Courts were factual ones, reviewable only for "clear error," (ii) the same holds true for reconsideration of the Tax Court's determination of willfulness in tax matters, and (iii) the Supreme Court, likewise, has held that "clear error" review applies to the determination by a District Court about "willful neglect" in regards to civil penalties for not paying federal taxes. Grounded in these points, as well as a series of cases applying "clear error" review to similar factual determinations, the Court of Appeals held that "a district court's determination in a bench trial as to willfulness under the FBAR statute is reviewed for clear error."[56]

One might think that this would resolve the matter, but not here. The Court of Appeals went on to explain that, although it would apply the "clear error" standard favoring the earlier decision of the District Court, it was premature to take the matter out of the hands of the District Court. Below is the justification for sending *Bedrosian* back to the District Court for round three of this FBAR litigation.

> On the surface, this should settle the issue. But not quite. Even when we review a trial court's primarily factual determination under a deferential standard of [clear error] review, we nonetheless have a duty to "correct any legal error infecting [the] decision." For example, if the record suggests a district court "somehow misunderstood the nature" of the operative inquiry, we then decide whether to remand the case to that court for clarification of the basis of its determination or, alternatively, whether to decide the primarily factual issue ourselves. In general, the proper course will be remand unless "the record permits only one resolution of the factual issue."[57]

Faulty Grounds for Determining Willfulness

The Court of Appeals began by noting that it agreed with the District Court in that the usual standard of willfulness applies to civil FBAR penalties, meaning the inquiry focuses on whether the violation was either knowing or reckless. It then stated that recklessness, in the context of the FBAR, is an objective, not subjective, measure. The Court of Appeals clarified that a person recklessly fails to comply with an IRS filing requirement, like the FBAR duty, when (i) the person clearly ought to have known, (ii) that there was a grave risk that the FBAR duty was not being met, and (iii) the person was in a position to find out for certain very easily.[58]

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

> Although we would afford clear error review to an ultimate determination [by a District Court] as to recklessness, we cannot defer to a determination we are not sure the District Court made based on our view of the correct legal standard. We therefore remand for further consideration and to render a new judgment.[59]
>
> Because we are unsure whether the District Court evaluated Bedrosian's conduct under this objective standard, we remand the case for further proceedings consistent with this opinion.[60]

Conclusion

Relief, joy, and excitement dominated the tax community in 2017 when the District Court determined, contrary to the trend, that the taxpayer in *Bedrosian* did not willfully violate his FBAR duties. These positive emotions have been somewhat tempered recently, though, with the recent decision by the Third Circuit Court of Appeals questioning the grounds on which the District Court reached its taxpayer-favorable decision. All eyes will be on this case as round three of the FBAR battle begins. ●

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58 Bedrosian, 122 AFTR2d 2018-7052 (CA-3, 2018), p. 15.

59 Bedrosian, 122 AFTR 2d 2018-7052 (CA-3, 2018), p. 16.

60 Id.